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 such 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 activities, 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 1996. Changes in the instruments during the year are reported in the records for the individual meetings.

Authorization for Domestic Open Market Operations

In Effect January 1, 1996

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 $8.0 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) When appropriate, to buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers acceptances held at any one time shall not exceed $100 million;

(c) 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, and prime bankers acceptances of the types authorized for purchase under 1(b) above, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 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; and provided further that in the event bankers acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

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 15 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(c), 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, 1996[1]

The information reviewed at this meeting suggests a substantial slowing in the expansion of economic activity after a strong gain in the third quarter. Nonfarm payroll employment increased further in November, but the civilian unemployment rate edged up to 5.6 percent. Industrial production was little changed on average over October and November after a moderate rise in the third quarter. Total nominal retail sales rose somewhat on balance over October and November. Housing starts were down in October after a large increase in the third quarter. However, orders for nondefense capital goods point to substantial expansion of spending on business equipment in the near term, and nonresidential construction has risen appreciably further. Wage trends have been stable and consumer prices have risen relatively slowly on average in recent months.

Most market interest rates have declined slightly since the Committee meeting on November 15. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen slightly on balance over the intermeeting period.

The substantial moderation in the growth of M2 and M3 since midsummer continued in November; however, for the year through November, M2 expanded at a rate in the upper half of its range for 1995 and M3 grew at a rate at the upper end of its range. Growth in total domestic nonfinancial debt has slowed somewhat in recent months but for the year to date remains around the midpoint of its monitoring 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 July reaffirmed the range it had established on January 31–February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

1. Adopted by the Committee at its meeting on December 19, 1995.

Authorization for Foreign Currency Operations

In Effect January 1, 1996

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

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	
Regular	3,000
Special	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 insofar as practicable, considering needs for minimum working balances. Such investments shall be in liquid form, and generally have no more than 12 months remaining to maturity. 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, 1996

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, 1996

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 clearance 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 January 30–31, 1996

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., starting on Tuesday, January 30, 1996, at 2:30 p.m. and continuing on Wednesday, January 31, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Ms. Phillips

Mr. Stern
Ms. Yellen

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

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

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Rosine,[2] Senior Economist, Division of Research and Statistics, Board of Governors
Mr. Reid,[2] Economist, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

2. Attended portions of meeting relating to the Committee's review of the economic outlook and establishment of its monetary and debt ranges for 1996.

Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Richmond, and Chicago respectively
Mses. Krieger and Rosenbaum, Vice Presidents, Federal Reserve Banks of New York and Atlanta 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, 1996, and ending December 31, 1996, had been received and that the named 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, with Ernest T. Patrikis, First Vice President of the Federal Reserve Bank of New York, as alternate;
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;
Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, with Michael H. Moskow, President of the Federal Reserve Bank of Chicago, as alternate;
Robert D. McTeer, 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, 1996, 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
Joseph R. Coyne	Assistant Secretary
Gary P. Gillum	Assistant Secretary
J. Virgil Mattingly, Jr.	General Counsel
Thomas C. Baxter, Jr.	Deputy General Counsel
Michael J. Prell	Economist
Edwin M. Truman	Economist

Richard W. Lang, David E. Lindsey, Frederic S. Mishkin, Larry J. Promisel, Arthur J. Rolnick, Harvey Rosenblum, Charles J. Siegman, Thomas D. Simpson, Mark S. Sniderman, 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, 1996.

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.

By unanimous vote, the Authorization for Domestic Open Market Operations shown below was reaffirmed.

Authorization for Domestic Open Market Operations

Reaffirmed January 30, 1996

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 $8.0 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) When appropriate, to buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers acceptances held at any one time shall not exceed $100 million;

(c) 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, and prime bankers acceptances of the types authorized for purchase under l(b) above, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 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; and provided further that in the event bankers acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

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 l(a) under agreements providing for the resale by such accounts of those securities within 15 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 l(c), 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.

By unanimous vote, the Authorization for Foreign Currency Operations shown below was reaffirmed.

Authorization for Foreign Currency Operations

Reaffirmed January 30, 1996

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
Pounds sterling	Norwegian kroner
French francs	Swedish kronor
German marks	Swiss francs

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)	Foreign bank	Amount (millions of dollar equivalent)
Austrian National Bank	250	Bank of Mexico	3,000[1]
National Bank of Belgium	1,000	Netherlands Bank	500
Bank of Canada	2,000	Bank of Norway	250
National Bank of Denmark	250	Bank of Sweden	300
Bank of England	3,000	Swiss National Bank	4,000
Bank of France	2,000	Bank for International Settlements:	
German Federal Bank	6,00	Dollars against Swiss francs	600
Bank of Italy	3,000	Dollars against authorized European currencies other than Swiss francs	
Bank of Japan	5,000		1,250

1. The additional temporary $3 billion swap arrangement with the Bank of Mexico, approved by the Committee on February 1, 1995, was allowed to lapse on January 31, 1996, in line with its original terms. See minutes of the FOMC meeting of December 19, 1995.

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 insofar as practicable, considering needs for minimum working balances. Such investments shall be in liquid form, and generally have no more than 12 months remaining to maturity. 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.

By unanimous vote, the Foreign Currency Directive shown below was reaffirmed.

Foreign Currency Directive

Reaffirmed January 30, 1996

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.

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 January 30, 1996

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.

Agreement to "Warehouse" Foreign Currencies

At its meeting on January 31–February 1, 1995, the Committee had approved an increase from $5 billion to $20 billion in the amount of eligible foreign currencies that the System was prepared to "warehouse" for the Treasury and the Exchange Stabilization Fund (ESF). The purpose of the warehousing facility, which has been in place for many years, is to supplement the U.S. dollar resources of the Treasury and the ESF for financing purchases of foreign currencies and related international operations. The enlargement of the warehousing agreement was intended to facilitate U.S. participation in the Multilateral Program to Restore Financial Stability in Mexico, announced by President Clinton on January 31, 1995, by warehousing up to $20 billion in German marks and Japanese yen held by the Treasury through the ESF. The Committee had agreed that it would review each year the need to maintain this level of warehousing authority in light of the progress and requirements of the program.

The Treasury and the Exchange Stabilization Fund had made no use of the warehousing facility over the past year. Nevertheless, consistent with Federal Reserve support for the program of assistance to Mexico, the members agreed that it was appropriate to postpone consideration of an adjustment in the overall size of the facility at least until the end of the disbursement phase of the Mexican program currently scheduled for August 1996. Accordingly, the Committee reaffirmed the warehousing authority by unanimous vote.

By unanimous vote, the Program for Security of FOMC Information was amended to conform it to the treatment of transcripts of FOMC meetings and the procedures that the Committee had been following for some time in regard to redactions of confidential information in transcripts and other documents that are released to the public after five years. In addition, the Committee agreed to amend the program so that the automatic extension of Federal Reserve staff access to confidential material after six months could be suspended for certain particularly sensitive documents.

On January 23, 1996, the continuing rules, resolutions, and other instruments 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 January 30–31 organization 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 such consideration were received.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 19, 1995, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. He indicated that the swap line drawing by the Bank of Mexico had been repaid in full on January 29, 1996. The Committee ratified that transaction by unanimous vote.

The Manager also reported on recent developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period December 19, 1995, through January 30, 1996. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 1996, 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.

Only a limited amount of new information was available for this meeting because of delays in government releases; that which was available, along with anecdotal commentary, suggested that the economy had been growing relatively slowly in recent months. Consumer spending had expanded modestly on balance, growth in business investment in capital goods appeared to have slackened somewhat recently, and housing demand seemed to have leveled out. Slower growth in final sales was leading to inventory buildups in a few industries, and these buildups, together with the disruptions from government shutdowns and severe weather, were having a restraining effect on economic activity. The demand for labor was still growing at a moderate pace, though, and the unemployment rate remained relatively low. The recent data on prices and wages had been mixed, but there was no firm evidence of a change in underlying inflation trends.

Nonfarm payroll employment continued to expand moderately in December; the gain was in line with the average monthly increase for 1995. Employment in manufacturing, boosted by the settlement of a strike at a major aircraft manufacturer, reversed the declines of October and November. Construction payrolls rose further in December, despite unfavorable weather in some parts of the country. Job growth remained solid in much of the services industry, although employment at personnel supply firms was little changed. The civilian unemployment rate remained at 5.6 percent in December.

Industrial production edged up in December and for the fourth quarter as a whole advanced only slightly; industrial activity remained sluggish in January according to the limited statistical information that was available. In December, manufacturing output rose a bit in association with an increase in motor vehicle assemblies and aircraft production. Elsewhere in manufacturing, the growth of output of office and computing equipment slowed somewhat from the rapid pace of previous months, and the production of defense and space equipment and of nondurable consumer goods registered sizable declines. The output of utilities was boosted somewhat in December by the effect of colder-than-average temperatures on the demand for heating services. Utilization of total industrial capacity fell slightly but remained at a moderately elevated level.

Retail sales continued to grow at a relatively modest rate in December, and the fourth-quarter increase was considerably smaller than those of the previous two quarters. In the fourth quarter, lower spending at general merchandisers offset much of the sales gains registered at automotive dealerships, furniture and appliance stores, and building and supply outlets. Consumer surveys indicated some deterioration in consumer confidence in January. Recent indicators of housing demand and activity were mixed. Sales of new homes edged still lower in November (latest data available), and sales of existing homes declined by a larger amount in December than in November. However, housing starts rebounded in November from a sizable October decline, and conditions in mortgage markets remained quite favorable, led by a further decline in rates.

The sparse statistical data available on business fixed investment, along with anecdotal information, suggested a moderation recently in the expansion of business spending on capital goods, including some slowing of investment in computers. Investment in transportation equipment, however, apparently had held up well in the fourth quarter. Incoming data on construction contracts pointed to some slowing in the growth of nonresidential building activity from a relatively brisk pace during most of 1995.

The information available on business inventories suggested that inventory imbalances might have emerged in a few sectors in association with weaker-than-expected sales. Motor vehicle inventories were at elevated levels compared with sales in late 1995, and manufacturers responded by offering incentive packages on new cars and trucks and by adjusting downward their January production schedules. Data on manufacturing and retail trade inventories for November had been delayed, but published information on inventories held by wholesale distributors indicated a decline in that month, reversing part of October's sizable run-up. Much of the decline occurred in nondurable goods, although machinery distributors also reported a sizable liquidation. The inventory–sales ratio for the wholesale trade sector edged down in November but remained near the high end of its range in recent years.

The nominal deficit on U.S. trade in goods and services narrowed in October from its average rate in the third quarter. The value of imports declined more than the value of exports. Much of the contraction in imports reflected reductions in oil and automotive products that more than offset another strong rise in computer goods. For exports, an advance in machinery exports to record levels was outweighed by a reduction in shipments of agricultural and automotive products. Available data on economic activity in the major foreign industrial countries suggested that the pace of expansion in Europe had slowed further on average while growth in Japan had picked up a little.

Recent data suggested little change in underlying inflation trends. Consumer prices increased slightly in December after having been unchanged in November; food prices were quiescent over the two-month period while energy prices rose on balance, with a December rebound more than offsetting a sizable November drop. Excluding food and energy items, consumer prices were up modestly over the November–December period and for all of 1995 advanced slightly more than in 1994. Producer prices of finished goods were up considerably in November and December after having risen slowly in earlier months; in large part, the price increases late in the year reflected sharp upward movements in both finished foods and finished energy prices. For 1995, producer prices of finished goods other than food and energy rose at a subdued pace, though somewhat more than in 1994. Commodity prices had been mixed recently after having trended down earlier. Average hourly earnings of production and nonsupervisory workers increased somewhat in December after having been unchanged in November. Increases in average hourly earnings had been trending up over the past several years.

At its meeting on December 19, 1995, the Committee adopted a directive that called for some slight easing in the degree of pressure on reserve positions, which was expected to result in a decline in the federal funds rate from around 5¾ percent to around 5½ percent. The directive did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, the directive stated that in the context of the Committee’s long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

After the meeting, open market operations were directed initially toward implementing the slight easing in the degree of reserve pressure that had been adopted by the Committee and thereafter toward maintaining this new reserve posture. Operations were complicated by large swings in reserve demands associated with year-end pressures and the adverse effects of unusually severe winter weather on check clearings. Although the federal funds rate exhibited somewhat greater volatility than normal over the period, it nonetheless averaged close to the expected level of 5½ percent. The occasional periods of firmness in reserve market conditions contributed to higher adjustment plus seasonal borrowing, on average, over the period.

Most market interest rates had declined somewhat further over the period after the December 19 meeting. Rates moved lower immediately after the policy easing action, and most fell still more on balance over the remainder of the intermeeting interval in response to incoming information about the economy and the prospects for fiscal policy, at least in the near term. Both were seen as suggesting slower economic expansion for a time and an increased likelihood of additional easing of monetary policy in coming months. With bond yields down on balance, and occasionally approaching two-year lows, major indexes of equity prices advanced sharply further.

