

FEDERAL RESERVE press release



For Use at 4:30 p.m.

May 24, 1985

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 March 26, 1985. This record also includes policy actions taken during the period between the meeting on March 26, 1985, and the next regularly scheduled meeting held on May 21, 1985.

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 March 26, 1985

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP, which had grown at an annual rate of about 4-1/4 percent in the fourth quarter, was expanding at a slower pace in the current quarter. Growth in domestic spending appeared to be relatively strong in early 1985, but an increased share of the demand for goods apparently was being met by imports rather than domestic production. Broad measures of prices and wages generally were continuing to rise at rates close to those recorded in 1984.

Total retail sales rose considerably over the first two months of 1985; outlays in February were more than 2 percent above the average in the fourth quarter. Sales of new domestic automobiles were at an annual rate of 8-1/2 million units in January and February, about 1 million units higher than the average in the fourth quarter of 1984. Auto sales during the first 20 days of March remained strong, at a rate a little below the January-February pace.

Nonfarm payroll employment rose 120,000 in February after average increases of about 300,000 in the preceding four months. Retail trade and service establishments reported further strong job gains in February, but employment in the manufacturing sector fell 75,000. The average length of the workweek in manufacturing also declined, partly because of adverse weather during the survey week. The civilian unemployment rate was 7.3

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percent, little changed from its level at year-end, and within the range of 7.2 to 7.5 percent that has generally prevailed since mid-1984.

Industrial production declined 0.5 percent in February, and data for the three preceding months were revised to show smaller increases than previously had been estimated. The recent sluggishness in production apparently reflected the continuing substitution of imports for domestically produced goods and ongoing corrections of inventory imbalances in some industries.

The U.S. merchandise trade deficit increased sharply in January, as non-oil imports rose by 16 percent from the reduced fourth-quarter rate. The trade balance had deteriorated markedly last year, and was the principal contributor to a current account deficit in the balance of payments of \$102 billion in 1984, as compared with \$42 billion in the previous year.

Total private housing starts declined in February after a sharp rise in January. Nevertheless, the average for the two months, at an annual rate of nearly 1-3/4 million units, was somewhat higher than the rate in the fourth quarter. Issuance of residential building permits during the January-February period was also above the fourth-quarter pace. Sales of new homes picked up slightly in January, according to preliminary data, but sales of existing homes edged down in February after posting four consecutive monthly gains.

Information on business capital spending suggested less rapid expansion in early 1985. Shipments by domestic producers of nondefense capital goods dropped sharply in January and recovered only a little in February; imports of business equipment, however, were especially strong

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in January. Spending on nonresidential construction continued at a relatively brisk pace in both months. New orders for nondefense capital goods fluctuated widely in January and February, but on balance were little changed from the average level in the second half of 1984. With respect to broader indicators of future business spending plans, recent surveys of anticipated plant and equipment expenditures pointed to continued, though moderating, gains in 1985.

Overall investment in business inventories has remained moderate thus far in 1985 though recent inventory developments have varied considerably across industries. In the manufacturing sector stocks fell in January for the third month in a row, largely in response to earlier weakness in orders and sales. On the other hand, retail trade inventories rose substantially, primarily reflecting increased stocks at automobile dealers to alleviate short supplies of some popular models.

The producer price index for finished goods, which was unchanged in January, edged down 0.1 percent in February. Petroleum prices fell sharply in both months, and food prices also declined as reductions for meats and most livestock offset weather-related increases for fresh fruits and vegetables. The consumer price index rose 0.3 percent in February, about the same as its monthly average over the past year; substantial declines in prices of energy-related items tempered the increases in prices of food and other commodities. Over the first two months of the year, the average hourly earnings index was rising at a rate close to that recorded in 1984.

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Since the Committee's meeting in mid-February, the trade-weighted value of the dollar in foreign exchange markets had fluctuated widely under often volatile market conditions. During the early part of the intermeeting period, the dollar rose by about 5 percent. At that time, especially during the last few days of February and the beginning of March, monetary authorities sold dollars on a large scale. More recently, the dollar dropped sharply on exchange markets, more than offsetting the earlier rise. The reversal was attributed in part to indications of slower growth in U.S. economic activity than many in the market had anticipated and to concerns abroad about the implications of problems with non-federally insured thrift institutions in Ohio.

At its meeting on February 12-13, 1985, the Committee had adopted a directive that called for maintaining the degree of reserve pressures that had characterized the weeks preceding the meeting. The members agreed that modest increases in reserve restraint would be sought if growth in M1 appeared to be exceeding an annual rate of about 8 percent and growth in M2 and M3 was running above 10 to 11 percent during the period from December to March. Lesser restraint on reserve positions would be acceptable in the event of substantially slower growth in the monetary aggregates. Such adjustments in the degree of pressure on reserves would be considered in the context of developments in the U.S. economy and conditions in foreign exchange markets. The intermeeting range for the federal funds rate was set at 6 to 10 percent.

