FEDERAL RESERVE press release

For Use at 4:30 p.m. October 5, 1990

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 August 21, 1990.

The record for each meeting of the Committee is made available a few days after the next regularly scheduled meeting and subsequently is published in the Federal Reserve Bulletin and the Board's Annual Report. The summary description of economic and financial conditions contained in each record is 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 August 21, 1990

Domestic policy directive

The information reviewed at this meeting suggested that economic activity was continuing to expand at a relatively slow pace. Growth in exports and some expansion in consumer spending were supporting final demands. At the same time, business capital spending appeared sluggish, and the demand for new housing had weakened further. Labor demand had softened on balance since the spring and the unemployment rate had risen recently, but labor costs showed no sign of decelerating. Underlying trends in inflation appeared to be little changed.

Total nonfarm payroll employment registered a large decline in July after having risen considerably over the two previous months. Much of the July drop resulted from layoffs of temporary census workers; however, payrolls shrank in manufacturing, construction, and business services, and hiring remained slow elsewhere. The civilian unemployment rate rose to 5.5 percent in July, just above the narrow range that had prevailed for an extended period. In contrast to the employment data, hours worked by production and nonsupervisory workers edged up in July, and initial claims for unemployment insurance continued to fluctuate narrowly around the average pace of the first half of the year.

After rising appreciably in the second quarter, industrial production was unchanged in July. Output of goods other than motor vehicles rose at about the moderate pace evident thus far this year. Total industrial capacity utilization retraced its June rise but

remained somewhat above its level at the start of the year. The operating rate in manufacturing also slipped in July, though it stayed in the narrow range that had prevailed this year after an appreciable reduction in 1989.

After declining in earlier months, nominal retail sales rose considerably on balance over June and July. There were substantial upward revisions to sales for both May and June; nevertheless, for the second quarter as a whole, gains in total personal consumption expenditures appeared to have been relatively limited. In July, housing starts fell for the sixth straight month. Most of the decline was in multifamily units, but starts in the single-family segment of the market edged lower as sales of new homes continued sluggish and inventories of unsold homes remained relatively large.

Shipments of nondefense capital goods rose sharply in June after a decline, on balance, in April and May; most of the gain in June reflected higher outlays for aircraft and for office and computing equipment. Over the past four quarters, however, equipment outlays had changed little as increases in spending on computers had been offset by reduced purchases of industrial equipment and motor vehicles. A net decline in the nominal value of orders for nondefense capital goods in recent months pointed to sluggishness in equipment spending in the near term. Nonresidential construction activity strengthened in June, especially for office buildings, but the downtrend in permits and contracts for new construction suggested continued softness in this sector. Business inventory investment had been moderate in the second quarter, and there was no general indication of inventory imbalances in

relation to sales. At manufacturing and wholesale establishments, inventories fell appreciably in June, and the ratio of inventories to shipments edged lower. At the retail level, nonauto stocks climbed somewhat further in June, but with recent gains in sales, inventory-sales ratios dropped back after widespread increases in the two previous months.

The nominal deficit in U.S. merchandise trade narrowed sharply in June. The value of exports rose substantially from the May level, with most of the increase occurring in civilian aircraft and parts, consumer goods, and agricultural products. The value of imports was down somewhat; about half of the decrease resulted from declines in the price and quantity of oil imports. The trade deficit for the second quarter was substantially reduced from its first-quarter rate and was the lowest quarterly average since 1983. Measures of economic activity for the second quarter suggested that growth had remained robust in Japan and West Germany but had slowed somewhat in other major foreign industrial countries. Measured inflation rates were unchanged or had declined slightly in major industrial nations other than the United Kingdom, although the recent rise in oil prices, among other factors, raised concerns about renewed inflationary pressures.

Crude oil prices had risen sharply in spot markets in the weeks before the Committee meeting, largely in response to the Iraqi invasion of Kuwait. Available aggregate measures of producer and consumer prices predated the increase in oil prices, and these data suggested persisting price pressures outside the food and energy categories. Producer prices of finished goods were little changed on balance in June

and July as declines in the prices of food and energy products offset a further rise in the prices of other finished goods. Consumer prices rose appreciably further in July, reflecting an acceleration in prices of nonfood, non-energy items. The latest data on total labor costs indicated that hourly compensation for private industry workers had increased more rapidly in the twelve months ended in June than in the year-earlier period.