The trade-weighted value of the dollar in terms of the other G-10 currencies continued to rise over the intermeeting period despite the decline in U.S. interest rates. The dollar's upward movement against the German mark and other European currencies was associated with increasing indications of further weakening of economic expansion in key European countries and greater declines in interest rates in those countries than in the United States. The dollar's appreciation relative to the Japanese yen appeared to be related in part to a narrowing of Japan's trade and current account surpluses. The dollar was unchanged on balance against the Canadian dollar, while the Mexican peso rose considerably in relation to the dollar.

Growth of M2 and M3 strengthened in December and January. The pickup in M2 growth partly reflected the effect of recent declines in short-term interest rates; those declines had made money market instruments less attractive relative to household savings accounts in M2, whose offering rates tend to be adjusted downward with a considerable lag. In addition, the flattening of the term structure of interest rates had lessened the comparative attractiveness of bond mutual funds, which had continued to experience only light inflows. Faster growth of M3 in December and January was associated with both the pickup in M2 expansion and the issuance of additional large time deposits to help finance a noticeable step-up in bank loan demand in January. The expansion of M2 from the fourth quarter of 1994 to the fourth quarter of 1995 was in the upper half of the Committee's annual range, and M3 grew at the upper end of its range. Growth of total domestic nonfinancial debt had been moderate in recent months, and for the year was near the midpoint of this aggregate's monitoring range.

The staff forecast prepared for this meeting suggested that economic activity would expand at a relatively slow pace over the near term. This forecast was not materially different from that prepared for the December meeting, except for a slightly weaker outlook for the current quarter that was related in part to an inventory correction and the effects of unusually severe winter weather on spending and output. Over the remainder of the two-year forecast horizon, the economy was expected to grow generally along its estimated potential. Consumer spending was anticipated to keep pace with the growth of disposable income; concerns about job security remained and consumer debt burdens had risen further, but the still-ample availability of credit and the substantial rise in the value of household equity holdings would support additional increases in consumption. The further decline in mortgage rates recently from already-favorable levels would help to sustain homebuilding activity at a relatively high level. With sales and profits projected to grow more slowly, and with utilization of existing capacity having eased considerably, business investment in new equipment and structures was expected to expand at a more moderate rate. In light of the recent strengthening of the dollar, the external sector was expected to exert a small restraining influence on real activity over the projection period as a whole. Much uncertainty still surrounded the fiscal outlook, but the recent impasse in the budget negotiations between the Administration and the Congress suggested a lower degree of fiscal restraint over coming years than had been assumed in the previous forecast. Given the projected outlook, rates of utilization of labor and capital resources and of inflation were not expected to change materially.

In the Committee's discussion of current and prospective economic activity, members noted a number of temporary factors that were retarding the expansion. The weakness in business activity this winter was to some extent the result of the partial shutdown of the federal government and the severe storms in a number of regions; both clearly were transitory influences on the economy. Growth of economic activity also was being constrained by production cutbacks stemming from efforts to bring stocks into better alignment with disappointing sales in a number of industries. Even so, in the absence of major overhangs in inventories of business equipment and consumer durables, and given favorable conditions in financial markets, members believed that a resumption of moderate, sustainable growth after a relatively brief period of weakness was the most likely outlook for the economy. At the same time, many observed that the risks to such an outcome did not seem balanced. A number of concerns, including the extent of the damping effects of high debt loads and employment uncertainty on consumption and questions about the sources of further export growth, suggested the possibility of sluggish expansion, while possible developments on the upside were more difficult to identify. With resource use unlikely to vary appreciably, the members generally expected no significant change in the underlying inflation picture over the year ahead. The recent performance of inflation had some encouraging aspects, and the odds on greater price pressures seemed relatively small at this time.

In keeping with the practice at meetings when the Committee establishes its long-run ranges for growth of the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared individual projections of economic activity, the rate of unemployment, and inflation for the year 1996. Measured on the basis of chain-weighted indexes, the forecasts of the growth in real GDP had a central tendency of 2 to 2¼ percent and a full range of 1½ to 2½ percent for the period from the fourth quarter of 1995 to the fourth quarter of 1996. The members and nonmember presidents generally anticipated that economic expansion in line with their forecasts would be associated with employment growth close to that of the labor force. Accordingly, their forecasts of the civilian rate of unemployment in the fourth quarter of 1996 were near the current level, with a central tendency of 5½ to 5¾ percent and a full range of 5½ to 6 percent. Projections of the rate of inflation, as reflected in the consumer price index, had a central tendency of 2¾ to 3 percent; that central tendency was on the high side of the outcome for 1995—when the rise in the index was held down by damped increases in food prices and declines in energy prices—but a few of the forecasts anticipated a slightly lower rate of inflation.

In their review of developments across the nation, the Federal Reserve Bank presidents reported modest growth in most major areas of the country. Many referred, however, to an admixture of strengths and weaknesses in their local economies, and a majority observed that on balance growth in regional business activity appeared to have slowed in the last few months. In keeping with the data available for the nation as a whole, the slowing seemed to be concentrated in manufacturing and especially at firms producing motor vehicles and parts. Some presidents referred to relatively negative, or at least cautious, sentiment among many of their business contacts.

Much of the recent softening in economic activity appeared to arise from production cutbacks in various sectors of the economy in which involuntary accumulation of inventories seemed to have occurred as a result of weaker sales trends in the past few months. The members expected this inventory adjustment process to have a relatively pronounced effect on production and overall business activity in the current quarter and perhaps to some extent in the second. While a greater-than-expected inventory adjustment with spreading effects through the economy could not be ruled out, the underlying strength of demand was likely to be sufficient to restore and sustain moderate growth in overall economic activity as the current inventory and production adjustments subsided.

With regard to consumer spending, members referred to overall indications of lackluster retail sales during the holiday season and into January. The anecdotal commentary on retail sales attributed some of the recent weakness in a number of areas to the clearly temporary effects of unusually severe winter weather and the partial shutdown of the federal government. The members anticipated that moderate growth in retail sales would resume, though some felt that the consumer sector might remain vulnerable on the downside. The consumer spending outlook was complicated by a number of crosscurrents. Negative factors cited by the members included ongoing concerns about job security that were being sustained by a continuing stream of workforce reduction announcements by major business concerns, increased consumer debt burdens that were showing up in rising delinquency rates on some types of loans, and the apparent satisfaction of much of the earlier pent-up demand for consumer durables. On the positive side, reduced interest rates, still readily available credit, and the accumulation of financial wealth from the sharp rise in stock and bond prices were seen as likely to support continuing gains in consumer spending.

Further increases in business fixed investment were viewed as a likely prospect for the year ahead, though the growth of such investment probably would be well below the strong pace experienced earlier in the current cyclical expansion. Anecdotal reports indicated continuing strength in nonresidential construction in some parts of the country, but declining rates of capacity utilization augured reduced growth going forward. The expansion of investment in producers' durable equipment also was expected to slow, but from a pace that had seemed unsustainable. While appreciable further growth could be expected in expenditures for high-tech equipment as business firms continued to focus on improving the efficiency of their operations in a highly competitive environment, spending for other types of equipment was likely to be sluggish. Members noted in particular the prospects for weaker business spending for motor vehicles, especially for heavy trucks. However, the fundamental determinants of investment in business equipment, including the reduced cost of financing such investment, remained positive and this sector of the economy should continue to provide considerable impetus to the expansion.

The members also viewed the considerable decline that had occurred in mortgage interest rates and the ample availability of housing finance as key factors in their forecasts of sustained residential construction at relatively high levels. Adverse weather conditions appeared to have retarded homebuilding activity in a number of areas in recent weeks, but several members commented that underlying trends in housing demand were favorable and that residential construction had remained relatively strong in several parts of the country.

The outlook for fiscal policy was uncertain, especially with regard to whether longer-term spending and taxation measures would be enacted to implement the goal of a balanced federal budget by the year 2002. For the year immediately ahead, however, the members continued to anticipate considerable restraint in federal spending, partly as a byproduct of the current budget debate between the Congress and the Administration. With regard to the external sector of the economy, prospects for economic growth in major trading partners—led by developments in Europe—appeared to have weakened, and the recent appreciation of the dollar in the foreign exchange markets also might tend to damp net exports. Consequently, several members saw downside risks in the foreign trade sector over the year ahead.

The members anticipated that inflation would remain contained in 1996, but they did not expect significant progress toward more stable prices. They referred to crosscurrents bearing on the outlook for wages and prices in the year ahead. Factors pointing to potentially higher inflation included increased pressures on food prices stemming from disappointing harvests in some areas and relatively low grain supplies. More generally, resource utilization was expected to remain high and greater pressures could emerge in labor and product markets. Members noted that one broad measure of wages had picked up and that there was a small rise in the number of anecdotal reports indicating that labor shortages were contributing to higher wages in some parts of the country. In addition, unusually muted increases in the costs of worker benefits had been holding down overall compensation costs, and this pattern might not persist. On the other hand, high levels of resource utilization had been associated for some time with lower rates of growth in costs than would have been anticipated on the basis of historical experience. In particular, a general sense of job insecurity in a period of major business restructurings was holding down increases in labor compensation. In an environment of strong competition, which was preventing many businesses from passing on rising costs through higher prices, firms continued to focus on efforts to control costs by improving the efficiency of their operations, and this was helping to hold down inflation. An apparent decline in inflationary expectations also would provide a moderating influence on inflation trends in the period ahead. While most of the members saw little reason to anticipate appreciably lower inflation over the year ahead, they also viewed the odds on a pickup in inflation as fairly low; they could see possible reasons for optimism on the long-run trend in inflation; and they generally remained confident that further progress toward price stability would be made over the longer term.

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 1996 that it had established on a tentative basis at its meeting in July 1995. The tentative ranges included expansion of 1 to 5 percent for M2 and 2 to 6 percent for M3, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was provisionally set at 3 to 7 percent for 1996. The tentative ranges for 1996 were unchanged from the actual ranges for 1995. In July, the range for M3 had been raised 2 percentage points to reflect developments that seemed to be fostering a return to the historical pattern of somewhat faster growth in M3 than in M2.

In their discussion, the members took note of a staff analysis which indicated that monetary expansion consistent with the moderate growth of nominal GDP that the members were projecting for 1996 most likely would be around the upper ends of the tentative ranges adopted last July. M2 and M3 velocity over the past couple of years had conformed more closely on balance with historical patterns, and the projections assumed that this behavior would continue in 1996. In light of the experience of earlier years, however, when the velocities of these aggregates had exhibited pronounced atypical behavior, substantial uncertainty still surrounded any projections of monetary expansion and the linkage between particular rates of money growth and the basic objectives of monetary policy.

Most members endorsed a proposal to adopt the relatively low ranges for growth of M2 and M3 in 1996 that the Committee had set on a tentative basis in July 1995. These members favored retention of the tentative ranges because they could be viewed as benchmarks for money growth that would be associated with price stability, assuming behavior of velocity in line with historical experience, and a reaffirmation of those ranges would underscore the Committee's commitment to a policy of achieving price stability over the longer term. Some members also noted that any adjustment of these ranges to align them more fully with projections of money growth consistent with the Committee's expectations for expansion of the economy and prices in 1996 could be misinterpreted. Such an action might be seen as suggesting that the Committee had a greater degree of confidence in the relationship between money growth and broad measures of economic performance than was warranted by its current understanding of that relationship or that the Committee was now placing greater emphasis on the broad monetary aggregates as a gauge of the thrust of monetary policy.

Two members favored somewhat higher growth ranges for M2 and M3 in 1996. They noted that the expansion of these broad aggregates was anticipated to be around the upper ends of their tentative ranges, and perhaps even higher, given the Committee's expectations for the performance of the economy and prices. In their view, the higher ranges would be more consistent with what they saw as the Committee's obligations under the Federal Reserve Act to set ranges consistent with expected or desired economic outcomes for the year, and the reasons for establishing those ranges could easily be set forth and understood as an appropriate technical adjustment that would not imply any lessened commitment to the Committee's price stability goal.

The Committee unanimously preferred to retain the 3 to 7 percent range for total domestic nonfinancial debt in 1996. This position took account of a staff projection indicating that the debt aggregate was likely to continue to grow at a rate generally in line with the expansion of nominal GDP, although some moderation in private credit demands was anticipated and there were indications that lenders were no longer easing their terms and conditions for granting credit to consumers and businesses.

At the conclusion of its discussion, the Committee voted to approve without change the tentative ranges for 1996 that it had established in July of last year. In keeping with its usual procedures under the Humphrey–Hawkins Act, the Committee would review its ranges at midyear, or sooner if interim conditions warranted, in light of the growth and velocity behavior of the aggregates and ongoing economic and financial developments. Accordingly, the following longer-run policy statement for 1995 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 1995 to the fourth quarter of 1996. The monitoring 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, Jordan, Kelley, McTeer, Ms. Phillips, and Mr. Stern. Votes against this action: Mr. Lindsey and Ms. Yellen.

