FEDERAL RESERVE press release

For Use at 4:15 p.m. December 27, 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 November 16, 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 November 16, 1982

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP would change little in the fourth quarter, after increasing at an annual rate of 3/4 percent in the third quarter according to preliminary estimates of the Commerce Department. Average prices, as measured by the fixed-weight price index for gross domestic business product, were continuing to rise at a much less rapid pace than in 1981.

The nominal value of retail sales rose 0.6 percent in October, but the level was little higher than in the second and third quarters. Sales increased at automotive outlets and furniture and appliance stores, but edged down at nondurable goods stores. Unit sales of new domestic automobiles fell back to an annual rate of 5.3 million units, after having increased to an annual rate of 6.2 million units in September in response to special promotions aimed at reducing excess stocks of 1982 models.

The index of industrial production declined 0.8 percent in October, a little more than in both August and September, and was about 11-1/2 percent below its recent peak in July 1981. Output of business equipment fell substantially further in October, and as in other recent months, defense and space equipment was the only major category of final products showing strength. Capacity utilization in manufacturing fell 0.8 percentage point to 68.4 percent, the lowest level in the postwar period.

Nonfarm payroll employment fell further in October, declining slightly more than the average over the previous four months. Cutbacks in employment were widespread and were especially marked in durables manufacturing. The unemployment rate rose an additional 0.3 percentage point to 10.4 percent, with the rise concentrated among adult workers. In recent weeks, moreover, initial claims for unemployment insurance remained exceptionally high.

Private housing starts rose in September and in the third quarter as a whole were nearly 17 percent higher than in the second quarter. Most of the third-quarter increase was in the multifamily sector and was attributable mainly to a surge in federally subsidized rental units at the end of the fiscal year. In September, newly issued permits for both single-family and multifamily dwellings rose substantially. Sales of new homes also advanced appreciably, exceeding the 1981 average rate for the first time this year; sales of existing homes, however, remained at the reduced August pace.

The producer price index for finished goods rose 0.5 percent in October, following a decline of 0.1 percent in September. Most of the October increase was attributable to higher prices for motor vehicles, which had been reduced in September by end-of-year liquidation allowances and discounts on 1982 models. Prices of consumer foods and energy-related items edged down in October. Over the first ten months of the year the index rose at an annual rate of about 3-1/4 percent, less than half the pace in 1981. The consumer price index rose 0.2 percent in September, as the homeownership component declined and most other categories registered relatively small increases. Over the first nine months of the year the index rose at an annual rate of about 4-3/4 percent, compared with an increase of about 9 percent in 1981. In recent months the advance in the index of average hourly earnings had remained considerably less rapid than it was during 1981.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies continued to appreciate from the end of September to mid-November. The dollar strengthened further despite somewhat greater declines, on balance, in U.S. interest rates than in foreign interest rates over the period. Moreover, release of data indicating that the U.S. merchandise trade deficit in the third quarter was more than double the rate in the first two quarters of the year apparently had little impact on exchange rates.

At its meeting on October 5, the Committee had agreed that it would seek to maintain expansion in bank reserves needed for an orderly and sustained flow of money and credit, consistent with growth of M2 (and M3) from September to December at an annual rate in a range of around 8-1/2 to 9-1/2 percent, and taking account of the desirability of somewhat reduced pressures in private credit markets in the light of current economic conditions. Somewhat slower growth, bringing those aggregates around the upper part of the ranges set for the year, would be acceptable and desirable in a context of declining interest rates. Should economic and financial uncertainties lead to exceptional liquidity demands, somewhat more rapid growth would be tolerated. The Committee had also decided that it would place much less than the usual weight on the movements of M1 during the period from September to December and would not set a specific objective for its growth, because its behavior would be substantially affected by special circumstances. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 7 to 10-1/2 percent.

Growth of M2 and M3, which had been sluggish in September, picked up to annual rates of about 8 percent and 9 percent respectively in October; still, growth remained below the brisk pace of earlier in the year. Growth of M1 surged to an annual rate of a little over 20 percent, influenced by shifts of funds in connection with the large volume of maturing all savers certificates.

Total credit outstanding at U.S. commercial banks grew at an annual rate of about 7 percent in October, up somewhat from the reduced September pace. Banks acquired a sizable volume of U.S. Treasury securities, but growth in loans generally remained relatively weak. Total short-term borrowing by nonfinancial businesses slowed further, as growth in business loans at banks moderated and the volume of commercial paper outstanding contracted substantially for the second month in a row. However, the weakness in short-term borrowing was offset in part by an increase in long-term financing in the bond market.

The demand for reserves was relatively strong in October, reflecting particularly the rapid growth of M1. Nonborrowed reserves grew rapidly, and adjustment borrowing (including seasonal borrowing) fell to an average of $337 million in October from an average of $815 million in September.