At its meeting on July 2-3, 1990, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions for at least a short period after the meeting and that provided for some slight easing subsequently unless incoming data on the monetary aggregates and the economy evidenced greater strength. Accordingly, slightly greater reserve restraint might be acceptable or somewhat lesser reserve restraint would be acceptable during the intermeeting period, depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. In the circumstances, M2 and M3 were expected to grow at annual rates of about 3 and 1 percent respectively over the period from June through September.

After the Committee meeting, open market operations were directed initially at maintaining unchanged reserve conditions. Later, in mid-July, pressures on reserve positions were eased slightly as restrictions on credit supplies at banks, signaled in part by lagging money growth, suggested that credit conditions were tighter than appropriate at a time when the economy already was growing very slowly.

Adjustment plus seasonal borrowing averaged about $500 million in the three reserve maintenance periods completed since the July meeting. In late July and early August, technical adjustments were made to assumed levels of such borrowing to reflect the continued upswing in seasonal borrowing. The federal funds rate averaged about 8-1/4 percent at the time of the July meeting but, after the easing of reserve conditions in mid-July, federal funds traded around the 8 percent level. Most other short-term interest rates had dropped somewhat since the July meeting, largely in reaction to easier reserve conditions but also to some extent in reflection of expectations of some further easing in light of additional indications of a relatively sluggish economy. Bond yields had remained unchanged on balance through the end of July, but the invasion of Kuwait at the beginning of August and the associated rise in energy prices propelled long-term rates upward. Broad measures of stock prices, some of which had reached record highs earlier in the intermeeting interval, were off substantially on net over the period.

The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies declined considerably over the intermeeting period. Tighter monetary conditions in Japan and West Germany and some easing of short-term interest rates in the United States, along with market perceptions that these divergent trends might continue, contributed to downward pressures on the dollar. The dollar declined more sharply against the German mark than the Japanese yen. Late in the intermeeting period, uncertainty associated with the Iraqi invasion of Kuwait provided a short-lived boost for the dollar.

M2 grew slowly in June and July, while M3 changed little; available data for August suggested that growth of both aggregates was rebounding. Growth of M2 and especially of M3 had been damped by the continuing contraction of deposits at thrift institutions resulting from the restructuring of the thrift industry. Through July, expansion of both M2 and M3 was estimated to be in the lower portions of their respective ranges for 1990. Expansion of total domestic nonfinancial debt appeared to have been near the midpoint of the Committee's monitoring range.

The staff projection prepared for this meeting recognized that the recent steep rise in oil prices could have important adverse effects on economic activity and inflation. It was not possible, though, to determine with any confidence how oil prices might evolve over time, and this was clouding further an already uncertain economic outlook. Under a variety of plausible assumptions about oil prices, economic activity was likely to expand over the balance of the year, but at a weaker pace than had been forecast earlier. The retarding effects of higher energy prices on the growth of disposable incomes were expected to damp consumer purchases of goods, notably consumer durables, over the quarters immediately ahead. If the price of oil were to fall back somewhat next year, a strengthening of disposable incomes would tend to boost economic growth toward a pace that was closer to the economy's long-run potential by the latter part of next year. If oil prices were to stay at high levels, however, the recovery in consumer spending and economic growth would be delayed for several quarters. In either event, the staff anticipated considerable growth in exports over the next

several quarters in conjunction with continuing economic expansion in some major foreign industrial nations and the depreciation that had already occurred in the foreign exchange value of the dollar. Business capital spending was projected to remain relatively sluggish in the quarters ahead, though expenditures on producers durable equipment could strengthen were oil prices to drop back and retail sales to improve. Moderate restraint in expenditures at all levels of government was assumed. The rise in oil prices was expected to boost price inflation to an appreciable degree for the next few quarters; the extent and duration of these effects would depend on the future behavior of oil prices, but the adverse effect on inflation expectations and on wage and price inflation over the longer run would be limited by reduced pressures on resources.