Mr. Lindsey and Ms. Yellen dissented because they preferred somewhat higher ranges for M2 and M3. They recognized that the relationships between the ranges for the monetary aggregates and broad measures of economic performance were subject to substantial uncertainty, but ranges higher than those adopted on a tentative basis in July 1995 were more likely to encompass monetary expansion consistent with the central tendency of members' current forecasts of nominal GDP growth for 1996. Raising the ranges for M2 and M3 would in their view conform those ranges more closely with the provisions in the Federal Reserve Act that require the System to communicate to the Congress its objectives and plans for the growth of the aggregates for the calendar year. They believed the Committee could readily explain that such an adjustment to the ranges did not represent a lessened commitment to its price stability goal or an increased emphasis on the monetary aggregates in policy formulation.

The Committee also discussed alternatives to the monetary aggregates for communicating its intentions with regard to the course of inflation over the longer run. Some members thought that explicit numerical goals or forecasts for inflation over a period of years would have several important benefits, including enhanced credibility that could reduce the costs of achieving price stability and greater flexibility to respond to the emergence of economic weakness by easing policy for a limited period of time without arousing inflation concerns. Other members, while endorsing fully the long-term goal of price stability, had a number of reservations about implementing such proposals, especially at this time. Based on experience in the United States and elsewhere, many were skeptical about the payoff in terms of greater credibility or flexibility in policy implementation. Moreover, they believed that substantially more study and deliberation were required to explore fully the alternatives and the consequences of changes in the way the Committee formulated and communicated its objectives. They also thought that any such assessment would need to take account of the prospects for, or disposition of, closely related legislation that was now being considered in the Congress. The Committee did not take any action on this issue at this meeting, but it recognized that the matter would need to be revisited from time to time.

In the Committee's discussion of policy for the intermeeting period ahead, the members supported a proposal calling for some slight easing in reserve conditions. Although a pickup to an acceptable rate of expansion was seen as the most likely course for the economy in coming quarters, the risks of a shortfall in growth were believed to be significant. At the same time, while most members were forecasting high levels of resource use and little change in the rate of inflation this year, they saw only a very limited risk that a slight easing move might foster higher inflation under prevailing circumstances, and some felt that there were favorable prospects for a slightly improved inflation performance. Under the circumstances, a slight decrease was warranted in the real federal funds rate from a level that a number of members considered still a bit to the firm side—a stance that seemed less appropriate in light of the reduced threat over the last year of a pickup in inflation. One member pointed out that such a decrease would tend to counter the effects on aggregate demand of the recent rise in the foreign exchange value of the dollar, which might continue to move higher if interest rate declines expected by the markets were not forthcoming. It was noted that postponing a decision in this uncertain economic climate could be defended on the ground that more evidence was needed to ascertain whether the weakness in the economy was quite temporary or more lasting; if it was the former, inflationary pressures could re-emerge at lower interest rates. On the other hand, a few members commented that the currently sluggish performance of the economy could be read as calling for a more pronounced easing move, but they preferred a cautious approach to policy in light of current inflation trends and the uncertainties that surrounded their forecasts of some strengthening in the economy.

The Chairman informed the Committee that he had asked the members of the Board of Governors to convene immediately after this meeting to consider a reduction of ¼ percentage point in the discount rate. Such a reduction had been proposed by a total of six Federal Reserve Banks at this point. Given the easing in reserve markets favored by the Committee and the possibility of a lower discount rate, the members did not believe that a further policy move was likely to be needed during the intermeeting period. Accordingly, they favored an unbiased directive that did not incorporate a presumption about the likely direction of any adjustments to policy during the next several weeks. In keeping with its usual practice, the Committee did not rule out the possibility of an intermeeting policy change on the basis of unanticipated economic or financial developments.

At the conclusion of the Committee's discussion, all the members supported a directive that called for a slight reduction in the degree of pressure on reserve positions and that did not include a bias about the likely direction of an adjustment to policy during the intermeeting period, should unanticipated developments warrant a change in policy. Accordingly, the Committee decided that in the context of its long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, 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 has been growing rather slowly in recent months. Nonfarm payroll employment continued to expand moderately in December, and the civilian unemployment rate remained at 5.6 percent. Industrial production increased only slightly further in the fourth quarter. Growth of consumer spending was modest, on balance, over the past several months. Housing starts rebounded in November from a sizable October decline. Orders for nondefense capital goods point to a moderation in the expansion of spending on business equipment, and nonresidential construction has risen appreciably further. The nominal deficit on U.S. trade in goods and services narrowed in October from its average rate in the third quarter. There has been no clear change in underlying inflation trends.

Most market interest rates have declined somewhat since the Committee meeting on December 19. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen further over the intermeeting period.

Growth of M2 and M3 strengthened in December and January. From the fourth quarter of 1994 to the fourth quarter of 1995, M2 expanded in the upper half of its range and M3 grew at the upper end of its range. Growth in total domestic nonfinancial debt has been moderate in recent months, placing this aggregate near the midpoint of its monitoring range for the year.

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 1995 to the fourth quarter of 1996. The monitoring 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.

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions, taking account of a possible reduction in the discount rate. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for short-run policy: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Ms. Phillips, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 26, 1996.

The meeting adjourned at 12:00 p.m.

Donald L. Kohn
Secretary

Meeting Held on March 26, 1996

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 26, 1996, at 8:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Ms. Phillips
Mr. Stern
Ms. Yellen

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

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

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

Messrs. Lang, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Reinhart, Assistant Director, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Stone, First Vice President, Federal Reserve Bank of Philadelphia
Messrs. Davis, Dewald, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of Kansas City, St. Louis, Richmond, and Chicago respectively
Mr. Judd, Ms. Rosenbaum, and Mr. Rosengren, Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, and Boston respectively
Mr. Bentley, Assistant Vice President, Federal Reserve Bank of New York

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on January 30–31, 1996, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets during the period January 31, 1996, through March 25, 1996. There were no open market transactions in foreign currencies for System account during this period, 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 January 31, 1996, through March 25, 1996. 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.

Much of the information reviewed at this meeting had been influenced to an uncertain degree by unusually severe winter weather, industrial strikes, and U.S. government shutdowns. On balance, however, growth of economic activity appeared to have picked up after having slowed appreciably in late 1995. Growth in consumer spending seemed to have resumed at a moderate rate in the wake of January's storms; business spending on durable equipment was recording further healthy gains; and housing demand was showing some signs of strengthening. With businesses making considerable progress in getting their inventories under control, industrial production and employment had rebounded briskly. The recent data on prices gave little indication of any change in underlying inflation trends.

A surge in nonfarm payroll employment in February considerably more than offset a large weather-related drop in January. Very large job gains were recorded in February in the construction, retail trade, and services industries; however, some of these increases reflected the reversal of the depressing effects of January's severe winter storms and the efforts of some firms to make up for associated production losses. A small rise in manufacturing employment in February only partially offset a further loss of factory jobs in January. The civilian unemployment rate fell to 5.5 percent in February.

Industrial production rose sharply in February, more than offsetting a sizable decline in January. Part of the net increase in output over the January–February period reflected an upturn in aircraft production after the settlement of a strike at a major aircraft manufacturer. In addition, output of office and computing machines continued to rise at a rapid pace, and the production of other types of business equipment picked up. Output of consumer goods changed little on balance over the two-month period. Manufacturing production expanded about in line with capacity over the first two months of the year, leaving the overall rate of utilization of manufacturing capacity little changed.

Nominal retail sales increased briskly in February after having registered little change in January. The February spurt was paced by strong motor vehicle purchases, but spending at general merchandise stores and apparel outlets also was up considerably after a weak performance in previous months. Sales at durable goods stores were less robust, rising only slightly in February. Recent indicators of housing demand and activity were generally favorable. Starts of both single-family and multifamily units moved higher on balance over January and February, and sales of new homes increased appreciably in January (latest data available). By contrast, sales of existing homes declined in January for a fourth consecutive month.

Business demand for durable equipment apparently remained fairly robust in early 1996. Incoming orders for computing equipment were particularly strong in January, and shipments of such equipment posted further healthy gains. With airline profits high and new models of airplanes being introduced, orders for aircraft had climbed rapidly over recent months. Orders for other types of equipment also had picked up on balance over the last several months, although shipments of such equipment dropped in January after a sizable rise in the fourth quarter. Nonresidential construction activity appeared to be growing more slowly: Non-office commercial construction continued its upward trend but office, institutional, and industrial building activity had slowed noticeably in recent months, and contracts for those categories also had softened.

Business inventories rebounded sharply in January from a large drop in December. Much of the January buildup in stocks occurred in manufacturing, where part of the backup may have been associated with delays in shipments as a result of winter storms. The inventory–sales ratio for the sector edged up in January but was little changed on balance in recent months. Inventories at the wholesale level also rose considerably in January; the inventory–sales ratio increased slightly but was still well below the high levels of last fall. Retail stocks recorded a modest rise in January after a sharp decline in December. The January increase was in line with the advance in sales, and the inventory–sales ratio for the sector as a whole was unchanged from December and remained well below levels seen over most of 1995.

The nominal deficit on U.S. trade in goods and services in December (latest data available) was little changed from its November level. On a quarterly-average basis, however, the deficit in the fourth quarter was substantially smaller than it had been in the third quarter. The value of exports of goods and services rose appreciably in the fourth quarter, with the largest increases occurring in machinery exports and foreign tourist services. The value of imports declined slightly, largely as a result of decreases in imports of automotive products, consumer goods, and oil. The data available on economic conditions in the major foreign industrial countries in early 1996 suggested that a moderate recovery was under way in Japan, and there were some signs of a pickup in activity in much of Western Europe, although the German economy remained weak.

Inflation trends had remained stable in recent months. At the consumer level, food prices continued to edge up in February and energy prices again were under appreciable upward pressure. Excluding the often-volatile food and energy items, consumer prices advanced in February at a slightly slower rate than in January; and for the twelve months ended in February, consumer prices rose a little less than in the comparable year-earlier period. At the producer level, prices of finished goods other than food and energy were unchanged on balance over January and February; the rise in this measure of prices over the twelve months ended in February was somewhat larger than in the comparable year-earlier interval. Average hourly earnings of production and nonsupervisory workers edged down in February after a considerable increase in January. However, for the twelve-month period ended in February, average hourly earnings rose more than in the year-earlier period.

At its meeting on January 30–31, 1996, the Committee adopted a directive that called for a slight reduction in the degree of pressure on reserve positions, taking account of a possible reduction of ¼ percentage point in the discount rate. The directive approved by the Committee did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period, should unanticipated developments warrant a policy change. Accordingly, the directive stated that in the context of the Committee’s long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

On January 31, the Board of Governors approved a reduction of ¼ percentage point in the discount rate, to a level of 5 percent. The decrease was made effective immediately and was passed through to interest rates in reserve markets. Open market operations during the intermeeting period were directed toward maintaining this new policy stance, and the federal funds rate averaged around 5¼ percent, the level expected to be associated with that stance.

Because the easing move had been largely anticipated in financial markets, the initial response was a small decline in short-term rates and little change in long-term rates. Over the remainder of the period, however, most interest rates moved higher in response to incoming economic data that were seen as suggesting improved prospects for economic growth and, accordingly, a reduced likelihood of further easings in monetary policy. In addition, the absence of much progress in federal budget negotiations was viewed by the markets as indicating that the chances a major multiyear deficit-reduction plan would be adopted this year were becoming more remote. Despite the increase in bond yields, major indexes of equity prices recorded sizable gains.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly over the intermeeting period. The dollar fell appreciably during the initial portion of the period—before evidence of a more robust U.S. economy emerged—while data on the German money supply and the Japanese economy were suggesting upward revisions to expected interest rates abroad. In late February, emerging signs that the U.S. economy was generally stronger than expected and that economic conditions abroad were comparatively weaker than they had seemed earlier fostered a rebound in the value of the dollar.

Growth of the broader monetary aggregates strengthened considerably in February and early March following the decline in short-term interest rates in late 1995 and early 1996. The acceleration of M2 reflected a surge in demand deposits as well as larger inflows to retail money market mutual funds, whose yields tend to adjust with a lag to changes in short-term market interest rates. Larger inflows to institution-only money market funds contributed to M3's stronger performance. Growth of total domestic nonfinancial debt slowed somewhat in December and January, reflecting reduced federal government borrowing, but remained moderate on balance.

The staff forecast prepared for this meeting suggested that the pace of economic expansion would pick up over coming months after a sluggish fourth quarter. Other than a better performance over the first half of 1996 associated with a somewhat faster increase in final sales, this forecast differed little from that prepared for the previous meeting and indicated that the economy was expected to expand generally along its estimated potential. Consumer spending was projected to grow slightly more than disposable income; the favorable effect of higher equity prices on household wealth and the still-ample availability of credit were expected to outweigh persisting consumer concerns about job security and the effects of already high household debt burdens. Homebuilding activity was projected to decline a little in response to the recent backup in residential mortgage rates but to remain at a relatively high level. A less rapid pace of business investment in equipment and structures was expected in light of the decline over the past year in the rate of utilization of production capacity and the moderate growth projected for sales and profits. The external sector was expected to exert a small restraining influence on economic activity over the projection period. The persisting impasse in the federal budget negotiations suggested little further fiscal contraction in coming quarters. Given the outlook for economic activity, rates of utilization of labor and capital were not expected to change materially and inflation was projected to increase modestly.

