Records

Record of Policy Actions of the Board of Governors

Regulation A
Extensions of Credit by Federal Reserve Banks

July 20, 1999—Amendments

The Board amended Regulation A to create a Century Date Change Special Liquidity Facility, a program for lending to depository institutions from October 1, 1999, through April 7, 2000.

> Votes for this action: Messrs. Greenspan, Kelley, Meyer, Ferguson, and Gramlich.[1]

The Board established the facility to help ensure that depository institutions have adequate liquidity to meet any unusual demands in the period around the century date change. The interest rate charged on loans from the special facility is 150 basis points higher than the Federal Open Market Committee's targeted federal funds rate. Although the collateral requirements are the same as for regular discount window loans, there are no restrictions on the use and duration of loans from the special facility while it is in operation, and borrowers are not required to seek funds elsewhere first.

Regulation D
Reserve Requirements of Depository Institutions

September 27, 1999—Amendments

The Board amended Regulation D to decrease the amount of net transaction accounts at depository institutions to which a lower reserve requirement applies and to increase the amount of reservable liabilities that is exempt from reserve requirements for 2000, effective for the reserve computation period beginning November 30, 1999, for institutions reporting weekly.

> Votes for this action: Messrs. Greenspan, Kelley, Meyer, Ferguson, and Gramlich.[1]

Under the Monetary Control Act of 1980, depository institutions, Edge Act corporations, agreement corporations, and U.S. agencies and branches of foreign banks are subject to reserve requirements set by the Board. The act directs the Board to adjust annually the amount subject to the lower reserve requirement to reflect changes in net transaction accounts at depository institutions. Recent declines in net transaction accounts warranted a decrease to $44.3 million, and the Board amended Regulation D accordingly.

The Garn–St Germain Depository Institutions Act of 1982 establishes a zero percent reserve requirement on the first $2 million of an institution's reservable liabilities. The act also provides for annual adjustments to that exemption amount based on increases in reservable liabilities at depository institutions. Recent growth in reservable liabilities warranted an increase in the amount exempted from reserve requirements to $5 million, and the Board amended Regulation D accordingly.

NOTE. In voting records throughout this chapter, Board members, except the Chairman and Vice Chairman, are listed in order of seniority.

1. Throughout this chapter, note 1 indicates that two vacancies existed on the Board when the action was taken.

For institutions reporting weekly, the amendments are effective with the reserve computation period beginning November 30, 1999, and the corresponding reserve maintenance period beginning December 30, 1999. For institutions reporting quarterly, the amendments are effective with the reserve computation period beginning December 21, 1999, and the corresponding reserve maintenance period beginning January 20, 2000.

To reduce the reporting burden on small institutions, depository institutions having total deposits below specified levels are required to report their deposits and reservable liabilities quarterly or less frequently, while larger institutions must report weekly. To reflect increases in the growth rate of total deposits at all depository institutions, the Board increased the deposit cutoff levels used in determining the frequency and detail of depository reporting to $84.5 million for nonexempt depository institutions and to $54.3 million for exempt depository institutions, beginning in September 2000.

Regulation H
Membership of State Banking Institutions in the Federal Reserve System

October 21, 1999—Year 2000 Standards for Safety and Soundness

The Board made final the interim guidelines establishing Year 2000 standards for insured depository institutions, effective November 29, 1999.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.[1]

The Board, jointly with the other federal banking and thrift agencies, made final the Interagency Guidelines Establishing Year 2000 Standards for Safety and Soundness for insured depository institutions that had been approved by the agencies as interim guidelines, effective October 15, 1998. The guidelines address project planning, renovation, testing, contingency planning, the role of management, risk assessment, and essential steps in each phase of Year 2000 readiness. The final guidelines make clarifying changes to the interim guidelines.

Regulation H
Membership of State Banking Institutions in the Federal Reserve System

Regulation K
International Banking Operations

Regulation Y
Bank Holding Companies and Change in Bank Control

March 23, 1999—Termination of Proposed Rulemaking

The Board withdrew a proposed rule that would have required the domestic and foreign banking organizations it supervises to develop and maintain ‘‘Know Your Customer’’ programs.

Votes for this action: Mr. Greenspan, Ms. Rivlin, and Messrs. Kelley, Meyer, Ferguson, and Gramlich.[2]

In December 1998, the Board and the other federal banking and thrift agencies requested comment on substantially similar ‘‘Know Your Customer’’ rules that would have required domestic and foreign depository institutions to de-

2. Throughout this chapter, note 2 indicates that one vacancy existed on the Board when the action was taken.

velop policies and procedures designed to identify customers and their normal and expected transactions, to monitor account activity, and to use this information to identify and report suspicious transactions. The Board and the other agencies withdrew the proposal on the basis of an analysis of the comments received.

Regulation H
Membership of State Banking Institutions in the Federal Reserve System

Regulation Y
Bank Holding Companies and Change in Bank Control

February 17, 1999—Amendment

The Board made final an interim rule amending Regulations H and Y to reduce regulatory burden on certain banking organizations having significant trading activities under the risk-based capital standards, effective July 1, 1999.

> Votes for this action: Mr. Greenspan, Ms. Rivlin, and Messrs. Kelley, Meyer, Ferguson, and Gramlich.[2]

The Board, jointly with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, made final an interim rule adopted in December 1997 by amending the risk-based capital standards for market risk applicable to certain banks and bank holding companies that have significant trading activities. If an institution's internal model adequately measures specific risk, the amendment eliminates the requirement that when using an internal model, the total capital charges for specific risk must equal at least 50 percent of the standard specific risk capital charge. The rule reduces regulatory burden for institutions having qualifying internal models by eliminating the calculation of a standard specific risk capital charge.

February 24, 1999—Amendments

The Board amended Regulation H to revise the risk-based and leverage capital standards for banks to make the capital treatment for certain transactions more consistent among the federal banking and thrift agencies and amended Regulation Y to apply the same standards to bank holding companies, effective April 1, 1999.

> Votes for this action: Mr. Greenspan, Ms. Rivlin, and Messrs. Kelley, Meyer, Ferguson, and Gramlich.[2]

The amendments, adopted by the Board jointly with the other federal banking and thrift agencies, revise the risk-based and leverage capital standards for state member banks, consistent with provisions of the Riegle Community Development and Regulatory Improvement Act of 1994. The amendments conform the risk-based capital treatments among the agencies for certain construction and real estate loans and investments in mutual funds, and simplify and make uniform the agencies' tier 1 leverage capital standards. The amendments to Regulation Y apply the same revisions to the risk-based capital standards for bank holding companies.

Regulation K
International Banking Operations

May 17, 1999—Amendment

The Board approved an amendment to Regulation K that makes final an interim rule extending the examination-frequency cycle for certain U.S. branches and agencies of foreign banks, effective October 22, 1999.

Votes for this action: Mr. Greenspan, Ms. Rivlin, and Messrs. Kelley, Meyer, Ferguson, and Gramlich.[2]

The amendment, which was issued jointly with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, implements provisions of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 by making U.S. branches and agencies of foreign banks having assets of $250 million or less eligible for an eighteen-month examination cycle rather than a twelve-month cycle if they meet the qualifying criteria set out in the rule.

Regulation L
Management Official Interlocks

September 7, 1999—Amendments

The Board amended Regulation L to conform with recent statutory changes and to simplify compliance with the rule's requirements, effective January 1, 2000.

Votes for this action: Messrs. Greenspan, Kelley, Meyer, Ferguson, and Gramlich.[1]

Regulation L implements the Depository Institution Management Interlocks Act by prohibiting management officials from serving simultaneously with two unaffiliated depository institutions or their holding companies based on the depository organizations' asset size and the location of their offices. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended three principal provisions of the Interlocks Act. It (1) increased the asset threshold for prohibiting management official interlocks between two unaffiliated depository organizations, regardless of office location, to interlocks involving organizations having total assets exceeding $2.5 billion and $1.5 billion respectively; (2) permanently exempted management officials whose service began before November 10, 1978; and (3) authorized exemptions from the Interlocks Act by regulation if the interlocking service would not result in a monopoly or substantially lessen competition. The Board, jointly with the other federal banking and thrift agencies, amended its management interlocks rules to comply with the new statutory provisions and to make other changes to simplify compliance with the rule's requirements.

Regulation CC
Availability of Funds
and Collection of Checks

March 17, 1999—Amendment

The Board amended Regulation CC to allow banks that consummate a merger on or after July 1, 1998, and before March 1, 2000, to treat themselves as separate banks for purposes of the regulation until March 1, 2001, in order to provide them greater time to implement software changes related to the merger.

Votes for this action: Mr. Greenspan, Ms. Rivlin, and Messrs. Kelley, Meyer, Ferguson, and Gramlich.[2]

Under the amendment, banks that consummate a merger within the specified time period will be treated as separate banks until March 1, 2001. The amendment is designed to provide relief to banks that are dedicating their automation resources primarily to renovating and testing software and replacing systems to address Year 2000 and leap year computer problems.

June 28, 1999—Termination of Proposed Rulemaking

The Board decided not to propose regulatory changes at this time to reduce the availability schedule for nonlocal checks.

Votes for this action: Mr. Greenspan, Ms. Rivlin, and Messrs. Kelley, Meyer, Ferguson, and Gramlich.[2]

In December 1998, the Board requested comment on an advance notice of proposed rulemaking to modify the availability schedule in Regulation CC for nonlocal checks. The proposal would have reduced the maximum hold for nonlocal checks from five to four business days, except for subcategories of nonlocal checks for which a depositary bank certifies that it does not receive a sufficient proportion of returns within four business days. After further analysis, the Board concluded that return times do not support a reduced availability schedule for nonlocal checks in the aggregate. The Board also determined that the costs and potential risks would outweigh the likely benefits of establishing subcategories of nonlocal checks for availability purposes.

October 26, 1999—Amendments

The Board amended Regulation CC to clarify the extent to which depository institutions and others may vary the terms of the regulation by agreement for the purpose of instituting electronic return of checks, effective December 15, 1999.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.[1]

In February 1999, the Board requested comment on options for amending Regulation CC, which governs when paying or returning banks may send notices instead of returning the original checks, to consider whether more flexibility would enable check system participants to experiment with methods to return checks electronically. Rather than adopting any of the proposed options, the Board revised the Commentary to Regulation CC to add examples of interbank agreements on electronic presentment and return of checks.

Regulation DD
Truth in Savings

August 18, 1999—Interim Amendment

The Board approved an interim amendment to Regulation DD to permit depository institutions to provide certain disclosures electronically if the customer agrees, effective September 1, 1999.

Votes for this action: Messrs. Greenspan, Kelley, Meyer, Ferguson, and Gramlich.[1]

Regulation DD, which implements the Truth in Savings Act, generally requires depository institutions to provide consumers with written disclosures of the yields, fees, and other terms for deposit accounts on request, when an account is opened, when changes in terms occur, and in periodic statements. The interim amendment permits depository institutions to provide Regulation DD's disclosures on periodic statements electronically if the customer agrees. The interim rule was adopted in response to comments received on a proposed rule issued in March 1998. Along with the interim amendment, the Board published for comment revised proposals to permit electronic disclosures under Regulations B (Equal Credit

Opportunity), E (Electronic Fund Transfers), M (Consumer Leasing), Z (Truth in Lending), and DD (Truth in Savings).

Miscellaneous Interpretations

Regulation K
International Banking Operations

October 25, 1999—Interpretation

The Board clarified that the scope of permissible data processing activities under Regulation K encompasses all those activities permissible for bank holding companies under Regulation Y (Bank Holding Companies and Change in Bank Control), effective November 1, 1999.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.[1]

Regulation K provides that a bank holding company or Edge Act corporation may control a foreign company that engages in activities that are usual in connection with the transaction of banking or other financial operations abroad, including data processing, but does not specify the scope of permissible data processing activities. Amendments to Regulation Y have expanded the scope of permissible data processing activities for bank holding companies in the United States, and those activities are equal to, and in some respects broader than, the data processing activities that were authorized by the adoption of Regulation K in 1979. The interpretation clarifies that the data processing provision of Regulation K encompasses the same data processing activities as described in Regulation Y under the same limitations. Banking organizations seeking to engage abroad in data processing or data transmission activities that are not authorized by Regulation Y must apply for the Board's prior consent under Regulation K.

Policy Statements and Other Actions

February 19, 1999—Policy Statement on Payments System Risk

The Board approved a modification to the procedures for measuring daylight overdrafts to include the posting time for settlement entries processed through the enhanced settlement service. The modification became effective on March 29, 1999, to coincide with the implementation of the enhanced settlement service.

Votes for this action: Mr. Greenspan, Ms. Rivlin, and Messrs. Kelley, Meyer, Ferguson, and Gramlich.[2]

In 1998, the Board approved an enhanced settlement service that combines and improves selected features of the Reserve Banks' existing net settlement services and may be used for either gross or net multilateral settlements. The service provides same-day, intraday settlement finality to participants in clearing arrangements using the service. Settlement entries processed by the enhanced settlement service will be posted on a flow basis as they are processed and are final and irrevocable.

May 20, 1999—Delegation of Authority

The Board delegated to its General Counsel the authority to return applications filed under the International Banking Act that are informationally incomplete, effective May 20, 1999.

Votes for this action: Mr. Greenspan and Messrs. Kelley, Meyer, Ferguson, and Gramlich. Absent and not voting: Ms. Rivlin.[2]

Under the International Banking Act, the Board may not approve an application by a foreign bank to establish a branch, agency, commercial lending company, or representative office unless the bank provides the Board with information needed to adequately evaluate the application. The Board delegated to the General Counsel, with the concurrence of the director of the Division of Banking Supervision and Regulation, the authority to return an application if material informational deficiencies are not corrected within a reasonable period of time.

June 22, 1999—Policy Statement Concerning Branch Closing Notices and Policies

The Board approved a revised policy statement on branch closings by insured depository institutions to incorporate changes in the law, effective June 29, 1999.

Votes for this action: Mr. Greenspan, Ms. Rivlin, and Messrs. Kelley, Meyer, Ferguson, and Gramlich.[2]

The Board, jointly with the other federal banking and thrift agencies, approved a revised policy statement on branch closings by insured depository institutions to incorporate changes enacted by the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 and the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The policy statement gives guidance on the procedure for branch closings in low- or moderate-income areas by an interstate bank and for convening a meeting with the appropriate parties if requested by a person from the affected area. The revised statement also provides that the prior-notice requirements for branch closings do not apply to automated teller machines, certain types of relocations and consolidations, and branches closed in connection with emergency acquisitions or assistance by the Federal Deposit Insurance Corporation.

July 14, 1999—Notice of Modification of Procedures for Deposit Reporting Frequency

The Board amended its requirements that depository institutions switch to new reporting categories for September 1999 in light of the century date change, effective August 1, 1999.

Votes for this action: Messrs. Greenspan, Kelley, Meyer, Ferguson, and Gramlich.[1]

Depository institutions may be required to switch to new reporting categories each September. Assignment to these reporting categories determines the frequency and detail of deposit-reporting over the subsequent year and depends on increases or decreases in the level of deposits and reservable liabilities. The Board suspended some shifts in reporting categories for September 1999, thereby reducing the need for depository institutions to modify their data processing systems before the impending century date change. Normal category shift procedures will apply in September 2000.

November 10, 1999—Settlement Day Finality for Automated Clearinghouse Credit Transactions

The Board approved modifications to the time when settlement becomes final for automated clearinghouse (ACH) credit transactions processed by Federal Reserve Banks and required prefunding for ACH credit transactions in certain Federal Reserve accounts. The effective date will be announced three months before implementation in 2001.

Votes for this action Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich.[1]

The Board made settlement for ACH credit transactions processed by the Federal Reserve final when posted, currently 8:30 a.m. eastern time on the day of settlement, and adopted a prefunding requirement for any ACH credit originations settled through a Federal Reserve account that is monitored in real time. The modifications are designed to reduce risk to receiving depository financial institutions in credit transactions and to manage settlement risks in credit originations in a manner comparable to other Federal Reserve services that have similar finality characteristics. To allow sufficient time for software modifications, the effective date for settlement-day finality for credit ACH transactions will be announced three months before implementation in 2001.

1999 Discount Rates

During 1999, the Board of Governors approved two increases of ¼ percentage point in the basic discount rate charged by the Federal Reserve Banks. These actions, taken in August and November, raised the basic rate from 4½ percent to 5 percent. The rates for seasonal and extended credit, which are set on the basis of market-related formulas, were changed more frequently, and they exceeded the basic rate by varying amounts during the year. In July, the Board announced the establishment of a temporary program, the Century Date Change Special Liquidity Facility (SLF), whose purpose was to lend to depository institutions to help them meet any unusual liquidity needs in the period around the century date change.

Basic Discount Rate

The Board's decisions on the basic discount rate were made against the background of the policy actions of the Federal Open Market Committee (FOMC) and related economic and financial developments. These developments are reviewed more fully in other parts of this REPORT, including the minutes of the FOMC meetings in 1999, which also appear in this REPORT.

January through Mid-August: No Changes in the Basic Rate

Economic activity expanded at a vigorous pace during the early months of the year, underpinned by notable further strength in consumer spending, but the recovery of financial markets in the United States and abroad and of foreign economies from the severe disruptions of the fall of 1998 was still tentative. Moreover, in an environment of robust improvements in productivity, inflation trends remained generally subdued despite very tight labor markets. Against this background, a majority of the Federal Reserve Banks favored an unchanged basic discount rate of 4½ percent, its level since mid-November 1998. However, two Banks particularly concerned about the mounting risks of higher inflation requested an increase of ¼ percentage point during March and April, and three other Banks joined them during the period from May through July. The Board took no action on these requests, but the Board members recognized the need to monitor carefully developments bearing on the outlook for rising inflation, notably, evidence of further tightening of labor markets in the context of continuing rapid growth of the economy.

Mid-August and Mid-November: Basic Rate Increased

In August a growing number of Federal Reserve Banks joined those requesting a ¼ percentage point increase in the basic rate—a total of ten by the third week of August—amid indications that recent wage and price increases had been a little larger on balance, though price inflation was still subdued. On August 24, the Board approved these pending actions in concert with a similar action by the FOMC to increase its intended level of the federal funds rate. These policy actions took account of the more normal functioning of the financial markets following the period of some unsettlement during the fall of 1998 and of the ongoing strength in domestic demand augmented by rising exports at a time when labor markets were already very tight. Against this background, the Board and the FOMC concluded that the degree of monetary ease that had been implemented during the autumn of 1998 to address the domestic effects of global financial turmoil was no longer consistent with sustained, noninflationary economic expansion.

In mid-October, two Federal Reserve Banks requested a further increase of ¼ percentage point in the basic rate, and by mid-November two additional Banks had joined them. On November 16, again in conjunction with a similar increase by the FOMC in the intended federal funds rate, the Board approved the pending actions, thereby raising the basic discount rate to 5 percent. Both actions reflected concerns that despite tentative evidence of some slowing in certain interest-sensitive sectors of the economy and of accelerating productivity, prevailing conditions in financial markets seemed likely to foster continued expansion in aggregate demand at a pace that would exceed the growth of potential output, with attendant risks of rising inflation over time. In light of market uncertainties associated with the century date change, no further changes in the discount rate were requested over the balance of the year despite ongoing concerns about the outlook for inflation.

Structure of Discount Rates

The basic discount rate is the rate normally charged on loans to depository institutions for short-term adjustment credit, while flexible, market-related rates generally apply on seasonal and extended credit. These flexible rates are calculated every two weeks in accordance with formulas that are approved by the Board. The rate on loans from the Special Liquidity Facility during the century date rollover period was set at 150 basis points above the intended federal funds rate established by the FOMC.

The objective of the seasonal program is to help smaller institutions meet liquidity needs arising from a clear pattern of intra-yearly movements in their deposits and loans. Funds may be provided for periods longer than those permitted under adjustment credit. Since its introduction in early 1992, the flexible rate charged on seasonal credit has been closely aligned with short-term market rates; it is never less than the basic rate applicable to adjustment credit.

The purpose of extended credit is to assist depository institutions that are under sustained liquidity pressure and are not able to obtain funds from other sources. The rate for extended credit is 50 basis points higher than the rate for seasonal credit and is at least 50 basis points above the basic rate. In appropriate circumstances, the basic rate may be applied to extended-credit loans for up to thirty days, but any further borrowings would be charged the flexible, market-related rate.

The Special Liquidity Facility was established as a temporary program for lending to depository institutions during the period October 1, 1999, through April 7, 2000. This facility was intended to help ensure that depository institutions would have adequate liquidity in the period surrounding the century date change.

Exceptionally large adjustment-credit loans that arise from computer breakdowns or other operating problems not clearly beyond the reasonable control of the borrowing institution are assessed the highest rate applicable to any credit extended to depository institutions; under the current structure, that is the rate on SLF credit.

At the end of 1999, the structure of discount rates was as follows: a basic rate of 5 percent for short-term adjustment credit and rates of 5.70 percent for seasonal credit, 6.20 percent for extended credit, and 7 percent for credit from the Special Liquidity Facility. During 1999, the rate for seasonal credit ranged from a low of 4.75 percent to a high of 5.75 percent, that for extended credit from a low of 5.25 percent to a high of 6.25 percent, and that for SLF credit from a low of 6.75 percent to a high of 7 percent.

Board Votes

Under the Federal Reserve Act, the boards of directors of the Federal Reserve Banks must establish rates on loans to depository institutions at least every fourteen days and must submit such rates to the Board of Governors for review and determination. The Reserve Banks are also required to submit requests on the same schedule to renew the formulas for calculating the rates on seasonal, extended, and SLF credit. Votes on the reestablishment of the formulas for these flexible rates are not shown in this summary. All votes taken by the Board of Governors during 1999 were unanimous.

Votes on the Basic Discount Rate

August 24, 1999. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Kansas City, and San Francisco to increase the basic discount rate ¼ percentage point, to 4¾ percent.

Votes for this action: Messrs. Greenspan, Kelley, Meyer, Ferguson, and Gramlich. Votes against this action: None.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Minneapolis and Dallas, effective August 25 and 26, 1999, respectively.

November 16, 1999. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, Cleveland, Richmond, Kansas City, and San Francisco to increase the basic discount rate ¼ percentage point, to 5 percent.

Votes for this action: Messrs. Greenspan, Ferguson, Kelley, Meyer, and Gramlich. Votes against this action: None.

The Board subsequently approved similar actions taken by the directors of the Federal Reserve Banks of Atlanta and Dallas, effective November 17, 1999, and by the directors of the Federal Reserve Banks of New York, Philadelphia, Chicago, St. Louis, and Minneapolis, effective November 18, 1999. ■

Minutes of Federal Open Market Committee Meetings

The policy actions of the Federal Open Market Committee, contained in the minutes of its meetings, are presented in the ANNUAL REPORT of the Board of Governors pursuant to the requirements of section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each policy action, and that it shall include in its annual report to the Congress a full account of such actions.

The minutes of the meetings contain the votes on the policy decisions made at those meetings as well as a résumé of the discussions that led to the decisions. The summary descriptions of economic and financial conditions are based on the information that was available to the Committee at the time of the meetings rather than on data as they may have been revised later.

Members of the Committee voting for a particular action may differ among themselves as to the reasons for their votes; in such cases, the range of their views is noted in the minutes. When members dissent from a decision, they are identified in the minutes along with a summary of the reasons for their dissent.

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market operations, the Federal Reserve Bank of New York operates under two sets of instructions from the Federal Open Market Committee: an Authorization for Domestic Open Market Operations and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, the Committee operates under an Authorization for Foreign Currency Operations, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations. These policy instruments are shown below in the form in which they were in effect at the beginning of 1999. Changes in the instruments during the year are reported in the minutes for the individual meetings.

Authorization for Domestic Open Market Operations

In Effect January 1, 1999

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 $12.0 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;

(b) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 60 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes and directs the Federal Reserve Banks to lend U.S. Government securities held in the System Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, under such instructions as the Committee may specify from time to time.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 60 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

Domestic Policy Directive

In Effect January 1, 1999[1]

The information reviewed at this meeting suggests that the economy has continued to expand at a brisk pace in recent months. Growth in nonfarm payroll employment was strong in November, after more moderate gains in September and October, and the civilian unemployment rate fell to 4.4 percent. Total industrial production declined somewhat in November, but manufacturing output was stable and up considerably from the third-quarter pace. Business inventory accumulation slowed appreciably in October after a sizable rise in the third quarter. The nominal deficit on U.S. trade in goods and services narrowed slightly in October from its third-quarter average. Total retail sales rose sharply in October and November, and housing starts were strong as well. Available indicators point to a considerable pickup in

1. Adopted by the Committee at its meeting on December 22, 1998.

business capital spending after a lull in the third quarter. Trends in various measures of wages and prices have been mixed in recent months.

Most short-term interest rates have changed little on balance since the meeting on November 17, but longer-term rates have declined somewhat. Share prices in equity markets have remained volatile and have posted sizable gains on balance over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has declined slightly over the period in relation to other major currencies and in terms of an index of the currencies of other countries that are important trading partners of the United States.

M2 and M3 have posted very large increases in recent months. For the year through November, both aggregates rose at rates well above the Committee's annual ranges. Total domestic nonfinancial debt has expanded in recent months at a pace somewhat above the middle of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at its meeting on June 30–July 1 the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1997 to the fourth quarter of 1998. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1999, the Committee agreed on a tentative basis to set the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1998 to the fourth quarter of 1999. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 4¾ percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period.

Authorization for Foreign Currency Operations

In Effect January 1, 1999

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Austrian schillings	Italian lire
Belgian francs	Japanese yen
Canadian dollars	Mexican pesos
Danish kroner	Netherlands guilders
euro	Norwegian kroner
Pounds sterling	Swedish kronor
French francs	Swiss francs
German marks	

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements (“swap” arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount (millions of dollars equivalent)
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico	3,000
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	4,000
Bank for International Settlements	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies, or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non–market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board Members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of

the Manager, System Open Market Account (''Manager''), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

Foreign Currency Directive

In Effect January 1, 1999

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency (''swap'') arrangements with selected foreign central banks and with the Bank for International Settlements.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the IMF Article IV.