In its discussion of the economic situation and outlook, the Committee focused on both the state of the economy before the increase in oil prices and the likely consequences for real output and inflation of that rise. Available data, which pertained to business conditions prior to the invasion of Kuwait, pointed to continuing slow economic growth, even though business activity was slipping in various sectors of the economy and some regions of the country. At the same time, broad measures of prices and labor costs suggested that the underlying rate of inflation--abstracting from swings in food and energy costs--had not turned down despite slow monetary expansion and the apparent growth of the economy at a pace below potential over the past several quarters. For some members, these data pointed to a relatively even balance, prior to the surge in oil prices, between the risks of a weakening economy and

rising inflation. For others, a deterioration in consumer and business attitudes even before the Iraqi invasion of Kuwait and the indications of continuing restrictions on credit availability at banks, among other factors, suggested that the risks had been tilted toward some potential further weakening of the economy.

The steep rise in oil prices was expected to have a retarding effect on economic activity during the months immediately ahead and to exacerbate inflationary pressures. The increase in oil prices also added greatly to the uncertainties about the prospects for economic activity and inflation over time, because the outcomes would depend on the response of consumers to reductions in real disposable incomes, the reaction of businesses to potentially lower sales, and the extent of acceptance by workers of declines in their real wages associated with a higher price of oil. Nonetheless, in the absence of more pronounced or long-lasting disturbances from events in the Middle East, the members generally felt that limited growth in economic activity remained a reasonable expectation, and in the circumstances they would anticipate some decline in the rate of inflation, though progress was likely to occur only after a nearer-term setback.

In their review of business conditions in specific sectors of the economy and regions of the country, members observed that continuing expansion in consumer spending and further growth in net exports appeared likely to sustain at least limited expansion in overall economic activity. Revised data suggested that total retail sales had been reasonably well maintained in recent months despite mixed reports from different parts of the country. However, as evidenced by surveys

conducted immediately after the Iraqi invasion of Kuwait, consumer sentiment could deteriorate rapidly. Apparently, consumer attitudes already had been adversely affected by the softening in home prices and worsening of employment prospects in many parts of the country; moreover, higher costs for energy were likely to limit any increase in discretionary spending. With regard to the prospects for foreign trade, a number of members expressed some optimism that the nation's trade balance would continue to improve, given the outlook for further economic growth in a number of major industrial countries. The report of a substantial decline in the trade deficit for the second quarter was viewed as an encouraging sign, and contacts in many parts of the country indicated that export demand was helping to sustain manufacturing activity at many firms. Higher oil prices would adversely affect foreign economies, but many other countries had trimmed their energy consumption considerably, and the reduction in oil supplies, if it persisted, should not disrupt in a major way the upward momentum of their expansion.

On the other hand, the prospects for business capital spending were less favorable, at least in the absence of faster growth in final demand than the members now anticipated. Business sentiment seemed to have deteriorated in several parts of the country. Commercial construction activity continued to be depressed by high vacancy rates in many areas and appeared to be softening in some others where previously it had been relatively well maintained. Housing construction in the view of some members might weaken somewhat further before it began to stabilize. With regard to the outlook for fiscal policy, members were

concerned that the prospects for a political compromise leading to a substantial reduction in the federal budget deficit had deteriorated as a consequence of the invasion of Kuwait. It might prove more difficult to curb spending or to raise taxes in a period of weak economic expansion or in conjunction with any surge in military expenditures. At the state and local level, by contrast, the worsening budgetary situation in many jurisdictions seemed likely to induce spending curbs and higher taxes.

In the course of the Committee's discussion, members commented on continuing indications of tightened credit standards. The results of a survey showed that credit availability had been reduced since the spring, but some members sensed that lending institutions as a group had not tightened credit terms further in recent weeks. Many lenders reported that they were making credit readily available to good credit risks, and it was clear that a sizable portion of the weakness in lending could be attributed to reduced loan demand on the part of borrowers, including consumers, rather than to a curtailed supply of loans. Nonetheless, contacts in many areas indicated that some business borrowers, notably builders, were continuing to experience serious problems in obtaining credit and that riskier borrowers were facing more stringent standards at banks at a time when markets for securities of less than investment grade had virtually disappeared. Members remained concerned about the exposure of many financial institutions and of heavily indebted business firms and individuals to adverse economic developments.

