FEDERAL RESERVE press release

For Use at 4:10 p.m.   July 10, 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 May 18, 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 May 18, 1981

Domestic policy directive

The information reviewed at this meeting suggested that growth of real gross national product was slowing in the current quarter from the rapid pace in the first quarter, but activity currently appeared stronger than had been projected at the time of the Committee's meeting on March 31. Real GNP had grown at an annual rate of 6-1/2 percent in the first quarter, according to preliminary estimates of the Commerce Department, and additional data that became available after release of the preliminary estimates suggested that growth had been even more rapid. Average prices, as measured by the fixed-weight price index for gross domestic business product, have continued to rise rapidly in the current quarter, but somewhat less so than earlier in the year.

The dollar value of total retail sales increased slightly further in March but declined appreciably in April, reflecting mainly a sharp drop in sales of new cars in response to the ending of manufacturers' price rebates. Unit sales of new automobiles fell from an annual rate of 10.3 million units in March to 8.1 million units in April. The value of sales excluding automobiles and building materials registered sizable gains in both March and April.

The index of industrial production, which had increased 0.5 percent in March, rose 0.4 percent in April. An increase in auto assemblies, to a rate substantially above the recent pace of sales, was a major factor in the

April advance, and output of business equipment and space and defense products exhibited considerable strength. A strike cut production of coal in half and limited the rise in the total industrial production index by about 0.3 percentage point.

Nonfarm payroll employment changed little in March and April after adjustment for strikes, and the unemployment rate was stable at 7.3 percent. In April employment continued to expand in service industries but declined considerably in retail trade establishments and in construction. Small employment gains were recorded in the manufacturing sector, and the average factory workweek edged up 0.1 hour to 40.1 hours.

Private housing starts in March remained at the annual rate of about 1-1/4 million units recorded in February; during the preceding six months, housing starts had been in a range of 1.4 million to 1.6 million units. Sales of new homes in March continued at the reduced pace of recent months, and sales of existing homes declined further.

Producer prices of finished goods rose at an annual rate of 9-1/2 percent in April, compared with an average rate of 12 percent during the first quarter. The surge of energy prices that had characterized earlier months of the year abated in April, and prices of consumer foods were unchanged. Prices of crude foodstuffs, however, rose sharply. The rise in the consumer price index slowed in March, reflecting a slowing in price increases of energy items and continued moderate increases in food prices and homeownership costs. Prices of other consumer items continued to rise at a relatively rapid pace. Over the first four months of 1981, the rise in the index of average hourly earnings of private nonfarm production workers was slightly less rapid than the pace recorded during 1980.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had risen by about 8-1/2 percent since the final days of March to its highest level in 3-1/2 years. In March the U.S. trade deficit declined sharply, bringing the first-quarter deficit to a level well below the average in 1980. The value and volume of exports rose substantially from that in the fourth quarter, and the value of imports increased moderately.

At its meeting on March 31, 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 in M-1B from March to June at an annual rate of 5-1/2 percent or somewhat less, after allowance for the impact of flows into NOW accounts, and growth in M-2 at an annual rate of about 10-1/2 percent. 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 13 to 18 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.

In the latter part of April, incoming data suggested that M-1B, after adjustment for the estimated effects of shifts into NOW accounts, was growing at a rate well above the short-run objectives set forth by the

Committee. Consequently, required reserves increased more than the supply of reserves being made available through open market operations. Banks adjusted to the constrained availability of reserves by reducing excess reserves and by increasing borrowings from the Federal Reserve. In the two statement weeks ending May 6, member bank borrowings averaged about $2.4 billion, compared with an average of about $1 billion in the first three statement weeks after the meeting on March 31; and the federal funds rate, which had averaged around 15-1/2 percent in the first three weeks of April, fluctuated within a range of 17 to 20 percent in the last days of April and the first days of May. On May 4 the Board of Governors announced an increase from 13 to 14 percent in Federal Reserve basic discount rates and an increase from 3 to 4 percentage points in the surcharge on frequent borrowings of large institutions.

In a telephone conference on May 6, the Committee agreed that in the brief period before the next regular meeting scheduled for May 18, the reserve path would continue to be set on the basis of the short-run objectives for monetary growth established on March 31. It was recognized that for a time monetary growth might be high in relation to those objectives and that the federal funds rate might continue to exceed the upper end of the range indicated for consultation. In the period remaining until this meeting, bank reserve positions remained under pressure, and federal funds typically traded between 18 and 19 percent.