Procedural Instructions with Respect to Foreign Currency Operations

In Effect January 1, 1999

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account (''Manager''), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any operations that are not of a routine character.

Meeting Held on February 2–3, 1999

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 2, 1999, at 2:30 p.m. and continued on Wednesday, February 3, 1999, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehn
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Ms. Rivlin
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the Federal Open Market Committee

Ms. Minehan, Messrs. Poole, and Hoenig, Presidents of the Federal Reserve Banks of Boston, St.Louis, and Kansas City respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Prell, Economist

Messrs. Alexander, Cecchetti, Hooper, Hunter, Lang, Lindsey, Rolnick, Rosenblum, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Winn,[2] Assistant to the Board, Office of Board Members, Board of Governors

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Reinhart, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Dennis,[3] Assistant Director, Division of Reserve Bank Operations and Payment Systems, Board of Governors

Messrs. Reifschneider[4] and Small,[4] Section Chiefs, Divisions of Research and Statistics and Monetary Affairs respectively, Board of Governors

Ms. Kole,[5] Messrs. English[5] and Rosine,[5] Senior Economists, Divisions of International Finance, Monetary Affairs, and Research and Statistics respectively

Ms. Garrett, Economist, Division of Monetary Affairs, Board of Governors

Mr. Evans,[3] Manager, Division of Reserve Bank Operations and Payment Systems, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Conrad, First Vice President, Federal Reserve Bank of Chicago

Messrs. Beebe, Eisenbeis, Goodfriend, Hakkio, and Rasche, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, Richmond, Kansas City, and St. Louis respectively

Messrs. Altig, Bentley, and Rosengren, Vice Presidents, Federal Reserve Banks of Cleveland, New York, and Boston respectively

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for the period commencing January 1, 1999, and ending December 31, 1999, had been received and that these individuals had executed their oaths of office.

The elected members and alternate members were as follows:

William J. McDonough, President of the Federal Reserve Bank of New York.[6]

Edward G. Boehne, President of the Federal Reserve Bank of Philadelphia, with J. Alfred Broaddus, Jr., President of the Federal Reserve Bank of Richmond, as alternate.

2. Attended Wednesday's session only.

3. Attended portions of meeting relating to the examination of the System Open Market Account and changes to the domestic securities lending program.

4. Attended portions of meeting relating to the discussion of the Committee's consideration of its monetary and debt ranges for 1999.

5. Attended portion of meeting relating to the Committee's review of the economic outlook and consideration of its monetary and debt ranges for 1999.

6. Mr. Jamie B. Stewart, Jr., incoming First Vice President of the Federal Reserve Bank of New York, took his oath of office as alternate member for Mr. McDonough on February 18, 1999.

Michael H. Moskow, President of the Federal Reserve Bank of Chicago, with Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, as alternate.

Robert D. McTeer, Jr., President of the Federal Reserve Bank of Dallas, with Jack Guynn, President of the Federal Reserve Bank of Atlanta, as alternate.

Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, with Robert T. Parry, President of the Federal Reserve Bank of San Francisco, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first meeting of the Committee after December 31, 1999, with the understanding that in the event of the discontinuance of their official connection with the Board of Governors or with a Federal Reserve Bank, they would cease to have any official connection with the Federal Open Market Committee:

Alan Greenspan	Chairman
William J. McDonough	Vice Chairman
Donald L. Kohn	Secretary and Economist
Normand R.V. Bernard	Deputy Secretary
Lynn S. Fox	Assistant Secretary
Gary P. Gillum	Assistant Secretary
J. Virgil Mattingly, Jr.	General Counsel
Thomas C. Baxter, Jr.	Deputy General Counsel
Michael J. Prell	Economist
Karen H. Johnson	Economist

Lewis S. Alexander, Stephen G. Cecchetti, Peter Hooper, III, William C. Hunter, Richard W. Lang, David E. Lindsey, Arthur J. Rolnick, Harvey Rosenblum, Larry Slifman, and David J. Stockton, Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after December 31, 1999.

By unanimous vote, Peter R. Fisher was selected to serve at the pleasure of the Committee as Manager, System Open Market Account, on the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

Secretary's note: Advice subsequently was received that the selection of Mr. Fisher as Manager was satisfactory to the board of directors of the Federal Reserve Bank of New York.

The Report of Examination of the System Open Market Account, conducted by the Board's Division of Reserve Bank Operations and Payment Systems as of the close of business on November 5, 1998, was accepted.

On the recommendation of the Manager of the System Open Market Account, the Committee amended paragraph 2 of the Authorization for Domestic Open Market Operations relating to the Treasury securities lending program. The revised facility introduces the auction technique for awarding borrowed securities to dealer firms on a competitive basis. The new facility is designed to implement more effectively the objective of providing a short-term ''last resort'' source of Treasury securities to the dealer market and thereby to facilitate the smooth clearing of Treasury securities and to ease liquidity strains in the market as they arise. The amended Authorization for Domestic Open Market Operations was approved unanimously in the form shown below:

Authorization for Domestic Open Market Operations

Amended February 2, 1999

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 $12.0 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;

(b) To buy U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 60 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding but that in no event shall be less than 1.0 percent per annum of the market value of the securities lent. The Federal Reserve Bank of New York shall apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer’s ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 60 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

On the Manager's recommendation, the Committee also amended the Foreign Currency Authorization and the Foreign Currency Directive to reflect changes triggered by the launch of the euro. Specifically, it dropped from the Authorization those European currencies that now exist as denominations of the euro (Austrian schillings, Belgian francs, French francs, Italian lire, Netherlands guilders, and German marks). The amendments also removed the central banks of Austria, Belgium, Denmark, England, France, Germany, Italy, Japan, Netherlands, Norway, Sweden, and Switzerland, and the Bank for International Settlements from the list of institutions with which the Federal Reserve Bank of New York was authorized to maintain reciprocal currency arrangements (swap facilities). In keeping with the Committee's decision at the November 1998 meeting and after consultations with officials at the foreign institutions, the reciprocal currency arrangements in question were not renewed after they matured on various dates in December.

Accordingly, the amended Authorization for Foreign Currency Operations and the Foreign Currency Directive were unanimously approved in the forms shown below:

Authorization for Foreign Currency Operations

Amended February 2, 1999

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Canadian dollars	Mexican pesos
Danish kroner	Norwegian kroner
Euro	Swedish kronor
Pounds sterling	Swiss francs
Japanese yen	

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and

with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Bank of Canada	2,000
Bank of Mexico	3,000

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1A. above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies, or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account (‘‘Manager‘‘), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

Foreign Currency Directive

Amended February 2, 1999

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the IMF Article IV.

By unanimous vote, the Procedural Instructions with Respect to Foreign Currency Operations shown below were reaffirmed.

Procedural Instructions with Respect to Foreign Currency Operations

Reaffirmed February 2, 1999

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$300 million on any day or \$600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding \$150 million, or \$300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding \$1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about

proposed swap drawings by the System and about any operations that are not of a routine character.

On January 27, 1999, the continuing rules, regulations, and other instructions of the Committee had been distributed with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention before the February 2–3 meeting to give members an opportunity to raise any questions they might have concerning them. Members were asked to indicate if they wished to have any of the instruments in question placed on the agenda for consideration at this meeting, and no requests for consideration were received. Accordingly, all of these instruments remained in effect in their existing form. The Committee discussed proposed changes to the Program for Security of FOMC Information to update the document with regard to certain security classifications and access to confidential FOMC information. The Committee decided to continue its discussion at a later meeting.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 22, 1998, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period December 22, 1998 through February 2, 1999. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that the economy expanded rapidly in the closing months of 1998. Widespread strength in domestic final demand and a diminished drag from net exports underpinned further solid gains in production, employment, and income. Inflation remained subdued despite very tight labor markets.

Nonfarm payroll employment recorded robust increases in November and December. Although manufacturing experienced further sizable job losses over the two months, strong employment gains were achieved in construction, retail trade, and the services industries. The civilian unemployment rate fell to 4.3 percent in December, and other measures of labor conditions also indicated that labor markets remained quite tight through year-end.

Industrial production rebounded in December from a small November decline. Industrial output strengthened for the fourth quarter as a whole, largely reflecting a surge in the production of motor vehicles and parts that more than offset sizable reductions in mining and utility output. The manufacture of high-tech equipment surged further and the production of construction supplies stayed on a brisk upward trend while activity in other manufacturing categories remained weak. On balance, output in manufacturing expanded at about the same pace as capacity, leaving the factory operating rate unchanged at a relatively low level.

Consumer spending, supported by further sizable gains in income and net worth, remained robust through year-end. Retail sales rose sharply in the fourth quarter. Expenditures for durable goods, particularly motor vehicles, were very strong. Outlays for nondurable goods were brisk despite sluggish growth in spending for apparel. Unseasonably mild weather held down spending for energy services in November and December, but purchases of other types of services recorded moderate increases. Surveys in early 1999 indicated buoyant consumer sentiment, reflecting optimism about personal finances and the employment outlook.

Residential housing activity continued to display substantial strength in the fourth quarter. Single-family housing starts remained at a very high level in December, and sales of new homes in that month were only slightly below the record established in November. Sales of existing homes hit a record high in December. Unseasonably favorable weather extended the construction season in some areas of the country, but low mortgage rates, rapid employment growth, rising net worth, and special financing programs designed to broaden opportunities for homeownership were important factors in the strength of home sales. Multifamily housing starts edged lower in the fourth quarter as a December increase partially reversed a November decline; rents have continued to rise in real terms over the last several years, but vacancy rates have changed little.

Business fixed investment picked up markedly in the fourth quarter after the small decline of the previous quarter. Much of the surge in spending on producers' durable equipment was attributable to a pickup in purchases of motor vehicles and aircraft. Elsewhere, investment in high-tech equipment expanded rapidly further, while spending for other types of durable equipment decelerated somewhat. Nonresidential construction activity apparently rose moderately in the fourth quarter. Office construction picked up further in an environment of falling vacancy rates and rising rental costs, but other building activity remained sluggish.

The pace of business inventory investment in October and November was slightly above that of the third quarter, but in comparison with strong sales inventory positions were relatively lean in most industries. In manufacturing, stocks increased moderately in the October–November period, and the aggregate stock–shipments ratio was in the middle of its narrow range for the past year. Inventory investment in the wholesale sector slowed considerably, but much of the swing reflected the unusually early harvest of farm products. The inventory–sales ratio for this sector was still at the top of its range for the last year, and inventory overhangs persisted in metals and minerals, machinery, and chemicals. Retailers stepped up their inventory accumulation in the October–November period. However, sales were robust and the inventory–sales ratio for this sector continued to trend downward.

The average deficit on U.S. trade in goods and services for October and November was a little smaller than the rate for the third quarter. The value of exports for the two-month period rose considerably, with the largest gains occurring in automotive products shipped to Canada, aircraft, machinery, agricultural products, and services. The value of imports also moved up, but by less than the value of exports. While the increases in imports were widespread across trade categories, particularly large advances were recorded for automotive products from Canada and Mexico and for computers. The available data suggested a weaker economic performance in most of the major foreign industrial countries in the fourth quarter; economic activity likely fell further in Japan, and economic growth apparently slowed in most countries of the euro bloc. Activity in most Asian developing countries remained depressed, though some seemed to be approaching a trough and Korea appeared to be in the early stages of a recovery. Moreover, economic conditions worsened in most Latin American economies.

Inflation remained low in 1998. Consumer prices changed little in December, reflecting a sizable drop in energy prices that offset the large increase in tobacco prices put in place after a settlement was reached between states and the tobacco makers. For 1998 as a whole, CPI inflation was slightly lower than in 1997; a substantial decline in energy prices more than offset a sizable pickup in food inflation and a small increase in core inflation. At the producer level, prices of finished goods edged down in 1998 following an appreciable decline in 1997. While finished energy prices fell by more in 1998, finished food prices were down only slightly and prices of core finished goods turned up after having been unchanged in 1997. Growth of hourly compensation of private industry workers slowed considerably in the fourth quarter of 1998, and the increase in hourly compensation for the year was little changed from that of 1997.

At its meeting on December 22, 1998, the Committee adopted a directive that called for maintaining conditions in reserve markets that were consistent with an unchanged federal funds rate of about 4¾ percent and that did not contain any bias with regard to the direction of possible adjustments to policy during the intermeeting period. In the Committee's view, the stance of policy appeared to be consistent with its objectives of fostering sustained low inflation and high employment, and the risks to this outlook were reasonably well balanced over the near term.

Open market operations during the intermeeting period were directed toward maintaining the federal funds rate at the Committee's desired level. In the event, however, the rate averaged a little below its intended level, largely reflecting the efforts of the Trading Desk to keep reserve pressures around year-end to a minimum. Other short-term market rates declined somewhat on balance, partly owing to the disappearance of year-end pressures. Most long-term interest rates changed little over the intermeeting period, but Treasury bond yields moved up slightly on balance, apparently in response to incoming data suggesting stronger-than-expected economic growth.

In foreign exchange markets, the trade-weighted value of the dollar appreciated slightly on balance over the period. A small decline in the dollar relative to other major currencies was more than offset by the dollar's appreciation in terms of the currencies of a broader group of countries that also are important trading partners of the United States. The dollar appreciated against the euro following the release of data confirming a slowdown of economic growth in much of the euro area and the absence of inflationary pressures, and it rose against the British pound after the Bank of England unexpectedly cut its repo rate. Moreover, the economic crisis in Brazil apparently contributed to an increase in the dollar relative to some emerging market currencies. Against the yen, however, the dollar fell in early January to its lowest level in more than two years, evidently in response to sharp increases in yields on Japanese bonds, but the decline was partially reversed subsequently.

M2 and M3 continued to expand rapidly in December, with their liquid components, especially money market funds, registering particularly large increases. The effects of recent monetary policy easings in reducing the opportunity costs of these components, strong growth in GDP, and perhaps continued heightened demands for liquid and safe assets seemed to have contributed to this performance. Available data for January pointed to appreciable moderation in the growth of both aggregates. From the fourth quarter of 1997 to the fourth quarter of 1998, M2 and M3 rose at rates well above their annual ranges, while total domestic nonfinancial debt expanded at a pace somewhat above the middle of its range.

The staff forecast prepared for this meeting pointed to a substantial moderation in the expansion to a rate commensurate with the growth of the economy's potential. Growth of private final demand would be damped by the anticipated waning of positive wealth effects stemming from earlier large increases in equity prices and by slow growth of spending on consumer durables, housing units, and business capital goods after the earlier buildup in the stocks of these items. Subdued expansion of foreign economic activity and the lagged effects of the earlier rise in the foreign exchange value of the dollar were expected to place continuing, though diminishing, restraint on the demand for U.S. exports for some period ahead and to lead to further substitution of imports for domestic products. Pressures on labor resources were likely to remain near current levels and inflation was projected to rise somewhat over the projection horizon, largely as a result of an expected upturn in energy prices.

In the Committee's discussion of current and prospective economic conditions, members referred to continuing indications of an exceptional economic performance that was characterized by the persistence of quite low inflation despite very high and rapidly rising levels of overall output and employment. The members currently saw few signs that the economic expansion had moderated to a more sustainable rate, but most continued to anticipate substantial slowing over the year ahead to a pace close to or somewhat above that of the economy's long-run potential. While many agreed that such an outlook was subject to greater upside risk than they had anticipated a few months ago—given the abatement of market turmoil and positive business and consumer sentiment—such factors as the waning effects of the earlier increases in stock market wealth on consumer spending and some slowing in the extraordinary growth in business expenditures for equipment were likely to exert a moderating effect on the expansion. Moreover, potentially greater weakness in foreign economies and possible disruption to foreign financial markets remained a downside risk to the outlook. Against this background, the members generally anticipated some pickup in inflation, though to a still relatively low rate, primarily as last year's declines in oil and other import prices were not repeated. A number referred, however, to the experience of recent years, which suggested that the inflation process was not well understood and that inflation forecasts were subject to a wide range of uncertainty.

In keeping with the practice at meetings just before the Federal Reserve's semiannual monetary policy report to Congress and the Chairman's associated testimony, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had provided individual projections of the growth in real and nominal GDP, the rate of unemployment, and the rate of inflation for the year 1999. Their forecasts of the rate of expansion in real GDP in 1999 had a central tendency of 2½ to 3 percent and a full range of 2 to 3½ percent. Such growth was expected to be associated with a civilian unemployment rate in a range centering on 4¼ to 4½ percent in the fourth quarter of this year, implying little or no change from the current level. With regard to nominal GDP growth in 1999, the forecasts were mainly in a range of 4 to 4½ percent, with an overall range of 3¾ to 5 percent. Projections of the rate of inflation, as measured by the consumer price index, had a central tendency of 2 to 2½ percent, somewhat above the outcome for 1998 when the rise in the index was held down by a marked decline in energy prices and reduced prices of non-oil imports.

In their review of developments across the nation, members reported a mix of high overall levels of economic activity in every region but softness in a number of specific business activities, notably those affected by foreign competition. In particular, many manufacturing firms along with businesses engaged in agriculture, mining, and energy were being adversely affected by weak demand in foreign markets, strong import competition, and depressed oil and other commodity prices in world markets. Foreign developments were seen as a continuing element of weakness for the U.S. economy and also as a major source of uncertainty in the outlook for the year ahead. In this regard many members referred in particular to the problems facing Brazil and the risk that further financial and economic instability in that nation would spread to other Latin American countries, with repercussions on the U.S. economy. Markets in the major trading nations around the world were likely to remain on the soft side, with Japan struggling to recover from its ongoing recession and economic growth in Europe showing signs of becoming more sluggish.

Robust domestic demand clearly had offset weakness in net exports by a large margin in 1998, and while the growth in such demand was projected to slow this year it was expected to remain sufficient to support appreciable further expansion in overall economic activity. Consumer spending had exhibited considerable vigor during the recent holiday season and anecdotal reports from several regions suggested that the momentum in such spending had carried into the opening weeks of this year. Further, though prospectively moderating, growth in jobs and incomes, supportive credit conditions, and upbeat consumer sentiment suggested that consumer expenditures were likely to be well maintained over coming quarters. Even so, members anticipated at least some moderation in the growth of consumption after an extended period of sizable accumulation of consumer durable goods. Among other factors, the positive effects on consumer spending of the large accumulation of stock market wealth in recent years were likely to abate over time in the absence of a further and unanticipated surge in stock market prices.

Growth in business capital spending also was expected to moderate as the year progressed to a pace well below that experienced in recent years. Members commented in this regard that slowing growth in overall spending normally fostered reduced capital investment, and indeed developments in the second half of 1998 suggested that such investment might already be on a less strong uptrend. Moreover, the prospects of reduced growth in profits and a less ebullient stock market could also be expected to damp business fixed investment. Nonetheless, growth in such investment likely would continue to exceed that of overall spending, reflecting ongoing efforts to improve efficiency and hold down labor costs in highly competitive markets and more generally to take advantage of the declining costs of business equipment and the rapid pace of technological innovation. Members also cited reports from contacts in various sectors of the economy and areas of the country that business plans continued to call for substantial outlays for business equipment. Nonresidential building activity remained robust in several regions, but given already ample capacity in many sectors, the prospects for such construction were relatively weak.

Housing activity had continued to display impressive strength in many parts of the country, evidently reflecting rapid growth in employment and incomes, rising household net worth, and low mortgage interest rates. With the affordability of new homes expected to remain unusually attractive, the members anticipated that housing activity would be sustained at a high level. Some moderation in housing starts from recent peak levels appeared likely, however, in the context of the slowing in job and income gains associated with the members' overall forecasts.

With regard to the outlook for inflation, the members saw no evidence of accelerating price inflation despite high levels of business activity and very tight labor markets across most of the nation. Indeed, the conjuncture over an extended period of strong economic growth, very low rates of unemployment, and the absence of any buildup of inflation could not be explained in terms of normal historical relationships. While temporary factors, such as declining oil prices, had played a role in depressing inflation, the persistence of very low inflation under these conditions most likely also resulted from more lasting changes in economic relationships. These were perhaps best evidenced by the widespread inability of business firms to raise prices because of strong competitive pressures in domestic and global markets and the related efforts to hold down costs, including labor costs. Contributing importantly to the success of those cost-saving efforts were the continued rapid growth of increasingly efficient business capital. The accumulation of such capital evidently had greatly enhanced productivity in a broad range of economic activities. In this regard, available indicators suggested that productivity gains had essentially matched increases in labor costs for nonfinancial corporations over the past year. Members also cited widespread expectations of low inflation as an important underlying factor in moderating wage and price increases.

Looking ahead, an abatement or reversal of some of the temporary factors reducing prices was likely to raise measured inflation. The course of underlying inflation pressures was more difficult to gauge, however. If growth slowed to trend, as many expected, uncertainty about evolving relationships among economic activity, productivity growth, and wages made it unclear whether the enhanced competitiveness in many markets and greater cost reducing efforts of businesses would be sufficient to continue to hold price increases in check at the current degree of tautness in labor markets. Members generally agreed that if labor markets continued to tighten, cost and price pressures would begin to pick up. Some members also expressed concern that rapid money growth, should it persist, would suggest that monetary policy was too accommodative to contain inflation pressures. On balance, while a somewhat less favorable inflation performance was viewed as likely over the year ahead, the members did not anticipate any substantial deterioration in the inflation climate if growth in economic activity approximated the central tendency of their forecasts.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act), the Committee reviewed the ranges for growth of the monetary and debt aggregates in 1999 that it had established on a tentative basis in early July 1998. Those ranges included expansion of 1 to 5 percent for M2 and 2 to 6 percent for M3, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The associated range for growth of total domestic nonfinancial sector debt was provisionally set at 3 to 7 percent for 1999. The tentative ranges for 1999 were unchanged from the ranges that had been adopted for the past several years.

All the members endorsed a proposal to adopt the growth ranges for M2 and M3 in 1999 that had been established on a provisional basis in July of last year. According to a staff analysis, growth of these aggregates would moderate considerably this year but was likely to remain above the tentative ranges, especially in the case of M3. The rapid growth of M2 and M3 in 1998 was associated with outsized declines in their velocities that appeared to have resulted in part from the turbulent behavior of financial markets and related efforts by the public to move funds to relatively safe and liquid assets and to turn to banks for credit. Other factors appear to have included some rechanneling of financial flows into money-type balances after an extended period of surging stock market prices and the drop in the opportunity cost of holding money as market interest rates fell over the latter part of the year. The expansion of M3 was further stimulated by the ongoing strength in institution-only money market funds whose popularity as a cash management tool continued to grow.

The calming of financial markets and forecasts of moderating nominal GDP growth pointed to reduced growth in the broad monetary aggregates this year. However, it was clear that substantial uncertainty still surrounded any projection of monetary expansion and the linkage between particular rates of money growth over a year and the basic objectives of monetary policy. In these circumstances, the members did not see any firm basis for deviating from the practice in recent years of setting ranges that, assuming velocity behavior consistent with average historical patterns, would serve as benchmarks for monetary expansion consistent with longer-run price stability and a sustainable rate of real economic growth.

Domestic nonfinancial debt, which had grown at a rate in the upper part of its 3 to 7 percent range in 1998, was thought likely to remain within that range this year, indeed near the midpoint of the range according to a staff analysis. Outstanding federal debt was expected to contract by a larger amount this year and, given current economic forecasts, the debt of the major nonfinancial sectors of the economy seemed likely to grow a bit more slowly. Thus, the members saw no reason to depart from the tentative range for nonfinancial debt, which was expected to readily encompass the likely rate of growth in this aggregate.

At the conclusion of this review, the Committee voted to approve without change the ranges for 1999 that it had established on a tentative basis on July 1, 1998. Accordingly, the following statement of longer-run policy and growth ranges for 1999 was approved for inclusion in the domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. 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.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Kelley, McTeer, Meyer, Moskow, Ms. Rivlin, and Mr. Stern. Votes against this action: None.

In the Committee's discussion of policy for the intermeeting period ahead, all the members favored an unchanged policy stance. Many were concerned that the odds were tilted toward rising inflation over time, especially if the expansion did not slow to a more sustainable rate. Members commented that the market unsettlement that had in large measure prompted the Committee's easing actions during the fall had now lessened appreciably. In the view of some, those actions might need to be reversed, at least in part, to restore what they regarded as a policy stance that seemed most likely to prove consistent with desirable economic trends. Still, the persistence of subdued inflation and the absence of current evidence of accelerating inflation were seen as arguing against a policy tightening move at this point. Moreover, it was clear that the outlook for economic activity was subject to considerable uncertainty and that some shortfall from current forecasts, perhaps in conjunction with unexpectedly adverse trade and financial influences stemming from developments abroad, might materialize and damp inflationary demand pressures. Even in the absence of greater-than-anticipated slowing in the economic expansion, the experience of recent years had amply demonstrated that the relationship between demand pressures on resources and inflation was not following historical patterns, and developments exerting a more lasting moderating effect on inflation, such as more productive capital investment and effective access to spare capacity overseas, could help to contain inflation for some time. Against this background, the members agreed on the need to continue to monitor the economy with care for signs either of a potential upturn in inflation or greater softness in the expansion than they were currently forecasting and to be prepared to respond promptly in either direction.

In light of the uncertainties and diversity of risks surrounding the economic outlook, most members were in favor of retaining the existing symmetry of the directive. In one view, however, the risks of rising inflation were strong enough to warrant consideration of an asymmetrical directive that was tilted toward restraint. Nonetheless, since inflation was difficult to predict and any needed adjustment to policy in the period ahead could readily be implemented even with a symmetrical directive, all the members indicated that they could accept such a directive.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that the economy expanded rapidly in the closing months of 1998. Nonfarm payroll employment posted strong gains in November and December, and the civilian unemployment rate fell to 4.3 percent in December. Total industrial production strengthened in the fourth quarter, owing in large measure to a surge in the production of motor vehicles and parts. Total retail sales rose sharply in the fourth quarter, and home sales and housing starts increased appreciably. Available indicators suggest that business capital spending picked up markedly in the fourth quarter after a lull in the third. In November, the nominal deficit on U.S. trade in goods and services was somewhat larger than in October, but the combined October–November deficit was slightly smaller than its third-quarter average. Inflation has remained subdued despite very tight labor markets.