Turning to the outlook for inflation, the members continued to express disappointment over the lack of evidence of a decline in the core rate of inflation; of particular concern was the failure of increases in labor costs to moderate. By some measures, inflation could be judged to have worsened marginally even before the recent surge in oil prices. The future course of oil prices was highly uncertain, but the recent rise in these prices would undoubtedly raise the measured inflation rate in the period ahead. Moreover, the depreciation of the dollar over the course of previous months would exert upward pressures on prices. Whether these pressures from oil prices and the dollar would be translated into higher inflation rates over longer periods of time would depend not only on their near-term passthrough into prices and wages but more fundamentally on their influence on inflation expectations. In this regard, the slack that seemed to be developing in resource utilization, while regrettable in some respects, would help to forestall a more permanent increase in wage and price inflation.

In the Committee's discussion of policy for the weeks ahead, members commented that the heightened uncertainties and the prospectively less satisfactory performance of the economy stemming from events in the Middle East had greatly complicated the formulation of an effective monetary policy. Uncertainties about the developments in the Middle East made it difficult to judge an appropriate policy stance, and those uncertainties had been reflected in unusually volatile financial markets. More fundamentally, with the surge in oil prices tending to weaken economic activity while also intensifying inflationary pressures, an easing in policy would incur the risk of overcompensating for

potential weakness in the economy at the expense of greater inflation, while a tightening move to counter inflation might stall an already weak economic expansion. In these circumstances, the members generally concluded that the Federal Reserve could best contribute to the nation's economic goals by fostering a stable policy environment. The prospective performance of the economy was very likely to be dominated by events that were outside the Committee's control, including not only developments in the Middle East but decisions to be made with regard to the federal budget deficit.

While acknowledging the current uncertainties and policy limitations that the Committee was facing, several members underscored the need to avoid any paralysis of policy as conditions evolved in the weeks and months ahead and circumstances permitted an effective policy response. In the opinion of several members, events appeared likely to unfold in a direction that would require an easing of policy at some point to counter weakening tendencies in the economy that had been in train before the oil price increase. The timing and circumstances of any such easing would have to be weighed carefully, however, to avoid an unfavorable impact on inflationary attitudes and associated upward pressure on long-term interest rates, especially since the dollar had been under downward pressure in the foreign exchange markets. A number of other members viewed the risks to the economy as more evenly balanced. These members saw a substantial risk of some intensification in inflationary pressures, particularly in the context of higher energy prices. The downward movement of the dollar since the fall of 1989, flat or even mildly rising commodity prices, and the now upward sloping

yield curve argued for a relatively restrictive monetary policy, pending further developments. For the present, all the members indicated that they could support a steady policy, given the current uncertainties and the possibility of unsettlement in foreign exchange and domestic financial markets.

In the course of the discussion, the members took account of a staff analysis which suggested that, on the assumption of an unchanged degree of reserve restraint, growth in M2 and M3 was likely to pick up to some extent from the pace in recent months, in part because of a narrowing in the opportunity costs of holding assets included in those monetary measures. Members noted that the very recent strengthening of the monetary aggregates tended to reinforce the staff assessment and to diminish the case for any near-term easing of reserve conditions, though it also was recognized that some of the strength represented a greater preference for liquidity in an uncertain environment. Given the particular difficulty of charting an appropriate course for monetary policy in current circumstances, some members suggested that the behavior of the monetary aggregates needed to be monitored with special care and that greater than usual emphasis should be given to fostering desired rates of monetary growth.