Growth in M1 accelerated to an annual rate of about 14 percent in February from 9 percent in January, but partial data available for

March indicated a considerable slowing. Growth in M2 and M3 moderated somewhat in February and averaged about 12 percent and 9 percent respectively over the January-February period. As with M1, growth in the broader aggregates appeared to be slowing considerably in March. Expansion in total domestic nonfinancial debt remained relatively rapid over the first two months of the year, though somewhat below the pace of previous months.

The average level of adjustment plus seasonal borrowing by depository institutions at the discount window rose somewhat over the intermeeting interval, averaging around \$600 million in the two complete maintenance periods after the February meeting and \$428 million in the first half of the current statement period. The higher level of borrowing for the most part reflected unexpectedly large demands for excess reserves, but for a time was also influenced to an extent by more cautious provision of reserves through open market operations, given the strength of the monetary aggregates, especially M1.

Federal funds traded mainly between 8-3/8 and 8-3/4 percent during the intermeeting interval, averaging a little above 8-1/2 percent, about the same as in the first half of February. Other short-term rates rose about 1/4 to 1/2 percentage point while long-term yields generally increased by 1/2 percentage point or more. Several measures of interest rates on new commitments for home mortgage loans also showed increases of about 1/2 percentage point from their levels in mid-February.

The staff projections presented at this meeting continued to suggest that real GNP would grow at a moderate pace in 1985. Business fixed investment, though slowing from the exceptionally rapid rates of

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increase in the past two years, was likely to expand further in 1985. Consumer spending was expected to remain relatively brisk during the year, supported by gains in real disposable income and in employment. Growth of real output, however, was expected to fall short of the rise in aggregate demand. The unemployment rate was projected to edge down over the period and the rate of increase in prices was expected to remain close to, or slightly below, that experienced in 1984.

During the Committee's review of current economic and financial conditions and the outlook for economic activity, most of the members agreed that continuing expansion at a moderate pace remained a reasonable expectation for 1985. However, considerable concern was expressed about the sensitive conditions in domestic financial and foreign exchange markets, especially against the background of the distortions and uncertainties stemming from massive and persisting deficits in the federal budget and the record and still widening gap in the nation's balance of trade. The members referred to the quite different trends in various sectors of the economy; in general, the service industries were doing well while industries related to agriculture, mining, energy, and a number of manufacturing activities were experiencing a variety of problems and were subject to varying degrees of financial strain. With a number of lending institutions, especially those associated with relatively depressed industries and with housing finance, also experiencing financial pressures, the overall economy was vulnerable to adverse developments. In this difficult set of circumstances several members commented that the risks of any deviation in the economy from their current expectations were in the direction of slower growth; a few members referred to the possibility of little or no expansion later in the year.

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A good deal of concern was expressed during the meeting about the adverse effects on domestic economic activity stemming particularly from the rising tide of imports but also from difficulties in export markets. With a large amount of domestic demand continuing to be met through imports rather than domestic production, adjustments were beginning to be made in production and distribution facilities that would not easily be reversed later. It was also noted that the growing trade deficit appeared to be damping incentives to invest domestically in a wide range of manufacturing industries. More generally, the point was made that, to a considerable extent, foreign trade developments were tending to offset the stimulus provided by an expansive fiscal policy and the still considerable upward momentum of private final demands.

The prospective performance of business fixed investment was cited as a key element in the outlook for economic activity. While the members generally anticipated further expansion in investment spending, developments over the course of recent months together with the results of surveys of business intentions suggested a pronounced deceleration from the unusually rapid growth experienced during the first two years of the current expansion. Moreover, the demand for domestically produced business equipment was being inhibited to an unusual extent by the level of the dollar internationally and the competitiveness of foreign substitutes. In addition, the exceptional demand for technically advanced, computer-related, equipment might not be sustained at the earlier rate of increase, according to reports from various contacts around the country. Commercial construction, including office

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structures, was still showing considerable strength, but some members questioned the sustainability of such investment over time in the face of relatively high vacancy rates and other factors. While lower interest rates since last summer were a supporting factor in housing, reference was also made to the possible vulnerability of multifamily housing construction, given the apparent overbuilding in some parts of the country. Construction of single-family housing appeared to be rising, but this sector was not thought likely to be the source of substantial further economic stimulus in the view of at least some members. One member expressed a relatively pessimistic view about the outlook for housing, partly because many mortgage lenders and private insurers were imposing stricter credit standards after experiencing losses, and incentives for investment in housing clearly had dimmed in many parts of the country.