Most short-term interest rates have declined somewhat on balance since the meeting on December 22, while longer-term rates have changed little. Share prices in equity markets have posted further sizable gains on balance over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has depreciated slightly over the period in relation to other major currencies but it has appreciated somewhat in terms of the currencies of a broader group that also includes other important trading partners of the United States. M2 and M3 continued to record very large increases in late 1998, but available data pointed to some moderation in January. From the fourth quarter of 1997 to the fourth quarter of 1998, both aggregates rose at rates well above the Committee's annual ranges. Total domestic nonfinancial debt expanded at a pace somewhat above the middle of its range in 1998.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 4¾ percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Kelley, McTeer, Meyer, Moskow, Ms. Rivlin, and Mr. Stern. Votes against this action: None.

Sunset Legislation Relating to Humphrey–Hawkins Reports

The Committee discussed the Federal Reports Elimination and Sunset Act of 1995 which provides for the termination of the legal requirements for semiannual Humphrey–Hawkins reports to Congress after 1999. At this meeting, the members agreed that the semiannual reports and associated Congressional hearings had been quite useful and should be continued. They had given the Committee an effective means to explain its policies and communicate its views on a variety of issues and had enhanced its accountability to the public and the Congress.

Sale of Euro Reserves

In a notation vote completed on March 22, 1999, the Committee unanimously approved an off-market sale of approximately $4.8 billion equivalent of the System's euro reserves to the Exchange Stabilization Fund (ESF). In return, the System received $3.4 billion in dollars and $1.4 billion equivalent of Japanese yen from the ESF. The transaction reduced the System's overall holdings of foreign currencies to the level of those held by the ESF and left the resulting balances of euro and yen equal in both the System and ESF accounts.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 30, 1999.

The meeting adjourned at 11:40 a.m. on February 3, 1999.

Donald L. Kohn
Secretary

Meeting Held on March 30, 1999

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, March 30, 1999, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Ms. Rivlin
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the Federal Open Market Committee

Mr. Hoenig, Ms. Minehan, and Mr. Poole, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Ms. Johnson, Economist

Messrs. Cecchetti, Hooper, Hunter, Lang, Lindsey, Slifman, Stockton, and Rosenblum, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Reinhart, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Pianalto, First Vice President, Federal Reserve Bank of Cleveland

Ms. Browne, Messrs. Eisenbeis, Goodfriend, Hakkio, Kos, Rasche, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Atlanta, Richmond, Kansas City, New York, St. Louis, and Cleveland respectively

Messrs. Judd and Weber, Vice Presidents, Federal Reserve Banks of San Francisco and Minneapolis respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on February 2–3, 1999, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period February 3, 1999, through March 29, 1999. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below. The domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York follows the summary.

The information reviewed at this meeting suggested that the economic expansion remained robust early in the year. Consumer spending was particularly strong, and housing starts climbed higher. While growth of business capital spending moderated somewhat after a fourth-quarter surge, it was still quite rapid. Heavy competition from imports damped the rise of industrial production; however, employment expansion remained brisk and labor markets tight. Price inflation was still low.

Nonfarm payroll employment posted sizable further gains in January and February. Hiring in construction and retail trade was notably strong, and employment in the service industries continued to trend higher. By contrast, manufacturing suffered further job losses. The civilian unemployment rate, at 4.4 percent in February, stayed in the narrow 4¼ to 4½ percent range that had prevailed since spring 1998.

Total industrial production was unchanged in January and rose slightly in February. Gas and oil extraction slumped in January, and mild weather restrained utility output in February. Manufacturing production increased modestly in both months, reflecting strong increases in the output of high-tech industries that more than offset declines in the production of aircraft and of motor vehicles and parts. The factory operating rate fell further in the January–February period, as the growth in manufacturing capacity continued to outpace the rise in production.

Consumer spending surged in the early months of 1999, supported by rapidly rising disposable personal income, soaring household net worth, and buoyant consumer sentiment. Attractive pricing and the favorable trends in income and wealth contributed to strong underlying demand for motor vehicles, and substantial gains were recorded in most other categories of retail sales as well. Expenditures on services in January (latest available data) also exhibited strength, most notably in spending for energy services, which picked up after an unseasonably warm December.

Housing demand remained elevated. Single-family home sales were still at a very strong level in January (latest data), despite a drop from their recent record high. Housing starts increased appreciably in the January–February period as builders took advantage of good weather to try to catch up with backlogged demand.

Business fixed investment appeared to have decelerated noticeably from the very fast pace of the fourth quarter. Data on shipments of nondefense capital goods in January and February suggested that business outlays for computers and motor vehicles were growing less rapidly, and purchases of most other types of durable equipment seemed to be slowing somewhat. Nonresidential construction activity was down on balance in January, though the construction of office buildings trended still higher and the building of lodging facilities picked up.

Total business inventories changed little in January and stocks generally were at comfortable levels, though conditions varied across industries. Manufacturing stocks fell in January, largely reflecting further reductions in inventories of aircraft and parts, and the aggregate stock–sales ratio for the sector was at the bottom of its range over the past twelve months. In the wholesale sector, a reduction in inventories in January was concentrated in motor vehicles. The decline in stocks was closely paralleled by a drop in sales, and the aggregate inventory–sales ratio for the sector stayed around the top of its range over the past twelve months. Retail inventories increased considerably in January, but with sales growing rapidly, the aggregate inventory–sales ratio remained at the bottom of its range over the past year.

The U.S. trade deficit in goods and services widened substantially in January from its fourth-quarter average. The value of exports fell for a third straight month and reached its lowest level since last August; half of the drop was in agricultural products. The value of imports retraced in January most of its December decline, with sizable increases recorded for imported consumer goods, computers, and motor vehicles from Canada. The economies of many of the major foreign industrial countries faltered in the fourth quarter. Japan recorded a fifth straight quarterly decline in economic activity, and growth in real output weakened in the euro area and remained sluggish in the United Kingdom. By contrast, economic activity rebounded in Canada. Elsewhere, while economic activity continued to decline in Latin America and Russia, there were indications that some Asian economies might be bottoming out and that recovery might be under way in Korea.

Inflation remained subdued in early 1999. Both the total and core measures of consumer prices increased only slightly in January and February, and core inflation for the twelve months ended in February was somewhat lower than for the year-earlier period. At the producer level, prices of finished goods other than food and energy changed little over January and February. For the twelve months ended in February, core producer price inflation was somewhat higher than for the year-earlier period, but the pickup partly reflected the large increase in tobacco prices that resulted from the settlement of the lawsuit brought by state attorneys general. Average hourly earnings of private production or nonsupervisory workers increased moderately on balance over the January–February period. The rise in average hourly earnings for the year ended in February was noticeably smaller than that for the year-earlier period.

At its meeting on February 2–3, 1999, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with an unchanged federal funds rate of about 4¾ percent and that did not contain any bias relating to the direction of possible adjustments to policy during the intermeeting period. The Committee judged this policy stance to be consistent with its objectives of fostering high employment and sustained low inflation and, over the near term at least, viewed the risks to this outlook as reasonably well balanced.

Open market operations throughout the intermeeting period were directed toward maintaining the federal funds rate at around 4¾ percent. Market interest rates changed little immediately after the February meeting because market participants had expected the Committee's decision. Subsequently, however, Treasury yields moved up significantly in response to incoming data suggesting further robust growth in aggregate spending, and then retraced much of the rise after the receipt of favorable news on inflation. Short-term interest rates changed little on balance over the intermeeting interval, and longer-term rates rose somewhat. Key indexes of stock market prices recorded mixed changes.

The trade-weighted value of the dollar in foreign exchange markets increased somewhat over the intermeeting period in relation to the currencies of a broad group of important U.S. trading partners. Much of the dollar's upward movement came against a subset of major currencies. A large rise in terms of the yen occurred in response to an easing of monetary policy by the Bank of Japan that reduced the overnight call rate to an extremely low level and fostered a considerable decline in Japanese bond yields. The dollar also rose substantially against the euro, which was weighed down by signs of continued weakness in Germany and, late in the period, by the outbreak of hostilities in the Balkans. Among the emerging countries, the Brazilian *real* depreciated on balance against the dollar, although it firmed late in the period as overall financial conditions in that country stabilized somewhat, and the Mexican peso appreciated against the dollar in association with a rebound in oil prices.

Expansion of M2 and M3 moderated considerably on balance in the early months of 1999 from the rapid increases of the fourth quarter. The deceleration of these aggregates apparently reflected the waning effects of the policy easings of last autumn in narrowing the opportunity cost of holding M2 assets, a slowdown in mortgage refinancing activity, and a bounceback in household purchases of stock mutual funds as conditions in financial markets brightened. Both aggregates were estimated to have increased over the first quarter at rates somewhat above the Committee's annual ranges. Total domestic nonfinancial debt continued to expand at a pace somewhat above the middle of its range.

The staff forecast prepared for this meeting suggested that the expansion would gradually moderate to a rate commensurate with the growth of the economy's estimated potential. Growth of private final demand would be damped by the anticipated waning of positive wealth effects stemming from earlier large increases in equity prices and by slower growth of spending on consumer durables, housing units, and business equipment after the earlier buildup in the stocks of these items. The lagged effects of the earlier rise in the foreign exchange value of the dollar were expected to place continuing, though diminishing, restraint on the demand for U.S. exports for some period ahead and to lead to further substitution of imports for domestic products. Pressures on labor resources were likely to remain substantial. Price inflation was projected to rise somewhat over the projection horizon, largely as a result of an expected upward trend in energy prices.

In the Committee's discussion of current and prospective economic developments, members commented that for an extended period most forecasters had been projecting slower economic growth and higher inflation than actually had materialized. With regard to output, current indicators provided little evidence of any moderation in the pace of the expansion from the robust growth experienced on average over the last few years. Even so, most members viewed a slowing to a rate closer to most estimates of the growth of the economy's potential as a reasonable expectation. They agreed, however, that the timing and extent of such moderation were subject to a wide range of uncertainty. Factors expected to foster slower growth in key demand sectors of the economy included the buildup of large stocks of business equipment, housing units, and durable goods by households and an assumption that the stock market would play a more neutral role than in recent years. The effects of domestic demand on domestic production would continue to be damped by further increases in the trade deficit, though the offset from this source might well diminish if financial markets and economies in key developing nations were to exhibit more signs of stabilization or improvement. Given the persistence of robust growth in domestic demand and the continuing forward momentum in U.S. economic activity, many of the members commented that the risks to their forecasts were tilted toward the eventual emergence of somewhat greater inflation pressures. Despite the persistence of very tight labor markets across the nation, however, there currently were only scattered indications of more rapid increases in wages and no evidence of rising price inflation. The reasons underlying this remarkable economic performance were potentially transitory but also possibly of a longer-term nature. Lower oil and other input prices had played a role. However, it also seemed likely that accelerating productivity helped to account for the economy's ability to sustain not only higher rates of growth of output but also relatively low levels of unemployment, at least for a time, without generating higher inflation.

In their review of developments across the nation, the members reported sustained, and in some areas rising, overall growth in regional economic activity. At the same time, some sectors were continuing to experience varying degrees of softness, notably those most affected by developments abroad such as manufacturing, agriculture, and energy. A number of members referred, however, to signs of recent improvement in manufacturing that appeared to be associated primarily with the strength of domestic demand but to some extent also with increased demand from some developing countries.

With regard to developments in key expenditure sectors of the economy, the members anticipated that growth in consumer spending would retain considerable upward momentum, given their expectations of favorable fundamentals such as further expansion in employment and incomes, the rise in financial wealth that had continued through the first quarter, and ready access to consumer credit. Some also referred to the currently elevated level of consumer confidence. As time went on, however, it seemed unlikely that growth in consumer spending would be sustained at its recent exceptional pace. The accumulation of durable goods by consumers in recent years should at some point inhibit further large increases in spending for such goods. Moreover, the favorable effect of the extended run-up in stock market wealth evidently had been a factor in bolstering consumer confidence and willingness to spend. While the course of stock market prices could not reliably be predicted, the market's stimulative effect on spending was likely to wane over time in the absence of further appreciable advances in prices. Current indications of some softening in home sales and reduced mortgage refinancing activity, should they persist, also augured less stimulus to consumer spending in coming quarters.

The extraordinary expansion in business fixed investment in recent years, fueled to a major extent by purchases of new equipment, was also expected to moderate over time as a result of the large buildup and reduced utilization of capacity and the forecasted slower growth in final sales. While the prospect of further declines in the prices of some equipment would encourage continued growth in spending, the lower prices were not expected to outweigh the effects of relatively low capacity usage and more moderate growth in overall demand in coming quarters. In this regard, some signs of deceleration could be detected in the currently available data, though from extremely rapid rates of growth. With respect to commercial building, members reported strong construction activity in many areas, but some also noted that such construction appeared to have reached a peak, as evidenced in part by signs of overbuilding in a few areas. Moreover, current data suggested little or no growth in overall expenditures on nonresidential structures.

Residential sales and construction were described as very strong in many parts of the country and indeed were being held down in some areas by low inventories of housing available for sale and a limited supply of qualified construction workers. Some members commented that housing construction backlogs and unusually mild winter weather in many areas had sustained a high level of housing construction in recent months. Looking ahead, however, members observed that residential building activity appeared to have peaked in some areas and an oversupply of apartments was reported in a few major cities. More generally, the rise in mortgage rates since last fall and some softening of demand indicators pointed to less strength in the housing sector. Even so, the outlook for jobs and income and the buildup of financial wealth constituted favorable home affordability factors that appeared likely to support a continuing high level of housing demand, especially in the single-family sector.

Relatively heavy spending on imports owing to strong domestic demand and low prices likely would exert a continuing negative effect on net exports over the next several quarters. Nevertheless, demand for U.S. exports could begin to pick up, given what now appeared to be improved prospects for economic activity in several emerging market economies. Financial market conditions had become more settled in a number of these economies, and contagion from developments in Brazil now seemed to present a reduced threat to that nation's trading partners. Even so, foreign-sector forecasts—for industrial as well as emerging market economies—remained subject to considerable downside risk, including uncertainties stemming from the recent flare-up of hostilities in the Balkans.

In the Committee's discussion of the outlook for inflation, members commented that they saw no evidence of any acceleration in price inflation despite the continuing strength of the economic expansion and the tightness of labor markets. Anecdotal reports from around the nation continued to underscore the difficulty or inability of most business firms to raise prices in highly competitive markets. There were a limited number of reports of relatively sizable increases in wages paid to workers with skills in especially short supply, but on the whole employers were successful in holding down increases in labor compensation and offsetting them through improvements in productivity. Indeed, increases in unit labor costs, at least in the nonfinancial corporate sector and perhaps more widely as well, had declined to a very low rate over the past year.

The members saw little reason to anticipate any significant, continuing increase in inflation in the near term. Inflation was expected to rise, owing to the recent hikes in oil prices, but the increase should be limited. And with little evidence of rising pressures on prices at early stages of production or on nominal wages, inflation should remain contained for a time. However, some members were concerned about the risk that sustained rapid growth in aggregate demand would stretch markets even more. Even presuming that growth in economic activity would moderate to a pace close to the economy's potential, labor markets would remain relatively taut and at some point could trigger faster increases in labor compensation and, in turn, rising price inflation. Moreover, the dissipation or reversal of favorable supply factors—including, for example, in addition to energy prices the waning effects of the dollar's earlier appreciation, could contribute to higher inflation expectations and faster nominal compensation increases. In the view of some others, though, the impact on prices of the unwinding of the favorable factors might well be muted or offset by a possible further uptick in productivity growth. Accelerating productivity had been spurring investment in capacity and intense competition among businesses, and had been holding down labor costs. Furthermore, optimism about improving productivity was evident in projections of business profits and the high level of equity prices. In any event, it was clear that forecasts in recent years typically had overstated the rise in inflation, and a great deal of uncertainty surrounded the extent to which productivity gains and other factors, some unspecified, might continue to hold down inflation in a period of robust economic growth and relatively tight labor markets.

In the Committee's discussion of policy for the intermeeting period ahead, all the members indicated that they favored an unchanged policy stance. Several commented that they saw no significant changes in the tenor of recent statistical and anecdotal reports that would constitute the basis for an adjustment to policy or a greater presumption that policy might need to be changed soon. Many referred in particular to the absence of any warning signs of accelerating inflation over the near term as a major consideration in support of a steady policy at this time. In the view of some, however, the next policy action was more likely to be a firming than an easing. They saw a greater likelihood that tight—and perhaps tightening—labor markets would add to price pressures than that demand would falter or that inflation would decrease further. Yet they recognized that such forecasts were subject to a substantial degree of uncertainty. This argued for a cautious approach to any policy change, especially in light of an economic performance that had not conformed to historical patterns in recent years. While a number of members noted that a case might be made for unwinding part of the Committee's easing actions during the fall of last year, given the recovery in financial markets and the improvement in the economic outlook since then, they argued that the incoming data and prospects for sustained favorable economic performance did not support such an action. The members concluded that the Committee was in a position to wait for developments to unfold, especially given the absence of any evidence of an impending acceleration of underlying inflation. If the risks of higher inflation intensified, it would still have time to take action to head off price pressures in order to foster sustained economic growth and a high level of employment. Many of the members emphasized, however, that in such circumstances the Committee might need to act promptly to forestall a buildup of inflationary forces that could destabilize the expansion.

All the members endorsed a proposal to retain the existing symmetry of the directive with respect to possible adjustments to policy during the intermeeting period. While many believed that the next policy move likely would be in the direction of some tightening, such an outcome was not a foregone conclusion, and in any event the timing of the next policy action was highly uncertain. It also was noted that a biased directive would not be consistent with the members' view that a policy adjustment was unlikely in the period just ahead. Moreover, while the Committee's disclosure procedures do not always require the immediate announcement of a shift in symmetry, the members agreed that were they to announce a shift to a tightening bias, it would likely have in current circumstances a relatively pronounced and undesired effect on financial markets. In particular, the markets might well build in higher odds of a policy tightening move at the May or June meetings than currently was consistent with the members' thinking. It also seemed desirable to defer any change in the directive and await further developments relating to the hostilities in the Balkans.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that the expansion in economic activity is still robust. Nonfarm payroll employment posted sizable further gains in January and February, and the civilian unemployment rate remained below 4½ percent. Total industrial production edged higher over the first two months of the year. Total retail sales rose sharply further over the two months, and housing starts increased appreciably from an already elevated level. Available indicators suggest that business capital spending decelerated in early 1999 but growth was still relatively rapid. The nominal deficit on U.S. trade in goods and services widened substantially in January from its fourth-quarter average. Inflation has remained subdued despite very tight labor markets.

Short-term interest rates have changed little since the meeting on February 2–3, 1999, while longer-term rates have risen somewhat on balance. Key measures of share prices in equity markets have registered mixed changes over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has risen somewhat over the period in relation to the currencies of a broad group of important U.S. trading partners, and the appreciation has been a bit larger against a subset of major currencies.

M2 and M3 continued to record large increases in January and February, but available data pointed to substantial moderation in March. Both aggregates are estimated to have increased over the first quarter at rates somewhat above the Committee's annual ranges. Total domestic nonfinancial debt has continued to expand at a pace somewhat above the middle of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 4¾ percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Kelley, McTeer, Meyer, Moskow, Ms. Rivlin, and Mr. Stern. Votes against this action: None

It was agreed that the next meeting of the Committee would be held on Tuesday, May 18, 1999.

The meeting adjourned at 12:35 p.m.

Donald L. Kohn
Secretary

Meeting Held on May 18, 1999

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, May 18, 1999, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Ms. Rivlin
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the Federal Open Market Committee

Mr. Hoenig, Ms. Minehan, and Mr. Poole, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Prell, Economist
Ms. Johnson, Economist

Messrs. Alexander, Cecchetti, Hooper, Hunter, Lang, Lindsey, Rolnick, Rosenblum, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Reinhart, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Connolly, First Vice President, Federal Reserve Bank of Boston

Ms. Browne, Messrs. Goodfriend, Hakkio, Ms. Krieger, and Mr. Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Richmond, Kansas City, New York, and Cleveland respectively

Messrs. Cunningham and Gavin, Vice Presidents, Federal Reserve Bank of Atlanta and St. Louis respectively

Mr. Trehan, Research Officer, Federal Reserve Bank of San Francisco

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 30, 1999, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period March 30, 1999, through May 17, 1999. By unanimous vote, the Committee ratified these transactions.

The Committee voted unanimously to extend for one year beginning in mid-December 1999 the reciprocal currency ("swap") arrangements with the Bank of Canada and the Bank of Mexico. The arrangement with the Bank of Canada is in the amount of $2 billion equivalent and that with the Bank of Mexico in the amount of $3 billion equivalent. Both arrangements are associated with the Federal Reserve's participation in the North American Framework Agreement, which was established in 1994. The vote to renew was taken at this meeting rather than later in the year to give the Committee members a timely opportunity to discuss whether or not they wanted to extend the maturity of the agreements; the terms of the agreements require that any decision not to renew be communicated to swap line partners at least 6 months in advance of the swap maturities.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below. The domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York follows the summary.

The information reviewed at this meeting suggested that economic activity had continued to expand vigorously. Consumer spending had maintained its strong forward momentum, and housing activity generally had remained at a high level. Growth of business capital spending had slowed appreciably but was still quite rapid. The expansion in industrial production had quickened recently while gains in employment had moderated somewhat. Inflation had remained low, although consumer prices registered a sizable rise in April; labor costs were still quiescent despite very tight labor markets.

Growth in nonfarm payroll employment slowed on balance over March and April, but hiring was still relatively rapid. Employment gains were concentrated in the services, retail trade, and finance, insurance, and real estate categories. By contrast, manufacturing experienced further job losses, and construction employment fell on balance over the March–April period after having expanded briskly since last fall. The civilian unemployment rate in April, at 4.3 percent, matched its first-quarter average.

Industrial production increased substantially in March and April after a period of sluggish growth. In manufacturing, the production of durable goods rose rapidly in both months, paced by sharp increases in the output of semiconductors and motor vehicles and parts. The production of office automation equipment picked up from an already rapid pace in the March–April period, and the manufacture of communications equipment surged in April. Although growth in the output of nondurable goods had increased somewhat in recent months, the level of production was still below its year-earlier level. The step-up in industrial production in recent months had lifted the rate of utilization of manufacturing capacity, but it remained below its long-term average.

Consumer spending has been very strong this year, supported by rapid income growth, soaring household net worth, and buoyant consumer sentiment. Retail sales edged still higher in April after recording large gains earlier in the year. Sales of motor vehicles in April again were exceptionally high, and outlays for non-auto goods remained robust. In addition, spending on services grew briskly in the first quarter (latest data available), paced by sharply increased outlays for energy, bank and brokerage services, and recreation.

Total housing starts fell in April after several months of unusually favorable weather conditions that had allowed builders to maintain a relatively high level of construction activity. Some of the decline in starts apparently reflected shortages of labor and some types of building materials. However, sales of new homes had fallen somewhat on balance thus far this year, and applications for mortgages to finance purchases of homes remained below their 1998 peak despite a recent turn upward.

Business capital spending decelerated in the first quarter, though to a still relatively rapid pace. Growth of spending on durable equipment was boosted by a surge in outlays for communications equipment, brisk expenditures for motor vehicles, and continuing though lessened strength in purchases of computers. Nonresidential building activity advanced moderately in the first quarter, reflecting significant further increases in the construction of office buildings and lodging facilities. Building activity in other nonresidential categories changed little.

Total business inventories rose considerably in March, mostly reflecting a huge run-up in inventories at automotive dealerships. For the first quarter as a whole, inventory accumulation exclusive of motor vehicles was near the subdued pace of late 1998, and stocks generally appeared to be at fairly low levels relative to sales. In the manufacturing sector, inventories fell further in the first quarter, largely reflecting reductions of stocks of aircraft and parts, and the aggregate inventory–sales ratio for the sector in March was somewhat below the bottom of its range over the previous twelve months. The first-quarter rise in non-auto wholesale inventories was nearly the same as the fourth-quarter increase. With sales up appreciably, however, the inventory–sales ratio for the sector dropped sharply and was near the bottom of its range for the past year. Non-auto retail inventories increased considerably in the first quarter, but sales grew by even more and the aggregate inventory–sales ratio was near the bottom of its range over the last year.

The U.S. trade deficit in goods and services widened substantially in January and February from its fourth-quarter average, with exports falling sharply and imports rising strongly. The drop in exports in the January–February period nearly reversed the large fourth-quarter increase, with substantial declines occurring in aircraft, machinery, industrial supplies, and agricultural products. The jump in imports was concentrated in consumer goods, automotive products, computers, and semiconductors. Economic growth continued to be sluggish in many of the major foreign industrial countries, according to the limited information available for the first quarter. Growth was weak on balance in the euro zone and the United Kingdom, and there were few signs of economic recovery in Japan. However, the expansion in Canada appeared to have remained strong. Elsewhere, the Korean economy grew vigorously in the first quarter, and there were indications that the slowdown in economic activity in Southeast Asia and Latin America might have bottomed out, with some countries beginning to recover.