Growth in M-1B, adjusted for the estimated effects of shifts into NOW accounts, accelerated sharply in April to an annual rate of about 14 percent. But adjusted M-1B had grown from the fourth quarter of 1980 to the first quarter of 1981 at an annual rate of only 1 percent, and its level in April was well within the Committee's longer-run range for that aggregate. M-2 had continued to grow rapidly in April, and its level continued above the upper end of its longer-run range. Growth in the nontransaction component of M-2 slowed markedly, however, as the total of savings and small-denomination time deposits was about unchanged and inflows into money market mutual funds slowed.

Total credit outstanding at U.S. commercial banks registered a slight decline in March and grew at an annual rate of about 4-1/2 percent in April. Holdings of investments changed little over the two months, and growth in loans, particularly business loans, was quite weak. Net issues of commercial paper by nonfinancial corporations declined in April, following expansion at a rapid pace in the first quarter. Issuance of publicly offered bonds remained heavy during April, and the volume of new equity offerings rose considerably.

Short-term market interest rates had risen substantially over the period since the Committee's meeting on March 31: yields on Treasury bills moved up 2-3/4 to 4 percentage points while yields on private short-term market instruments increased 4-1/2 to 5-1/4 percentage points. Most long-term interest rates rose to record levels and on balance advanced about 1 percentage point. Over the intermeeting interval, the prime rate charged by commercial banks on short-term business loans was raised in steps from 17-1/2 percent to 19-1/2 percent. In home mortgage markets, average rates on new commitments for fixed-rate loans at savings and loan associations rose above 16 percent, from 15.40 percent at the end of March.

The staff projections presented at this meeting suggested that the surge in growth of real GNP in the first quarter would be followed by much slower growth over the rest of 1981. The rise in the fixed-weight price index for gross domestic business product was projected to moderate as the year progressed but nevertheless to remain rapid.

In the Committee's discussion of the economic situation and outlook, members commented on the considerably greater strength in activity in the first quarter than had been expected, and they continued to stress the difficulties of economic forecasting currently and the importance of adhering to longer-term objectives. While generally anticipating a substantial slowing of growth from the exceptionally rapid pace now indicated for the first quarter, a number of members expressed the view that expansion in activity over the rest of the year was likely to continue to exceed the rates typically being forecast. The observation was made that weakness in demands and activity appeared to be confined to a few sectors, albeit such major ones as housing and automobiles, and that the risks of a significant decline in overall activity appeared to be tempered by the prospect that some accumulated backlogs of demands would be activated whenever interest rates declined. It was also suggested, on the other hand, that high and volatile interest rates could begin to have a cumulative effect in dampening activity, and that little was known about the effects of financial stress that might be developing.

At its meeting on February 2-3, the Committee had adopted the following ranges for growth of the monetary aggregates over the period from the fourth quarter of 1980 to the fourth quarter of 1981: M-1A and M-1B, 3 to 5-1/2 percent and 3-1/2 to 6 percent respectively, after adjustment for the estimated effects of flows into NOW accounts; M-2, 6 to 9 percent; and M-3, 6-1/2 to 9-1/2 percent. The associated range for growth of commercial bank credit was 6 to 9 percent. It was understood that the distorting effects of shifts into NOW accounts would change during the year and that other short-run factors might cause considerable variation in annual rates of growth from one month to the next and from one quarter to the next.

In the Committee's discussion of policy for the period immediately ahead, it was emphasized that on March 31 the Committee had established an objective for growth of M-1B (adjusted for the estimated effects of shifts into NOW accounts) over the three months from March to June at an annual rate of 5-1/2 percent or somewhat less, and that growth in April had greatly exceeded that pace. According to a staff analysis, some retardation of M-1B growth over the remaining two months of the quarter was to be expected, in light of the greater pressure on bank reserve positions that had developed recently and the apparent slowing of growth in nominal GNP in the current quarter. But growth of M-1B over the two-month period would have to be negligible if the specifications adopted on March 31 were to be realized.

The staff analysis also suggested that growth of M-2 would be less rapid over the second quarter than had been anticipated earlier, reflecting a slowing of growth in savings deposits and small-denomination time deposits as well as continued weakness in money market mutual funds. Thus, growth of the broader monetary aggregates might begin to move down toward their target ranges for growth over the year from the fourth quarter of 1980 to the fourth quarter of 1981.

