FEDERAL RESERVE press release

For Use at 4:10 p.m. August 21, 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 July 6-7, 1981. This record also includes policy actions taken during the period between the meeting on July 6-7, 1981, and the next regularly scheduled meeting held on August 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 July 6-7, 1981

1. Domestic policy directive

The information reviewed at this meeting suggested that real gross national product changed little in the second quarter, following expansion in the first quarter at an annual rate of 8.6 percent. Average prices, as measured by the fixed-weight price index for gross domestic business product, rose less rapidly than in the first quarter.

The dollar value of retail sales was virtually unchanged in May after having declined appreciably in April. Unit sales of new automobiles remained weak in June; sales in the second quarter as a whole were about one-fifth below the first-quarter rate.

The index of industrial production rose 0.3 percent in May, following an increase of only 0.1 percent in April. A further increase in automobile assemblies in May, to an annual rate nearly 2 million units above the recent pace of sales of domestic models, accounted for more than half of the increase in the total index. Production of business equipment and space and defense products continued to expand, while output of construction supplies fell.

Nonfarm payroll employment, adjusted for changes in the number of workers on strike, continued to advance in April and May but declined appreciably in June; employment fell substantially further in construction and state and local government in June, and it also declined in retail trade. In manufacturing, employment was about unchanged, while the average factory workweek edged down to 40.1 hours. The unemployment rate was 7.3 percent, lower than in May but unchanged from earlier months of the year.

The Department of Commerce survey of business spending plans taken in May suggested that current-dollar expenditures for plant and equipment would rise about 8-1/2 percent in 1981, compared with 10-1/4 percent reported in the February survey and an actual expansion of about 9-1/4 percent in 1980. The latest survey results implied little growth in nominal expenditures over the remainder of the year, given the relatively large increase in outlays in the first quarter.

Private housing starts fell 14 percent in May to an annual rate of 1.15 million units, 25 percent below the average pace in the fourth quarter of 1980. Combined sales of new and existing homes in May continued at about the reduced rate of recent months.

Producer prices of finished goods increased 0.6 percent in June, about the same as the April-May average. Over the second quarter producer prices rose at an annual rate of about 7 percent, considerably below the average rate of 12 percent in the first quarter. Prices of consumer foods continued to change little on balance during the quarter; and energy prices, which had surged in the first quarter following decontrol of oil prices, rose at an annual rate of only 5-1/4 percent. Price increases for other finished goods on the average were somewhat higher in the second quarter than in the first. The rise in the consumer price index slowed in April to an annual rate of 5 percent; but it accelerated in May to a rate of 8 percent, reflecting primarily a sharp rise in the homeownership component of the index. Over the two-month period, food prices declined slightly on balance, and the rate of increase in prices of energy items slowed substantially. Over the first six months of 1981, the rise in the index of average hourly earnings of private nonfarm production workers was slightly less rapid than it was during 1980.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies continued to rise through May and early June and then leveled off. On the average in June, the value of the dollar was about 25 percent above its year-earlier level. The U.S. trade deficit in the April-May period was somewhat above the average in the first quarter. The value of exports was down marginally, but the value of imports was considerably higher.

At its meeting on May 18, the Committee had decided 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 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 M2 at an annual rate of about 6 percent. A shortfall in growth of M1-B 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 at its meeting on March 31 for growth from March to June at an annual rate of 5-1/2 percent or somewhat less. 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 Chairman might call for Committee consultation.

During the intermeeting period, incoming data indicated a progressive weakening of M1-B. In accordance with the Committee's decision on May 18, reserves provided through open market operations were constrained to accommodate the weakness up to a point, but subsequently they were more ample. Reserves borrowed from the discount window remained around $2-1/4 billion through most of June and then declined to around $1-3/4 billion toward the end of the intermeeting period. Federal funds generally traded in a range of 18-1/2 to 19-1/2 percent throughout the intermeeting period. However, most other short-term market interest rates declined 3/4 to 1-3/4 percentage points, on balance.

M1-B, adjusted for the estimated effects of shifts into NOW accounts, declined at annual rates of about 5 percent and 10-1/2 percent in May and June respectively, following expansion at an annual rate of close to 17 percent in April. From the fourth quarter of 1980 to the second quarter of 1981, shift-adjusted M1-B grew at an annual rate of about 2-1/4 percent, below the lower end of the Committee's range for growth in that aggregate for the year ending in the fourth quarter of 1981. Growth in M2 slowed to an annual rate of about 4-3/4 percent on average in May and June, reflecting not only the contraction in M1-B, but also a moderation in growth of money market mutual funds. The recent slowing brought M2 to a level in the second quarter that was only slightly above the upper end of the growth path consistent with its range for the year from the fourth quarter of 1980 to the fourth quarter of 1981.