Consumer prices rose substantially in April. Energy prices increased sharply, food prices edged up, and the prices of consumer items other than food and energy rose appreciably. For the twelve months ended in April, core consumer inflation was slightly higher than for the year-earlier period. Producer prices of finished goods also increased in April, but by less than consumer prices. Finished energy prices were up sharply, but prices of finished foods declined appreciably, and prices of core producer goods advanced only slightly. For the twelve months ended in April, core producer inflation was up noticeably over that for the year-earlier period, reflecting importantly the sharp increase in prices of tobacco products. In contrast to price inflation, labor costs appeared to have remained quiescent. The increase in average hourly earnings was the same in April as in March, and the rise for the twelve months ended in April was significantly smaller than that for the year-earlier period.

At its meeting on March 30, 1999, the Committee adopted a directive that called for maintaining conditions in reserve markets that would be consistent with an unchanged federal funds rate of about 4¾ percent and that did not contain any bias relating to the direction of possible adjustments to policy during the intermeeting period. The Committee judged this policy stance to be consistent with its objectives of fostering high employment and sustained low inflation, with the risks of different outcomes being reasonably well balanced, at least for the near term.

Open market operations throughout the intermeeting period were directed toward maintaining the federal funds rate at around 4¾ percent. The average rate for the period was in line with the Committee's target level; however, substantial fluctuations in the rate associated with tax-season uncertainties complicated reserve management. Yields on Treasury securities rose appreciably on balance, with the largest increases occurring in intermediate- and longer-term maturities. The climb in rates reflected not only the strength of incoming data on the U.S. economy but also improved economic prospects in many foreign countries and higher world commodity prices. Increasing optimism about economic conditions in the United States and abroad apparently eased concerns about the creditworthiness of business borrowers, especially firms of relatively low credit standing, and rates on private obligations registered mixed changes over the period. Most key measures of share prices in equity markets recorded sizable gains over the intermeeting period.

The trade-weighted value of the dollar in foreign exchange markets depreciated somewhat over the intermeeting period in relation to the currencies of a broad group of important U.S. trading partners. The dollar's decline partly reflected improvements in the economic and financial outlook for many emerging market economies. The dollar also depreciated significantly against the Canadian and Australian currencies as the prices of metals, oil, and lumber moved higher. By contrast, the dollar moved up on balance in terms of the euro and the Japanese yen. A reduction in the European Central Bank's refinance rate and the diminished prospects for a near-term resolution of hostilities in the Balkans weighed on the euro. The dollar's rise against the yen evidently was partly a response to a decline in the yield on ten-year Japanese government bonds while dollar yields moved higher.

M2 and M3 recorded sizable increases in April, apparently arising from a buildup of liquid accounts by households to make larger-than-usual final tax payments. For the year through April, M2 and M3 had grown less rapidly than in 1998; even so, M2 was estimated to have grown this year at a rate somewhat above the Committee's annual range, and M3 at a rate slightly above its range. Total domestic nonfinancial debt continued to expand at a pace somewhat above the middle of its range.

The staff forecast prepared for this meeting suggested that the expansion would gradually moderate to a rate commensurate with the rise in the economy's estimated potential. Growth of private final demand would be damped by the anticipated waning of positive wealth effects stemming from large increases in equity prices and by slower growth of spending on consumer durables, houses, and business equipment after the earlier buildup in the stocks of these items. The lagged effects of the rise that had occurred in the foreign exchange value of the dollar were expected to place continuing, though diminishing, restraint on the demand for U.S. exports for some period ahead. Labor markets were anticipated to remain tight, and inflation was projected to increase somewhat on balance over the projection period, partly as a result of some firming of import prices that, in turn, would give domestic firms somewhat more leeway to raise their prices.

In the Committee's discussion of current and prospective economic developments, members commented that they saw few signs of any moderation in the expansion of economic activity from the rapid pace that had prevailed in recent quarters—a pace greater than the growth in the economy's potential, even though the growth of potential was rising as a result of accelerating productivity. For a number of reasons, they still viewed some slowing in the expansion to a growth rate more in line with that of potential as a reasonable expectation. However, the timing and extent of the moderation remained subject to substantial uncertainty. And in light of the persistent strength in domestic demand, the reduced risks of economic weakness abroad, and the recovery in U.S. financial markets, most members believed that for the year ahead the odds around their forecasts were tilted toward further robust growth that would add to pressures on already tight labor markets. The latest statistical and anecdotal information on wages and prices, while somewhat more mixed than earlier, continued on balance to present a picture of benign inflation. However, the firming of oil and other commodity prices, the more frequent anecdotal reports of increases in some costs and prices, and the most recent CPI statistics could be read as suggesting at least that the trend toward lower inflation was coming to an end and perhaps also as harbingers of a less favorable inflation performance going forward, especially if growth in demand did not slow to a more sustainable pace. A key uncertainty in the outlook for inflation related to the prospects for productivity, whose continued acceleration over the past several quarters clearly had helped to contain cost pressures despite widespread indications of persistently tight labor markets. On balance, while an upward trend in underlying inflation had not materialized thus far, the members were concerned that if recent developments continued—especially if demand did not slow to a more sustainable pace—inflation was more likely to rise over time.

The impressive strength in private domestic spending during the first several months of the year featured notable gains in consumer and business expenditures and appreciable growth in outlays for residential construction. Underlying the strength in these key sectors of the economy was the marked improvement in overall financial market conditions since the fall of last year, including the ample availability of financing on relatively favorable terms for many borrowers and the sharp rise in stock market prices. Indicators of possible slowing in these sectors of the economy were limited, especially outside of housing.

Consumer expenditures were expected to be well maintained in conjunction with projections of appreciable further growth in jobs and incomes and a ready availability of financing. A major uncertainty in the outlook for the consumer sector was the largely unpredictable behavior of the stock market. The very large equity price increases in recent years evidently had contributed to high levels of consumer confidence and robust consumer spending, and the further gains in those prices thus far this year would continue to bolster spending for a while. A leveling trend in stock market prices, should one materialize, likely would have a significant restraining effect on consumer confidence and the growth of spending over time. In addition, the substantial accumulation of durable goods by consumers in recent years was seen as a constraining influence on spending for such goods going forward.

Expenditures by business firms for durable equipment were expected to post further sizable gains this year and next, though probably at rates somewhat below those recorded in recent years. Technical advances and ongoing competitive pressures were likely to remain relatively stimulative factors, but a number of developments also were anticipated to exert a tempering influence.

These included the large buildup in equipment over the course of recent years, some moderation in the growth of demand for capital associated with slower expansion of overall spending, and in these circumstances more sluggish growth of business profits. The behavior of stock market prices also would play a role in the cost of business finance and the level of business confidence but one that could not readily be predicted. According to anecdotal reports, commercial and other nonresidential construction activity was at high levels in several regions, though constrained in a number of areas by shortages of skilled labor and some construction materials. Concerns about overbuilding were reported in a few parts of the country. Residential construction activity also was at a high level, and backlogs had developed in some regions because of shortages of labor and some building materials. While these backlogs and continued affordability of home purchases were expected to help sustain residential construction activity near current levels for some period of time, statistical and survey indicators pointed to some loss of momentum in housing sales and new construction, perhaps partly in response to the rise in long-term interest rates.

Foreign trade on net was damping demand pressures on U.S. production capacity, but its negative impact was thought likely to diminish over time. Factors underlying this outlook included indications of stabilizing or improving financial and economic conditions in several East Asian and Latin American countries and expectations of some strengthening in European economies. The resulting impetus to exports was projected to be accompanied by a lower rate of growth in imports as the expansion of the U.S. economy slowed. Anecdotal reports of rising exports, notably to Asian markets, lent some support to this outlook. Members commented, however, that financial and economic prospects remained worrisome in several parts of the world and that the outlook for net exports continued to be subject to downside risks, albeit to a lesser extent than in late 1998 and early 1999.

Members expressed concern about what they now saw as a greater risk of rising inflation even though current indicators continued on the whole to point to quiescent wage and price behavior. The recent performance of the CPI and industrial commodity prices and the more numerous anecdotal reports of price and cost increases were reasons for added caution about the outlook for inflation, though these developments still constituted only very tentative evidence of a possible change in inflation trends. Several members commented in particular that substantial weight should not be attached to the one-month jump in the just-released CPI data. Unexpectedly large gains in productivity had both contributed to demand and helped output to keep pace with the strong growth in demand, but an important portion of that demand also had been met by drawing down the pool of available workers and by rapid increases in imports. Inflation expectations, while perhaps deteriorating a bit recently, were still subdued and undoubtedly continued to help account for restrained pricing behavior and for relatively moderate wage demands despite the tightness in labor markets.

Partly because the economy continued to demonstrate a marked ability to absorb large increases in demand without generating significant cost and price pressures, the members did not see a sizable upturn in underlying inflation as a likely prospect over the next few quarters. The longer-run outlook was more worrisome and would depend importantly on the extent to which the expansion put pressure on labor resources. In particular, if that pressure intensified, at some point further gains in productivity would not be able to offset rising wage increases. Moreover, the effect on prices would tend to be exacerbated by the ebbing or reversal of temporary factors that had served to damp inflation; notable among those factors were the upturn in energy prices and the current or prospective firming of commodity and other import prices as economic activity strengthened abroad. With both the extent of prospective pressures in labor markets and the outlook for productivity subject to considerable uncertainty, a firmer assessment of the future course of inflation needed to await further developments.

Against this background, all the members supported a proposal to maintain an unchanged policy stance and to adopt and announce an asymmetric directive that was tilted toward tightening. Although their concerns about the outlook for inflation had increased significantly since the previous meeting, the members felt that there was still a reasonable chance that the current stance of policy would remain consistent with containing price pressures for some period of time. Signs of an actual change in inflation were still quite tentative and anecdotal, and they did not warrant an adjustment to policy at this meeting. Moreover, as the experience of recent years had amply demonstrated, improvements in productivity growth might permit the economy to continue to accommodate strong demand for some time without generating higher inflation, especially if the growth of demand were to moderate somewhat in the months ahead. In that regard, the prospective strength of demand pressures and related outlook for productivity were subject to a wide range of uncertainty, and there were reasons to believe that economic growth could well slow without any adjustment to policy. The members recognized that the recovery in credit markets, the rise in equity prices, and the turnaround in some foreign economies could imply that the lower federal funds rate established last fall was no longer entirely appropriate. However, they concluded that given the prevailing uncertainties in the economic outlook it was preferable to defer any policy action and to monitor the economy closely for further signs that inflationary pressures were likely to rise.

The members nonetheless agreed that their increased concerns about the outlook for inflation called for the adoption of an asymmetric directive that was tilted toward tightening and, in keeping with the Committee's recently reaffirmed policy, to announce that change after this meeting. The Committee had said that it would not necessarily publish every change in the symmetry of its directive, but this shift to asymmetry represented a significant change in the Committee's assessment of the risks of higher inflation, and its announcement would alert the financial markets and the public more generally to this development. That, in turn, should encourage stabilizing reactions in financial markets and perhaps reduce the odds of an outsized response if evolving circumstances in the near term were to require an adjustment to policy that had not previously been anticipated. It was important that the public, including those who participated in financial markets, understood the Committee's resolve to keep inflation at a low level. A number of members emphasized, however, that the adoption and announcement of an asymmetrical directive should not be viewed as necessarily implying a near-term policy change or indeed any change over time unless circumstances warranted. For now, an asymmetric directive represented the right balance in terms of positioning the Committee for possible tightening at some point.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests continued vigorous expansion in economic activity. Nonfarm payroll employment moderated on balance over March and April, and the civilian unemployment rate in April matched its first-quarter average. Total industrial production increased substantially in March and April. Total retail sales edged up in April after recording large gains earlier in the year. Housing starts fell in April. Available indicators suggest that growth of business capital spending has remained relatively rapid. The nominal deficit on U.S. trade in goods and services widened substantially in January and February from its fourth-quarter average. Consumer prices rose substantially in April, boosted by a sharp increase in energy prices; labor costs have remained quiescent thus far this year despite very tight labor markets.

Interest rates on Treasury securities have risen appreciably since the meeting on March 30, 1999, with the largest increases concentrated in intermediate- and long-term maturities; rates on private obligations show mixed changes over the period. Most key measures of share prices in equity markets have registered sizable gains over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has depreciated somewhat over the period in relation to the currencies of a broad group of important U.S. trading partners.

M2 and M3 recorded sizable increases in April, apparently owing to a tax-related buildup in liquid accounts. For the year through April, M2 is estimated to have increased at a rate somewhat above the Committee's annual range and M3 at a rate slightly above its range. Total domestic nonfinancial debt has continued to expand at a pace somewhat above the middle of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 4¾ percent. In view of the evidence currently available, the Committee believes that prospective developments are more likely to warrant an increase than a decrease in the federal funds rate operating objective during the intermeeting period.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Kelley, McTeer, Meyer, Moskow, Ms. Rivlin, and Mr. Stern. Votes against this action: None

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, June 29–30, 1999.

The meeting adjourned at 12:45 p.m.

Donald L. Kohn
Secretary

Meeting Held on June 29–30, 1999

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, June 29, 1999, at 2:30 p.m. and continued on Wednesday, June 30, 1999, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the Federal Open Market Committee

Mr. Hoenig, Ms. Minehan, and Mr. Poole, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Johnson, Economist

Messrs. Alexander, Cecchetti, Hooper, Hunter, Lang, Lindsey, Rolnick, Rosenblum,[7] Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Messrs. Porter[8] and Reinhart, Deputy Associate Directors, Division of Monetary Affairs, Board of Governors

Mr. Reifschneider,[8] Section Chief, Division of Research and Statistics, Board of Governors

Mses. Edwards,[9] and Mauskopf,[9] and Messrs. Lebow[8] and Orphanides,[8] Senior Economists, Divisions of Monetary Affairs, International Finance, Research and Statistics, and Monetary Affairs respectively, Board of Governors

Ms. Garrett and Mr. Tetlow,[8] Economists, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Barron, First Vice President, Federal Reserve Bank of Atlanta

Messrs. Beebe, Eisenbeis, Goodfriend, Hakkio, Rasche, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, Richmond, Kansas City, St. Louis, and Cleveland respectively

Mr. Fuhrer and Ms. Perelmuter, Vice Presidents, Federal Reserve Banks of Boston and New York respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 18, 1999, were approved.

7. Attended Tuesday's session only.

8. Attended portions of the meeting relating to the discussion of the policy implications of uncertainty about key economic variables.

9. Attended portions of the meeting relating to the Committee's review of the economic outlook and consideration of its monetary and debt ranges for 1999 and 2000.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period May 18, 1999, through June 29, 1999. The Committee ratified these transactions by unanimous vote.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 1999 and 2000, and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that economic activity continued to expand vigorously, though at a somewhat slower pace than earlier in the year. Consumer outlays and construction spending had decelerated somewhat after having grown very rapidly in the first quarter, but the deceleration had been partly offset by a step-up in business purchases of durable equipment and a smaller decline in net exports. Labor markets remained very tight, and recent wage and price increases had been a little larger on balance; nonetheless, longer-term inflation trends continued generally favorable in an environment of robust improvements in productivity.

Nonfarm payroll employment rose substantially further on balance in April and May, but the increase was a little below the rate for the first quarter. Growth in employment remained robust in the service-producing sector in the April–May period. However, the number of jobs fell in the goods-producing sector: payrolls in manufacturing and mining continued to contract, and construction employment changed little on net after a sizable first-quarter increase. The civilian unemployment rate edged down in May to 4.2 percent, matching its low for the year and for the period since 1970.

Industrial production advanced somewhat further in May despite a sharp weather-related drop in utility services and continued sluggishness in mining activity. Manufacturing output registered another substantial advance, reflecting a surge in the production of motor vehicles and parts and persisting strength in the manufacture of many other durable goods. The output of nondurable goods posted another small increase in May, with the gains being relatively broadly based. Reflecting the stepped-up pace of manufacturing, the rate of utilization of capacity edged higher in May but continued to be below its long-run average level.

Growth of consumer spending appeared to have slowed somewhat from its extraordinary pace of the first quarter; nonetheless, the underlying trend in consumption remained strongly upward, with household income and wealth continuing to expand rapidly and consumer sentiment remaining very high. Total retail sales rose substantially in May following large increases on average earlier in the year. Gains in retail sales were relatively widespread, with outsized advances in the food, general merchandise, and durable goods categories.

Housing demand remained robust in recent months despite the recent rise in mortgage rates. However, builders were faced with shortages of workers and some materials and were hard-pressed to keep pace with the demand for new homes. As a result, both single-family and multifamily housing starts fell somewhat on balance over April and May.

Information on shipments of nondefense capital goods in April and May suggested that business investment in durable equipment picked up substantially in the second quarter from the already brisk pace of the first quarter. Shipments of high-tech equipment, notably computers, were particularly robust over the April–May period. In addition, business demand for motor vehicles continued to be strong, particularly for medium and heavy trucks for which the backlog of unfilled orders was still quite large. By contrast, nonresidential construction activity weakened in April (latest data) after a rise in the first quarter, and available information on contracts for future construction pointed to sluggish building activity for some period ahead.

Business inventory accumulation slowed a bit in April from the relatively subdued first-quarter pace, and total business stocks remained at fairly low levels in relation to sales. In manufacturing, inventories continued to decline in April, and the aggregate inventory–shipment ratio for this sector stayed at the bottom of its range for the past twelve months. Wholesale stocks rose in April at about their average pace for the early months of the year, and the ratio of stocks to sales in this sector stayed in the lower end of its range for the past year. Retail inventory accumulation slowed in April after a relatively large gain in the first quarter, and the aggregate inventory–sales ratio also remained in the lower end of its range for the past twelve months.

The nominal deficit on U.S. trade in goods and services widened somewhat in April from its first-quarter average. The value of exports increased slightly from its first-quarter average, primarily reflecting greater exports of computers and semiconductors, motor vehicles, and industrial supplies. The value of imports rose somewhat more, principally owing to larger imports of oil. The available information suggested that economic activity had picked up somewhat on balance in the major foreign industrial countries. The Japanese economy was reported to have expanded markedly in the first quarter, recording its first quarterly rise in the past year and a half. In Europe, economic growth rebounded in Germany but slowed somewhat in France and the United Kingdom. Signs of an improved economic performance also were evident in Latin America and Southeast Asia.

The consumer price index was unchanged in May following a sizable increase in April that was associated in part with a jump in energy prices. Excluding the effects of movements in food and energy prices, though, consumer inflation was a little higher in the April–May period than in the first quarter; for the twelve months ended in May, core consumer prices rose slightly less than in the previous twelve-month period. Producer prices of finished goods also were affected by the volatility of energy prices in April and May, but core producer prices recorded only a small rise in each month. For the twelve months ended in May, however, core producer inflation was up noticeably compared with the year-earlier period, owing in important part to sharp increases in the prices of tobacco products. With regard to labor costs, average hourly earnings grew a little faster in May than in April, but they rose less in the twelve months ended in May than in the previous twelve-month period.

At its meeting on May 18, 1999, the Committee adopted a directive that called for maintaining conditions in reserve markets that would be consistent with an unchanged federal funds rate of about 4¾ percent, but the directive also contained a bias toward a possible tightening of policy. The members' concerns about inflation had increased appreciably since the meeting in late March; nonetheless, the members felt that the current stance of policy could remain consistent with subdued inflation for some time, especially if productivity gains continued robust and, as projected, the growth of aggregate demand moderated somewhat in the months ahead.

Open market operations were directed throughout the intermeeting period toward maintaining the federal funds rate at around 4¾ percent, and the average rate for the period was very close to the Committee's target. Other interest rates rose somewhat over the period since the May meeting in response to the combined effects of the Committee's announcement of an asymmetric directive, economic data that generally were stronger than expected, and reported comments of Federal Reserve officials. With the market effects of higher interest rates roughly offset by brighter second-quarter earnings prospects, broad indexes of share prices in equity markets changed little on balance over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar edged up over the intermeeting period in relation to the currencies of a broad group of important U.S. trading partners. The dollar appreciated against the euro, partly reflecting the contrast between continuing robust growth in the United States and generally subpar activity in euro-area economies. The dollar also rose against the pound in association with slower growth in the United Kingdom and a reduction in the Bank of England's repo rate. By contrast, the dollar weakened against the yen as yields on Japanese government debt increased sharply relative to rates on U.S. Treasury securities. Among other important trading partners, the dollar fell against the currencies of many emerging Asian economies, whose financial markets had generally improved, but appreciated in terms of the Brazilian *real* in association with periods of particular stress in Brazil's financial markets.

After having recorded sizable increases in April that apparently were associated with tax-related buildups in liquid accounts, the growth of M2 and M3 slowed sharply in May, as tax payments cleared, and appeared to have remained moderate in June. The expansion of these aggregates also seemed to have been damped in recent months by the rise in their opportunity costs associated with earlier increases in interest rates. M2 was estimated to have increased for the year through June at a rate somewhat above the Committee's annual range and M3 at a rate near the upper end of its range. Although growth of total domestic nonfinancial debt had moderated a little recently, it continued to expand at a pace somewhat above the middle of its range.

The staff forecast prepared for this meeting suggested that the expansion would gradually moderate to a rate commensurate with the growth of the economy's estimated potential. The lagged effects of the earlier rise in the foreign exchange value of the dollar were expected to place continuing, though diminishing, restraint on the demand for U.S. exports for some period ahead. The increase of private final demand would be restrained by the anticipated waning of positive wealth effects associated with earlier large increases in equity prices; by slower growth of spending on consumer durables, houses, and business equipment in the wake of the prolonged buildup in the stocks of these items; and by the rise that had already occurred in market interest rates, especially for intermediate and longer maturities, in the expectation that higher interest rates would be needed to achieve a better balance between aggregate demand and aggregate supply. Price inflation was projected to rise somewhat over the projection horizon, in large part as a result of some upturn in import prices and a slight firming of gains in nominal labor compensation that would not be fully offset by rising productivity.

In the Committee's discussion of the outlook for economic activity and inflation, members commented that the incoming information continued to suggest a vigorous expansion but also subdued inflation despite very tight labor markets. Growth in aggregate demand was estimated to have slowed somewhat in the second quarter from outsized advances in the two previous quarters, largely as a result of less ebullient though still robust growth in consumer spending. The members questioned, however, whether the limited indications of some moderation in the expansion in recent months were a harbinger of a more sustainable pace of economic activity that would be consistent with the economy's estimated output potential and low inflation. Indeed, in the absence of some policy firming most of the members saw tightening labor markets and an upward drift in measured inflation as a significant risk. They acknowledged that the timing and extent of a potential rise in inflation were subject to considerable uncertainty. In particular, as the experience of recent years had amply demonstrated, strengthening advances in productivity had reduced increases in unit costs to very low or even slightly negative levels despite growing scarcities of labor and some rise in the growth of labor compensation and in profit margins. Rising productivity growth had not been sufficient, however, to keep labor markets from tightening, given the extraordinary strength in final U.S. demands, which if continued would show through into higher inflation. Moreover, it remained unclear how long faster gains in productivity could continue to offset increases in labor costs and avert an intensification of price inflation.

In keeping with the practice at meetings just before the Federal Reserve's semiannual monetary policy report to the Congress and the Chairman's associated testimony, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had provided individual projections of the growth in nominal and real GDP, the rate of unemployment, and the rate of inflation for the years 1999 and 2000. With regard to the growth of nominal GDP, most of the forecasts were in ranges of 5 to 5½ percent for 1999 as a whole and 4 to 5 percent for 2000. The forecasts of the rate of expansion in real GDP for 1999 had a central tendency of 3½ to 3¾ percent and for 2000 they were centered on a range of 2½ to 3 percent, below the increases experienced over the last three years. The civilian rate of unemployment associated with these forecasts had central tendencies of 4 to 4¼ percent in the fourth quarter of 1999 and 4¼ to 4½ percent in the fourth quarter of 2000. Projections of the rate of inflation, as measured by the consumer price index, pointed to an appreciable increase in 1999, largely reflecting a swing in the price of energy, and little further change in 2000; specifically, the projections converged on CPI inflation rates of 2¼ to 2½ percent in 1999 and 2 to 2½ percent in 2000. The members anticipated that the effects of the century date change on economic activity would, on balance, be limited or negligible over the forecast period, possibly adding somewhat to growth later this year and temporarily reducing growth early next year.

Key factors underlying the members' forecasts of appreciable moderation in the trend of real GDP growth included a waning of the financial stimulus that had boosted domestic demand in recent years and the buildup of stocks of consumer durables, housing, and business equipment after an extended period of rapidly expanding purchases. However, the members acknowledged that the signs of slower growth in household and business spending were still quite limited.

In the household sector, further substantial increases in income and financial wealth and high levels of consumer confidence had fostered continued robust growth in consumer spending in recent months, but apart from exceptional strength in purchases of motor vehicles, growth in real spending for durable consumer goods appeared to have moderated recently from a very rapid pace earlier in the year. How long the favorable factors that continued to stimulate substantial growth in consumer expenditures would persist was uncertain, notably with regard to the outlook for stock market prices and their effects on consumer resources and willingness to spend. The stimulus to household spending from rapidly rising stock market wealth obviously would diminish should prices in the stock market tend to level out as many expected. In that event, growth in consumer spending might be expected to moderate to a pace more in line with the expansion in disposable incomes.

Business investment spending, which featured exceptional growth in expenditures for producers' durable equipment, appeared to have picked up in recent months from an already rapid pace earlier in the year. Nonetheless, business firms were expected to trim the growth in their outlays for equipment as forecasts of moderating expansion in aggregate demand materialized. Such a cutback would be abetted to an extent by the somewhat higher levels of market interest rates that business borrowers now faced. While growth in spending for high-technology equipment and related products probably would remain rapid in light of the accelerated pace of innovations and declining prices for such equipment, a significant deceleration or slowdown in spending for other types of capital equipment seemed likely under projected economic conditions, especially given currently reduced rates of capacity utilization in many manufacturing industries. In the nonresidential construction sector, business expenditures were expected to remain near current levels, reflecting ongoing strength in many parts of the country but also some signs of overbuilding in other areas.