A number of members observed that consumer expenditures would probably remain a source of strength in the economic expansion, although some commented that consumer sentiment -- while still favorable -- may have been negatively affected by the news about the problems of some financial institutions. Members also took note of the rapid growth of consumer debt and its potentially adverse implications for future retail sales. It was observed that automobile sales had remained strong, but the prospects for added economic thrust from this sector appeared limited, in part because any further expansion in the demand for automobiles might well be met largely through imports.

With regard to the outlook for inflation, it was noted that prices of services were still tending to rise with some momentum, while

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prices of most goods were basically flat. Given the members' expectations for economic activity and assuming no major changes in the value of the dollar or developments abroad, the members saw little basis for expecting significant deviations from recent price trends.

At its meeting in February the Committee had agreed on policy objectives that called for monetary growth ranges for the period from the fourth quarter of 1984 to the fourth quarter of 1985 of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9-1/2 percent for M3. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for 1985. In keeping with the Committee's usual procedures under the Humphrey-Hawkins Act, these ranges would be reviewed at the July meeting or sooner if warranted by unanticipated economic and financial developments.

In the Committee's discussion of policy implementation for the intermeeting period, the members did not differ greatly in their views regarding the appropriate operational approach, and all indicated that they could support an approach directed, at least initially, toward maintaining about the current degree of restraint on reserve positions. The members recognized that current uncertainties about the economic outlook and the sensitive conditions in domestic credit and foreign exchange markets weighed against a significant increase in the degree of reserve restraint. At the same time, several placed considerable emphasis on the desirability of fostering slower monetary expansion over the period ahead to help assure growth within the Committee's target ranges for the year. While growth

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in M1 and M2 appeared to be decelerating appreciably in March and a staff analysis suggested that current reserve conditions might be associated with considerably slower growth in the second quarter than over the first three months of the year, a number of members expressed concern that such growth might remain more rapid than was desirable. A rate of growth in coming months higher than seemed reasonably consistent with the growth targets for the year might raise questions about the Committee's commitment to an anti-inflationary policy, with adverse effects on inflationary expectations and possibly also on financial markets. Conversely, if monetary growth over the next few months were held within the Committee's ranges for the year, it was observed that the Committee would have more flexibility later in fostering monetary growth consistent with continuing economic expansion and progress toward containing inflation. In any event, the members generally felt that under prevailing circumstances monetary growth might appropriately remain relatively high within the ranges for the year, a prospect that the Committee also had contemplated at the previous meeting.

The members gave considerable attention to the question of possible intermeeting adjustments in the degree of reserve restraint. In keeping with past practice, the members agreed that such adjustments should not be made automatically in response to the behavior of the monetary aggregates alone, but needed to take account of emerging evidence on the business situation, domestic credit conditions, and the foreign exchange value of the dollar. Nonetheless, there was some difference of views among the members

with regard to their willingness to tolerate relatively rapid growth in the monetary aggregates, should it occur, over the period ahead. While no member contemplated the need for a substantial move toward greater reserve restraint, some commented that a small but timely move might well avert the necessity for a more vigorous, and potentially more disruptive, adjustment later. On the other hand, a number of members felt that the current economic uncertainties and related volatility that appeared to pervade domestic credit and foreign exchange markets would argue for more tolerance toward growth in the aggregates, particularly to the extent that such growth might signify an increase in demands for liquidity.

At the conclusion of the Committee's discussion, a majority of the members favored and all could accept a directive that called for no change in reserve conditions, though a few members indicated some preference for a directive that specified a slight increase in the degree of reserve restraint. The members anticipated that the approach to policy implementation adopted by the Committee would be consistent with growth of M1, M2, and M3 at annual rates of around 6, 7, and 8 percent respectively for the period from March to June. The members agreed that somewhat lesser restraint might be acceptable in the context of substantially slower growth in the monetary aggregates, while somewhat greater restraint might be acceptable if monetary growth were substantially faster. In either event, the need for greater or lesser restraint would also be appraised against the background of developments relating to the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign

exchange markets. It was agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, would be left unchanged at 6 to 10 percent.

At the conclusion of the meeting, 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 is currently expanding at a slower pace than in the fourth quarter, with an increased share of domestic spending apparently being met out of imports. Total retail sales rose considerably for January and February combined and housing starts, though declining in February, were above their fourth-quarter pace. However, information on business capital spending suggests less rapid expansion in early 1985. Business inventory investment continues at a moderate rate. Industrial production declined on balance in January and February and, with employment falling in the manufacturing sector, total nonfarm payroll employment increased at a somewhat reduced pace. The civilian unemployment rate, at 7.3 percent in February, was little changed from its level at year-end. Broad measures of prices and the index of average hourly earnings appear to be continuing to rise at rates close to those recorded in 1984.