Total credit outstanding at U.S. commercial banks expanded at an annual rate of 11-3/4 percent in May, but the rate slowed to about 5 percent in June. Heavy acquisitions of U.S. government securities characterized both months. Growth in total loans accelerated in May and then slowed in June, but business loans picked up in May from the sluggish pace of earlier months and accelerated further in June. Net issues of commercial paper by non-financial corporations grew at exceptionally rapid rates in May and June, following a decline in April.

Yields on most long-term securities trended downward through much of the intermeeting period but moved up in the final days to levels little changed from those at the time of the May meeting. Over the interval, the prime rate charged by commercial banks on short-term business loans moved in a range of 19-1/2 to 20-1/2 percent; at the end of the period the rate was 20 percent at most banks. In home mortgage markets, average rates on new commitments for fixed-rate loans at savings and loan associations remained close to the level of 16-3/4 percent prevailing since mid-May.

The staff projections presented at this meeting suggested that growth in real GNP would probably be sluggish over the second half of 1981 and into the first half of 1982. That development might well be accompanied by an upward drift in the unemployment rate but also by some progress in reducing inflation. The rise in the fixed-weight price index for gross domestic business product was projected to change little during the rest of this year from the reduced pace of the second quarter and to decline somewhat further in the first half of next year.

A substantial number of members believed that growth in real GNP would prove to be stronger than projected by the staff, although in some cases anticipated strength was concentrated in 1982. Other members thought that economic activity was likely to be weaker than projected by the staff; they anticipated a decline in real GNP over the balance of 1981 followed by relatively sluggish recovery in 1982. While expecting the rate of inflation to remain high by historical standards, nearly all members anticipated some improvement. A number questioned whether progress thus far represented more than a temporary respite; and they felt that significant and sustained progress in reducing the underlying rate of inflation would take time and might not be consistent with an early and strong rebound in economic activity. Others were more optimistic, suggesting that significant improvement in the behavior of prices would help to set the stage for sizable growth in 1982.

A number of members commented that realization of forecasts of sustained growth in real GNP over the next year or more, even at a slow pace, depended upon declines in interest rates. In their opinion, an extended period with interest rates at or near the high levels currently prevailing would more likely induce both a decline in economic activity and a spreading of financial strains. A few members described monetary policy, and its objective of restrained growth in monetary aggregates, as a "governor" on the economy that retarded expansion in economic activity as long as inflation and inflationary expectations remained high but tended to prevent any contraction in activity from cumulating. In this framework, a pickup in demands for goods and services while inflation remained high would lead to rising interest rates and increasing restraint on expenditures, and any easing in demands for goods and services would tend to lower interest rates and lessen restraint on expenditures. It was also suggested that long-term interest rates might be on the verge of easing, in response to the improvement in the outlook for prices that appeared to be developing, which would permit stronger expansion in economic activity next year than generally projected. On the other hand, some skepticism was expressed about the chances of emerging from the current environment of rapid inflation and high interest rates gradually, and without considerable stress in the financial structure and risks for economic activity during the transition to lower rates of inflation.

At its meeting on February 2-3, 1981, 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: M1-A and M1-B, 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; M2, 6 to 9 percent; and M3, 6-1/2 to 9-1/2 percent. The associated range for growth of commercial bank credit was 6 to 9 percent. In establishing the ranges then, the Committee had agreed that monetary growth should slow in 1981 in line with the continuing objective of contributing to a reduction in the rate of inflation and providing the basis for restoration of economic stability and sustainable growth in output of goods and services.

At this meeting, in accordance with the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee reviewed its ranges for growth of the monetary and credit aggregates for the period from the fourth quarter of 1980 to the fourth quarter of 1981 and gave preliminary consideration to objectives for monetary growth that might be appropriate for 1982.[1/] In doing so, the members recognized the likelihood of continued divergence in the growth of the different aggregates,

1/ The Board's midyear report under the act was transmitted to the Congress on July 20, 1981.

partly reflecting institutional change, and the considerable uncertainty about how such institutional change might affect monetary growth in the future. As noted earlier, expansion of shift-adjusted M1-B from the fourth quarter of 1980 to the second quarter of 1981 was relatively low in relation to the path implied by the Committee's range for the year. However, growth of M2 and M3 so far in 1981 had been at or above the Committee's ranges.