A number of recent indicators suggested that on a seasonally adjusted basis residential building activity had slowed a bit in the second quarter from an elevated level earlier in the year. However, homebuilding apparently had been held back to some extent recently by scarcities of labor and some building supplies, and sizable backlogs evidently had built up. Looking ahead, the members expected residential construction expenditures to hold near current levels in the second half of this year as backlogs were worked lower, but they anticipated some softening subsequently. Factors bearing on this outlook included the large additions to the stock of housing in recent years and to some extent the backup that had occurred in mortgage rates. At some point the higher financing costs would begin to show through to housing demand.

The available information indicated that U.S. exports of goods and services had declined on balance thus far this year, while imports had posted very strong gains in line with continuing strength in U.S. domestic spending. However, improving economies in a number of the nation's important trading partners and the slower expansion forecast for the U.S. economy were expected to have a favorable effect on exports and to moderate increases in imports over the next several quarters. Indeed, recent data suggested that U.S. exports had advanced slightly after having posted sizable declines during the first quarter while imports had continued to grow strongly. On net, the members anticipated that the nation's trade balance would continue to worsen, although more slowly and with a less negative effect on the U.S. economy over the forecast period.

Members commented that inflation, as reflected in a wide range of statistical measures and anecdotal reports, remained remarkably subdued despite the persisting strength of the expansion and very tight labor markets across the nation. It seemed likely that rising productivity, which appeared to have accelerated markedly of late, accounted for much of the surprising combination of rapid growth in economic activity and low inflation. In particular, accelerating labor productivity clearly had curbed the rise in unit labor costs and damped pressures on prices. Very recent data on underlying productivity trends were not yet available, but the fact that profit forecasts had continued to be marked up suggested that it might still be accelerating and holding down costs. Such increases in productivity along with slack in foreign economies contributed to the very strong competition in most markets that was continuing generally to suppress efforts to raise prices. Other factors constraining inflation that were cited by the members included the ample availability of capacity in most industries and the declines that had occurred in non-oil import prices. Despite these favorable developments, most members had become increasingly worried about the risks of an overheating economy and rising inflation over time.

The concerns about the outlook for inflation tended to focus on the risk that, in the absence of an appreciable moderation in overall demands, very tight labor markets would at some point foster significantly faster increases in labor compensation that could no longer be offset by stronger productivity growth. Indeed, at recent rates of increase in output, labor utilization was likely to continue to rise, adding to pressures on costs. The higher labor cost increases would in turn generate more rapid price inflation. Members noted in this regard that the trend in average hourly earnings appeared to have tilted up in recent months. While this relatively recent development was not yet conclusive evidence of accelerating labor costs, especially without further information about productivity, anecdotal reports of faster increases in labor compensation also appeared to have multiplied. In addition, improving economic conditions abroad, among other factors, had induced a firming in oil and other commodity prices, and had supported the foreign exchange value of other currencies relative to the dollar. As a consequence, the declines in commodity and other import prices that had helped to suppress inflation and inflation expectations over the past two years were not likely to be repeated. Members acknowledged that the prospects for rising inflation, including the potential timing of an acceleration, if any, remained uncertain given the questions surrounding both the ongoing strength of aggregate demand and the outlook for productivity, but they viewed the risks of added price pressures as having risen further.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act), the Committee reviewed at this meeting the ranges for growth of the monetary and debt ranges that it had established in February for 1999, and it set tentative ranges for those aggregates for 2000. The current ranges approved in February for the period from the fourth quarter of 1998 to the fourth quarter of 1999, which were unchanged from those for the last several years, included growth of 1 to 5 percent for M2 and 2 to 6 percent for M3. An unchanged range of 3 to 7 percent also was set in February for growth of total domestic nonfinancial debt in 1999.

All the members favored retaining the current ranges for this year and extending them on a provisional basis to 2000. The members recognized that the growth of both M2 and M3, while decelerating markedly from 1998, might still exceed the ranges for the current year and be near the upper ends of the ranges in 2000, assuming economic and financial conditions approximating their current expectations. However, as had been the case for many years, the members remained concerned that forecasts of money growth were still subject to a wide range of error in terms of the anticipated relationships between money growth and aggregate economic performance. Accordingly, they agreed that those ranges should not reflect or be centered on forecasts of money growth under projected economic and financial conditions, but should be regarded as anchors or benchmarks for money growth that would be associated with approximate price stability and sustained economic expansion, assuming behavior of velocity in line with historical experience. A reaffirmation of those ranges for 1999 and their extension to 2000 would therefore underscore the Committee's commitment to achieving and maintaining price stability over time and thereby fostering maximum sustainable economic growth. It was noted during this discussion that the apparent pickup in productivity, if it persisted, suggested that somewhat higher ranges than those adopted in recent years might more accurately reflect money growth under conditions of price stability and historically typical velocity trends. However, the members agreed that the marked degree of uncertainty in the outlook for productivity as well as velocity argued against any increases in the ranges at this point.

The Committee members were unanimously in favor of retaining the current range of 3 to 7 percent for growth of total domestic nonfinancial debt in 1999 and extending that range on a provisional basis to 2000. They took account of a staff projection indicating that growth of the debt aggregate was likely to be around the middle of this range, perhaps somewhat above in 1999 and somewhat below in 2000. Unlike the ranges for the monetary aggregates, selection of the range for debt did not reflect a price stability and sustainable economic growth rationale but was based on forecasts of actual growth in this measure.

At the conclusion of this discussion, the Committee voted to reaffirm the ranges for growth of M2, M3, and total domestic nonfinancial debt that it had established in February for 1999 and to extend these ranges on a tentative basis to 2000. In keeping with its usual procedures under the Humphrey–Hawkins Act, the Committee would review its preliminary ranges for 2000 early next year. Accordingly, the Committee voted to incorporate the following statement regarding the 1999 and 2000 ranges in its domestic policy directive:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 2000, the Committee agreed on a tentative basis to set the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1999 to the fourth quarter of 2000. 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.

> Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, McTeer, Meyers, Moskow, Kelly, and Stern. Votes against this action: None. Absent and not voting: Ms. Rivlin

In the Committee's discussion of policy for the intermeeting period ahead, all but one member supported a proposal for a slight tightening of conditions in reserve markets consistent with an increase of ¼ percentage point in the federal funds rate to an average of around 5 percent. In the view of most members, such a policy move represented a desirable and cautious preemptive step in the direction of reducing what they saw as a significant risk of rising inflation. While current indications of accelerating inflation were quite limited, the economy had been expanding rapidly enough to put added pressure on labor markets over time, and many members expressed growing concern that, given the current stance of monetary policy, the persisting strength of domestic demand augmented by increasing demand from abroad would show through at some point to even tighter labor markets and higher inflation, which would impinge over time on the economy's ability to realize its full growth potential. In these circumstances, a small preemptive move at this time would provide a degree of insurance against worsening inflation later. Members commented that the action in question would reverse a portion of the easing actions implemented during the fall of 1998 that had been undertaken in part to protect against the possibility that unsettled global markets would place even greater constraints on foreign and domestic economic activity than were then evident. As financial markets and foreign economies stabilized and recovered, that added protection was no longer required and policy needed to move to a less accommodative stance to promote sustainable growth in spending. One member did not agree that any tightening of policy was necessary to contain inflation, given the persistence of low inflation, accelerating productivity, and what in his view was an already sufficiently restrictive monetary policy stance.

The members were divided over whether to retain the current asymmetrical directive tilted toward restraint or to adopt a symmetrical directive in conjunction with the contemplated tightening action. A majority endorsed a proposal to shift to a symmetrical directive. They agreed that following today's limited policy move the risks would still remain tilted toward rising inflation, and they expected that the announcement of a change in policy shortly after the meeting would include a reference to the Committee's ongoing concerns in that regard. But in light of the marked degree of uncertainty relating to the extent and timing of prospective inflationary pressures, they believed that further firming of policy might not be necessary in the near term and in any case would depend importantly on future developments. Some of these members were concerned that retention of asymmetry might be interpreted as an indication that the Committee was relatively certain that it would need to take further tightening action fairly soon, a view that tended to be reinforced by the behavior of expectations in the period after the announcement of a shift to asymmetry at the May meeting.

Members who preferred to retain an asymmetrical directive agreed that, although there was little likelihood of a further policy change during the intermeeting period, such a directive was the best way to convey their concerns about the risks of rising inflation and the potential need for policy tightening over time. A number of those in favor of asymmetry were concerned that a symmetrical directive would not capture the Committee's thinking with regard to the most likely policy course over an extended period of time and could foster the misleading conclusion that the Committee no longer believed a further adjustment to policy might be warranted at some point later this year. They saw the odds as reasonably high that further tightening would be needed before the end of the year to gain adequate assurance that inflation would be contained. Despite their differing preferences, all the members who supported a policy tightening move also indicated that they could accept a symmetrical directive because the announcement to be released after this meeting along with the Chairman's Humphrey–Hawkins testimony during the latter part of July could serve to correct possible misinterpretations.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests continued vigorous expansion in economic activity. Nonfarm payroll employment has increased at a relatively rapid pace in recent months and the civilian unemployment rate, at 4.2 percent in May, matched its low for the year. Manufacturing output rose substantially further in May. Total retail sales increased briskly last month after recording large gains on average earlier in the year. Housing activity has remained robust in recent months. Available indicators suggest that business capital spending, especially for information technology, has accelerated this spring. The nominal deficit on U.S. trade in goods and services widened somewhat in April from its first-quarter average. Consumer price inflation was up somewhat on balance in April and May, boosted by a sharp increase in energy prices; improving productivity has held down increases in unit labor costs despite very tight labor markets.

Interest rates have risen somewhat since the meeting on May 18, 1999. Key measures of share prices in equity markets are unchanged to somewhat lower on balance over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has changed little over the period in relation to the currencies of a broad group of important U.S. trading partners.

After recording sizable increases in April, apparently owing to a tax-related buildup in liquid accounts, growth of M2 and M3 slowed in May as tax payments cleared and appears to have remained moderate in June. For the year through June, M2 is estimated to have increased at a rate somewhat above the Committee's annual range and M3 at a rate near the upper end of its range. Total domestic nonfinancial debt has continued to expand at a pace somewhat above the middle of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 2000, the Committee agreed on a tentative basis to set the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1999 to the fourth quarter of 2000. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 5 percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Meyers, Moskow, Kelley, and Stern. Vote against this action: Mr. McTeer. Absent and not voting: Ms. Rivlin

Mr. McTeer dissented because he believed that tightening was unnecessary to contain inflation. He noted that most measures of current inflation remain low, and he saw few signs of inflation in the pipeline. Conditions that called for a preemptive tightening in 1994—rapidly rising commodity prices and real short-term interest rates near zero—are not present today. While money growth has been rapid by historical standards, market-based indicators of monetary policy suggest sufficient restraint. Except for oil, most sensitive commodity prices have risen only slightly after years of decline, the dollar remains strong, real short-term interest rates are near historical norms, and productivity growth has accelerated in recent quarters. Mr. McTeer does not believe that rapid growth based on new technology, rising productivity, and other supply-side factors is inflationary, especially in the current global environment. He would have preferred to continue to test the growth limits of the new economy.

By notation vote completed on July 14, 1999, available members of the Committee voted unanimously to delegate responsibility to Mr. Gramlich and in his absence to Mr. Ferguson for making decisions on appeals of denials by the secretary of the Committee for access to Committee records. This action was taken in keeping with the provisions of 271.4(d) of the Committee's Rules Regarding Availability of Information.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Meyers, Moskow, Kelley, and Stern. Votes against this action: None. Not voting: Mr. McTeer and Ms. Rivlin

It was agreed that the next meeting of the Committee would be held on Tuesday, August 24, 1999.

The meeting adjourned at 11:45 a.m.

Donald L. Kohn
Secretary

After the meeting, the following press release was issued:

The Federal Open Market Committee today voted to raise its target for the federal funds rate 25 basis points, to 5 percent. Last fall the Committee reduced interest rates to counter a significant seizing-up of financial markets in the United States. Since then much of the financial strain has eased, foreign economies have firmed, and economic activity in the United States has moved forward at a brisk pace. Accordingly, the full degree of adjustment is judged no longer necessary.

Labor markets have continued to tighten over recent quarters, but strengthening productivity growth has contained inflationary pressures.

Owing to the uncertain resolution of the balance of conflicting forces in the economy going forward, the FOMC has chosen to adopt a directive that includes no predilection about near-term policy action. The Committee, nonetheless, recognizes that in the current dynamic environment it must be especially alert to the emergence, or potential emergence, of inflationary forces that could undermine economic growth.

Meeting Held on August 24, 1999

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, August 24, 1999, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the Federal Open Market Committee

Mr. Hoenig, Ms. Minehan, and Mr. Poole, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Prell, Economist
Ms. Johnson, Economist

Messrs. Howard, Hunter, Lang, Lindsey, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Whitesell, Assistant Director, Division of Monetary Affairs, Board of Governors

Ms. Edwards,[10] Senior Economist, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Stewart and Ms. Strand, First Vice Presidents, Federal Reserve Banks of New York and Minneapolis respectively

Mr. Beebe, Ms. Browne, Messrs. Eisenbeis, Hakkio, Ms. Krieger, Messrs. Lacker, Rasche, and Steindel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Atlanta, Kansas City, New York, Richmond, St. Louis, and New York respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Mr. Bryan, Assistant Vice President, Federal Reserve Bank of Cleveland

10. Attended portion of meeting relating to issues pertaining to year-end operations.

Mr. Viard, Senior Economist, Federal Reserve Bank of Dallas

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 29–30, 1999, were approved.

By unanimous vote, Christine Cumming and David Howard were elected to serve as associate economists until the first meeting of the Committee after December 31, 1999, with the understanding that in the event of the discontinuance of their official connection with a Federal Reserve Bank or with the Board of Governors, they would cease to have any official connection with the Committee.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period June 30, 1999, through August 23, 1999. By unanimous vote, the Committee ratified these transactions.

At this meeting, the Committee considered a number of proposals whose purpose was to enhance the Manager's ability to counter potential liquidity strains in money and financing markets in the period surrounding the century date change and in the process help to ensure the effective implementation of the Committee's monetary policy objectives. The members believed that the prospects for major liquidity problems associated with the century date change were remote, but some strains were already in evidence, and they agreed that it would be prudent to provide the Manager with added leeway and flexibility for a limited period. Because the plans of market participants were likely to be influenced by the Federal Reserve's contemplated action and because detailed preparations with market participants needed to begin promptly, the Committee decided to put the new authorizations in place at this meeting.

The new authority encompassed three policy instruments that, unless renewed, would expire during the early part of 2000 and one permanent change. The temporary authorizations included (1) the expansion of collateral that could be accepted in System open market transactions, (2) authority to use reverse repurchase agreements in addition to the currently available matched sale-purchase transactions to absorb reserves on a temporary basis, and (3) a standby financing facility involving the auction of options on repurchase agreements, reverse repurchase agreements, and matched sale–purchase transactions that could be exercised in the period surrounding the year-end. The permanent change, which also might prove useful during the year-end period, involved the extension of the maximum maturity on regular repurchase and matched sale-purchase transactions from sixty days to ninety days.

The broader range of collateral approved by the Committee for repurchase transactions included mainly pass-through mortgage securities of GNMA, FHLMC, and FNMA, U.S. Treasury STRIPS, and "stripped" securities of other federal government agencies. The expanded pool would facilitate the Manager's task of addressing what potentially could be very large needs to supply reserves in the months ahead, especially in the weeks surrounding the year-end. Such transactions would have to be undertaken at a time of likely heightened demand for U.S. government securities that would diminish the available pool of currently authorized securities for System open market operations. The Federal Reserve Bank of New York would need to establish custody arrangements with commercial banks to manage the clearing of the newly authorized securities on a triparty basis. Some time would be needed to make these arrangements and inform other market participants, and it was anticipated that the new arrangements would not be in place before early October. To implement this decision, the Committee voted unanimously to suspend until April 30, 2000, several provisions of the ''Guidelines for the Conduct of System Operations in Federal Agency Issues,'' which impose limits on transactions in federal agency transactions. The ''Guidelines'' as temporarily amended now read as follows:

1. System open market operations in Federal agency issues are an integral part of total System open market operations designed to influence bank reserves, money market conditions, and monetary aggregates.
2. System open market operations in Federal agency issues are not designed to support individual sectors of the market or to channel funds into issues of particular agencies.

The Committee's decision to authorize the use of reverse repurchase agreements until April 30 was intended to facilitate temporary reserve draining operations. These agreements are fundamentally equivalent to matched sale-purchase transactions, which the Manager already has the authority to employ. However, the latter are not a common instrument in financial markets. Partly as a consequence, they lack the flexibility for use to drain reserves late during the business day, a flexibility that might be particularly desirable to have in place during the upcoming year-end period. Accordingly, the Committee voted unanimously to add reverse repurchase agreements to its ''Authorization for Domestic Open Market Operations,'' as shown in new paragraph 1(c) below.

The Committee also approved a temporary financing facility authorizing the Federal Reserve Bank of New York to sell options on repurchase agreements, reverse repurchase agreements, and matched sale-purchase transactions. The members hoped that the availability of such a System facility would reduce concerns about year-end financial conditions and thus help avert the emergence of the illiquid markets that were feared by an apparently growing number of market participants and that would complicate the conduct of open market operations. The sales would be made on a competitive basis to the primary government securities dealers who are regular counterparties in the System's open market operations. The details of these transactions would be worked out during the weeks ahead.

Members agreed that there was some risk of unintended consequences in implementing these untried transactions. Nonetheless, the costs stemming from a dysfunctional financing market at year-end, in the unlikely event that it materializes, were immeasurably greater. The members did not question the desirability of addressing the latter risks and providing greater assurance that financing markets would retain sufficient depth and liquidity to permit market participants including the Federal Reserve to make necessary portfolio adjustments at year-end. Accordingly, the Committee voted unanimously to authorize the sale of options on temporary transactions for exercise though January 2000. This authority is indicated in the temporary addition of paragraph 4, shown below, to the Authorization for Domestic Open Market Operations.

The decision to extend the maximum maturity on repurchase and sale-purchase transactions was intended to bring the terms of such transactions into conformance with market practice and the pattern of market demand, thereby enhancing the Manager's ability to use these instruments. This maturity extension, which the Committee decided to make permanent, was likely to prove particularly useful in the period of unusually large reserve operations over the months ahead. The new authority is incorporated in paragraphs 1(b), 1(c), and 3 below.

The paragraphs of the Authorization for Domestic Open Market Operations that were amended or added by the Committee, all by unanimous vote, read as follows:

Authorization for Domestic Open Market Operations

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:

(b) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 90 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account.

(c) To sell U.S. Government securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 90 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 90 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

4. In order to help ensure the effective conduct of open market operations during the transition period surrounding the century date change, the Committee authorizes the Federal Reserve Bank of New York to sell options on repurchase agreements, reverse repurchase agreements, and matched sale purchase transactions for exercise no later than January 2000.

The Committee then turned to a discussion of the economic and financial outlook, and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that expansion of economic activity remained solid. The growth of consumer spending and business outlays for durable equipment had moderated somewhat after having increased rapidly earlier in the year. Residential construction activity had weakened a little from the level of last winter but was still elevated. Job growth was quite strong, however, and industrial production appeared to be picking up. Labor markets remained very tight, and recent wage and price increases had been a little larger on balance, though price inflation continued subdued.

Nonfarm payroll employment increased sharply in June and July. Job growth in the service-producing industries soared in both months, and construction employment remained on an upward trend. In manufacturing, the number of jobs turned up in July. The civilian unemployment rate was 4.3 percent in July, matching its average for the first half of the year.

Industrial production recorded a large increase in July after having edged up in June. Part of the July advance reflected a surge in the output of electric utilities associated with the heat wave in the eastern United States and an upturn in mining production after a weak first half of the year. In manufacturing, production advanced briskly over the June–July period. While production of motor vehicles and aircraft fell on balance over the two months, output of high-tech products continued to expand at a rapid pace, and the manufacture of other goods rebounded strongly in July after a small decline in June. Utilization of manufacturing capacity edged up in July but remained below its long-run average rate.

Growth of consumer spending slowed appreciably in the second quarter after having surged earlier in the year; still, the underlying trend in spending remained relatively strong as a result of continuing robust expansion of disposable incomes and household wealth thus far this year and very positive consumer sentiment. Retail sales had increased moderately recently—a small decline in June was more than offset by a July rebound—while consumer outlays for services were buoyant in the second quarter (latest data). Housing activity remained strong in the June–July period; housing starts were only a little below the very high levels of earlier months of the year, and home sales remained at an elevated level in June (latest data).

The limited available information suggested that the pace of expansion in business fixed investment had moderated somewhat after having advanced rapidly in the second quarter. Demand for high-tech equipment remained strong overall, even though growth of outlays for computers appeared to have eased a little recently; spending for motor vehicles and aircraft seemed to be leveling out after a marked decrease in the first half of the year; and expenditures on other types of durable equipment remained sluggish. Nonresidential construction activity slipped in the second quarter after sizable gains last year and the early part of this year.

The book value of business inventories increased moderately in the second quarter, and in many industries the levels of inventory stocks were lean in relation to sales. In manufacturing, inventories continued to edge down in the second quarter, and the aggregate inventory–sales ratio for the sector at the end of the quarter was slightly below the lower end of its range for the preceding twelve months. Wholesale stocks recorded another modest gain in the second quarter, and the stock–shipments ratio for this sector at quarter's end was below the bottom of its narrow range for the past year. Inventory accumulation in the retail sector slowed in the second quarter, but stocks kept pace with sales, and the aggregate stock–sales ratio was in the middle of its range for the past twelve months.

The nominal deficit on U.S. trade in goods and services widened substantially in the second quarter, as the value of imports increased much more than that of exports. The rise in imports was spread widely across the major trade categories; sharply higher prices for imported oil, along with a moderate addition in the quantity imported, accounted for much of the rise, but there also were sizable step-ups in imports of computers, semiconductors, and industrial supplies—notably building materials. The increase in exports was concentrated in agricultural goods, automotive products, industrial supplies, computers, and semiconductors. Recent information suggested that economic recovery in Europe was continuing to gain momentum through the second quarter, while the Japanese economy was showing some signs of having bottomed out over the first half of the year. Economic activity had remained on a strong upward trend in Canada in recent months, and economic growth picked up during the spring in the United Kingdom after having stagnated over the previous two quarters. The recent economic performance of the developing countries had been mixed. Most Asian economies grew robustly in the first half of the year, but economic activity in a number of Latin American economies, with the notable exceptions of Brazil and Mexico, remained weak.

Consumer prices rose moderately in July after having been unchanged in May and June; a rebound in energy prices contributed to the July increase. The strong upturn in energy prices this year accounted for all of the uptick in consumer price inflation in the twelve months ended in July compared with the previous twelve-month period. Excluding food as well as the volatile energy component, core consumer price inflation had remained subdued thus far in 1999 and during the twelve months ended in July. Inflation was modest at the producer level as well, as prices of finished goods other than food and energy edged lower over the June–July period. Core producer prices rose more in the twelve months ended in July than in the year-earlier period, but that pickup resulted in important part from sharp increases in the prices of tobacco products. At earlier stages of processing, producer prices of crude and intermediate materials other than food and energy had firmed noticeably in recent months. While the source of some of those increases had been the pass-through of higher crude oil prices, improved worldwide growth, especially in Asia, also contributed. With labor markets very tight, increases in wages and total compensation had been somewhat larger recently. The employer cost index for hourly compensation of private industry workers jumped in the second quarter after an unusually small gain in the first quarter, and increases in average hourly earnings of production or nonsupervisory workers picked up in June and July. Nonetheless, year-over-year changes in some measures of nominal compensation continued to decline.

At its meeting on June 29–30, 1999, the Committee adopted a directive that called for a slight tightening of conditions in reserve markets consistent with an increase of ¼ percentage point in the federal funds rate to an average of around 5 percent. The members noted at that meeting that there were few current indications of rising inflation; nonetheless, with financial markets and foreign economies recovering since the Committee had eased policy last fall, the persisting strength of demand was enough to put added pressure over time on already very tight labor markets and at some point lead to a pickup in inflation that could threaten the sustainability of the economy's expansion. Because there was substantial uncertainty relating to the extent and timing of prospective inflationary pressures and thus the possibility that further firming of policy might not be needed in the very near term, the directive did not contain any bias relating to the direction of possible adjustments to policy in the intermeeting period.

Open market operations immediately after the meeting were directed toward implementing the desired, slightly greater pressure on reserve positions, and the federal funds rate averaged very close to the Committee's 5 percent target over the intermeeting period. Treasury coupon yields fell early in the intermeeting interval, as market participants apparently adjusted downward their expectations regarding further monetary tightening in response to the generally unexpected move to a neutral directive and, subsequently, the receipt of favorable data on inflation. Yields later retraced their declines, however, in reaction to the semiannual monetary policy report and the Chairman's associated testimony and to the release of data indicating an acceleration of labor costs, growing signs of a firming of activity abroad, and a weaker dollar. On net, most interest rates were about unchanged over the intermeeting interval. Key measures of share prices in equity markets, buoyed early in the period by lower interest rates and better-than-anticipated quarterly earnings reports, largely reversed those gains when rates backed up, and share prices ended the period with mixed results.

In foreign exchange markets, the trade-weighted value of the dollar depreciated slightly over the intermeeting period in relation to the currencies of a broad group of important U.S. trading partners. The dollar declined against the currencies of the major industrial countries in response to indications of improved economic performances in Europe and Japan and to higher long-term interest rates in many of those countries. However, this depreciation was partially offset by a rise in relation to the currencies of other important trading partners, reflecting increased uncertainty in financial markets in many Asian and Latin American countries that was associated in part with concerns about rising U.S. interest rates.

The expansion of broad measures of money had moderated in recent months. The slower growth of nominal GDP and the rise in market interest rates in the spring and summer likely had restrained increases in both M2 and M3. In addition, M3's expansion probably had been held down by a sharp slowing in the growth of bank credit in July. For the year through July, M2 was estimated to have increased at a rate somewhat above the Committee's annual range and M3 at a rate approximating the upper end of its range. Total domestic nonfinancial debt had continued to expand at a pace somewhat above the middle of its range, though borrowing by nonfinancial sectors had slowed in recent months.