In the Committee's discussion of current and prospective economic developments, members commented on the resiliency of the economy, which appeared to have strengthened appreciably after a period of subpar growth. The latter had been induced to a large extent by inventory adjustments whose effects were exacerbated temporarily by government shutdowns, unusually severe winter weather, and industrial strikes. The adjustment in inventory investment seemed to be nearing its completion, and some members observed that the settlement of the recent strike in the motor vehicle industry might well impart added impetus to the expansion over the nearer term. Considerable volatility could be expected in the short-run performance of the economy, but the members continued to view trend growth at a pace near the economy's potential as the most probable outcome. Many also commented that the risks to such a forecast appeared to have shifted from being predominantly on the downside earlier in the year to better balanced currently. Still, substantial uncertainties attended the economic outlook, and a number of members observed that an economic performance that differed considerably in either direction from their current forecasts might well materialize over the projection period. Regarding the outlook for inflation, members' assessments tended to center on expectations of little change in average consumer price inflation over the projection horizon.

The review of regional economic developments by the Federal Reserve Bank presidents pointed to moderate expansion in economic activity across much of the nation, though growth was described as modest in a few regions and relatively robust in some others. Business conditions appeared to have improved in a number of areas since early in the year, but as had been true previously, activity in various sectors of the economy remained uneven. Manufacturing of most durable goods other than motor vehicles and some defense industry products displayed considerable strength, while the production of many nondurable goods tended to lag. In agriculture, high feed costs and low market prices were depressing the cattle industry, while elevated grain prices were boosting the incomes of farmers not subject to the effects of locally adverse weather conditions.

The economy had displayed considerable resilience in the face of adjustments to production associated with efforts by many business firms to reduce inventories and a number of additional, albeit temporary, developments that had tended to retard the expansion in the latter part of 1995 and at the start of this year. Apparently, relatively low long-term interest rates and the related substantial appreciation in the value of stock and bond market holdings had been important factors helping to sustain spending in this period. In the context of continued underlying momentum in final demand and some decline in excess stocks of unsold motor vehicles stemming from the recently ended strike at a major domestic producer, inventories now seemed to be in better balance with sales and the economy to be better positioned to accommodate sustained expansion. Some members observed, however, that the recent increase in intermediate- and long-term interest rates would tend to blunt demand in interest-sensitive sectors of the economy. Moreover, stock market prices had risen to comparatively high levels in relation to earnings and interest rates and might be vulnerable to further weakness in the debt markets or to any tendency for business profit margins to erode.

In the course of their comments about developments in key sectors of the economy, members referred to recent indications, including anecdotal reports, of appreciable strengthening in retail sales that tended to support forecasts of sustained growth in consumer spending in coming quarters. In addition, surveys of consumer sentiment, which had been more favorable recently, and sharply increased household net worth were seen as positive factors in the outlook for consumer expenditures. On the negative side, some members observed that the rise in consumer indebtedness and the recent increase in interest rates would tend to damp consumer spending. Given these financial crosscurrents, it was suggested that growth in consumer spending might approximate that of disposable income over the forecast horizon.

The prospects for business capital spending remained a supportive element in the outlook for further economic expansion, but growth in such spending was expected to slow considerably from its rapid pace over the past few years. The ready availability and fairly low cost of business finance in equity and debt markets and the continuing commitment of business firms to modernizing their facilities to hold down costs in highly competitive markets would tend to support growth in business fixed investment. Profits and cash flows were expected to remain reasonably strong, though there were tentative signs of some softening in profit margins. On the other hand, the longevity of the current expansion had resulted in the addition of a good deal of production capacity in recent years. This development in conjunction with some decline in capacity utilization over the past several quarters pointed to less need for expansion in plant and equipment. The rise in outlays for computers and related products was likely to remain fairly robust in light of the continuing advances in technology and the marked downtrend in computer prices, but the growth of computer expenditures was projected to be well below the extraordinary pace of the past few years. The slowdown would reflect factors that were expected to damp the growth of overall business investment spending and a greater saturation of potential computer markets that might lead to more emphasis on replacement demand rather than the further expansion of capacity.

Housing activity generally was expected to be well maintained in coming quarters, though likely to moderate to some extent from current levels in lagged response to the rise that had occurred in mortgage interest rates. The response of housing expenditures to rate increases was uncertain, and a few members commented that the prospective slowing in housing construction could be fairly pronounced. For the nearer term, however, recent data were indicative of considerable underlying strength in housing markets, especially in light of the adverse effects of notably unfavorable weather conditions in many parts of the country this winter. Those data tended to be supported by anecdotal reports of significant improvement in housing markets in several regions over the course of recent months. Contributing to that performance, however, might be a temporary acceleration of purchases by homebuyers who anticipated further increases in mortgage interest rates. The latter were viewed, nonetheless, as still low in comparison with their average level over the past several years.

The outlook for fiscal policy remained uncertain, especially for future years. It was suggested that the stalemate between the Congress and the Administration on major spending and tax issues might not be resolved in coming months or indeed during the current session of the Congress. However, already legislated appropriations and current continuing resolutions still pointed to considerable restraint in federal spending this year. With regard to the external sector of the economy, projections of appreciable growth in exports tended to be supported by anecdotal comments of strong export demand for goods produced in various parts of the country, including some improvement in exports to Mexico. At the same time, imports might well expand somewhat more rapidly than exports if the domestic economy strengthened as projected this year from its reduced rate of growth in 1995.

The members did not differ greatly in their assessments of the most probable course of inflation. Their expectations ranged from essentially unchanged to slightly higher inflation in comparison with 1995. At the same time, members expressed somewhat differing views about possible deviations of inflation from their expectations. Those who emphasized the risks of higher-than-projected inflation tended to cite the potential for increasing wage and price pressures in an economy that already was operating at or close to its estimated capacity. Increases in labor costs had been unusually subdued in light of the relatively low unemployment nationwide and widespread anecdotal reports of labor shortages. In this view the rise in labor costs could well accelerate at some point, though not necessarily in the near term, with some feedthrough to prices. Other developments that generated some concern about the outlook for inflation included the rise in the costs of medical benefits in the fourth quarter, price pressures in the energy and food sectors of the economy, and the possibility that the recent rise in intermediate- and long-term interest rates might to some extent reflect worsening inflationary expectations. Other members saw only a limited risk of higher inflation, and a few indicated that they did not rule out some reduction in consumer price inflation from that experienced in 1995. In this view there was sufficient capacity in the economy to allow room for moderate growth of economic activity in line with their forecasts without fostering added inflation. Moreover, there was only scattered evidence of accelerating increases in worker compensation associated with labor shortages and little indication that possibly diminishing worries about job security would induce rising labor militancy. Some members also stressed the persistence of strong competition in numerous markets that tended to preclude or restrain raising prices.

In the Committee's discussion of policy for the intermeeting period ahead, all the members endorsed a proposal to maintain an unchanged degree of pressure in reserve markets. This policy preference was based on expectations of growth in business activity at a pace averaging in the vicinity of the economy's potential, a perception among the members that the risks to such an outlook were more balanced than earlier, and anticipations that under these circumstances inflation would remain constrained. The economy seemed to have adequate forward momentum and did not appear to require any further stimulus, whose implementation might contribute to inflationary pressures in the economy. Several members observed that robust growth in broad money for some months suggested that monetary policy had been supportive of sustained economic expansion. At the same time, information on the economy and prices did not seem to indicate developing inflation pressures that needed to be contained by tightening policy at this juncture. Indeed, some members commented that, judged from one perspective, financial conditions had tightened somewhat as a consequence of the recent rise in intermediate- and long-term interest rates, though it was difficult to disentangle the real and the inflation components of the rate increases. Nonetheless, a number of members noted that inflation was not expected to moderate further over the projection horizon and that it could move higher and the Committee would need to be particularly vigilant in guarding against such an outcome. Against this background, the members favored an unbiased instruction in the directive that did not prejudice possible intermeeting adjustments to policy in either direction.

At the conclusion of the Committee's discussion, all the members indicated a preference for a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

Many of the data for recent months reviewed at this meeting were influenced to an uncertain degree by unusually severe winter weather, industrial strikes, and U.S. government shutdowns. On balance, the expansion in economic activity appears to have picked up after slowing appreciably in late 1995. Nonfarm payroll employment surged in February, considerably more than offsetting a large drop in January, and the civilian unemployment rate fell to 5.5 percent. Manufacturing production increased sharply in February after a sizable decline in January. Growth of consumer spending, which had been sluggish earlier in the winter, spurted in February, paced by strong motor vehicle purchases. Housing starts rose in January and February. Orders and contracts point to continuing expansion of spending on business equipment and nonresidential structures. The nominal deficit on U.S. trade in goods and services narrowed substantially in the fourth quarter from its average rate in the third quarter. There has been no clear change in underlying inflation trends.

Changes in short-term market interest rates have been mixed while long-term rates have risen appreciably since the Committee meeting on January 30–31. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined slightly over the intermeeting period.

Growth of M2 and M3 has strengthened considerably in recent months, while expansion in total domestic nonfinancial debt has remained moderate on balance.

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 January 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 1995 to the fourth quarter of 1996. The monitoring 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.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Ms. Phillips, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, May 21, 1996.

The meeting adjourned at 10:35 a.m.

Donald L. Kohn
Secretary

Meeting Held on May 21, 1996

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 21, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Ms. Phillips
Mr. Stern
Ms. Yellen

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

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Rives, First Vice President, Federal Reserve Bank of St. Louis

Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Atlanta, Richmond, and Chicago respectively

Mr. Altig, Mses. Chen and Rosenbaum, Vice Presidents, Federal Reserve Banks of Cleveland, New York, and Atlanta respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 26, 1996, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets during the period March 26 through May 20, 1996. There were no open market transactions in foreign currencies for System account during this period, 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 26 through May 20, 1996. 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 economic activity had expanded moderately on balance in recent months. Final demand, which had been quite robust early in the year, was showing some signs of slowing in recent data. Consumer spending appeared to be growing at a moderate pace; business expenditures on durable equipment had registered further large gains, though new orders had flattened out; and housing demand seemed to be holding up well despite the increase in mortgage interest rates this year. Business inventories, most notably in the automotive industry, had been brought into better alignment with sales, and industrial production and employment had risen appreciably. Upward pressures on food and energy prices accounted for somewhat larger increases in consumer prices.

Nonfarm payroll employment was essentially unchanged in April after rising substantially in the first quarter; part of the slowdown resulted from an unwinding of special factors that had boosted job growth in the first quarter. Payrolls continued to expand in April in retail trade; finance, insurance, and real estate; and the services industries. In contrast, employment in construction fell sharply, reversing much of the large first-quarter gain. In manufacturing, employment declined further in April despite the settlement of a major strike in the automotive sector and the return of affected workers to their jobs. The civilian unemployment rate fell to 5.4 percent.

Industrial production rebounded in April from an appreciable decline in March. The changes in industrial output over the two-month period largely reflected fluctuations in motor vehicle assemblies associated with a strike and its subsequent settlement. Manufacturing of products other than motor vehicles rose moderately in April on the strength of further large advances in the output of office and computing equipment and of construction supplies. Utilization of total industrial capacity, which had varied in recent months in concert with movements in production, climbed in April to a rate slightly above that of the fourth quarter of 1995.

Retail sales declined somewhat in April after posting a strong gain in the first quarter. Sales of durable goods, which had increased substantially in the first quarter, retraced part of that advance in April; the drop more than offset a further rise in sales of nondurable goods. Housing activity was well sustained in April, with the run-up in mortgage rates that began in February having had little perceptible effect to date. Single-family housing starts were up considerably in April, and sales of new and existing homes remained brisk in March (latest data available).

Business fixed investment accelerated sharply in the first quarter of 1996 following three quarters of relatively moderate expansion; however, recent data on orders and contracts pointed, on balance, to some deceleration in business spending on both durable equipment and nonresidential structures. Much of the first-quarter pickup reflected stronger spending for durable equipment; purchases of computing equipment remained robust and spending on other durable equipment increased. Nonresidential construction activity also advanced further in the first quarter; however, construction of office buildings continued to lag, and construction of other commercial buildings slowed after recording strong gains for several years.

Business inventories declined in March after rising appreciably on average over January and February; inventory accumulation over the quarter as a whole was of modest proportions, as firms sought to bring stocks into better balance with sales. In manufacturing, inventories changed little in March and the ratio of stocks to sales was not far above historical lows. In the wholesale sector, inventories declined a little further in March, reflecting a reduction in stocks of motor vehicles, and the inventory–sales ratio remained near the middle of its range in recent years. Retail inventories also declined in March, with cuts in stocks of motor vehicles more than accounting for the drop. The inventory–sales ratio for the retail sector was near the low end of its range in recent years.