The shortfall in growth of shift-adjusted M1-B in the first half of the year followed relatively rapid growth in the latter part of 1980; and it was accompanied by an unusually rapid rise in the income velocity of money, as nominal GNP expanded strongly. In partial explanation, extraordinarily high interest rates in combination with the introduction of NOW accounts on a nationwide basis apparently provided a greater stimulus to intensive management of cash balances than that normally associated with an increase in interest rates. In the period ahead, M1-B might behave somewhat differently from earlier measures of transaction balances, because of the sizable volume of deposits earning interest and because of the greater weight of household balances in the total. The behavior of M2 was likely to be affected to some extent by two recent decisions of the Depository Institutions Deregulation Committee, effective August 1: one removed rate caps on the two and one-half year small saver certificate, enabling the rate to fluctuate with the yield on two and one-half year Treasury securities at all levels; and the other eliminated ceilings altogether on small time deposits with initial maturities of four years or more. The rapid growth of money market funds appeared to influence the growth of both M1 and M2, in opposite directions, but the magnitude of the effects was difficult to judge.

In the Committee's discussion of the longer-run ranges, the members were in agreement on the need to maintain a policy of restraint. However, continuation of the increase in velocity of M1-B at the rate of the first half seemed unlikely, and thus the public's demand for narrowly defined money would probably pick up in the second half. Moreover, a significantly more rapid increase in narrowly defined money would be necessary to reach the Committee's objective for the year. At the same time, it was observed that the present situation provided a critical opportunity to sustain the signs of progress in reducing the rate of inflation, an opportunity that could be lost if monetary growth in the months ahead became too rapid. Even if rapid monetary expansion should lower interest rates, which was debatable, such effects would likely be temporary, and latent demands for goods and services would be released at the potential cost of a still more difficult period of high interest rates and financial strains later. The point was made that lasting declines in nominal interest rates and a solid base for sustained growth would depend on convincing progress in reducing inflation.

In light of all the circumstances, the Committee agreed to retain the previously established ranges for the monetary aggregates for 1981. In the course of the discussion, some sentiment was expressed for a reduction of 1/2 percentage point in the range for M1-B, which would indicate that the System did not intend to seek very rapid monetary growth in the second half of the year. However, a small adjustment of that sort, though partly justified by institutional change, was considered on balance potentially more confusing than useful. Instead, in light of its desire to maintain moderate growth in money over the balance of the year, the Committee wished to affirm that growth in M1-B near the lower end of its range would be acceptable and desirable. At the same time, the Committee recognized that growth in the broader monetary aggregates might be high in their ranges.

> The Committee reaffirmed the ranges for growth in the aggregates for the period from the fourth quarter of 1980 to the fourth quarter of 1981 that it had adopted at its meeting in early February 1981. These ranges, abstracting from the impact of NOW accounts on a nationwide basis, were 3 to 5-1/2 percent for M1-A, 3-1/2 to 6 percent for M1-B, 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 high in their ranges.
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> > Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Keehn, Partee, Rice, Schultz, Mrs. Teeters, and Mr. Wallich. Votes against this action: None.

With respect to 1982, the Committee favored some reduction in the objectives for monetary growth in keeping with the long-standing goal of moving gradually toward rates of monetary expansion consistent with general price stability. Looking toward completion of the major shift into NOW accounts, the Committee decided to establish a range for a single M1 aggregate having the same coverage as the present M1-B. Moreover, on the assumption that shifts into NOW accounts from nontransaction balances would no longer be significant, calculation of rates of growth for M1 after adjustment for such shifts would not be necessary. The Committee also decided to widen the range for the narrow monetary aggregate to 3 percentage points, from 2-1/2 points, reflecting the greater uncertainty at this time in judging the relationship of this aggregate to economic and financial developments resulting from the recent change in its composition; because of the possibility of some residual shifting into NOW accounts, the upper end of the range was reduced by less than the lower end.

Thus, the Committee 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. The upper and lower ends of the range for M1 were reduced 1/2 percentage point and 1 percentage point respectively from the 1981 range for M1-B. The ranges for the broader aggregates were unchanged from those for 1981. However, given the expectation that growth of these aggregates in 1981 would be around the upper end of the ranges and looking toward results in 1982 more toward the middle of the ranges, the new ranges were fully consistent with year-to-year reductions in growth.