The staff forecast prepared for this meeting suggested that the expansion would gradually moderate to a rate commensurate with the growth of the economy's estimated potential. The growth of domestic final demand increasingly would be held back by the anticipated waning of positive wealth effects associated with earlier large gains in equity prices; the slower growth of spending on consumer durables, houses, and business equipment in the wake of the prolonged buildup in the stocks of these items; and the higher intermediate- and longer-term interest rates that had evolved as markets came to expect that a rise in short-term interest rates would be needed to achieve a better balance between aggregate demand and aggregate supply. The lagged effects of the earlier rise in the foreign exchange value of the dollar were expected to place continuing, though diminishing, restraint on U.S. exports for some period ahead. Price inflation was projected to rise somewhat over the forecast horizon, in part as a result of higher import prices and some firming of gains in nominal labor compensation in persistently tight labor markets that would not be fully offset by rising productivity.

In the Committee's discussion of current and prospective economic developments, members commented that the expansion of economic activity continued to display substantial underlying strength with few indications of slowing in the growth of consumer and business expenditures. While the information for the second quarter pointed to a marked deceleration from the pace in other recent quarters, the slowdown was induced to an important extent by sharply reduced inventory investment that partly offset robust further growth in consumer and housing expenditures and a surge in spending by business for equipment. The members generally anticipated a rebound in the rate of economic expansion over the balance of the year and in 2000, possibly to a pace averaging around the economy's long-run potential. Growth at this rate would represent a noticeable slowing from the pace that had prevailed in recent years, and its realization depended importantly on the damping effects on domestic demand of the less accommodative financial conditions that had developed in recent months—higher long-term interest rates and a flattening of equity prices. Given the persistent strength of domestic demand and improving economies abroad, many members saw the risks to this outlook as tilted to the upside, especially if short-term interest rates were to remain at their current levels. Against this background, the risks in the outlook for prices also seemed to be tilted toward somewhat higher inflation. Price inflation had been held in check by accelerating productivity and declines in oil and other import prices. Evidence was mixed on whether the acceleration in productivity was persisting, but the earlier favorable developments in import prices were already dissipating, adding to the inflation risk posed by the possibility of further tightening in labor markets should domestic demand fail to moderate.

In their comments about regional economic developments, the members reported generally favorable business conditions and further growth in all regions, with variations ranging from some acceleration in a number of Federal Reserve Districts to modest deceleration in some others. Several indicated that economic activity in some parts of the country was being held down by shortages of labor. Most industries continued to exhibit strength, but weakness was reported in agriculture and related businesses and in manufacturing industries such as textiles.

With regard to the outlook for key sectors of the economy, members referred to the favorable prospects for continued robust growth in employment and incomes that likely would sustain appreciable further expansion in consumer expenditures. However, substantial uncertainty surrounded the outlook for stock market prices whose sharp rise and the associated increase in wealth over the course of recent years had helped to foster a high level of consumer confidence and willingness to spend. The absence of further large gains in stock prices, should recent trends persist, would remove this stimulus and probably induce some moderation in the growth of consumer spending. However, as the experience of recent years had amply demonstrated, stock market trends were very difficult to predict. Concerning the prospects for business capital investment, members saw indications that outlays might rise more moderately after a surge in the second quarter. Weak trends in orders for many types of equipment and softness in nonresidential construction pointed to a considerable deceleration in total business investment. At the same time, however, further advances in technology and declining prices were likely to underpin continued very strong expenditures for computer and communications equipment, thereby sustaining still robust if reduced increases in overall business investment.

Residential construction activity was expected to moderate a bit over coming quarters as the rise that had occurred in mortgage interest rates exerted its lagged effects. The deceleration was likely to be limited in the near term, however, as the backlogs that had built up earlier in the year and associated shortages in inventories of new homes were worked down. Indeed, anecdotal reports indicated currently strong housing markets in several areas of the country. Over time, the outlook for employment and incomes should provide support to the housing market, but likely at a modestly diminished level.

The outlook for inventory investment remained characteristically uncertain, though the members commented that there were reasons to anticipate some pickup in such investment following the shortfall in the second quarter. While the long-run trend undoubtedly remained in the direction of declining inventory–sales ratios, the shortfall of inventory investment during the spring probably had on the whole lowered holdings at least temporarily below intended levels as evidenced in part by anecdotal reports that lean inventories had reduced sales in some areas. Moreover, some buildup relating to century date change concerns seemed likely; in this regard, anecdotal reports suggested that some businesses planned to accumulate inventories in the form of imports because of questions about the availability of such goods around the year-end. Members acknowledged that available survey and anecdotal evidence did not point to any widespread perception of a significant need to build up inventories, and indeed there were indications of overstocking in some industries. Even so, appreciable inventory accumulation was seen as the most likely prospect for the balance of the year. While such a forecast was subject to substantial risks in both directions, it implied, if realized, a significant boost to GDP growth over the second half of the year.

The government sector was now expected to exert somewhat less restraint on overall demand in the economy, as burgeoning budget surpluses seemed to be weakening restraints on federal government outlays and tax cuts were a possibility. In addition, export growth was projected to strengthen in conjunction with an improving economic outlook in a number of important U.S. trading partners, and import growth seemed likely to moderate over the next several quarters, reflecting the projected deceleration in the U.S. economy and the waning effects of the past appreciation of the dollar. A number of members commented, however, that they saw downside risks to the trade outlook despite the improving economic performance in many countries. Adverse developments in those countries remained a worrisome concern in light of unsettled political conditions that made it very difficult for government authorities in many of them to implement the measures that were needed to solve underlying economic problems.

In the course of the Committee's discussion of the outlook for inflation, members commented that there was no persuasive evidence in recent statistical measures that price inflation was currently picking up or that inflation expectations were rising, though the declines in both inflation and expectations experienced over the course of recent years no longer seemed to be occurring. Members nonetheless expressed concern about the risks of some acceleration under foreseeable economic circumstances. They cited a variety of statistical and anecdotal signs that could be viewed as harbingers of rising price inflation. Those included an upturn in commodity prices, notably that of oil whose effects tended over time to spread relatively widely through the economy, and the direct and indirect effects of the dollar's depreciation. Members also reported some indications of reduced discounting by business firms and plans for, or actual implementation of, higher prices that businesses now saw as less likely than earlier to be reversed for competitive reasons. However, these reports were still relatively scattered.

The members' basic concern about the outlook for inflation related to the possibility that continued strength in demand might not be accommodated without placing greater pressures on labor compensation and prices. The greatest risks would come from a further tightening of labor markets, but many members were also concerned about the possibility of accelerating costs at current levels of labor resource utilization. The major uncertainty was the extent to which labor productivity would continue to accelerate and hold down the rise in unit labor costs. Recent data from the product side of the national income and product accounts suggested some slowing in productivity growth and pressure on unit labor costs, but these tendencies were not confirmed by a close reading of income side data. In these circumstances, the outlook for price inflation remained subject to considerable uncertainty.

In the Committee's discussion of policy for the period ahead, the members with one exception favored a proposal for a slight tightening of conditions in reserve markets that would be consistent with an increase in the federal funds rate to an average of about 5¼ percent. In the view of these members, a limited policy move at this time would appropriately supplement the small firming action taken at midyear and at least for now would position monetary policy where it needed to be to foster continued subdued inflation and good economic performance. It would tend to validate the appreciable firming in financial markets that had occurred in recent months, to some extent in anticipation of Committee tightening. That firming was important to hold the expansion of economic activity to a sustainable pace, especially as improving foreign economies boosted the demand for U.S. exports. While key measures of prices did not at this point suggest any upturn in inflation, a failure to act would incur a substantial risk of increasing pressure on already tight labor markets and higher inflation. During the discussion, some members observed that today's action would reduce further the stimulus provided during the autumn of last year to counter the global financial turmoil and related risks to the U.S. economy. While not all vestiges of that turmoil had disappeared, financial conditions had improved markedly, foreign economies had strengthened on balance, and downside risks to economic performance in the United States were generally reduced. One member indicated that in light of the persistence of low inflation, a policy tightening move was not warranted at this time and would in fact incur some risk of unnecessarily curbing the expansion in economic activity.

All the members who supported a tightening action also favored the retention of a symmetric directive. These members agreed that the Committee should keep its options open with regard to the next policy move, whose direction and timing would depend on evolving economic and financial conditions. In this regard, while agreeing that inflation risks had been substantially reduced by the actions taken in June and contemplated at today's meeting, many members continued to see a possible increase in inflation pressures as the main threat to sustained economic expansion. However, they did not anticipate that further tightening would be needed in the near term, allowing the Committee time to gather substantial additional information about the balance of aggregate supply and demand. The members all agreed that a symmetric directive would not preclude a tightening move if warranted by developments over the months ahead.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests continued solid expansion of economic activity. Nonfarm payroll employment has increased rapidly in recent months, and the civilian unemployment rate, at 4.3 percent in July, matched its average for the first half of the year. Manufacturing output continued to grow moderately on average in June and July. Total retail sales have grown less rapidly in recent months, while housing activity has remained robust. Available indicators suggest that the expansion in business capital spending has slackened somewhat after a surge this spring. The nominal deficit on U.S. trade in goods and services widened substantially in the second quarter. Consumer price inflation has been boosted in recent months by an appreciable rise in energy prices; against the background of very tight labor markets, increases in wages and total compensation have been somewhat larger.

Most interest rates are little changed on balance since the meeting on June 29–30, 1999. Key measures of share prices in equity markets have posted mixed changes over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has declined slightly over the period in relation to the currencies of a broad group of important U.S. trading partners.

M2 and M3 have grown at a moderate pace in recent months. For the year through July, M2 is estimated to have increased at a rate somewhat above the Committee's annual range and M3 at a rate approximating the upper end of its range. Total domestic nonfinancial debt has continued to expand at a pace somewhat above the middle of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at its meeting in June the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 2000, the Committee agreed on a tentative basis in June to retain the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1999 to the fourth quarter of 2000. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 5¼ percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Meyers, Moskow, Kelley, and Stern. Vote against this action: Mr. McTeer.

Mr. McTeer dissented for essentially the same reasons he did at the June 30 meeting: low inflation and, except for energy, minimal inflation in the pipeline. He believes that positive supply-side forces will continue to damp the impact of strong demand on output prices and that productivity gains will continue to damp the effect of higher wages on unit labor costs.

Establishment of Subcommittee

Chairman Greenspan announced the formation of a subcommittee to review the wording of the directive, its meaning, and what the Committee announces shortly after its meetings. He noted that the sentence relating to the symmetry of the directive was subject to differing interpretations, and the Committee's decision to announce immediately significant changes in the symmetry or asymmetry in the directive had made it desirable to clarify its meaning. Members also had expressed some discomfort with the way these announcements had been interpreted. While the Committee did not contemplate retreating from its policy of immediate announcements, it might want to examine whether some adjustment in its procedures would be helpful. The Chairman did not feel that the Committee was prepared to come to a decision on these issues before more experience was gained with the current announcement approach, but he believed it was advisable to form a subcommittee at this time to study the various questions that were involved. He anticipated that the subcommittee would come back to the Committee no later than next spring with recommendations or at least some alternatives for Committee consideration. He asked Mr. Ferguson to serve as its chairman and to select other members after consultation with his colleagues on the Committee.

It was agreed that the next meeting of the Committee would be held on Tuesday, October 5, 1999.

The meeting adjourned at 1:40 p.m.

Donald L. Kohn
Secretary

After the meeting, the following press release was issued:

The Federal Open Market Committee today voted to raise its target for the federal funds rate by 25 basis points to 5¼ percent. In a related action, the Board of Governors approved a 25 basis point increase in the discount rate to 4¾ percent.

With financial markets functioning more normally, and with persistent strength in domestic demand, foreign economies firming and labor markets remaining very tight, the degree of monetary ease required to address the global financial market turmoil of last fall is no longer consistent with sustained, noninflationary, economic expansion.

Today's increase in the federal funds rate, together with the policy action in June and the firming of conditions more generally in U.S. financial markets over recent months, should markedly diminish the risk of rising inflation going forward. As a consequence, the directive the Federal Open Market Committee adopted is symmetrical with regard to the outlook for policy over the near term.

In taking the discount rate action, the Federal Reserve Board approved requests submitted by the Boards of Directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Kansas City, and San Francisco. The discount rate is the interest rate that is charged depository institutions when they borrow from their district Federal Reserve Banks.

Meeting Held on October 5, 1999

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, October 5, 1999, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the Federal Open Market Committee

Mr. Hoenig, Ms. Minehan, and Mr. Poole, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis respectively

Mr. Kohn, Secretary and Economist
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Ms. Johnson, Economist

Ms. Cumming, Messrs. Howard, Lang, Lindsey, Rolnick, Rosenblum, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Messrs. Ettin and Reinhart, Deputy Directors, Divisions of Research and Statistics and International Finance respectively, Board of Governors

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Whitesell, Assistant Director, Division of Monetary Affairs, Board of Governors

Mr. Kumasaka, Assistant Economist, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Browne, Messrs. Eisenbeis, Goodfriend, Kos, Rasche, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Atlanta, Richmond, New York, St. Louis, and Cleveland respectively

Messrs. Judd and Sullivan, Vice Presidents, Federal Reserve Banks of San Francisco and Chicago respectively

Mr. Filardo, Assistant Vice President, Federal Reserve Bank of Kansas City

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 24, 1999, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period August 24, 1999, through October 4, 1999. By unanimous vote, the Committee ratified these transactions.

The information reviewed at this meeting suggested that the expansion of economic activity was substantial in the quarter just ended. Consumer spending and business investment in durable equipment remained strong, and inventory investment picked up from the sluggish pace of the second quarter, while residential housing activity showed some signs of deceleration. To meet aggregate demand, industrial production increased further and employment gains continued to be relatively robust, keeping labor markets taut. Inflation was moderate, but somewhat above that in 1998, owing to a sharp rebound in energy prices.

Although private nonfarm payroll employment expanded relatively slowly in August, the slowdown had followed a surge in July, and growth for the two months was very close to the brisk pace of the first half of the year. Job gains in the service-producing sector remained strong in the July–August period, while employment in the goods-producing sector continued to decline, though at a slightly slower rate than earlier in the year. The civilian unemployment rate dropped back to 4.2 percent in August, matching its low for the year.

Industrial production was up appreciably further on balance in July and August. Mining activity rose markedly, utility output increased moderately on balance, and manufacturing production recorded a further sizable advance over the two months. Within manufacturing, high-tech goods and motor vehicles were sources of particular strength, while the production of nondurable goods changed little. The rate of utilization of manufacturing capacity climbed over the two months but remained well below its long-term average.

Total retail sales posted strong gains over July and August. Increases in sales were spread across all major categories, with spending for nondurable goods and motor vehicles notably strong. Expenditures on services rose moderately in the two-month period. There were mixed signals with regard to the housing sector. Construction was at a high level, the inventory of unsold homes remained quite low, and starts of multifamily units rose over the July–August period. However, single-family housing starts edged lower on balance over July and August, and sales of existing homes weakened.

The available information suggested that business capital spending continued to climb rapidly. Shipments of nondefense capital goods posted further large gains in July and August, with outlays for high-tech machinery and transportation equipment particularly strong. In addition, new orders for durable equipment turned up sharply in the two months. Nonresidential construction activity changed little on balance in July as continued strength in the office and an increase in the lodging and miscellaneous categories offset reductions in the industrial and non-office commercial categories.

Manufacturing and trade inventories, outside of motor vehicles, picked up sharply in July after posting a small increase in the first half of the year, but inventories remained lean in relation to sales. In manufacturing, stocks rebounded from a substantial June decline; however, the aggregate stock–shipments ratio remained at the bottom of its range for the past twelve months. Wholesalers also increased their inventories in July; while the inventory–shipments ratio for this sector rose, it was in the low end of its range for the past year. In the retail sector, inventories contracted somewhat in July, and the inventory–sales ratio for this sector also was near the bottom of its range over the past year.

The nominal deficit on U.S. trade in goods and services widened in July from its second-quarter average, with the value of imports rising more than the value of exports. The increase in imports was concentrated in aircraft, consumer goods, industrial supplies, and oil. The step-up in exports occurred primarily in industrial machinery and semiconductors. Among the major foreign industrial countries, the limited available information suggested that economic activity was strengthening in Europe and the United Kingdom in the third quarter while economic indicators for Japan were mixed after the strong advance in the first half of the year. Economic growth in Canada seemed to be continuing at a robust pace, and economic recovery in most of the Asian emerging-market economies was proceeding briskly.

Inflation remained relatively moderate, though somewhat above the pace of 1998 because of a sharp rebound in energy prices. Overall consumer prices increased in July and August at about the second-quarter rate. Abstracting from the sharp advances in energy prices and the mild increases in food prices, consumer inflation continued to be relatively subdued over the two months. In the past twelve months, the core CPI rose less than in the previous twelve-month period. At the producer level, prices of finished goods other than food and energy were essentially unchanged over the two months; moreover, the change in core producer prices in the past year was about the same as in the year-earlier period. At earlier stages of processing, however, producer prices of crude and intermediate materials excluding food and energy had firmed noticeably over recent months. Average hourly earnings continued to grow at a moderate pace over July and August, and the rise over the past year was considerably smaller than that for the year-earlier period.

At its meeting on August 24, 1999, the Committee adopted a directive that called for a slight tightening of conditions in reserve markets consistent with an increase of ¼ percentage point in the federal funds rate to an average of around 5¼ percent. The members noted that this move, together with the firming in June, should help to keep inflation subdued and to promote sustainable economic expansion. The Committee also agreed that the directive should be symmetric. A possible rise in inflation remained the main threat to sustained economic expansion, but it was not anticipated that further tightening would be needed in the near term and there would be time to gather substantially more information about the balance of risks relating to trends in aggregate demand and supply.

Open market operations after the meeting were directed toward implementing and maintaining the desired slight tightening of pressure on reserve positions, and the federal funds rate averaged very close to the Committee’s 5¼ percent target. Most other short-term market interest rates posted small mixed changes on balance because the policy action was widely anticipated and the FOMC's policy announcement after the August 24 meeting referenced markedly diminished inflation risks. However, longer-term yields rose somewhat over the intermeeting period in response to the receipt of new information indicating both surprisingly strong spending at home and abroad and higher commodity prices. Most measures of share prices in equity markets registered sizable declines over the intermeeting period, apparently reflecting not only higher interest rates but also concerns that U.S. stocks might be overvalued and that foreign equities were becoming relatively more attractive as economic prospects brightened abroad.

In foreign exchange markets, the trade-weighted value of the dollar changed little over the period in relation to the currencies of a broad group of important U.S. trading partners. The dollar depreciated against the currencies of the major foreign industrial countries, especially the Japanese yen, in response to generally stronger-than-expected incoming data on spending and production in those countries. However, the dollar rose against the currencies of the other important trading partners in the broad group, reflecting sizable declines in the currencies of several countries in Latin America and Asia.

Despite a further rise in opportunity costs, M2 and M3 continued to grow at moderate rates in August and evidently in September as well. Expansion of these two monetary aggregates was supported by further rapid expansion in the demand for currency and stronger inflows to retail money market funds at a time of weakness in U.S. bond and equity markets. In addition, growth of M3 was sustained by large flows into institution-only money market funds as the yields on those funds caught up to earlier increases in short-term market rates. For the year through September, M2 was estimated to have increased at a rate somewhat above the Committee's annual range and M3 at a rate just above the upper end of its range. Total domestic nonfinancial debt continued to expand at a pace somewhat above the middle of its range.

The staff forecast prepared for this meeting suggested that the expansion would gradually moderate to a rate around or perhaps a little below the growth of the economy's estimated potential. The growth of domestic final demand increasingly would be held back by the anticipated waning of positive wealth effects associated with earlier large gains in equity prices; the slower growth of spending on consumer durables, houses, and business equipment in the wake of the prolonged buildup in the stocks of these items; and the higher intermediate- and longer-term interest rates that had evolved as markets came to expect that a rise in short-term interest rates would be needed to achieve a better balance between aggregate demand and aggregate supply. The lagged effects of the earlier rise in the foreign exchange value of the dollar were expected to place continuing, but substantially diminishing, restraint on U.S. exports for some period ahead. Core price inflation was projected to rise somewhat over the forecast horizon, in part as a result of higher non-oil import prices and some firming of gains in nominal labor compensation in persistently tight labor markets that would not be fully offset by rising productivity growth.

In the Committee's discussion of current and prospective economic conditions, members commented that the incoming information suggested that the expansion had been considerably stronger in recent months than many had anticipated, while most measures of inflation had remained subdued. The economy's substantial momentum seemed likely to persist over the balance of the year, but the members continued to expect some slackening during the year ahead. This outlook was supported by the emergence of somewhat less accommodative conditions in financial markets, including the increases that had occurred in interest rates over the past several months and the steadying of stock market prices over the same period. On the other hand, foreign economies were strengthening more quickly than anticipated and rising exports were likely to offset part of the slowdown in domestic demand.

The implications of continued robust growth for the inflation outlook depended critically on judgments about the supply side of the economy. Productivity and economic potential seemed to have been growing at an increasingly rapid rate in recent years. That acceleration had itself tended to boost consumption and investment demand—in complex interactions of aggregate supply and demand—but it also had held down increases in unit costs and prices. A great deal of uncertainty surrounded the behavior of productivity growth going forward, but some further pickup, and the associated ability of the economy to accommodate more rapid growth without added inflation, was a possibility that could not be overlooked. However, a further pickup in productivity growth was by no means assured, and a number of other favorable developments in supply and prices that had acted to restrain inflation in recent years had already begun to dissipate or reverse. These included the substantial upturn in energy prices, the ebbing of import price declines, and the pickup in health care costs; adverse trends in the latter two factors in particular were likely to be extended. In these circumstances, members generally saw some risk of rising inflation going forward, but they also recognized that similar forecasts in recent years had proved wrong and that considerable uncertainty surrounded expectations of somewhat higher core inflation.

In their review of developments across the nation, members reported continued high levels of activity in all regions and few indications of moderating growth, though agriculture remained relatively depressed in many areas. The anecdotal information from around the nation clearly supported the overall statistical evidence of persisting strength in key components of domestic demand. Consumer spending, notably for light motor vehicles, was continuing to rise at a brisk pace. Some of the strength in consumer durables was related to purchases associated with homebuilding, which, though likely to slacken a little owing to the rise in mortgage interest rates, seemed to be staying at a high level. While consumer spending probably would be sustained by further anticipated growth in employment and incomes, the pause in the stock market, should it persist, and the attendant effects on financial wealth were expected with some lag to damp further gains in consumer expenditures.

Business fixed investment appeared to have accelerated to a surprising extent in the third quarter from an already robust pace earlier in the year. Further noteworthy gains were recorded in business expenditures for computing and communications equipment, evidently reflecting ongoing efforts to take advantage of declining prices and improving technology. Some of the rise in such spending could represent accelerated purchases in advance of the century date change and might well tend to be offset in early 2000. Over time, however, ongoing efforts to enhance productivity for competitive reasons suggested further vigorous growth in spending for such equipment. Forecasts of other business investment expenditures were much less ebullient and on the whole pointed to little change. Building activity currently displayed substantial strength in some major cities, largely involving office and hotel structures, but nonresidential construction activity more generally was relatively sluggish. It seemed likely that commercial building activity would be damped later as new capacity was completed and financing became less attractive in response to the rise that had occurred in market interest rates.

The prospects for business inventories over coming months were difficult to evaluate, with the usual uncertainties accentuated by century date change effects. According to fragmentary information, inventory investment picked up during the summer months from a very low pace in the second quarter. To some extent, the recent strengthening may have reflected precautionary stockbuilding as insurance against potential supply disruptions relating to the century date change. Such stockbuilding might well intensify during the closing months of the year and be reversed early next year, with effects of uncertain magnitude on overall economic activity in that period. Looking beyond such a swing, business inventories, which currently appeared to be near desired levels in most industries, were projected to grow at a moderate pace broadly in line with the expansion in final sales.

The strengthening of many economies around the world was seen as a harbinger of increasing demand for U.S. exports, a view that was reinforced by growing anecdotal indications of improving foreign markets for a wide range of U.S. products. An aspect of that improvement was more attractive investment opportunities abroad and some associated weakening in the foreign exchange value of the dollar that implied upward pressure on the prices of imports and to an uncertain extent on those of competing domestically produced products. Moreover, some members saw the possibility of a steeper drop in the dollar—under pressure from burgeoning foreign dollar portfolios as a consequence of very large U.S. current account deficits—as an added source of risk to the maintenance of sustainable growth and low inflation in the United States.

In the Committee's discussion of the outlook for inflation, a number of members emphasized that the behavior of prices had remained surprisingly benign for an extended period, confounding earlier forecasts of appreciable acceleration stemming from tight labor markets and rising labor costs. That experience argued forcefully in their view for the need to regard forecasts of increasing inflation with considerable caution. Most members nonetheless continued to view some increase in core price inflation as a definite possibility. This view reflected their expectations that the current expansion, even if it did moderate to a pace approximating the economy's trend potential growth, would do so at a level of resource use that, based on the historical record, exceeded the economy's sustainable capacity—perhaps by even more than at present, given the evident strength of aggregate demand. Such an outcome seemed likely to generate further pressures on unit labor costs, which had tended in recent years to be contained by accelerating productivity. There was no evidence that the acceleration was coming to an end, but the members saw a clear risk that upward pressures on labor costs could at some point outpace gains in productivity. Members also mentioned that labor compensation would come under greater pressures as a result of rising healthcare benefit costs and possible increases in the minimum wage.