The nominal deficit on U.S. trade in goods and services in the first quarter was substantially larger than in the fourth quarter of last year. The value of imports increased sharply in the first quarter after declining in the two previous quarters. Moreover, growth in the value of exports slowed considerably in the first quarter from the pace of other recent quarters. Available data indicated that the performance of the economies of the major foreign industrial countries was mixed in the first quarter. The recovery in Japan was still under way while economic activity in continental Europe remained generally weak, with the German economy apparently having contracted further and the French economy exhibiting signs of only a modest upturn after a fourth-quarter decline. Moderate further expansion in economic activity evidently was occurring in Canada and the United Kingdom.

Rising crude oil and, to a lesser extent, food prices led to somewhat larger increases in consumer and producer price indexes in March and April. For nonfood, non-energy items, however, consumer prices rose only slightly in April after three months of somewhat faster advances; over the twelve months ended in April, this measure of consumer inflation increased a little less than the rise over the comparable year-earlier period. At the producer level, prices of finished goods other than food and energy items recorded a third straight small increase in April. Over the twelve months ended in April, this measure of producer prices rose slightly less than over the comparable year-earlier period. Hourly compensation of private industry workers expanded in the first quarter at the average rate for all of 1995; the growth was associated with a decline in benefit costs and a sharp rise in wages and salaries.

At its meeting on March 26, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth in M2 and M3 over coming months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period, and the federal funds rate averaged near 5¼ percent, the level expected to be associated with that unchanged policy stance. Other short-term market interest rates changed little over the period, and because the Committee's decision had been largely anticipated in financial markets, longer-term rates also were little changed initially. Over the remainder of the period, however, intermediate- and long-term rates came under upward pressure when incoming economic data were seen by market participants as pointing to stronger growth in output and employment and therefore to a somewhat tighter monetary policy stance than previously had been expected. Despite the increase in bond yields, most indexes of stock prices rose on balance over the intermeeting period, apparently reflecting generally favorable first-quarter earnings reports and the improved economic outlook.

In foreign exchange markets, the rise of U.S. interest rates contributed to a considerable appreciation of the trade-weighted value of the dollar in terms of the other G-10 currencies. The dollar was particularly strong against the German mark, reflecting incoming data that suggested continued weakness in economic activity in Germany and, accordingly, a greater likelihood of further monetary policy easing by the Bundesbank. The dollar rose less against the yen, partly owing to information indicating a strengthening of the economic recovery in Japan and heightened market expectations of a near-term tightening of monetary policy by the Bank of Japan.

Growth of M2 and M3 slowed substantially in April after having recorded sizable increases earlier in the year. Weakness in demand deposits after unusually rapid first-quarter expansion and sluggishness in currency demand were factors in the slowdown. In addition, the rise in market interest rates in recent months, which had increased the opportunity costs of holding retail deposits, likely had a restraining effect on these deposits. For the year through April, both aggregates grew at rates somewhat above the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt remained moderate on balance over recent months, and this aggregate stayed near the middle of its monitoring range for the year.

The staff forecast prepared for this meeting suggested that the economy would remain generally around its estimated potential. Consumer spending was expected to grow in line with disposable income; the favorable effect of higher equity prices on household wealth and the still-ample availability of credit were expected to outweigh persisting consumer concerns about job security and the influence of already-high household debt burdens. Homebuilding was projected to decline a little in response to the recent backup in residential mortgage rates but to remain at a relatively high level because of generally supportive employment and income conditions and the still- favorable cash flow affordability of homeownership. Business spending on equipment and structures was expected to grow less rapidly in light of the projected moderate growth of sales and profits and the lower rate of utilization of production capacity now prevailing. The external sector was projected to exert a small restraining influence on economic activity over the projection period, even though an anticipated firming of economic activity abroad would bolster demand for U.S. exports. Little additional fiscal contraction was anticipated over the projection period. Inflation recently had been lifted by adverse developments in the energy market and was projected to remain above the levels of recent years, given the high level of resource utilization and the effects of tight grain supplies on food prices. Further risks of inflationary pressure were associated with a possible elevation of the federal minimum wage.

In their discussion of current and prospective economic conditions, members commented that the economy had been stronger this year than they had anticipated and appeared to be growing at a quite robust pace. However, they generally expected the expansion to slow, keeping the economy close to its potential. Views differed to some extent with regard to the risks surrounding such an outlook. Some saw those risks as fairly evenly balanced, given prospective restraint from the rise in bond yields and the foreign exchange value of the dollar since early this year. Others expressed concern that economic growth might continue at a pace that could increase pressures on resources, with adverse implications for inflation in an economy already operating in the neighborhood of its estimated long-term potential. Moreover, faster increases in energy and food prices could contribute to higher overall inflation, both directly and by boosting inflationary expectations, and the proposed increase in the minimum wage would add to cost pressures if it were enacted into law. Nonetheless, while the chances of a pickup in inflation later had risen to some extent, a number of members emphasized that no firm evidence had surfaced thus far to signal that labor compensation was increasing at a faster rate or that core inflation was worsening, and even the early signs of increased pressures on costs and prices were mixed. The past few years had witnessed significantly lower cost pressures and more subdued inflation than typically would have been experienced in earlier years with similar rates of resource utilization, but whether this favorable outcome would persist was an open question.

Members observed that the stronger-than-expected performance of the economy thus far this year reflected relatively rapid growth in final demand. Favorable financial conditions, notably the relatively low interest rates of the latter part of 1995 and early 1996 and increases in wealth stemming from sizable advances in stock market prices, evidently were undergirding the expansion. Indications of improving or continuing high levels of economic activity were widespread across the nation according to recent anecdotal reports and regional data, though agricultural conditions in many areas were cited as a significant exception. While the economy appeared to have solid and balanced momentum that pointed to sustained growth, a number of factors were seen as likely to foster more moderate expansion beginning in the second half of the year. These included the effects of higher intermediate- and long-term interest rates on interest-sensitive sectors of the economy such as housing, consumer durables, and business fixed investment. The appreciation of the dollar over the past year and near-term moderation in federal government spending also were expected to exert some restraint on economic activity over the forecast horizon. Some members also questioned the sustainability of the performance of the stock market; a correction in this market would help to restrain aggregate demand. Nonetheless, the continued strength in economic activity raised questions about whether these developments would damp demand sufficiently to keep resource utilization at sustainable levels.

In their review of recent developments and the outlook for key sectors of the economy, members noted that consumer spending had strengthened considerably this year after a period of sluggish growth in late 1995. The recent data on consumer spending were reinforced by anecdotal reports from various parts of the country. The wealth effects from the further gains that had occurred in stock market prices, along with sustained increases in employment and a ready availability of consumer financing, were seen as playing a positive role in boosting consumer expenditures. Barring changes in these underlying factors, continued growth in consumer spending seemed likely, although members referred to developments that could begin to slow such growth over the months ahead. The latter included the satisfaction of much of the earlier pent-up demand for consumer durables and fairly elevated levels of consumer debt. On balance, moderate expansion in consumer expenditures, perhaps in line with the growth in incomes, seemed likely over the projection period.

Business fixed investment was believed likely to remain a source of considerable strength in the expansion, though growth in this sector of the economy also was expected to moderate from the elevated pace thus far this year. The desire of many business firms and other users of capital equipment to take advantage of new, more effective, and less expensive computer and other technologies and more generally to add further to capital in an effort to reduce costs in highly competitive markets would continue to underpin investment spending. In addition, equity and other financing remained available on relatively attractive terms. On the other hand, the rise in business investment in recent years had brought capital stocks into more acceptable alignment with expected sales, damping the need for further sizable additions.

Business firms appeared to have completed, or nearly completed, their efforts to bring inventories into better balance with sales, including the rebuilding of motor vehicle stocks after the strike at a major manufacturer was settled in March. On the basis of recent experience, subdued growth in inventories could be anticipated in the context of the projected expansion of overall economic activity at a pace near the economy's long-run potential. It was suggested, however, that such an expectation implied relatively restrained inventory investment in comparison with past cyclical patterns. Accordingly, much stronger growth in such investment could occur, with concomitant effects on incomes and the growth of overall spending.

With regard to the outlook for housing, the rise in mortgage rates in the past few months could be expected to retard residential construction activity to some extent. Thus far, however, increased interest costs did not appear to have had any perceptible effects on housing sales or construction. Indeed, the housing sector was continuing to display a good deal of strength in many parts of the country. Some members observed that the appreciable momentum in housing activity reflected strength in the underlying fundamentals, including continued affordability, that seemed likely to sustain a high level of housing construction for a considerable period of time despite somewhat higher mortgage rates.

In the area of fiscal policy, legislative agreement had not yet been reached on how to implement the objective of a balanced federal budget over time, but decisions covering the nearer term implied continued budget restraint. On the foreign trade side of the economy, an anticipated firming of economic conditions abroad would provide impetus to real net exports. At the same time, however, imports were expected to rise appreciably in response to the expansion of domestic economic activity and the appreciation of the dollar, and on balance the external sector probably would not be boosting real GDP.

The outlook for inflation was of key importance to the formulation of monetary policy at this time, but it was clouded by substantial uncertainty. One source of uncertainty was the behavior of food and energy prices. Increases in these prices largely accounted for the more rapid rise in consumer prices thus far this year, and they likely would continue to add to inflation in the months ahead. Retail energy prices had risen appreciably, but at least some of that increase was expected to be reversed over the near term. Retail food prices did not yet display any significant effects from the sizable rise in grain prices in recent months, and while some effects on retail prices were likely, their extent and duration were difficult to gauge at this point. Moreover, it was difficult to anticipate how much the higher food and energy prices might affect inflation expectations and wage demands and thereby potentially become embedded more generally in the price structure.

Also of concern to the members were the possible effects on inflation of continued pressures on resources, especially if the current pace of the expansion should fail to moderate as much as projected. In recent years, the relationship between resource use and inflation had not followed earlier patterns. In particular, increases in labor compensation had been comparatively subdued over an extended period of what seemed to be relatively full employment highlighted by anecdotal reports of scarcities of various types of labor in numerous parts of the country. In part, worker willingness to accept comparatively limited increases in compensation could be attributed to the apparent rise in insecurity about the permanence of jobs or the availability of alternative jobs, but the reasons were not fully understood. From the standpoint of the inflation outlook, it therefore was uncertain how long the period of relatively restrained increases in labor compensation would last. Against this background, a number of members indicated that they perceived an appreciable risk of rising labor costs and related inflation, even though there was little evidence to date of such developments; others noted that they could not rule out the possibility that the favorable experience would be extended.

In the Committee's discussion of policy for the intermeeting period ahead, all the members supported a proposal to maintain an unchanged degree of pressure in reserve markets. The members agreed that the balance of risks on inflation had shifted substantially since early in the year. At that time, the economy had seemed sluggish and inflation was seen as possibly easing, but more recent developments indicated that the economy was stronger and rising inflation down the road could not be ruled out. Nonetheless, while policy might need to be firmed at some point to head off emerging inflation pressures, financial conditions were not so obviously stimulative as to counsel a need for any immediate tightening of policy. The real federal funds rate probably was not greatly out of line with its appropriate level, and the rise in longer-term interest rates and the exchange rate meant that financial conditions were now exerting more restraint than earlier this year. More information might provide a better sense of how the higher interest rates were affecting aggregate demand and perhaps also help—to a small degree—to shed light on the considerable uncertainties surrounding the relationship of output to inflation. In any event, actual inflation data—apart from food and energy prices—and many of the usual early warning signs of mounting price pressures did not yet indicate a pickup in the underlying trend of prices. Accordingly, the members viewed policy as appropriately positioned under current circumstances, though ongoing developments would need to be reassessed at the upcoming meeting in early July. Some members noted that the Committee would need to anticipate, and act to preclude, a rise in the core rate of inflation that, if it were to materialize, would be difficult and costly to reverse. In this regard, the view was expressed that a firming in policy sooner rather than later was likely to end up promoting stability in output and prices.

In the Committee's discussion of possible intermeeting adjustments to policy, all the members indicated at least some preference for retaining a symmetric directive. Members commented that the probability of developments during this period that would warrant a change in policy before the next meeting was quite low. Moreover, symmetry did not rule out an intermeeting adjustment, and the Chairman could call for a Committee consultation should the incoming information raise questions about the stance of monetary policy. Some members felt that it was especially appropriate that a policy action that represented a reversal of the previous move be made with a full discussion at a regular meeting. Some members also commented that an asymmetric directive toward restraint would imply a predisposition on the part of the Committee to tighten policy at some point, possibly at the next meeting. While they would be prepared to take such a step if the evidence warranted, their preference was to come into the July meeting without such a presumption.

At the conclusion of the Committee's discussion, all the members indicated a preference for a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that, on balance, economic activity has grown moderately in recent months. Nonfarm payroll employment changed little in April after rising substantially in the first quarter; the civilian unemployment rate fell to 5.4 percent. Industrial production increased sharply in April, largely reflecting a rebound in motor vehicle assemblies after a strike in March. Retail sales declined somewhat in April after posting a strong gain in the first quarter. Single-family housing starts rose considerably in April. Orders and contracts point to some deceleration in spending on business equipment and nonresidential structures after a very rapid expansion in the first quarter. The nominal deficit on U.S. trade in goods and services widened significantly in the first quarter from its rate in the fourth quarter of last year. Upward pressures on food and energy prices have led to somewhat larger increases in the consumer price index over recent months.