While all the members could support an unchanged policy stance for at least some initial period after today's meeting, their somewhat differing assessments of the most likely course for monetary policy were associated with some differences in their views with regard to the possible need to adjust reserve conditions later during the intermeeting period. A majority indicated a preference for a directive that was

tilted toward potential easing. Some of these members indicated that they had been leaning toward an easing move prior to the events in the Middle East, and they now felt that reserve conditions should be eased promptly if conditions in domestic financial and foreign exchange markets provided an appropriate opportunity. Tightening would be especially inappropriate in this view, given the current indications of weaknesses in the economy and the vulnerability of many financial institutions and heavily indebted borrowers to higher interest costs. Other members acknowledged the threat of a deteriorating economy, but because they also saw a considerable risk that underlying inflationary pressures might worsen, they preferred a symmetrical directive that gave equal weight to possible intermeeting adjustments in either direction. A few members would not rule out the possibility of some tightening, which might foster some decline in long-term interest rates by having quite beneficial effects on inflation expectations and by reinforcing the public's perception of the Committee's commitment to its price-stability objective.

At the conclusion of the Committee's discussion, all the members indicated that they favored or could accept a directive that called for maintaining unchanged conditions of reserve availability, at least initially, in the intermeeting period ahead and that provided for giving emphasis to potential developments that might require some easing during the intermeeting period. Accordingly, slightly greater reserve restraint might be acceptable during the intermeeting period, while some easing of reserve pressure would be acceptable, depending on progress toward price stability, the strength of the business expansion, the

behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with somewhat faster near-term growth in money than the members had anticipated earlier, including growth in M2 and M3 at annual rates of about 4 and 2-1/2 percent respectively over the three-month period from June to September. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was 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 economic activity is continuing to expand at a relatively slow pace. After a sizable rise in May and June, total nonfarm payroll employment registered a large decline in July, much but not all of which reflected layoffs of temporary census workers. The civilian unemployment rate rose to 5.5 percent in July, just above the narrow range that had prevailed for an extended period. Industrial production was unchanged in July after rising appreciably in the second quarter. Retail sales rose considerably on balance over June and July after declines in earlier months. Available indicators point to a sluggish trend in business capital spending. Residential construction weakened further in July. The nominal U.S. merchandise trade deficit narrowed sharply in June; for the second quarter, the trade deficit was substantially reduced from its first-quarter rate. Consumer prices rose appreciably further in June and July, while producer prices were about unchanged over the two months The latest data on labor costs suggest no improvement in underlying trends. Crude oil prices have risen sharply over the last several weeks.
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> Short-term interest rates have fallen somewhat since the Committee meeting on July 2-3, while rates in bond markets have risen appreciably, as oil prices have increased. The trade-weighted foreign exchange

value of the dollar in terms of the other G-10 currencies declined considerably over the intermeeting period.

M2 grew slowly in June and July, while M3 was little changed; available data for August suggest a partial rebound in both aggregates. Growth of M2 and especially of M3 has been damped by the continuing contraction of deposits at thrift institutions resulting from the restructuring of the thrift industry. Through July, expansion of both M2 and M3 was estimated to be in the lower portions of their respective ranges for 1990. Expansion of total domestic nonfinancial debt appears to have been near the midpoint of its monitoring range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the range it had established in February for M2 growth of 3 to 7 percent, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The Committee in July also retained the monitoring range of 5 to 9 percent for the year that it had set for growth of total domestic nonfinancial debt. With regard to M3, the Committee recognized that the ongoing restructuring of thrift depository institutions had depressed its growth relative to spending and total credit more than anticipated. Taking account of the unexpectedly strong M3 velocity, the Committee decided in July to reduce the 1990 range to 1 to 5 percent. For 1991, the Committee agreed on provisional ranges for monetary growth, measured from the fourth quarter of 1990 to the fourth quarter of 1991, of 2-1/2 to 6-1/2 percent for M2 and 1 to 5 percent for M3. The Committee tentatively set the associated monitoring range for growth of total domestic nonfinancial debt at 4-1/2 to 8-1/2 percent for 1991. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly

greater reserve restraint might or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from June through September at annual rates of about 4 and 2-1/2 percent respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Hoskins, Kelley, LaWare, Mullins, Ms. Seger, and Mr. Stern. Votes against this action: None.