Other factors cited as pointing to a less benign inflation performance involved the waning or reversal of a number of temporary influences that had exerted a beneficial effect on prices in recent years. In particular, the decline of the dollar from its recent high in July, especially if it were to continue, would mean higher import prices and reduced price competition for a wide range of domestic goods. In this regard, several members observed that they were hearing noticeably fewer comments by business contacts about their inability to raise prices. Members also noted that, in the context of apparently strengthening economic activity worldwide, non-oil commodity prices seemed poised to turn upward, though they had risen only slightly thus far. While oil prices, which had increased sharply this year, had changed relatively little recently and could move down in the future, secondary effects of the earlier increase on costs and prices in other sectors of the economy seemed likely. Nonetheless, considerable uncertainty surrounded expectations of rising inflation. Labor cost increases had not turned up, and core inflation continued to edge lower. Further improvements in productivity growth could keep price pressures in check for some time.

In the Committee's discussion of policy for the intermeeting period ahead, all the members indicated that they favored or could accept an unchanged policy stance. Members commented that they saw little risk of a surge in inflation over coming months, though some pickup from the currently subdued level of core price inflation was a distinct possibility under prospective economic conditions. It was noted that expanding aggregate supply, boosted by accelerating productivity, had remained in reasonable balance with rapidly growing aggregate demand despite an already high level of economic activity; however, substantial uncertainty surrounded the outlook for aggregate supply and aggregate demand going forward, and it was unclear how their interaction would affect the behavior of inflation. In light of the uncertainties surrounding these developments, the members agreed that it would be desirable to await more evidence on the performance of the economy, and in this regard considerable new information on the behavior of the economy and the outlook for inflation would become available during the intermeeting period. The risks of waiting seemed small at this juncture, in part because inflation and inflation expectations were not likely to worsen substantially in the near term, and the Committee had demonstrated its willingness to take needed anticipatory action to curb rising inflationary pressures that could threaten the overall performance of the economy. They also agreed that century date change concerns were not likely to be of a kind or magnitude that would preclude a policy tightening move at the November meeting, should such an action seem warranted at that time.

On the issue of the tilt in the Committee's directive, a majority of the members favored associating an unchanged policy stance with a directive that was biased toward restraint. These members did not anticipate that intermeeting developments would require policy to be tightened during the weeks immediately ahead, but they believed that the Committee probably would need to move to a less accommodative policy stance in the relatively near future, possibly at the November meeting. They also believed that, given the Committee's recently adopted practice of immediately announcing its decisions to change the symmetry of the directive, an asymmetrical directive would help convey the message that policy adjustments might not yet be completed for the balance of this year and that the Committee remained concerned about potential inflationary developments in coming months. Other members, while generally agreeing that the risks pointed on balance to some rise in inflation over time, nonetheless were quite uncertain about the timing of any additional firming in monetary policy and preferred to leave the Committee's possible future course of action more open. Even so, they could accept an asymmetric directive in light of the consensus that had emerged at this meeting in favor of an unchanged policy stance.

With regard to the Committee's announcement of its decision to adopt an asymmetric directive, members observed that the recent practice of making such announcements had led to some misinterpretations of the Committee's intentions and seemed to have added to volatility in financial markets. As a consequence, Committee members briefly considered alternative treatments of symmetry and disclosure for this meeting. Because the Committee had begun a process for examining the wording of its directive and its announcement policy, most of the members concluded that the most satisfactory alternative for now, though it was not fully satisfactory, was to continue with the Committee's recent announcement practice. However, the working group chaired by Governor Ferguson was requested to expedite its report, if possible.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that the expansion of economic activity was substantial in the quarter just ended. Nonfarm payroll employment increased briskly through August, and the civilian unemployment rate dropped back to 4.2 percent, matching its low for the year. Industrial production was up appreciably further in July and August. Total retail sales posted sizable gains over the two months. Housing construction apparently has slowed somewhat but has remained at a high level. Available indicators suggest that the expansion in business capital spending has continued to be rapid. The nominal deficit on U.S. trade in goods and services widened in July from its average in the second quarter. Inflation has continued at a moderate pace, albeit somewhat above that in 1998 owing to a sharp rebound in energy prices.

Most short-term interest rates have posted small mixed changes since the meeting on August 24, 1999, while longer-term yields have risen somewhat. Most measures of share prices in equity markets have registered sizable declines over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has changed little over the period in relation to the currencies of a broad group of important U.S. trading partners.

M2 and M3 have continued to grow at a moderate pace. For the year through September, M2 is estimated to have increased at a rate somewhat above the Committee's annual range and M3 at a rate just above the upper end of its range. Total domestic nonfinancial debt has continued to expand at a pace somewhat above the middle of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at its meeting in June the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 2000, the Committee agreed on a tentative basis in June to retain the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1999 to the fourth quarter of 2000. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 5¼ percent. In view of the evidence currently available, the Committee believes that prospective developments are more likely to warrant an increase than a decrease in the federal funds rate operating objective during the intermeeting period.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, McTeer, Meyers, Moskow, Kelley, and Stern. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, November 16, 1999.

The meeting adjourned at 1:25 p.m.

Donald L. Kohn
Secretary

Meeting Held on November 16, 1999

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, November 16, 1999, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the Federal Open Market Committee

Mr. Hoenig, Ms. Minehan, and Mr. Poole, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Ms. Johnson, Economist
Mr. Prell, Economist

Ms. Cumming, Messrs. Howard, Hunter, Lang, Lindsey, Rolnick, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Messrs. Ettin and Reinhart, Deputy Directors, Divisions of Research and Statistics and International Finance respectively, Board of Governors

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Whitesell, Assistant Director, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Stewart and Stone, First Vice Presidents, Federal Reserve Banks of New York and Philadelphia respectively

Messrs. Beebe, Eisenbeis, Lacker, Rasche, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, Richmond, St. Louis, and Cleveland respectively

Messrs. Bentley, Fuhrer, and Kahn, Vice Presidents, Federal Reserve Banks of New York, Boston, and Kansas City respectively

Mr. Wynne, Research Officer, Federal Reserve Bank of Dallas

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 5, 1999, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market transactions in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period October 5, 1999, through November 15, 1999. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of recent and prospective economic and financial developments, and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that economic activity continued to expand briskly. The limited data on aggregate demand that had become available since the summer pointed to some moderation in the growth of consumer spending and of business investment in capital equipment and software. Residential construction appeared to have weakened somewhat. However, industrial production was trending up, job growth was still solid, and the unemployment rate had edged down. Despite tight job markets, labor compensation had been rising more slowly than last year. Inflation remained moderate, though at a pace above that in 1998 because of a sharp rebound in energy prices.

A large increase in nonfarm payroll employment in October followed a small rise in September; the average gain for the two months was appreciable but somewhat below the pace of earlier in the year. Job growth rebounded strongly in most employment categories, but further small losses were posted in manufacturing and retail trade. The robust expansion in the demand for workers in October led to a small decline in the civilian unemployment rate, to 4.1 percent, a new low for the year.

Industrial production recorded a strong gain in October after having fallen slightly in September as a result of the adverse effects of Hurricane Floyd. Manufacturing and utilities output advanced strongly in October, while mining activity edged up. The increases in manufacturing were widespread; however, production of transit equipment, particularly aircraft and parts, and farm equipment continued to decline. The utilization of total industrial capacity rebounded in October from the hurricane-related production losses of the previous month but remained somewhat below its long-run average level.

Growth of consumer spending apparently had moderated somewhat further recently, but surveys indicated that consumer confidence continued to be high and personal income rose briskly in the third quarter. Total nominal retail sales changed little in September and October, with purchases at auto dealerships falling in both months and sales at other stores growing less rapidly on balance. Housing activity weakened somewhat over the summer but was still at a high level. Some of the drop in housing starts in September probably was attributable to unusually heavy rains in parts of the South and Northeast. In addition, sales of both new and existing homes declined appreciably in September.

The expansion of business fixed investment picked up sharply in the third quarter, as a marked acceleration in outlays for durable equipment and computer software more than offset a further weakening of nonresidential construction activity. The strength in spending for durable equipment was concentrated in computer hardware and transportation equipment; the latter included medium and heavy trucks, fleet sales of light vehicles, and commercial aircraft. Outlays for computer software and communications equipment also were up appreciably. Trends in orders suggested that the buoyancy in business spending for capital equipment had continued into the fourth quarter. Weakness in nonresidential building activity in the third quarter was widespread, though office construction remained on a solid upward trend.

Business inventory investment in book value terms picked up somewhat in the third quarter, but with sales increasing rapidly stock–sales ratios generally remained quite low. Manufacturers added slightly to their stocks after two quarters of inventory liquidation. However, the buildup of stocks in the third quarter did not keep pace with the rise in shipments, and the sector's stock–shipments ratio was near the bottom of its range over the preceding twelve months. Wholesalers also added to their inventories in the third quarter, and with stockbuilding keeping pace with sales, the inventory–sales ratio for the sector remained in the lower portion of its range over the past year. In the retail sector, the pace of inventory accumulation slowed noticeably in the third quarter, reflecting a runoff of stocks at auto dealerships. Excluding autos, the rate of retail inventory accumulation changed little from that of the second quarter, and with sales rising rapidly the aggregate inventory–sales ratio fell to its lowest quarterly level since 1980.

The deficit in U.S. trade in goods and services widened on balance over July and August from its average for the second quarter. The value of exports picked up considerably over the two months, with gains widely spread across major trade categories. The value of imports surged, with large increases recorded in all the major trade categories except food. The available information indicated that economic expansion in the foreign industrial countries strengthened further in the third quarter. Economic recovery continued in Japan, though there were signs that consumer demand was lagging somewhat. In the euro area, the United Kingdom, and Canada, economic activity appeared to have accelerated in the third quarter. Among the developing countries, economic activity continued to expand in emerging Asia and parts of Latin America.

Consumer prices increased at a slightly faster rate in September, with a further large rise in energy prices a contributing factor. Core consumer inflation also picked up in September, in part because of a sharp jump in tobacco prices. Nonetheless, core consumer prices rose less over the twelve months ended in September than over the preceding twelve-month period. At the producer level, price inflation for finished goods other than food and energy items slowed appreciably in October from the elevated September rate, which had been boosted by the tobacco price increase. For the year ended in October, core producer prices rose appreciably more than in the preceding year. Measured on a year-over-year basis, labor compensation rose more slowly in the year ending in the third quarter than it had in the preceding year. However, the gain in the third quarter was a little larger than the subdued average pace for the first half of the year; the step-up was entirely attributable to larger increases in benefits. Average hourly earnings edged up in October after a large rise in September. For the twelve months ended in October, average hourly earnings decelerated slightly from the previous twelve months.

At its meeting on October 5, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with an unchanged federal funds rate of around 5¼ percent. The members noted that the behavior of prices had continued to be relatively subdued and that the risk of a substantial worsening in inflation and inflation expectations over coming months seemed to be small. Nonetheless, they saw some pickup in inflation as a distinct possibility under anticipated economic conditions and concluded that the directive should indicate that prospective developments were more likely to warrant an increase than a decrease in the funds rate objective in the near term.

Open market operations throughout the intermeeting period were directed toward maintaining the federal funds rate at around 5¼ percent, and the rate averaged close to the Committee's target. On balance, most market interest rates posted small mixed changes over the intermeeting interval. The Committee's announcement of a bias toward tightening surprised many market participants, and interest rates rose somewhat after the meeting. Yields climbed further in response to incoming data on producer prices and retail sales that boosted market concerns about unsustainable growth, higher inflation, and further monetary tightening. Over the second half of the intermeeting period, however, rates largely retraced their increases in reaction to the release of data indicating low wage and consumer price inflation. Most measures of share prices in equity markets registered sizable gains over the intermeeting period, apparently reflecting stronger-than-expected earnings reports and greater optimism about the prospects for continued robust output growth and low inflation.

In foreign exchange markets, the trade-weighted value of the dollar changed little over the period in relation to the currencies of a broad group of important U.S. trading partners. A small appreciation against the currencies of the major foreign industrial countries offset a comparable depreciation in relation to the currencies of other important trading partners. Among the major currencies, the dollar rose against the euro and the pound sterling despite a tightening of European monetary policy in response to the implications for future inflation of indications of a strong pickup in economic activity. The dollar fell further against the yen, whose strength presumably reflected evidence of continued economic recovery in Japan and the prospect of another substantial fiscal stimulus package. The dollar's drop in terms of the currencies of other important trading partners reflected in part optimism about continued recovery in Asian emerging economies as well as signs of renewed political stability in some Latin American and Asian countries.

M2 continued to grow at a moderate rate in October. The recent performance of this aggregate likely was associated, at least in part, with the rise in market interest rates earlier in the year that boosted the opportunity cost of holding liquid balances. The expansion of M3 picked up over September and October, reflecting a strong acceleration in its non-M2 component that was associated with strong inflows to institutional money market funds and stepped-up issuance of large time deposits to meet credit demands. For the year through October, M2 and M3 were estimated to have increased at rates somewhat above their annual ranges for 1999. Total domestic nonfinancial debt continued to expand at a pace somewhat above the middle of its range.

The staff forecast prepared for this meeting suggested that the expansion would moderate gradually to a rate around, or perhaps a little below, the growth of the economy's estimated potential. The expansion of domestic final demand increasingly would be held back by the anticipated waning of positive wealth effects associated with earlier large gains in equity prices; the slower growth of spending on consumer durables, houses, and business equipment and software in the wake of the prolonged buildup in the stocks of these items; and the higher intermediate- and longer-term interest rates that had evolved as markets came to expect that a rise in short-term interest rates would be needed to achieve sustainable, noninflationary growth. The lagged effects of the earlier rise in the foreign exchange value of the dollar were expected to place continuing, though substantially diminishing, restraint on U.S. exports for some period ahead. Core price inflation was projected to rise somewhat over the forecast horizon, partly as a result of the passthrough of higher non-oil import prices and some firming of gains in nominal labor compensation in persistently tight labor markets that would not be fully offset by rising productivity growth.

In the Committee's discussion of current and prospective economic developments, members commented that the statistical and anecdotal information that had become available since the October meeting continued to point to robust growth in overall economic activity, despite some indications of softening in interest-sensitive sectors of the economy. Although productivity developments remained quite favorable, the faster rise in productivity itself apparently had tended to bolster demand more than supply through its effects on equity prices and consumption and on the demand for capital equipment. While real interest rates had increased to some extent to restore balance between supply and demand, they evidently had not risen enough or had not been high for long enough, and growth at an unsustainable pace continued to ratchet up pressures in labor markets. Abstracting from possible temporary fluctuations associated with the upcoming century date change, the members saw few signs of significant slowing in aggregate demand over the next few months. Over a somewhat longer horizon, however, they believed that growth in aggregate demand was likely to moderate to a more sustainable pace that would bring it into closer balance with the expansion in aggregate supply. Key factors cited by the members in support of their expectations of slower growth in overall domestic spending were the lagged and to some extent already evident effects of the rise that had occurred in long-term interest rates, including mortgage rates, and the effects on business and consumer sentiment of a less buoyant stock market, should the latter persist. However, the recent depreciation of the dollar and the ongoing strengthening of many foreign economies would stimulate rising export demand and perhaps substantially reduce the drag exerted on the economy by the foreign trade sector. The members acknowledged that their forecasts were subject to a substantial degree of uncertainty, but the risks on balance were seen as tilted toward growth strong enough to put added pressures on already tight labor markets. Greater pressures on labor resources, should they materialize, would at some point foster larger increases in labor costs, with potentially adverse implications for price inflation over time.

With regard to the prospective performance of key sectors of the economy, forecasts of somewhat slower growth in consumer spending appeared to be supported by recent reports of some moderation in sales of motor vehicles from extraordinarily high levels. Anecdotal reports relating to recent retail sales around the country were mixed, but members indicated that their contacts in the retail industry were uniformly optimistic about the outlook for sales during the holiday season and recent surveys suggested a very high level of consumer confidence. Retail sales might be also augmented during the closing weeks of the year by precautionary purchases related to century date change concerns. Looking ahead, and abstracting from the unwinding in the early part of 2000 of some transitory stockpiling of consumer goods, growth in consumer spending seemed likely to moderate over time. In part, forecasts of a less ebullient consumer sector reflected expectations of reduced demand for household goods associated with a mild downturn in housing activity and the previous slowdown in mortgage refinancings that had lowered household debt-servicing burdens and frequently had made accumulated housing equity available for consumer expenditures. A potentially more important factor in the outlook for consumer spending, however, was the prospect that the wealth effects from sharp earlier increases in the value of stock market holdings would wane in the absence of a new upsurge in stock market prices.

Growth of business spending for equipment and software was expected to moderate in the current quarter, largely in conjunction with what was seen as a temporary slowdown in purchases of computers in the period before the century date change. However, the members saw no significant evidence that the strong uptrend in spending on capital equipment might otherwise be weakening. In contrast to the pattern for business fixed investment, nonfarm inventory investment was projected to rise in the current quarter in connection with a temporary bulge related to the century date change but also to bring lean inventories into better alignment with anticipated sales. Once the perturbations related to the century date change had run their course, inventory growth was expected to return to a more normal pace during 2000.

In the housing market, rising mortgage rates had fostered some declines from recent peaks in starts and sales, and persisting softness in housing activity was anticipated. This expectation tended to be supported by anecdotal reports of moderating homebuilding activity in several parts of the country. Nonetheless, the members cited a number of factors that should tend to sustain overall housing activity at a fairly elevated level. These included continuing though diminishing backlogs of unbuilt homes, rising incomes, and high levels of consumer confidence. In any event, the outlook for housing was subject to considerable uncertainty as reflected in recent surveys that had produced mixed results with regard to the near-term prospects for housing activity.

Members anticipated that the dollar's recent depreciation and the strengthening of foreign economies would foster a significant further pickup in exports. Indeed, available data and anecdotal reports from around the country indicated that foreign demand already had improved markedly for some U.S. products. In these circumstances, domestic demand would need to decelerate considerably for growth to proceed at a sustainable pace.

Concerning the outlook for inflation, members noted that despite the long duration of very tight labor markets across the nation, labor compensation had increased at a slightly lower rate this year while consumer price inflation had remained moderate, albeit above year-earlier levels owing to a sharp rise in energy prices. The deceleration in labor compensation may have been induced in large measure by the low level of consumer price inflation in 1998. In addition, a major factor underlying the persistence of generally subdued price inflation in a period of robust economic expansion was the continued acceleration in productivity, which clearly was holding down increases in unit production costs. The latter contributed to ongoing competitive pressures that severely limited the ability of firms to raise prices, helping to this point to keep inflation at a low level.

The members nonetheless remained concerned about the outlook for inflation. They continued to focus especially on the possibility that the anticipated moderation in the growth of aggregate demand, taking into account the outlook for rising foreign demand for U.S. goods and services, might not be sufficient to avoid added pressures on labor and other resources. To be sure, the economy's potential output appeared to be expanding briskly, with much of the impetus provided by accelerating productivity. Even so, the pool of unemployed workers willing to take a job had continued to be drawn down, and it seemed likely to many members that prospective growth in aggregate demand might generate increasing pressures on the economy's ability to produce goods and services and thus add to inflationary pressures over time. This concern was heightened by the prospect that a number of developments that had tended to contain inflation in the last few years were now reversing. Members mentioned in particular the likelihood that increases in labor compensation might be headed higher in lagged response to the pickup in consumer price inflation this year. Also likely adding to labor cost pressures were relatively large advances in the cost of health care benefits and the possibility of a higher minimum wage. Moreover, the turnaround in energy and import prices could tend to feed through more directly into the prices of U.S.-produced goods by raising costs and reducing competitive pressures to hold down prices. Strengthening demand around the world already seemed to be contributing to higher prices of materials and other nonlabor inputs in the production "pipeline." In general, however, the members anticipated that any pickup in inflation was likely to be gradual, with cost pressures quite possibly continuing to be held largely in check for some time by improving productivity trends. They recognized that forecasts of rising inflation had failed to materialize in recent years, raising questions about their understanding of the empirical specification of the relationships that currently underlie the inflation process. On balance, though, the unsustainable pace of economic expansion along with the reversal of factors that previously had held down overall price increases suggested a significant risk that inflation would strengthen over time given prevailing financial conditions.

Against this background, all the members supported raising the Committee's target for the federal funds rate by 25 basis points at this meeting. Views differed to an extent on the outlook for inflation and policy going forward. However, with tightening resource constraints indicating unsustainable growth, only tentative signs that growth might be slowing, and various factors that had been damping prices now turning around, all the members agreed on the need for a slight tightening at this meeting to raise the odds on containing inflation and forestalling the inflationary imbalances that would undercut the very favorable performance of the economy. This view was reinforced by the prospect that the Committee might not find it desirable to adjust policy at its December meeting when a tightening action could add to the potential financial uncertainties and unsettlement surrounding the century date change. Accordingly, any action might have to wait until the meeting in early February, and the members agreed that the risks of waiting for such an extended period were unacceptably high.

All the members accepted a proposal to adopt a symmetric directive. Such a directive was viewed as consistent with the Committee's current expectation that no further policy move was likely to be considered before the Committee's meeting in February. In the circumstances, a Committee decision to retain the existing asymmetry toward tightening could well send a misleading signal about the probability of near-term action and have an unsettling effect on financial markets at a time when concerns relating to the century date change might be adding to normal year-end pressures. As noted previously, however, views differed to some degree regarding the subsequent outlook for policy. On the basis of currently available information, a number of members indicated that they were quite uncertain about the possible need for further tightening action over coming months to keep inflation within acceptable limits. Continued favorable price and unit cost data, driven in part by improving productivity, suggested that any further action should depend on incoming information about economic activity, pressures on resources, and inflation. Other members, emphasizing the persistently strong growth in economic activity and the unusually high level of labor resource utilization, suggested that additional firming of the stance of policy probably would be necessary to keep inflation in check and hence maintain the favorable backdrop for maximum economic growth. However, in view of the questions surrounding the outlook, the amount of firming already undertaken by the Committee this year including at this meeting and its uncertain effects, and the special situation in financial markets over the year-end, they supported the adoption of a symmetric directive. At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic directive:

The information reviewed at this meeting suggests continued solid expansion of economic activity. Nonfarm payroll employment increased appreciably on average over September and October, and the civilian unemployment rate dropped to 4.1 percent in October, its low for the year. Industrial production recorded a strong gain in October after having been depressed in September by the effects of Hurricane Floyd. Total retail sales were flat in September and October owing to a drop in sales at auto dealers; sales at other stores were fairly robust. Housing activity softened somewhat over the summer but has remained at a high level. Trends in orders suggest that business spending on capital equipment has continued to increase. The July–August deficit in U.S. trade in goods and services was higher than its average in the second quarter, as further growth in imports exceeded the rise in exports. Inflation has continued at a moderate pace, though above that in 1998 owing to a sharp rebound in energy prices. Labor compensation rates have been rising more slowly than last year.

Most market interest rates have posted small mixed changes since the meeting on October 5, 1999. However, measures of share prices in equity markets have registered sizable increases over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has changed little over the period in relation to the currencies of a broad group of important U.S. trading partners. M2 continued to grow at a moderate pace in October while M3 accelerated. For the year through October, M2 and M3 are estimated to have increased at rates somewhat above the Committee's annual ranges for 1999. Total domestic nonfinancial debt has continued to expand at a pace somewhat above the middle of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at its meeting in June the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 2000, the Committee agreed on a tentative basis in June to retain the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1999 to the fourth quarter of 2000. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 5½ percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Kelley, McTeer, Meyers, Moskow, and Stern. Votes against this action: None.

At this meeting, the working group chaired by Mr. Ferguson provided an interim report on its work to date concerning the wording of the Committee's directives, the Committee's announcements after each meeting, and related issues. The members expressed broad agreement with the direction of the working group's tentative recommendations and provided feedback on specific issues and wording. It was contemplated that the Committee would consider the working group's final report at a meeting in the near future.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 21, 1999. The meeting adjourned at 1:40 p.m.

Donald L. Kohn
Secretary

After the meeting, the following press release was issued:

The Federal Open Market Committee today voted to raise its target for the federal funds rate by 25 basis points to 5½ percent. In a related action, the Board of Governors approved a 25 basis point increase in the discount rate to 5 percent.

Although cost pressures appear generally contained, risks to sustainable growth persist. Despite tentative evidence of a slowing in certain interest-sensitive sectors of the economy and of accelerating productivity, the expansion of activity continues in excess of the economy's growth potential. As a consequence, the pool of available workers willing to take jobs has been drawn down further in recent months, a trend that must eventually be contained if inflationary imbalances are to remain in check and economic expansion continue.

Today's increase in the federal funds rate, together with the policy actions in June and August and the firming of conditions more generally in U.S. financial markets over the course of the year, should markedly diminish the risk of inflation going forward. As a consequence, the directive the Federal Open Market Committee adopted is symmetrical with regard to the outlook for policy over the near term.

In taking the discount rate action, the Federal Reserve Board approved requests submitted by the Boards of Directors of the Federal Reserve Banks of Boston, Cleveland, Richmond, and Kansas City. The discount rate is the rate charged depository institutions when they borrow short-term adjustment credit from their District Federal Reserve Banks.

Meeting Held on December 21, 1999

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, December 21, 1999, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Ferguson
Mr. Gramlich
Mr. Kelley
Mr. McTeer
Mr. Meyer
Mr. Moskow
Mr. Stern

Messrs. Broaddus, Guynn, Jordan, and Parry, Alternate Members of the Federal Open Market Committee

Mr. Hoenig, Ms. Minehan, and Mr. Poole, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Ms. Johnson, Economist
Mr. Prell, Economist

Ms. Cumming, Messrs. Howard, Hunter, Lang, Rosenblum, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors

Messrs. Ettin and Reinhart, Deputy Directors, Divisions of Research and Statistics and International Finance respectively, Board of Governors

Messrs. Madigan and Simpson, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Ms. Roseman,[11] Director, Division of Reserve Bank Operations and Payment Systems, Board of Governors

Messrs. Dennis[11] and Whitesell, Assistant Directors, Divisions of Reserve Bank Operations and Payment Systems and Monetary Affairs respectively, Board of Governors

11. Attended portion of meeting relating to the Committee's consideration of the Report of Examination of the System Open Market Account.