Short-term market interest rates have changed little while long-term rates have risen somewhat further since the Committee meeting on March 26. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has appreciated considerably over the intermeeting period.

Growth of M2 and M3 slowed substantially in April after recording sizable increases earlier in the year. For the year through April, both aggregates grew at rates somewhat above the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt remained moderate on balance over recent months.

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 January 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 1995 to the fourth quarter of 1996. The monitoring 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.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Ms. Phillips, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, July 2–3, 1996.

The meeting adjourned at 1:15 p.m.

Donald L. Kohn
Secretary

Meeting Held on July 2–3, 1996

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, July 2, 1996, at 1:00 p.m. and continued on Wednesday, July 3, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen

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

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

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

Messrs. D. Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn,[3] Assistant to the Board, Office of Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
Mr. Brayton,[4] Ms. Johnson,[4] Messrs. Reinhart and Smith,[5] Assistant Directors, Divisions of Research and Statistics, International Finance, Monetary Affairs, and International Finance respectively, Board of Governors
Ms. Kusko[4] and Mr. Wilcox,[4] Senior Economists, Divisions of Research and Statistics and Monetary Affairs respectively, Board of Governors
Ms. Garrett, Economist, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Holcomb, First Vice President, Federal Reserve Bank of Dallas
Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Atlanta, Richmond, and Chicago respectively
Messrs. Kos and Meyer, Vice Presidents, Federal Reserve Banks of New York and Philadelphia respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 21, 1996, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market trans-

3. Attended portion of meeting concerning issues relating to the long-run price objective for monetary policy.

4. Attended portion of the meeting relating to the Committee's discussion of the economic outlook and its longer-run growth ranges for the monetary and debt aggregates.

5. Attended portion of the meeting relating to the Committee's review of its swap line agreements.

actions in foreign currencies for System account during the period since the meeting on May 21, 1996, and thus no vote was required of the Committee.

The Manager also reported on recent developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period May 21, 1996, through July 2, 1996. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 1996 and 1997, 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 economic activity advanced considerably further in the second quarter, although growth in aggregate final demand showed some signs of slowing. Consumer spending continued to post sizable gains, but business investment in equipment and structures apparently was rising less vigorously, and higher mortgage rates evidently were starting to exert some restraint on housing construction activity. Business inventories had been brought into better balance with sales, and production and employment had risen appreciably. Upward pressures on food and energy prices had led to somewhat larger increases in the consumer price index over recent months.

Nonfarm payroll employment continued to expand briskly over April and May. Job gains were concentrated in the service-producing and construction industries, while employment in manufacturing was stable on balance over the April–May period after having declined somewhat in 1995 and the first quarter of 1996. The civilian unemployment rate rose in May to 5.6 percent, which was the average rate for the year to date.

Industrial production increased appreciably further in May. In contrast to April's advance, much of which had resulted from the resumption of operations at a major motor vehicle manufacturer after the settlement of a strike, the May rise largely reflected gains in a wide range of non-auto-related manufacturing industries as well as a weather-related jump in electricity generation. The surge in overall output lifted total utilization of industrial capacity somewhat above the average rate recorded during the previous two quarters.

Total nominal retail sales surged in May after having changed little in April; the increase in sales, coupled with available information on prices, suggested that real consumer spending on goods had risen substantially on balance since the first quarter. Recent data (available through April) indicated that spending on services had increased moderately on balance in recent months. Single-family housing starts fell considerably in May from the relatively high April level. The decline suggested that the rise in mortgage rates in recent months had begun to damp construction activity, but indicators of housing demand, such as sales of new and existing homes, remained relatively robust.

Growth in business expenditures on durable equipment and nonresidential structures appeared to be slowing following a surge in outlays in the first quarter. In May, shipments of nondefense capital goods rebounded from the substantial decline in April; however, excluding movements in the volatile aircraft category, shipments were down on balance over the two months. Among the major components, shipments of both computing and communications equipment fell sharply in April and retraced only part of that decline in May. Recent data on new orders pointed to more modest increases in spending on business equipment over the months ahead. Nonresidential building activity increased considerably further in April (latest data available), but incoming information on contracts suggested that growth in nonresidential construction would weaken somewhat in coming months.

Businesses had made considerable progress in recent months in bringing their inventories into better alignment with sales. In manufacturing, stocks rose moderately in April after a decline in March. The stock-to-shipments ratio dropped further in April and was at a low level. At the wholesale trade level, inventory accumulation was appreciable in April after several months of modest growth. The inventory-to-sales ratio for this sector edged up in April but remained well below the elevated levels of last fall. Retail inventories increased slightly in April after a large decline in March associated with a substantial liquidation of motor vehicle stocks. The aggregate ratio of inventories to sales for retail establishments was around the lower end of its range in recent years.

The nominal deficit on U.S. trade in goods and services widened in April from its rate in the first quarter, reflecting a slightly larger increase in the value of imports than in that of exports. The expansion in imports was concentrated in oil as U.S. refiners sought to meet growing domestic demand and rebuild their inventories. The rise in exports was broadly based, although exports of computers, semiconductors, and automotive products edged off. Economic activity in the major foreign industrial countries appeared to have expanded moderately on balance since the beginning of the year. In the first quarter, economic performance ranged from unexpectedly robust in Japan to further weakness in Germany; the limited data available for the second quarter suggested a slowdown in Japan, a bounceback in Germany, and moderate growth in other major trading partners.

Although upward pressures on energy prices continued to boost overall consumer prices in April and May, price increases for nonfood, non-energy items remained small. Over the twelve months ended in May, the increase in core consumer prices was appreciably smaller than in the previous twelve-month period; much of the deceleration reflected swings in automobile finance charges. At the producer level, higher prices for finished energy goods over April and May were partially offset by slightly lower prices for finished foods; prices for nonfood, non-energy finished goods were little changed over the two-month period and rose less over the twelve months ended in May than in the comparable year-earlier period. Data on average hourly earnings of production and nonsupervisory workers indicated that this measure of labor costs had increased by a somewhat larger amount in the year ended in May than in the comparable year-earlier period.

At its meeting on May 21, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth in M2 and M3 over coming months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate averaged near 5¼ percent, the level expected to be associated with the unchanged policy stance. Because the Committee's decision had been largely anticipated in financial markets, other market interest rates also were little changed during the early part of the period. However, market rates increased appreciably following the release of a strong employment report in early June, though most of that rise was later retraced as expectations of near-term tightening of monetary policy diminished. On balance, most market rates were up a little over the intermeeting period. Major indexes of stock prices were down on balance over the period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated slightly over the intermeeting period. The dollar declined against the German mark and other European currencies as growing indications of a recent pickup in economic activity in Germany damped market expectations of any further easing of monetary policy by the Bundesbank. By contrast, the dollar rose against the yen in apparent response to a series of statements by Japanese officials suggesting that there would be no near-term firming of Japanese monetary policy.

The broad monetary aggregates were weak in May: M2 declined, and M3 expanded relatively sluggishly. The weakness in M2 and M3 was associated in part with the adverse effects of the earlier rise in market interest rates on the opportunity costs of holding deposits. Deposit balances also may have been drawn down to meet unusually large individual tax liabilities on the April 15 tax date. Partial data for June pointed to a rebound in both aggregates. For the year through June, these aggregates were estimated to have grown at rates around the upper bounds of their respective annual ranges. Expansion of total domestic nonfinancial debt had slowed somewhat in recent months, but the debt aggregate had remained in the middle portion of its annual range.

The staff forecast prepared for this meeting suggested that, after a sizable advance in economic activity in the second quarter, growth would moderate and the economy would expand around or perhaps a little above its estimated potential. Consumer spending was projected to expand at a more moderate pace, in line with disposable income; the favorable effect of higher equity prices on household wealth and the still-ample availability of credit were expected to balance persisting consumer concerns about job and retirement security and the restraining effect of high household debt burdens. Homebuilding was forecast to slow somewhat in response to the back-up in residential mortgage rates but was expected to remain at a relatively high level in the context of sustained income growth and the still-favorable cash flow affordability of home ownership. Business spending on equipment and structures was projected to grow less rapidly in light of the anticipated moderate growth of sales and profits and the reduced rate of utilization of production capacity now prevailing. The external sector was expected to exert a small restraining influence on economic activity over the projection period, even though an anticipated firming of economic activity abroad would bolster demand for U.S. exports. Little further fiscal contraction was forecast over the projection period. Inflation recently had been lifted by adverse developments in energy markets and was projected to remain above the levels of recent years, given the still-high level of resource utilization and the effects of tight grain supplies on food prices.

In the Committee's discussion of current and prospective economic developments, members commented on the stronger-than-expected expansion in overall economic activity in recent months, but for a variety of reasons they anticipated that growth would slow appreciably over the second half of the year to a pace more in line with the growth in the economy's potential. Key factors bearing on this outlook included the prospective effects of the rise in interest rates and the dollar that had occurred since earlier in the year and the waning influence of transitory factors that had stimulated economic activity in the second quarter. The members generally agreed, however, that, apart from evidence of some moderation in the growth of business investment expenditures from a very rapid pace, there were few hard indications of a slowing in the expansion and the risks were clearly to the upside of their current forecasts. Against that background, they were concerned that inflation could begin to rise. Cost and price pressures had been surprisingly well contained at high levels of resource utilization, but this unusually favorable performance might not be sustained, and in any event even greater resource utilization, as would occur if growth did not moderate appreciably, carried substantial inflation risk. There were some scattered indications in statistical and anecdotal reports that tended to suggest that wage inflation might be trending higher, although key measures of price inflation, excluding their food and energy components, continued to display a flat or even a declining trend.

In keeping with the practice at meetings when the Committee sets its long-run ranges for the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members provided individual projections of the growth in real and nominal GDP, the rate of unemployment, and the rate of inflation for the years 1996 and 1997. (The ranges in this paragraph take into account minor revisions made by a few members subsequent to the meeting.) The forecasts of the rate of expansion in real GDP for 1996 as a whole had a central tendency of 2½ to 2¾ percent, reflecting expectations of considerable moderation in the rate of economic growth over the second half of the year; for 1997, the projections centered on continued moderate growth of GDP in a range of 1¾ to 2¼ percent. With regard to the expansion of nominal GDP, the forecasts were concentrated in growth ranges of 5 to 5½ percent for 1996 and 4¼ to 5 percent for 1997. The civilian rate of unemployment associated with these forecasts was expected by most members to remain around 5½ percent this year and to be in a range of 5½ to 5¾ percent in 1997. This level of resource utilization was expected to be associated with a slightly higher rate of inflation in 1996, as measured by the consumer price index, than that recorded in 1995 owing to developments in the food and energy sectors, but a decline was anticipated in 1997. Specifically, the projections converged on rates of 3 to 3¼ percent in 1996 and 2¾ to 3 percent in 1997. The projections for both 1996 and 1997 were based on individual views concerning what would be an appropriate monetary policy over the projection horizon.

In their assessment of factors bearing on the outlook for final demand, members commented that growth in consumer spending was likely to moderate in coming quarters from its pace thus far this year. This moderation would reflect the projected slowing in income growth. While overall employment conditions, the buildup of household net worth, and access to financing would bolster consumer expenditures, members also cited a number of limiting factors. The latter included the increase in consumer indebtedness, satisfaction of earlier pent-up demand for consumer durable goods, and continuing concern about job security. Higher interest rates also were expected to exert an inhibiting effect on purchases of consumer durables, including those related to housing. Some members observed that while slower growth in consumer spending was the most probable forecast, they saw an upside risk from the wealth effects of the large rise that had occurred in the value of stock market holdings.

Business expenditures for plant and equipment were expected to grow at a slower though still appreciable pace. Indeed, such spending already appeared to be moderating. Contract data suggested that nonresidential construction activity was on a slowing growth trajectory and expansion of outlays for producers' durable equipment also appeared to have softened. Given the outlook for slower growth in final demand, many businesses would not have to add significantly to capacity. However, spending for computing equipment, while perhaps moderating from the exceptional pace of recent quarters, was thought likely to remain buoyant as continuing innovations and declining prices stimulated further solid gains in this segment of business spending.

Housing was seen as another important sector of the economy that was likely to exert a retarding effect on the expansion as the rise that had occurred in mortgage interest rates was felt increasingly in housing markets. The anecdotal information from around the nation and the available statistics suggested, however, that those markets generally had remained surprisingly ebullient thus far, and there were only limited indications of some softening in home construction activity.

Business inventory investment was viewed as a key upside risk in the economic outlook for coming quarters. An inventory overhang at the end of last year had been corrected in the first quarter, and inventory investment was indicated to have turned positive again in the second quarter. However, current inventory-to-sales ratios appeared to be relatively lean, and final sales that exceeded current expectations might well induce a sharp upward adjustment in inventory accumulation, especially if lead times were to lengthen and producers perceived shortfalls in their safety stocks.