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

Mrs. Teeters dissented from this action because she believed that, in light of all the uncertainties in the economic situation, it was premature to adopt objectives calling for reduced monetary growth in 1982. She preferred to specify the same ranges for 1982 as for 1981, pending the Committee's reconsideration of monetary objectives for 1982 at its meeting next February.

In the Committee's discussion of policy for the short run, the members in general agreed that operations in the period before the next meeting should be directed toward growth of monetary aggregates over the third quarter at rates that would promote achievement of the monetary objectives for the year as a whole. Thus, they wished to foster growth of M1-B over the third quarter at a rate high enough to permit growth of this monetary aggregate toward the lower end of its range for the year. At the same time, however, they wished to avoid generating an excessively rapid rebound in growth of M1-B, both because the pace would need to be sharply reduced later and because such a rebound might tend to raise growth of M2 above the upper end of its range for the year. With respect to the inter-meeting range for the federal funds rate that provided a mechanism for initiating further consultation of the Committee, proposals typically were from 15 or 16 percent to 21 or 22 percent.

Specifically, the members agreed to seek 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, provided that growth of M2 remained around the upper end of its range for the year or tended to move down within the range. Given the declines in May and June, growth of M1-B at the rate specified for the period from June to September would result in growth at an annual rate of about 2 percent from the average in the second quarter to the average in the third quarter. The members recognized that shifts into NOW accounts would continue to distort measured growth in M1-B 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 15 to 21 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 changed little in the second quarter, following the substantial expansion in the first quarter; prices on the average rose less rapidly than in the first quarter. The dollar value of total retail sales was virtually unchanged in May after having declined appreciably in April, and sales of new cars remained weak in June. Industrial production rose slightly on the average in April and May, while nonfarm payroll employment continued to advance, after adjustment for strikes. In June strike-adjusted nonfarm employment declined appreciably; the unemployment rate was 7.3 percent, somewhat lower than in May but unchanged from earlier months of 1981. In May housing starts declined sharply. Over the first six months of 1981, the rise in the index of average hourly earnings was slightly less rapid than during 1980.
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> The weighted average value of the dollar against major foreign currencies continued to rise through May and early June and then leveled off. In April-May the U.S. foreign trade deficit was somewhat above the first-quarter rate.
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> M1-B, adjusted for the estimated effects of shifts into NOW accounts, declined substantially in May and June following the sharp expansion in April, and growth in M2 slowed. The level of adjusted M1-B in the second quarter on the average was 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 in the second quarter was slightly above the upper end of its range for the year. Since mid-May, on balance, short-term market interest rates have declined somewhat while long-term yields generally have changed little.
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> 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 February, the Committee agreed that these objectives would be furthered by growth of M1-A, M1-B, M2, and M3 from the fourth quarter of 1980 to the fourth quarter of 1981 within ranges of 3 to 5-1/2 percent, 3-1/2 to 6 percent, 6 to 9 percent, and 6-1/2 to 9-1/2 percent

respectively, abstracting from the impact of introduction of NOW accounts on a nationwide basis. 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 has been running somewhat above the upper ends of the ranges. The Committee reaffirmed its ranges for 1981, but 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 may 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 June to September at an annual rate of 7 percent after allowance for the impact of 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 remains around the upper limit of, or moves within, its range for the year. It is recognized that shifts into NOW accounts will continue to distort measured growth in M1-B 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 15 to 21 percent.

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

Mr. Partee dissented from this action because, in light of the indications of weakening in economic activity, he preferred to give more emphasis to reducing the risk of a cumulative shortfall in growth of M1-B.

Accordingly, he favored specification of a somewhat higher objective for growth of M1-B over the period from June to September, and without the additional weight assigned to the potential for more rapid growth of M2. In his view, the short-run behavior of M2 was subject to great uncertainty because of both the volatile influence of money market mutual funds and the recent DIDC actions authorizing certain deposit instruments to be offered at competitive interest rates beginning August 1.

2. Authorization for domestic open market operations

On August 6, 1981, the Committee voted to increase from $3 billion to $4-1/2 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 August 18, 1981.

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

This action was taken on recommendation of the Manager for Domestic Operations. The Manager had advised that since the July meeting, substantial net purchases of securities had been undertaken to counter the effects on member bank reserves of the transfer of funds associated with settlement of Iranian accounts and also the effects of levels of float that were lower than normal. The leeway for further purchases had been reduced to about $200 million, and additional purchases in excess of that amount might be required over the rest of the intermeeting interval.