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Moore, First Vice President, Federal Reserve Bank of San Francisco

Messrs. Beebe, Eisenbeis, Goodfriend, Hakkio, Rasche, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, Richmond, Kansas City, St. Louis, and Cleveland respectively

Ms. Perelmuter, Messrs. Rosengren and Weber, Vice Presidents, Federal Reserve Banks of New York, Boston, and Minneapolis respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on November 16, 1999, were approved.

The Report of Examination of the System Open Market Account, conducted by the Board's Division of Reserve Bank Operations and Payment Systems as of the close of business on September 10, 1999, was accepted.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period November 16, 1999, through December 20, 1999. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of recent and prospective economic and financial developments, and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested continued strong expansion of economic activity. Consumer demand was particularly robust, and business fixed investment remained on a strong upward trend. Housing activity was still at an elevated level despite some recent slippage. As a consequence, manufacturing production had increased briskly in recent months, and nonfarm payrolls continued to rise rapidly. Despite very tight labor markets, labor compensation had been climbing more slowly than last year. Aggregate price increases had been smaller in recent months, reflecting a flattening in energy prices after a rapid run-up.

Nonfarm payroll employment rose substantially further in October and November. Job growth in the services industry remained rapid in the two months, construction hiring continued buoyant against a backdrop of project backlogs and unseasonably warm weather, and the pace of job losses in manufacturing slowed further. The civilian unemployment rate fell to 4.1 percent in October, its low for the year, and remained at that level in November.

Industrial production continued to advance briskly in the October–November period, reflecting sizable gains in manufacturing and mining output. Within manufacturing, the production of consumer goods, construction supplies, and materials was up substantially. The further advance in manufacturing production in the two months boosted the factory operating rate, but capacity utilization in manufacturing in November was still a little below its long-term average.

Total nominal retail sales rose appreciably in the first two months of the fourth quarter. Sales gains were widespread, but purchases of durable goods, especially light vehicles, were particularly strong. Anecdotal reports suggested that growth in consumer outlays was remaining brisk in December.

Housing activity, though somewhat softer in recent months, continued at a high level. Total private housing starts slipped in November after having held steady in October. In addition, sales of new homes in the September–October period (latest data) were a little below the pace recorded in the spring and early summer months, and existing home sales registered a fourth consecutive decline in October.

The available information on orders and shipments suggested some slowing in the very rapid growth of business spending for capital equipment. Shipments of nondefense capital equipment recovered only partially in October from a large September decline. Much of the pickup reflected a surge in shipments of computers and related equipment in October after a plunge in the preceding two months. Trends in orders suggested that business spending on capital equipment, notably for high-tech and transportation equipment, probably had increased further over the balance of the fourth quarter. Outlays and contracts for nonresidential construction slowed further in October. The pace of office construction was close to its third-quarter average; spending for industrial buildings continued to drop, and outlays for commercial structures were unchanged from their low September level.

Business inventory investment slowed in October from the third-quarter pace, primarily reflecting a sizable liquidation of stocks at automotive dealerships. Stockbuilding among manufacturers stepped up slightly in October, but the stock–sales ratio for the sector was near the bottom of its range for the last twelve months. At the wholesale level, inventory accumulation slowed noticeably and the inventory–sales ratio for this sector also was near the bottom of its range for the last twelve months. Total retail stocks changed little on balance in October because of the sharp runoff at automotive dealerships. The inventory–sales ratio for the retail sector as a whole was at the bottom of its range for the last year.

The U.S. deficit on trade in goods and services widened somewhat in October from its average for the third quarter. The value of exports edged up in October from its third-quarter level but the value of imports rose appreciably more, with much of the increase reflecting greater imports of consumer goods and machinery. The available information suggested that economic expansion in the euro area, the United Kingdom, and Canada picked up sharply in the third quarter. In contrast, economic activity declined in Japan during the third quarter after a surge in the first half of the year. Among the developing countries, economic activity continued to expand in emerging Asia and parts of Latin America.

Inflation had remained subdued in recent months. Consumer price inflation edged down in October and November as energy prices steadied after having increased rapidly earlier in the year. Moreover, excluding the volatile food and energy components, consumer prices rose slightly less in the twelve months ended in November than in the previous twelve-month period. At the producer level, prices of finished goods other than food and energy were unchanged in November after a moderate increase in October. For the year ended in November, core producer prices rose somewhat more than in the preceding year. However, producer prices at earlier stages of processing continued to register increases somewhat larger than those for finished goods. With regard to labor costs, the rise in compensation per hour in the nonfarm business sector over the four quarters ending in September was down considerably from the advance in the preceding four-quarter period. In addition, average hourly earnings rose moderately in the October–November period and in the twelve months ended in November.

At its meeting on November 16, the Committee adopted a directive that called for a slight tightening of conditions in reserve markets consistent with an increase of ¼ percentage point in the federal funds rate to an average of around 5½ percent. The members noted that the slight tightening would enhance the chances for containing inflation and forestalling the emergence of inflationary imbalances that could undermine the economy's highly favorable performance. The members also agreed on a symmetric directive. The special situation in financial markets over the year-end, along with uncertainty about the economy's response to the firming already undertaken in 1999, suggested that the Committee would want to assess further developments through early next year before considering additional policy action.

Open market operations during the intermeeting period were directed toward implementing the desired slightly greater pressure on reserve positions, and the federal funds rate averaged close to the Committee's 5½ percent target. However, with the economic expansion still quite strong and in the context of the expression of concern about the inflationary implications of unsustainably fast growth in the Committee's announcement of its decision at the November meeting, incoming economic data were viewed by market participants as increasing, on balance, the chances of further monetary tightening in 2000. As a result, most market interest rates rose somewhat in the period after the November 16 meeting. Despite the appreciable increase in Treasury bond yields, most broad stock market indexes advanced further during the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar changed little over the period in relation to the currencies of a broad group of important U.S. trading partners. The dollar appreciated against the euro and the Canadian dollar, but those movements were largely counterbalanced by declines against the Japanese yen and the currencies of other important trading partners.

M2 continued to grow at a moderate rate in November despite strong currency demand that likely was associated with a combination of robust holiday spending and precautionary stockpiling for the century rollover. Higher opportunity costs and currency demand apparently damped growth in holdings of liquid deposits. By contrast, M3 surged in November, reflecting heavy issuance of large time deposits to fund increases in bank credit and vault cash and large inflows to institution-only money market funds. For the year through November, M2 and M3 were estimated to have increased at rates somewhat above the Committee's annual ranges for 1999. Total domestic nonfinancial debt continued to expand at a pace in the upper portion of its range.

The staff forecast prepared for this meeting suggested that the expansion would gradually moderate from its currently elevated pace to a rate around or perhaps a little below the growth of the economy's estimated potential. The expansion of domestic final demand increasingly would be held back by the anticipated waning of positive wealth effects associated with large earlier gains in equity prices, the slower growth of spending on consumer durables, houses, and business equipment and software in the wake of the prolonged buildup in the stocks of these items, and the higher intermediate- and longer-term interest rates that had evolved as markets came to expect that a rise in short-term interest rates would be needed to achieve sustainable, noninflationary growth. However, continued solid economic expansion abroad was expected to boost the growth of U.S. exports for some period ahead. Core price inflation was projected to rise somewhat over the forecast horizon, partly as a result of higher non-oil import prices and some firming of gains in nominal labor compensation in persistently tight labor markets that would increasingly outpace even continued rapid productivity growth.

In the Committee's discussion of current and prospective economic developments, members commented that the most recent statistical and anecdotal information provided further evidence of persisting strength in the expansion and of relatively subdued wage and price inflation. The economy clearly would carry substantial expansionary momentum into the new year, quite possibly in excess of growth in the economy's long-run potential, and the key issue for the Committee was whether growth in aggregate demand would slow to a more sustainable pace without further tightening in the stance of monetary policy. Members noted in this regard that evidence of a slowdown in the expansion was quite marginal at this point and seemed to be limited largely to some softening in housing activity. Looking beyond the near term, members continued to anticipate some moderation in the growth of domestic demand, though the extent of the moderation remained subject to a wide range of uncertainty related in part to the difficulty of anticipating trends in stock market prices and their effects on business and consumer sentiment and spending. Members also noted that prospective slowing in domestic demand was likely to be offset, at least to some extent, by further growth in exports should foreign economies as a group continue to strengthen as many forecasters anticipated.

Uncertainties about the level and growth of potential output and the dynamics of the inflation process made it difficult to relate with confidence projections of demand and activity to prospects for inflation. Members observed that they saw no indications that the impressive gains in productivity might be moderating, and, indeed, the most recent data suggested some further acceleration. Moreover, persistent disparities between the household and establishment series on employment growth might be reconciled by higher immigration than previously estimated, further boosting potential growth. Nonetheless, the increase in aggregate demand had been exceeding even the now-higher sustainable rate of growth in aggregate supply, as indicated by declines in the pool of available but unemployed workers to a very low level and by the rise in imports. This difference between the growth of demand and potential supply could well persist unless demand moderated. Absent a possible moderation, an upturn in unit labor costs was seen as a likely possibility, with eventual adverse implications for price inflation. Inflation pressures might also be augmented over time by a number of special factors such as the rise in energy prices, the effects on import prices of the dollar's depreciation and strengthening foreign economies, and faster increases in medical costs. While several of these factors implied limited price level adjustments, they could become embedded to a degree in ongoing inflation through their effects on wage increases and inflation expectations. Over the nearer term, however, subdued inflation expectations were likely to damp any incipient uptrend in the rate of price inflation.

In their review of economic conditions across the nation, several members noted that high levels of business activity were severely taxing available labor resources and appeared to be constraining growth in a number of industries and parts of the country. Rising employment and incomes, along with the advance in stock market prices to new highs in recent weeks, were fostering elevated levels of consumer confidence and would be supporting consumer spending going forward. Anecdotal reports pointed to notably brisk retail sales during the current holiday season in many parts of the country. Sales of new automobiles had rebounded recently after moderating somewhat from an exceptionally rapid pace earlier. While recent developments provided little basis for anticipating slower growth in consumer spending, members commented that such spending could be vulnerable to adverse developments in the stock market and the attendant effects on consumer wealth and confidence; and spending for household durables could be damped by the anticipated softness in housing activity.

The capital goods markets also displayed very little evidence of any weakening. They continued to be characterized by disproportionately large investments in high-tech business equipment, although demand for more conventional equipment, apart from farm equipment, also was relatively robust. Assessments of the outlook for overall business capital investment pointed to further rapid growth led by outlays for equipment. Business spending on construction was expected to change little on the whole, with strength in some sectors, such as warehouse facilities, offset by softness in sectors such as industrial structures and office buildings. Some members noted, however, that public works projects would help to support overall construction activity.

Recent data along with anecdotal reports indicated some loss of vigor in the nation's housing markets, though overall activity was still at a high level. The recent pace of homebuilding was somewhat uneven, with relative strength in some areas supported by seasonally favorable weather conditions or large backlogs. Rising mortgage rates were cited as a key factor underlying the limited moderation in residential construction, but other factors included the scarcity of skilled construction workers, with some diverted to nonresidential construction projects, and indications of overbuilding in some areas. Looking ahead, the members anticipated that further growth in incomes and the ready availability financing for most homebuyers would sustain overall housing activity at a relatively high level.

Forecasts indicated that while real net exports would continue to decline over the next several quarters, the rate of decline would moderate substantially. The solid further expansion expected in many foreign economies, the slower growth of domestic demand in the United States, and the effects of the slippage of the foreign exchange value of the dollar on the relative prices of U.S. goods and services were all seen as contributing to this outcome. In the course of their comments, members cited a number of examples of already-improved export markets for a variety of U.S. products. While expanding foreign demand for U.S. goods and services was a welcome development from the perspective of numerous business firms, such demand might add to pressures on U.S. resources with potentially inflationary implications, depending on the extent to which the growth in domestic demand would slow going forward. Several members indicated their concern about the burgeoning current account deficit and the potential that it could lead to a considerable weakening of the dollar at some point, which would tend to add to upward pressure on prices and demand.

In their comments regarding the outlook for inflation, a number of members expressed concern that the anticipated moderation in overall demand might not be large enough or soon enough to forestall added pressures on already-taut labor markets. Although wage growth had remained moderate to date and unit labor costs damped, at some point tightening labor markets would begin to generate wage gains increasingly in excess of productivity gains. Indeed, a few members were concerned that unit labor costs could begin to accelerate even at existing labor utilization levels. In addition, some of the forces that had been restraining inflation—declining oil, import, and commodity prices, and subdued increases in the costs of health care—had already reversed. Even so, resulting acceleration in price inflation might be held down and possibly averted for a time by the economy's buoyant upward trend in productivity, which could support profit margins and help maintain the highly competitive conditions in many markets that made it difficult or impossible for most business firms to raise their prices. In addition, there had been no evidence of any erosion in the widespread expectation that inflation would remain subdued over the long run.

In the Committee's discussion of policy for the period immediately ahead, all the members endorsed a proposal to maintain an unchanged policy stance consistent with a target for the federal funds rate centering on 5½ percent. The members agreed that the Committee's primary near-term objective was to foster steady conditions in financial markets during the period of the century date change and to avoid any action that might erode the markets' confidence that the Federal Reserve was fully prepared to provide whatever liquidity would be needed in this period. The members generally agreed that, if necessary, their concerns about rising inflation could be addressed at the meeting in early February. They saw little risk of a significant acceleration in inflation over the near term, given recent price trends and the absence of indications that inflationary expectations might be deteriorating, and thus little cost in deferring consideration of a policy tightening action. Moreover, the Committee would be in a better position by early February to assess the delayed effects of its earlier tightening actions.

On the issue of the intermeeting tilt in the Committee's directive, most of the members expressed a preference for retaining the symmetry adopted at the November meeting. While a preemptive tightening move might be warranted in the not-too-distant future to help contain inflationary pressures in the economy, these members believed that a symmetrical directive would best convey the message that no tightening action was contemplated for the weeks immediately ahead. Such a directive would therefore be more consistent with their desire to avoid any misinterpretations of their policy intentions that might unsettle financial markets during the sensitive century-date-change period. In this view, longer-run concerns about rising inflation could be addressed in the press statement that would be issued after this meeting. A few members indicated a marginal preference for an asymmetric directive that focused on the possibility of an eventual rise in interest rates. In their view, an asymmetric directive would be more consistent with the consensus among the Committee members regarding the most likely course of monetary policy over the next few meetings and the use of the bias statement that had come to encompass this longer horizon and was understood as such by financial market participants and the public. Moreover, such a directive was widely anticipated in financial markets and hence would incur little risk in their view of a market disturbance in the weeks immediately ahead. However, they could readily accept a symmetrical directive in light of the contemplated press announcement.

At the conclusion of this discussion, the members voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic directive:

The information reviewed at this meeting suggests continued strong expansion of economic activity. Nonfarm payroll employment increased substantially further in October and November, and the civilian unemployment rate stayed at 4.1 percent in November, its low for the year. Manufacturing output recorded sizable gains in October and November. Total retail sales rose appreciably over the two months. Housing activity has softened somewhat over recent months but has remained at a high level. Trends in orders suggest that business spending on capital equipment has increased further. The U.S. nominal trade deficit in goods and services rose in October from its average in the third quarter. Aggregate price increases have been smaller in the past two months, reflecting a flattening in energy prices; labor compensation rates have been rising more slowly than last year.

Most market interest rates are up somewhat since the meeting on November 16, 1999. Measures of share prices in equity markets have risen further over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar has changed little over the period in relation to the currencies of a broad group of important U.S. trading partners.

M2 continued to grow at a moderate pace in November while M3 surged. For the year through November, M2 and M3 are estimated to have increased at rates somewhat above the Committee's annual ranges for 1999. Total domestic nonfinancial debt has expanded at a pace in the upper end of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at its meeting in June the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1998 to the fourth quarter of 1999. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 2000, the Committee agreed on a tentative basis in June to retain the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1999 to the fourth quarter of 2000. 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.

To promote the Committee's long-run objectives of price stability and sustainable economic growth, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 5½ percent. In view of the evidence currently available, the Committee believes that prospective developments are equally likely to warrant an increase or a decrease in the federal funds rate operating objective during the intermeeting period.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Ferguson, Gramlich, Kelley, McTeer, Meyer, Moskow, and Stern. Votes against this action: None.

Disclosure Policy

The members of the Committee agreed at this meeting to adopt a number of proposals offered by the Working Group on the Directive and Disclosure Policy chaired by Mr. Ferguson, effective with the first meeting in 2000. One proposal was to issue a press statement after every meeting even when the Committee decided to maintain its existing policy stance and did not change its view of future developments in a major way.

Another proposal was to change the way the Committee characterizes its view of future developments. A few members wanted to retain the current focus on the possible future stance of policy because they thought that the Committee would more readily be able to reach agreement on the likelihood of future actions than on the potential reasons such actions might be considered. The consensus opinion, however, was to replace the Committee's judgment about the likelihood of an increase or decrease in the intended federal funds rate with a description of the Committee's perception of the risks in the foreseeable future to the attainment of its long-run goals of price stability and sustainable economic growth. Although the Committee would vote on this assessment of the risks together with its policy stance, the Committee would no longer include its view of future developments in the domestic policy directive to the Federal Reserve Bank of New York, because the new wording did not refer to an operational matter. The Committee's new directive would contain only a general statement of its policy objectives, its specific operating instructions for the intermeeting period, and in February and July a paragraph on the yearly money and debt ranges. To inform the public about these decisions, the members agreed that an explanatory press release should be issued before the February meeting.

The Committee also accepted a proposal to codify current practice regarding policy moves in the intermeeting period by amending the Authorization for Domestic Open Market Operations in February. The amendment was made necessary by the change in the language of the directive. Intermeeting moves, authorized by the Chairman, would remain possible but, as in recent years, would be made only in exceptional circumstances. One member expressed reservations about the proposed amendment, questioning its need in light of the instruments already in place to deal with liquidity emergencies and its appropriateness because it could potentially allow policy moves to be made, however rarely, without necessarily drawing on the benefits of full Committee participation. The other members, however, noted that the practices in place had worked well over the years, proving themselves a useful adjunct to the regular Committee decision-making process; that the new language would maintain those practices, clarifying that latitude to change policy was to be exercised against the background of the Committee's previous discussions and only in unusual circumstances; and that, if necessary, adjustments to the Authorization could be made in the future.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, February 1–2, 2000.

The meeting adjourned at 1:30 p.m.

Donald L. Kohn
Secretary

Litigation

During 1999, the Board of Governors was a party in ten lawsuits or appeals filed that year and was a party in fourteen other cases pending from previous years, for a total of twenty-four cases; in 1998, the Board had been a party in a total of thirty-three cases. One of the lawsuits or appeals filed in 1999 raised questions under the Bank Holding Company Act. As of December 31, 1999, twelve cases were pending.

Judicial Review of Board Orders under the Bank Holding Company Act

Irontown Housing Corp. v. Board of Governors, No. 99–9549 (10th Circuit, filed December 27, 1999), is a petition for review of a Board order dated December 13, 1999, approving the merger of First Security Corporation and Zions Bancorporation, both of Salt Lake City, Utah (86 *Federal Reserve Bulletin* 122).

In *Independent Community Bankers of America v. Board of Governors*, No. 98–1482 (D.C. Circuit, filed October 21, 1998), petitioners sought review of a Board order dated September 23, 1998, conditionally approving the application of Travelers Group, Inc., New York, New York, to become a bank holding company by acquiring Citicorp, New York, New York, and its bank and nonbank subsidiaries (84 *Federal Reserve Bulletin* 985). On November 2, 1999, the court affirmed the Board's order (195 F.3d 28).

Attorneys Against American Apartheid v. Board of Governors, No. 98–1483 (D.C. Circuit, filed October 21, 1998), was a petition for review of a Board order dated August 17, 1998, approving the application by NationsBank Corporation, Charlotte, North Carolina, to merge with BankAmerica Corporation, San Francisco, California (84 *Federal Reserve Bulletin* 858). The court dismissed the petition on January 19, 1999.

Litigation under the Financial Institutions Supervisory Act

In *Board of Governors v. Carrasco*, No. 98–3474 (S.D. New York, filed May 15, 1998), the Board sought to freeze the assets of an individual pending the administrative adjudication of an action by the Board requiring restitution by the individual. On May 26, 1998, the district court granted the Board's request for a preliminary injunction. Following entry of the Board's order requiring restitution, 85 *Federal Reserve Bulletin* 142 (1998), the court granted the Board's motion for judgment in the asset freeze action and authorized a judicial sale of the seized property.

In *Board of Governors v. Pharaon*, Nos. 98–6101 and 98–6121 (2nd Circuit, filed May 4 and May 22, 1998), both parties appealed an order of the U.S. District Court for the Southern District of New York (No. 91–6250, March 18, 1998) granting in part and denying in part the Board's motion for partial summary judgment in an action to freeze the assets of an individual pending adjudication of a civil money penalty assessment by the Board. On February 24, 1999, the court of appeals affirmed the district court's grant of a

10 percent surcharge on an unpaid civil money penalty and reversed the district court to the extent it denied the Board prejudgment interest on that penalty. 169 F.3d 110. The case is pending before the district court.

In *Banking Consultants of America v. Board of Governors*, No. 98–5354 (6th Circuit, filed March 10, 1998), plaintiffs appealed an order of the U.S. District Court for the Western District of Tennessee (No. 97–2791, January 23, 1998) dismissing their action to enjoin an investigation by the Board, the Office of the Comptroller of the Currency, and the Department of Labor. The appeal was voluntarily dismissed on November 10, 1999.

Towe v. Board of Governors, No. 97–71143 (9th Circuit, filed September 15, 1997), was a petition for review of a Board order dated August 18, 1997 (83 *Federal Reserve Bulletin* 849), prohibiting Edward Towe and Thomas E. Towe from further participation in the banking industry. On February 23, 1999, the court affirmed the Board's order. 1999 U.S. App. LEXIS 3078.

Other Actions

Wasserman v. Board of Governors, No. 99–6290 (2nd Circuit, filed October 27, 1999), is an appeal by plaintiff of the denial of various post-dismissal motions following the voluntary dismissal of the plaintiff's action in the United States District Court for the Southern District of New York (No. 98–CIV–6017).

Artis v. Greenspan, No. 1:99CV02073 (EGS) (D. District of Columbia, filed August 3, 1999), is an employment discrimination action.

Sheriff Gerry Ali v. U.S. State Department, No. 99–7438 (C.D. California, filed July 21, 1999), is an action relating to impounded bank drafts.

Kerr v. Department of the Treasury, No. 99–16263 (9th Circuit, filed April 28, 1999), is an appeal of the district court's dismissal of an action challenging income taxation and Federal Reserve notes.

Sedgwick v. Board of Governors, No. Civ 99 0701 (D. Arizona, filed April 14, 1999), is an action under the Federal Tort Claims Act alleging violation of bank supervision requirements.

Gadson v. Federal Reserve Bank, No. 99–0866 (N.D. Georgia, filed April 2, 1999), was dismissed as frivolous on May 14, 1999. On December 21, 1999, the Eleventh Circuit Court of Appeals affirmed the dismissal (No. 99–11608).

Folstad v. Board of Governors, No. 1:99 CV 124 (W.D. Michigan, filed February 17, 1999), was an action under the Freedom of Information Act. On November 16, 1999, the district court granted the Board's motion for summary judgment and dismissed the action. 1999 U.S. Dist. LEXIS 17852.

Hummingbird v. Greenspan et al., No. 99–D–319 (D. Colorado, filed February 13, 1999), was a suit involving a federal tax lien. The case was dismissed on March 1, 1999.

Nelson v. Greenspan, No. 1:99CV00215 (EGS) (D. District of Columbia, filed January 28, 1999), is an employment discrimination complaint.

In *Fraternal Order of Police v. Board of Governors*, No. 98–3116 (D. District of Columbia, filed December 22, 1998), plaintiff seeks a declaratory judgment regarding the Board's labor relations policy.

Hunter v. Board of Governors, No. 1:98CV02994 (TFH) (D. District of Columbia, filed December 9, 1998), is an action under the Freedom of Information Act, the Privacy Act, and the First Amendment.

In *Inner City Press/Community on*

the Move v. Board of Governors, No. 98–4608 (2nd Circuit, filed December 3, 1998), plaintiff appealed an order of the U.S. District Court for the Southern District of New York (No. 98–4608, September 30, 1998) granting the Board's motion for summary judgment on plaintiff's Freedom of Information Act complaint. On June 23, 1999, the court of appeals affirmed the district court's dismissal. 1999 U.S. App. LEXIS 3078.

Goldman v. Department of the Treasury, No. 98–9451 (11th Circuit, filed November 10, 1998), was an appeal from an order of the U.S. District Court for the Northern District of Georgia (No. 1–97–CV–3798, November 2, 1998) dismissing an action challenging Federal Reserve notes as lawful money. The district court's judgment was affirmed on August 9, 1999.

Clarkson v. Greenspan, No. 98–5349 (D.C. Circuit, filed July 29, 1998), was an appeal of a district court order granting the Board's motion for summary judgment on plaintiff's Freedom of Information Act complaint. The court of appeals affirmed the district court's order on March 2, 1999.

Fenili v. Davidson, No. C–98–01568CW (N.D. California, filed April 17, 1998), was a case claiming tort and constitutional violations arising out of the return of a check. The case was dismissed on September 29, 1999.

Logan v. Greenspan, No. 98–0049 (D. District of Columbia, filed January 9, 1998), was an employment discrimination action. On September 29, 1999, the case was dismissed without prejudice.

Bettersworth v. Board of Governors, No. 97–CA–624 (W.D. Texas, filed August 21, 1997), is a complaint under the Privacy Act. ■