Members viewed the outlook for inflation as a source of substantial uncertainty in their forecasts, though many saw reasonable prospects that a rate of economic expansion in line with their forecasts and associated levels of capacity utilization would prove to be consistent with little change in the core rate of inflation. Some important measures of price inflation, after adjustment to exclude their volatile food and energy components, had shown a flat or even a declining trend in recent quarters. The outlook for overall price increases would remain contingent in part on food and energy price developments, but more importantly on underlying cost pressures in the economy.

Several members commented that the levels of utilization of capital and labor resources that had prevailed over the past couple of years would have been expected, on the basis of historical patterns, to foster rising cost pressures and greater inflation. However, labor compensation gains had been subdued in relation to earlier cyclical experience, likely as a consequence of increased worker concerns about job security and job opportunities. Despite the continued low rate of unemployment and widespread anecdotal reports of tight labor markets across the country, there were only limited indications in national data that wage inflation might be increasing. Whether greater labor cost pressures would emerge in the context of the members' consensus forecast for economic activity was a critical issue in the outlook for prices, though it was noted that at least some of the rising costs were likely to be absorbed in shrinking profit margins. Even if greater price inflation were averted under that scenario, the members saw a substantial risk that if economic growth did not slow in line with their current forecasts, the resulting added pressures on resources would at some point translate into higher price inflation. Accordingly, the factors bearing on the outlook for resource use and inflation needed to be monitored with special care in this period.

With regard to inflation over the long run, the members agreed that it was essential for the Committee to continue to focus on reducing inflation over time because the achievement of an even less inflationary economic environment would foster a more productive economy and maximum sustainable economic expansion. The members acknowledged that as inflation diminished to very low levels, questions about the measurement of the overall price level presented difficult problems for assessing progress toward price stability. Some also observed that the precise level of average price inflation that might be compatible with the optimal functioning of the economy was an unsettled issue owing, for example, to potential rigidities in labor markets. Thus far, such rigidities had not impeded the economy from functioning at a very high level as inflation came down, and continued adaptation to even lower inflation rates was very likely. However, the Committee would need to pay careful attention to these potential problems as inflation fell further. For now, the members agreed that some additional progress in reducing inflation was very likely to improve the ultimate performance of the economy, and that it was particularly important at this juncture to resist firmly any tendency for inflation to worsen.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey–Hawkins Act), the Committee at this meeting reviewed the ranges for growth of the monetary and debt aggregates that it had established in January for 1996, and it decided on tentative ranges for those aggregates for 1997. The current ranges set in January for the period from the fourth quarter of 1995 to the fourth quarter of 1996 were unchanged from the ranges for 1995 and included expansion of 1 to 5 percent for M2 and 2 to 6 percent for M3. An unchanged monitoring range of 3 to 7 percent was set in January for growth of total domestic nonfinancial debt in 1996.

A majority of the members favored retaining the current ranges for this year and extending them on a provisional basis to 1997. They anticipated that growth of M2 and M3 probably would continue at rates close to the upper limit of their respective ranges in both years, given the Committee's expectations for the performance of the economy and prices. However, despite a degree of concern about setting ranges that did not more comfortably encompass expected growth, these members preferred not to change the ranges for a variety of reasons. The current ranges for the broad monetary aggregates could be viewed as anchors or benchmarks for money growth that would be associated with approximate price stability and sustained economic growth, assuming behavior of velocity in line with historical experience. Accordingly, a reaffirmation of those ranges would underscore the Committee's commitment to a policy of achieving price stability over time; and in the view of some members, higher ranges could raise questions in this regard. Moreover, a change in the ranges might be misinterpreted as a signal of greater reliance on the broad monetary aggregates in the formulation and conduct of monetary policy. In this connection, the members noted that the behavior of M2 in relation to nominal GDP and interest rates had displayed a pattern over the past two years or so that was in line with historical norms before the 1990s. However, in light of difficulties in the early 1990s and changes in financial markets, the prospective growth of M2 and its velocity remained subject to considerable uncertainty and the members felt that it would be premature for the Committee to place increased reliance on M2 at this point.

A few members preferred somewhat higher growth ranges for M2 and M3 because such ranges would more comfortably surround the Committee's expectations for monetary growth. The higher ranges would be more informative for the Congress and the public as to the money growth likely to be associated with the Committee's expected economic outcomes for the period covered by the ranges. They believed that the reasons for establishing the higher ranges could readily be explained and understood as appropriate technical adjustments that did not imply any lessened commitment to the Committee's price stability goal. For example, such an explanation appeared to have been accepted with little or no comment by the public when the range for M3 was increased in July 1995.

The Committee members were unanimously in favor of retaining the current monitoring range of 3 to 7 percent for growth of total domestic nonfinancial debt in 1996 and extending that range on a provisional basis to 1997. They took account of a staff projection indicating that growth of the debt aggregate was likely to slow somewhat from its pace earlier this year in line with some moderation in the expansion of nominal income. According to the staff projection, growth in the debt measure would be near the midpoint of the existing range over the period through 1997.

At the conclusion of this discussion, the Committee voted to reaffirm the ranges for growth of M2 and M3 and the monitoring range for expansion of total domestic nonfinancial debt that it had established in January for 1996. For the year 1997, the Committee approved provisional ranges for M2 and M3 and a provisional monitoring range for total domestic nonfinancial debt that were unchanged from the 1996 ranges. In keeping with its usual procedure under the Humphrey–Hawkins Act, the Committee would review its preliminary ranges for 1997 early next year, or sooner if interim conditions warranted, in light of their growth and velocity behavior and ongoing economic and financial developments. Accordingly, the Committee voted to incorporate the following statement regarding the 1996 and 1997 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 January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1996 to the fourth quarter of 1997, of 1 to 5 percent for M2 and 2 to 6 percent for M3. The Committee provisionally set the associated monitoring range for growth of total domestic nonfinancial debt at 3 to 7 percent for 1997. 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, Jordan, Kelley, McTeer, Meyer, Mses. Phillips and Rivlin, and Mr. Stern. Votes against this action: Mr. Lindsey and Ms. Yellen.

Mr. Lindsey and Ms. Yellen dissented because they preferred somewhat higher ranges for M2 and M3 growth in 1996 and 1997. The central tendencies of the members' forecasts of nominal GDP for the two years were likely to be associated with growth of the broad monetary aggregates at rates around the top of the current ranges. Somewhat higher ranges would more comfortably encompass the anticipated growth of the monetary aggregates and in their view would conform more closely with the provisions and intent of the Federal Reserve Act that require the System to communicate its objectives and plans for monetary growth to the Congress. They believed the reasons for raising the ranges could easily be explained and understood as a technical adjustment that did not represent a reduced commitment to the goal of price stability or an increased emphasis on the monetary aggregates in policy formulation.

In the Committee's discussion of policy for the intermeeting period ahead, all but one of the members supported a proposal to maintain an unchanged policy stance. These members also indicated that they preferred or could accept an asymmetric directive that was biased toward restraint. In their view, the most likely outcome was a slowing of the expansion to a more sustainable pace and a continuation of subdued inflation. Nevertheless, they were concerned that the risks to that outcome were tilted toward higher inflation. While a strong economy generally was a welcome development, at current levels of resource use a continuation of rapid growth was not likely to be sustainable because it would have the potential for adding significantly to inflation pressures. However, inflation had remained relatively damped thus far, and the rise in interest rates among other factors was expected to curb demand. Moreover, any tendency for price pressures to mount was likely to emerge only gradually and be reversible through a relatively limited policy adjustment. The current stance of monetary policy could not be described in this view as clearly accommodative. While the federal funds rate had been reduced appreciably in nominal terms over the past year, its current level on an inflation-adjusted basis seemed to be only marginally below its peak prior to mid-1995. In the circumstances, the Committee could afford to wait for more evidence to see whether additional inflation pressures were likely to develop. A number of key economic data would become available over the next several weeks that would provide a much better basis for assessing the economy's momentum over the second half of the year and the outlook for inflation.

A differing view gave more emphasis to prospects for rising inflation and the need for immediate action to forestall a buildup of cost and price pressures before they undermined the expansion. There was little firm evidence that economic growth was slowing and reports of appreciable wage pressures were increasing. Inflation expectations persisted in financial markets, and probably in product and labor markets as well; if they were allowed to worsen, the Committee's long-run goal of price stability would become much more difficult to achieve. Delaying action risked the need for a greater adjustment in policy at a later date with possible disruption to the economy.

Members observed that an asymmetric directive would represent a shift from the symmetric directives that had been adopted over the past year but would be in keeping with their assessments of the risks of higher inflation. Several commented that an asymmetric directive did not imply a commitment to tighten monetary policy at some point, whether during the intermeeting period or at a future meeting, but it did imply the need for special vigilance. Some noted that a policy tightening action could tend to have a more pronounced effect than usual because it would indicate a shift in the direction of policy and might generate expectations of further tightening. Under the circumstances, the Committee would consult in some way before any policy tightening was undertaken.

At the conclusion of the Committee's discussion, all but one member indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that economic activity advanced considerably further in the second quarter, but increases in final demand showed some signs of moderation. Nonfarm payroll employment was up substantially in April and May; the civilian unemployment rate rose to 5.6 percent in May. Industrial production increased appreciably further in May, reflecting gains across a wide range of industries. Real consumer spending rose substantially on balance over April and May. Single-family housing starts fell considerably in May from a relatively high level in April. Orders and contracts point to some deceleration in spending on business equipment and nonresidential structures after a very rapid expansion earlier in the year. The nominal deficit on U.S. trade in goods and services widened in April from its rate in the first quarter. Upward pressures on food and energy prices have led to somewhat larger increases in the consumer price index over recent months.

Most market interest rates have edged higher since the Committee meeting on May 21. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated slightly over the intermeeting period.

M2 declined in May, though partial data for June pointed to a rebound. Growth of M3 was relatively sluggish in May but also appears to have turned up in June. For the year through June, both aggregates are estimated to have grown at rates around the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion 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 January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1996 to the fourth quarter of 1997, of 1 to 5 percent for M2 and 2 to 6 percent for M3. The Committee provisionally set the associated monitoring range for growth of total domestic nonfinancial debt at 3 to 7 percent for 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for short-run policy: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, and Yellen. Vote against this action: Mr. Stern.

Mr. Stern dissented because he was convinced that a modestly more restrictive policy was warranted. In his view, the momentum of the economy and strains on capacity in labor and some other markets raised the possibility of an acceleration of inflation that would jeopardize the economic expansion. This concern aside, Mr. Stern also believed that current circumstances were favorable for policy action to reduce inflation further and thereby help to sustain the ongoing improvement in the economy.

As a prelude to its formal review later in the year, the Committee at this meeting considered its existing network of swap arrangements with a number of foreign central banks and the Bank for International Settlements. From time to time in recent years the Committee had discussed a variety of issues relating to its foreign exchange activities and its financial arrangements with other central banks. In this discusssion, the Committee considered in particular whether the swap arrangements, all of which had been put in place in the 1960s, remained an appropriate approach to international financial cooperation among central banks in light of the evolution of the international financial system in recent decades, and whether other approaches should be considered. The Committee made no decisions relating to these matters, though it was understood that these issues would be explored further.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 20, 1996.

The meeting adjourned at 12:50 p.m.

Donald L. Kohn
Secretary

Meeting Held on August 20, 1996

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 20, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen

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

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

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, 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 Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
Ms. Johnson, Assistant Director, Division of International Finance, 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
Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, and Goodfriend, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Atlanta, and Richmond respectively
Ms. Krieger, Vice President, Federal Reserve Bank of New York
Mr. Sullivan, Assistant Vice President, Federal Reserve Bank of Chicago
Mr. Bryan, Consultant, Federal Reserve Bank of Cleveland

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on July 2–3, 1996, 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 System account during the period since the meeting on July 2–3, 1996, 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 U.S. government securities and federal agency obligations during the period July 3, 1996, through August 20, 1996. 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 economic expansion had moderated somewhat recently. Growth in consumer spending appeared to be slowing, business purchases of equipment and structures were rising less vigorously, and higher mortgage rates were beginning to exert a restraining effect on housing construction. Business inventory accumulation had been quite modest, and production and employment were expanding less rapidly. Increases in labor compensation had been somewhat larger this year, but consumer price inflation, adjusted for food and energy prices, had remained on a fairly steady trend.

Private nonfarm payroll employment increased relatively rapidly in July, though at a considerably slower pace than in the second quarter. Job growth in the services industry slowed sharply, and manufacturing employment declined appreciably after having risen somewhat in the second quarter. In contrast, the expansion in employment in wholesale and retail trade picked up slightly in July, and the number of jobs in construction continued to increase at about the second-quarter pace. The average workweek for private production or nonsupervisory workers fell considerably in July, to a level a little below its average for the second quarter, and the civilian unemployment rate edged up to 5.4 percent.