Short-term market interest rates on private instruments declined about 1-1/2 percentage points on balance over the intermeeting interval, after a temporary reversal in September. Yields on short-term U.S. Treasury securities declined less, by about 3/4 to 1 percentage point, and the rate on three-month Treasury bills actually rose somewhat. Quality spreads in the money markets, after widening in September, had narrowed in recent weeks as concerns about private credit risks apparently lessened. On October 8 the Federal Reserve announced a reduction in the discount rate from 10 percent to 9-1/2 percent. Shortly thereafter, and over the balance of the intermeeting interval, federal funds traded at rates close to the new discount rate, compared with a trading level somewhat above 10 percent in September and early October. In the long-term capital markets, bond yields continued to decline over the period, falling about 1 to 1-1/4 percentage points; common stock prices advanced sharply, with many indexes touching new highs in early November. In home mortgage markets, average rates on new commitments for fixed-rate conventional home mortgage loans declined about 1-1/4 percentage points further to around 13-7/8 percent.

The staff projections presented at this meeting, like those of early October, suggested that real GNP would grow moderately during 1983, but that any recovery in economic activity in the months just ahead was likely to be quite limited. The projections for the year ahead also suggested that unemployment would remain at a high level. The rate of increase in prices, as measured by the fixed-weight price index for gross domestic business product, was expected to drift down.

In the Committee's discussion of the economic situation and outlook, several members commented that the staff projection of moderate growth over the year ahead remained a reasonable expectation and the view was expressed that the projected growth could be exceeded. However, many members continued to stress that there were substantial risks of a shortfall from the projection. Considerable emphasis was given to the widespread signs of weakness in economic activity and to the continuing absence of evidence that an economic recovery might be under way. In the view of some members, a number of indicators of economic activity were in fact consistent with a further decline, at least over the near term. Reference was also made to the unusually sharp impact of the drop in exports--the consequence of worldwide recession and of the very high foreign exchange value of the dollar--and to expectations of a very slow recovery abroad. Moreover, the prospects for worldwide recovery were complicated by the financing difficulties of many developing countries.

Although widely held expectations of a domestic recovery had been repeatedly disappointed, the members noted that the large decline in interest rates over recent months had eased financial strains in the economy, fostered some recovery in housing and related industries, and appeared in recent weeks to have improved confidence somewhat among businessmen and consumers. One indicator of the less bearish sentiment was the decline in risk premiums in securities markets as rates on private credit instruments had fallen in recent weeks relative to those on U.S. government obligations. The improvement in attitudes was also reflected in the sharp rise of prices in the stock market. Several members commented, however, that the apparent easing of concerns was still quite tentative and could easily be reversed, with highly adverse consequences for the economy, if interest rates were to rise significantly from current levels.

Some Committee members, while acknowledging the absence of evidence of an imminent upturn in economic activity, nonetheless viewed the prospects for recovery as relatively favorable. They emphasized that fiscal policy and monetary policy tended to exert their impacts with a lag and that the sharp turn toward fiscal stimulus and the easing of conditions in financial markets were relatively recent developments. In this connection, concern was expressed that an overly expansive combination of fiscal and monetary policies would stimulate inflationary expectations, foster a rise in long-term interest rates, and limit or abort the economic recovery.

Turning to policy, the Committee reviewed the short-run objectives for monetary growth that it had established at its meeting on October 5 calling for expansion in M2 (and M3) at an annual rate in a range of around 8-1/2 to 9-1/2 percent for the period from September to December. No specific objective had been set for M1 growth in the fourth quarter because of the anticipated difficulty of interpreting the behavior of that aggregate during the quarter.

In their discussion the Committee members agreed that the behavior of M1 would continue to be distorted by institutional developments. The first involved the large buildup of checkable deposits associated with the maturing of a very large volume of all savers certificates, especially in early October. The resulting bulge in M1 growth had persisted somewhat longer than some members had anticipated; but, according to a staff analysis, M1 growth could be expected to decelerate over the balance of the quarter as the transaction balances built up from maturing all savers certificates were invested or drawn down. Growth of M1 and also M2 could be positively affected in the near term, however, by a possible buildup of balances for eventual placement in the short-term deposit account that had recently been authorized by the Depository Institutions Deregulation Committee, effective December 14, 1982. It was generally expected that the new account, which would be free from interest rate ceilings and could be used to a limited extent for transaction purposes, would draw funds from regular transaction accounts, thereby tending to reduce M1 after its introduction. In view of these institutional distortions, the Committee decided that it would continue to give much less than the usual weight to M1 and that it would not set a specific objective for its growth over the fourth quarter.

The behavior of M2 and M3, though not of their components, appeared to have been affected only marginally by the maturing of all savers certificates, and these broader aggregates were also expected to be affected much less than M1 when the new deposit account was introduced in mid December. In reviewing the growth objectives for M2 and M3 that had been set for the fourth quarter, most of the Committee members endorsed the view that monetary growth running somewhat above the Committee's target ranges set early in the year was appropriate given the indications of continuing strong demands for liquidity during a period of relatively weak economic activity. In that connection, emphasis was placed by some members on the evidence that velocity trends over the past year or so seemed to suggest a distinct break from earlier postwar experience. While questions could be raised about the persistence of the slowdown in velocity, available evidence suggested that unusual economic and financial uncertainties, as well as lower interest rates, were inducing a greater desire to hold liquid assets than had been assumed in setting the annual targets.