In considering objectives for monetary growth over the remainder of the quarter, the members in general agreed that a posture of restraint needed to be maintained. They generally agreed with the view that it was particularly important to reduce growth of the monetary aggregates rather quickly, and initial differences in views concerning the precise specifications for monetary growth were relatively narrow. In the discussion, a number of points were emphasized. The indications of continuing strength in economic activity combined with the recent exceptional rise in the income velocity of money posed the risk of pressure for excessive expansion in money and credit as the year developed. Growth of the broader monetary aggregates was already somewhat high relative to the Committee's ranges for the year. The indications of some slowing of the rise in the consumer price index did not appear to reflect as yet any clear relaxation of underlying inflationary pressures, and emphasis was placed on the importance of conveying a clear sense of restraint at a critical time with respect to inflation and inflationary expectations.

With respect to the federal funds rate, it was again stressed that the specification of an intermeeting range for fluctuations over a period of time provided a mechanism for initiating timely consultations between regularly scheduled meetings when it appeared that fluctuations within the specified range were proving to be inconsistent with the objectives for the behavior of the reserve and monetary aggregates. The ranges proposed for the period ahead typically were from 16 or 17 percent to 21 or 22 percent.

At the conclusion of the discussion, the Committee decided to seek behavior of reserve aggregates associated with growth of M-1B from April to June at an annual rate of 3 percent or lower, after allowance for the impact of flows into NOW accounts, and growth in M-2 at an annual rate of about 6 percent. A shortfall in growth of M-1B from the two-month rate of 3 percent would be acceptable, in light of the rapid growth in April and the objective adopted by the Committee on March 31 for growth from March to June at an annual rate of 5-1/2 percent or somewhat less. The members recognized that shifts into NOW accounts would continue to distort measured growth in M-1B to an unpredictable extent and that operational paths would have to be developed in the light of evaluation of those distortions. The Chairman might call for Committee consultation if it appeared to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting was likely to be associated with a federal funds rate persistently outside a range of 16 to 22 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 grow much less rapidly in the current quarter, following the substantial expansion in the first quarter; prices on the average have continued to rise rapidly, although somewhat less so most recently than earlier in the year. The dollar value of total retail sales increased slightly further in March, but it declined appreciably in April when sales of new cars fell in response to the ending of price concessions. Industrial production rose moderately in both months, while nonfarm payroll employment changed little, after adjustment

for strikes, and the unemployment rate was stable at 7.3 percent. In March housing starts remained at a reduced pace. Over the first four months of 1981, the rise in the index of average hourly earnings was slightly less rapid than during 1980.

The weighted average value of the dollar against major foreign currencies has risen steadily since the end of March to its highest level in three and a half years. The U.S. trade deficit declined sharply in March, bringing the first-quarter deficit to a level well below the 1980 average.

Growth in M-1B, adjusted for the estimated effects of shifts into NOW accounts, accelerated sharply in April and growth in M-2 remained rapid. Since March, both short-term and long-term market interest rates have risen substantially. On May 4 the Board of Governors announced an increase in Federal Reserve discount rates from 13 to 14 percent and an increase in the surcharge from 3 to 4 percentage points on frequent borrowings of large institutions.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation, promote economic growth, and contribute to a sustainable pattern of international transactions. At its meeting in early February, 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 1980 to the fourth quarter of 1981 within ranges of 3 to 5½ percent, 3½ to 6 percent, 6 to 9 percent, and 6½ to 9½ percent respectively, abstracting from the impact of introduction of NOW accounts on a nationwide basis. The associated range for bank credit was 6 to 9 percent. These ranges will be reconsidered as conditions warrant.

In the short run the Committee seeks behavior of reserve aggregates consistent with a substantial deceleration of growth in M-1B from April to June to an annual rate of 3 percent or lower, after allowance for the impact of flows into NOW accounts, and with growth in M-2 at an annual rate of about 6 percent. The shortfall in growth of M-1B from the two-month rate specified above would be acceptable, in light of the rapid growth in April and the objective adopted by the Committee on March 31 for growth from March to June at an annual rate of 5½ percent or somewhat less. It is recognized that shifts into NOW accounts will continue to distort measured growth in M-1B to an unpredictable extent, and operational reserve paths will be developed in the light of evaluation of those distortions. 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 16 to 22 percent.

Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Partee, Rice, Schultz, Mrs. Teeters, Messrs. Wallich, and Winn. Votes against this action: None. (Mr. Winn voted as an alternate member.)