Since the Committee's meeting in mid-February, the foreign exchange value of the dollar has fluctuated widely in often volatile market conditions. Most recently, the trade-weighted value of the dollar against major foreign currencies has dropped sharply, more than offsetting its rise earlier in the intermeeting interval. Monetary authorities sold dollars on a large scale during the period, especially in late February and early March. The merchandise trade deficit increased sharply in January from relatively low December and fourth-quarter rates. The current account deficit for the full year 1984 was more than double that recorded in 1983.

Growth in M1 accelerated in February, following relatively rapid expansion in other recent months, but information available through mid-March indicates a considerable slowing. Growth in the broader aggregates moderated in February and appears to be slowing further in March. In January and February expansion in total domestic nonfinancial debt remained relatively rapid, though somewhat below the pace of previous months. Most interest rates have risen somewhat since the February meeting of the Committee.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at its meeting in February to establish ranges for monetary growth of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9-1/2 percent for M3 for the period from the fourth quarter of 1984 to the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for the year 1985. The Committee agreed that growth in the monetary aggregates in the upper part of their ranges for 1985 may be appropriate, depending on developments with respect to velocity and provided that inflationary pressures remain subdued.

The Committee understood that policy implementation would require continuing appraisal of the relationships not only among the various measures of money and credit but also between those aggregates and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

In the implementation of policy for the immediate future, taking account of the progress against inflation, uncertainties in the business outlook, and the exchange value of the dollar, the Committee seeks to maintain the existing degree of pressure on reserve positions. This action is expected to be consistent with growth in M1, M2, and M3 at annual rates of around 6, 7, and 8 percent respectively during the period from March to June. Somewhat lesser reserve restraint might be

acceptable in the event of substantially slower growth of the monetary aggregates while somewhat greater restraint might be acceptable in the event of substantially higher growth. In either case such a change would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. 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, Corrigan, Balles, Black, Forrestal, Gramley, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: None.

2. Review of continuing authorizations

The Committee followed its customary practice of reviewing all of its continuing authorizations and directives at this first regular meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1985. The Committee reaffirmed the authorization for foreign currency operations, the foreign currency directive, and the procedural instructions with respect to foreign currency operations in the forms in which they were currently outstanding. 1/

1/ Prior to this meeting, on March 6, 1985, certain other routine authorizations of the Committee, including various resolutions, rules, and procedures, and the agreement with the U.S. Treasury to warehouse foreign currencies, were distributed to the Committee members and Reserve Bank Presidents for their review. It was agreed that these authorizations would continue to stand as previously adopted and would not be placed on the agenda for consideration at this meeting unless any member so requested, and no such requests were received.

Votes for these actions: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Gramley, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against these actions: None.

3. Authorization for Domestic Open Market Operations

On the recommendation of the Manager for Domestic Operations, System Open Market Account, the Committee amended paragraph 1(a) of the authorization for domestic open market operations to raise from \$4 billion to \$6 billion the limit on intermeeting changes in System account holdings of U.S. government and federal agency securities. The Manager noted that the Committee had found it necessary to authorize temporary increases in the limit with greater frequency, primarily because of the increased size of the net variation, especially from seasonal influences, in market factors such as the Treasury balance that affect reserves. In 1984 such temporary increases had been authorized on six occasions, more than in any other recent year. A permanent increase in the limit to \$6 billion would reduce the number of occasions requiring special Committee action, while still calling needs for particularly large changes to the Committee's attention. The Committee concurred in the Manager's view that such an increase would be appropriate.

Accordingly, effective immediately, paragraph 1(a) of the authorization for domestic open market operations was amended to read as follows:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U. S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U. S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U. S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than \$6.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

Votes for this action: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Gramley, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: None.

Subsequently, on April 15, 1985, the Manager advised that projections indicated very large needs for reserves during the current intermeeting period, mainly because of sharply increasing Treasury balances in April. Accordingly, effective April 16, 1985, the Committee approved the recommendation of the Manager that the limit in paragraph 1(a) be raised from \$6 billion to \$9 billion for the intermeeting period ending May 21, 1985.

Votes for this action: Messrs. Volcker, Balles, Black, Forrestal, Gramley, Keehn, Martin, Ms. Seger and Mr. Timlen. Votes against this action: None. (Absent and not voting: Messrs. Corrigan, Partee, Rice and Wallich. Mr. Timlen voted as alternate for Mr. Corrigan.)