With regard to the choice of specific objectives for the broader aggregates in the fourth quarter, all of the members favored growth rates that were within or slightly above the range adopted at the October 5 meeting. It was suggested that such growth rates would balance the desirability of meeting current liquidity needs and fostering economic recovery against the risk of creating excess liquidity that might later complicate the achievement of sustained progress toward price stability, particularly in light of the prospect of continuing large deficits as the economy recovered. Several members commented that further declines in interest rates would be welcome for both domestic and international reasons, but concern was also expressed that any sizable declines in association with unduly rapid monetary growth could prove to be unsustainable, with unsettling effects on financial markets and adverse consequences for inflationary expectations and the economy.

At the conclusion of its discussion the Committee agreed that, against the background of prevailing economic and financial conditions and current liquidity demands, it would seek to maintain expansion in bank reserves needed for an orderly and sustained flow of money and credit, consistent with growth of M2 (and M3) from September to December at an annual rate of around 9-1/2 percent. The Committee also decided that somewhat slower growth in M2 and M3, to the extent of reducing their expansion for the year to nearer the upper part of the ranges for 1982, would be acceptable and desirable if such growth were associated with declining interest rates. On the other hand, somewhat more rapid growth would be tolerated if continuing economic and financial uncertainties should appear to be reflected in exceptional liquidity demands. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 6 to 10 percent.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests little change in real GNP in the fourth quarter and continuation of the rise in prices at a much less rapid pace than in 1981. In October the nominal value of retail sales edged up, but was little higher than in the second and third quarters; industrial production and nonfarm payroll employment continued to decline; and the unemployment rate rose another 0.3 percentage point to 10.4 percent. Initial claims for unemployment insurance have remained exceptionally high. In September and the third quarter as a whole, housing starts had strengthened. In recent months the advance in the index of average hourly earnings has remained considerably less rapid than during 1981.
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> The weighted average value of the dollar against major foreign currencies continued to appreciate from the end of September to mid-November. The U.S. merchandise trade deficit in the third quarter was more than double the rate in the first two quarters of the year.
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> Growth of M1, already rapid in August and September, accelerated sharply in October in association with the maturing of a large volume of all savers certificates. Growth of M2 and M3 picked up from sluggish rates in September, but remained below the brisk pace of earlier in the year. Most short-term market interest rates have declined on balance since early October, after a reversal in September, and bond yields and mortgage rates have declined further. On October 8 the Federal Reserve

announced a reduction in the discount rate from 10 percent to 9-1/2 percent. Quality spreads in the money markets, which had widened, have narrowed in recent weeks as interest rates have declined, and common stock prices have advanced sharply.

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. In July, the Committee agreed that these objectives would be furthered by reaffirming the monetary growth ranges for the period from the fourth quarter of 1981 to the fourth quarter of 1982 that it had set at the February meeting. These ranges were 2-1/2 to 5-1/2 percent for M1, 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 agreed that growth in the monetary and credit aggregates around the top of the indicated ranges would be acceptable in the light of the relatively low base period for the M1 target and other factors, and that it would tolerate for some period of time growth somewhat above the target range should unusual precautionary demands for money and liquidity be evident in the light of current economic uncertainties. The Committee also indicated that it was tentatively planning to continue the current ranges for 1983 but that it would review that decision carefully in the light of developments over the remainder of 1982.

Specification of the behavior of M1 over the balance of the year remains subject to substantial uncertainty because of special circumstances in connection with the reinvestment of funds from maturing all savers certificates and the public's response to the new account directly competitive with money market funds mandated by recent legislation. The difficulties in interpretation of M1 continue to suggest that much less than usual weight be placed on movements in that aggregate during the current quarter.

In all the circumstances, the Committee seeks to maintain expansion in bank reserves needed for an orderly and sustained flow of money and credit, consistent with growth of M2 (and M3) of around 9-1/2 percent at an annual rate from September to December. Somewhat slower growth, bringing those aggregates around the upper part of the ranges set for the year, would be acceptable and desirable in a context of declining interest rates. Should economic and financial uncertainties lead to exceptional liquidity demands, somewhat more rapid growth in the broader aggregates would be tolerated. 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 6 to 10 percent.

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

Mr. Ford dissented from this action because he believed that it ran the risk of complementing very large budget deficits with substantial increases in the supply of money. In his view the result would be an overly stimulative combination of policies that could rekindle inflation and drive up interest rates during 1983.

2. Authorization for domestic open market operations

At this meeting 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 from October 6, 1982 through the close of business on November 16, 1982.

Votes for this action: Messrs. Volcker, Solomon, Balles, Black, Ford, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, Mrs. Teeters, and Mr. Wallich. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that substantial net purchases of securities in recent weeks had reduced to about $500 million the leeway for further purchases during the intermeeting period ending with the close of business today. Purchases of securities in excess of that leeway seemed desirable during the course of today's operations to provide reserves to meet increased seasonal needs.