Industrial production rose slightly further in July after three consecutive months of strong gains; manufacturing production expanded less rapidly, and electricity generation dropped sharply as a result of unseasonably cool weather. A substantial increase in the production of motor vehicles and parts accounted for most of the advance in manufacturing output. Elsewhere, the manufacture of office and computing equipment continued on its strong upward trend in July while the production of other business equipment slipped. The output of consumer goods edged lower after having risen slightly in May and June. The rate of utilization of total industrial capacity declined a little in July but remained at a relatively high level.

Retail sales weakened somewhat over June and July following several months of robust growth. Sales of motor vehicles were down in both months, and spending on other goods rose sluggishly on balance. Housing starts fell somewhat further in July, reflecting a sizable decline in single-family starts that more than offset a bounceback in multifamily starts. The drop in housing starts, coupled with lower sales of new and existing homes in June (latest data available), suggested that the rise in mortgage rates was exerting a damping effect on housing demand and homebuilding activity.

Growth in business spending on durable equipment and nonresidential structures had slowed after a very rapid expansion earlier in the year. Shipments of nondefense capital goods were little changed in June after a sizable increase in May. Weakness in outlays for aircraft more than offset persisting strength in spending on office and computing equipment, and purchases of other types of equipment, notably communications and industrial equipment, continued to advance briskly. Nonresidential construction activity rebounded in June from an appreciable decrease in May. The pace of office building picked up, and construction of other commercial and industrial structures posted healthy gains after May declines.

Business inventories increased by a modest amount in June after having contracted in May. In manufacturing, inventories continued to run off in June, reducing the sector's stock–sales ratio to near its historical low. Wholesale trade stocks also fell in June, and the inventory–sales ratio was in the lower portion of its range over recent years. Retail inventories rose in June; larger stocks at automotive dealers more than accounted for the increase. The inventory–sales ratio for the sector as a whole edged higher but remained at a relatively low level.

The nominal deficit on U.S. trade in goods and services narrowed in June, but on a quarterly average basis the deficit widened in the second quarter from its rate in the first quarter. In June, the value of exports declined slightly, but the value of imports dropped by a considerably larger amount from a relatively high rate in May. Available information suggested that economic activity in the major foreign industrial countries continued to advance, but at an uneven pace; in Germany, activity rebounded from the contraction in the first quarter, while in Japan a considerable slowing of growth had occurred in the second quarter after very rapid expansion in the first quarter.

Price inflation remained moderate on balance in June and July, with declines in energy prices essentially offsetting increases in food prices. Over a somewhat longer horizon, consumer prices for nonfood, non-energy items rose slightly less in the twelve months ended in July than in the previous twelve-month period. Producer prices of finished goods other than food and energy also increased more slowly in the twelve months ended in July. In contrast, growth in labor costs had picked up. The employment cost index for private industry workers advanced at a somewhat faster rate in the second quarter than in the first quarter or in the second half of 1995. Measured over the year ended in June, the index rose by a slightly larger amount than in the previous year.

At its meeting on July 2–3, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

With economic growth moderating and inflation quiescent, open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate averaged a little higher than the level expected with an unchanged policy stance, in part because of unexpectedly high demand for reserves in late July and early August. On balance, most other short-term market interest rates declined slightly, and intermediate- and long-term rates fell somewhat more, over the intermeeting period. In the days immediately following the meeting, rates rose sharply in response to incoming data, notably the employment report for June that market participants viewed as indicating increasing pressures on economic resources and labor costs. Subsequently, however, that rise was more than reversed when further data releases were interpreted as suggesting that the economic expansion might be slowing and that the upturn in labor compensation was mild. Equity prices also exhibited considerable volatility over the period since the Committee meeting on July 2–3, with major indexes of stock prices falling steeply through late July before recouping part to most of their losses in association with the bond market rally and favorable earnings reports.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly over the intermeeting period. The flow of information suggesting a slowing in U.S. economic growth and reduced prospects for a near-term tightening of Federal Reserve policy weighed against the dollar. On the other hand, the yen was bolstered by incoming data suggesting that the Japanese current account surplus was again widening, and the German mark benefited from the Bundesbank's inaction at a time when market participants were expecting a policy easing.

Growth of M2 and M3 moderated in July. Much of the slowdown in the expansion of M2 was associated with an unexpected decline in demand deposits, which had grown rapidly earlier in the year. With bank credit expanding sluggishly, the funding needs of banks were modest, and the slower growth of M2 showed through to M3. For the year through July, both aggregates were estimated to have increased at rates somewhat below the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt had been moderate on balance over recent months and had remained in the middle portion of its range.

The staff forecast prepared for this meeting suggested that the expansion would slow to a rate around, or perhaps a little above, the economy's estimated growth potential. Consumer spending was projected to expand at a more moderate pace that would be in line with the projected increase in disposable income; the favorable effect of the earlier run-up in equity prices on household wealth and the generally ample availability of credit were expected to balance continuing consumer concerns about the adequacy of their savings and the restraining effect of high household debt burdens. Homebuilding was forecast to slow somewhat in response to the backup in residential mortgage rates but to remain at a relatively high level in the context of sustained income growth and the still-favorable cash flow affordability of home ownership. Business spending on equipment and structures was projected to grow less rapidly in light of the anticipated moderate growth of sales and profits. On balance, the external sector was expected to exert a small restraining influence on economic activity over the projection period. Only modest fiscal restraint was anticipated over the forecast horizon. Inflation recently had been lifted by adverse developments in energy markets and was projected to remain above the levels of recent years, given the high level of resource utilization, the effects of tight grain supplies on food prices, and a noticeable step-up in labor compensation reinforced by the legislated rise in the federal minimum wage.

In the Committee's discussion of current and prospective economic developments, members commented that on balance the information received since the July meeting, including anecdotal reports from around the nation, pointed to some slowing in the growth of economic activity from a very rapid pace during the spring. The extent of the slowing remained uncertain, and it was unclear at this juncture whether the expansion would slow sufficiently to contain pressures on labor and other producer resources. Nonetheless, broad measures of price inflation, adjusted to exclude their volatile food and energy components, did not exhibit any uptrend despite robust growth in economic activity this year and high levels of resource use. Indeed, some price measures suggested that inflation had trended lower through the second quarter. Moreover, there were no early signs of pressures or imbalances in the industrial sector. In labor markets, however, there were increasing indications of tightness that might at some point feed through to greater inflation. Upward wage adjustments were becoming more evident and increases in overall compensation had edged up, suggesting the possibility of further increases in labor costs at current or higher levels of labor utilization even before taking account of the effects of the rise in the minimum wage. Although increases in compensation might be moderated by greater productivity or absorbed for a time by lower profit margins, the risks seemed tilted toward increases in inflation at some point, especially if the growth of the economy continued to outstrip its potential and added to pressures on resources.

In the course of the Committee's discussion, members cited a variety of indications that economic growth was slowing from a very rapid pace, and they pointed to a number of factors that in their view should promote continued, though more moderate, expansion in economic activity. These included generally supportive financial conditions, relatively high levels of consumer confidence, and the absence of major imbalances in the economy. It was noted that much of the stimulus for the strong expansion in the first half of the year had been provided by large increases in spending for consumer durables, housing, and business equipment; however, growth in such spending could be expected to slow in the context of increasingly satisfied pent-up demands and the lagged effects of earlier increases in intermediate- and long-term interest rates on these interest-sensitive sectors of the economy. A key uncertainty in the outlook was the prospective behavior of inventories. Should the expansion in final demand fail to moderate to a sustainable pace, business firms would be likely to intensify their efforts to build their inventories, which currently were widely viewed as satisfactory or even relatively lean in relation to sales. While some buildup in inventories appeared to be occurring in the current quarter, developments that might lead to a sharp increase in inventory investment, such as shortages of various goods and materials and lengthening delays in securing deliveries, were not in evidence at this time. Accordingly, aggressive inventory accumulation remained an upside risk to the projected expansion but not one that was likely to materialize unless final demand were to exceed current forecasts by a significant margin.

In their discussion of the outlook for inflation, members observed that increases in prices had remained remarkably subdued for an extended period in relation to measures of resource utilization, notably the rate of unemployment. Such behavior differed markedly from the historical experience under similar circumstances. One factor tending to hold down prices has been highly competitive markets—throughout the nation and internationally as well—that have made it very difficult for business firms to raise prices. Another key factor, though one whose importance might now be starting to diminish, was the persistence of comparatively small increases in labor compensation, which remained appreciably below earlier norms in relation to levels of unemployment. This development appeared to reflect worker concerns about job security in a period of major business restructuring and downsizing activities as well as substantially reduced increases in benefit costs, notably those relating to health care.

In assessing whether a relatively favorable inflation performance was likely to continue, the members focused on a variety of issues. One was whether the expansion would moderate sufficiently to keep pressures on labor and other resources from intensifying. Another was whether a rate of unemployment in the vicinity of its current level would foster added wage pressures. Uncertainty also surrounded the extent to which further increases in labor compensation costs, should they materialize, would be passed through to higher prices. Improvements in productivity were likely to offset part of such increases, but how much remained an open question. In addition, profit margins were high, but the extent to which they might narrow to absorb increasing labor costs was difficult to predict. With regard to the outlook for wages, members observed that, though it was too early to reach a firm judgment, the acceleration of wage increases this year might well augur faster advances that were more in line with historical experience under essentially full employment conditions. Moreover, the tendency toward reduced increases in the costs of benefits might tend to dissipate, though some members commented that further economies in the provision of medical services might well be achievable for some period. On balance, the inflation risks in the outlook clearly seemed to be to the upside, with the potential for more inflation stemming from rising labor compensation costs augmented by a rise in the minimum wage and the prospect of higher food prices and perhaps energy prices over the next several quarters.

In the Committee's discussion of policy for the intermeeting period ahead, members focused on indications that the economy already was slowing, perhaps by enough to limit pressures on resources, and they noted that broad statistical measures of prices and the anecdotal evidence did not suggest that a pickup in inflation was already under way. Consequently, all but one of the members supported a proposal to maintain an unchanged policy stance. A number also commented that real interest rates were not unusually low, suggesting that any pickup in inflationary pressures, should that occur, would be modest and readily contained. One concern was that policy tightening at this point might generate an excessive reaction in financial markets, both because it was not generally expected and because it would represent a change in policy direction that might well lead to expectations of further policy tightening. Such a development could have serious adverse consequences for economic activity if the expansion was in fact already slowing to a more sustainable and less inflationary pace. These members therefore concluded that the prudent course at this point was to await further developments that would permit them to assess the possible need for some tightening with a higher degree of confidence. At the same time, it was emphasized that the Committee remained committed to a policy that would resist a rise in inflation; such a policy would entail moving in anticipation of greater price pressures and before they showed through to actual inflation. Accordingly, they also agreed on the desirability of a directive that remained biased toward possible tightening in the intermeeting period ahead. Such a directive would imply that any tightening should be implemented promptly if developments were perceived as pointing to rising inflation. For now, the Committee should remain particularly vigilant to incoming information bearing on the outlook for inflation.

A differing view gave more weight to the risks of rising inflation. In this view, while there were uncertainties, the weight of the evidence suggested that a prompt policy action was needed to contain inflation and set the stage for further progress toward price stability. The possibility of an overreaction in financial markets to a tightening move could not be ruled out, but such a reaction was likely to be short-lived. More importantly, a prompt action would reduce the risk that inflation would worsen and pose difficult problems for monetary policy later.

At the conclusion of the Committee's discussion, all but one member indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and M3 over coming months.

At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that growth in economic activity recently has moderated somewhat. Private nonfarm payroll employment grew less rapidly in July, the average workweek fell sharply, and the civilian unemployment rate edged up to 5.4 percent. Industrial production increased slightly in July after three months of strong gains. Real consumer spending weakened somewhat on balance over June and July following several months of robust growth. Housing starts fell somewhat further in July. Growth in spending on business equipment and nonresidential structures has slowed after a very rapid expansion earlier in the year. The nominal deficit on U.S. trade in goods and services widened in the second quarter from its rate in the first quarter. Increases in labor compensation have been somewhat larger this year, but consumer price inflation, adjusted for food and energy prices, has remained on a fairly steady trend.

Most short-term market interest rates have declined slightly while intermediate- and long-term rates have fallen somewhat more since the Committee meeting on July 2–3, 1996. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated slightly over the intermeeting period.

Growth of M2 and M3 moderated in July. For the year through July, both aggregates are estimated to have grown at rates somewhat below the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion 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 July reaffirmed the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on a tentative basis to set the same ranges as in 1996 for growth of the monetary aggregages and debt, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, and Yellen. Vote against this action: Mr. Stern.

Mr. Stern dissented because he believed that policy should become modestly more restrictive. He was concerned that, in the absence of a substantial and sustained improvement in productivity, the prevailing pattern of demand might engender an increase in inflationary pressures, and that such pressures would ultimately threaten the ongoing economic expansion. In Mr. Stern's judgment, it was prudent at this point to resist such a development in order to lay a foundation for the long-term health of the economy.

It was agreed that the next meeting of the Committee would be held on Tuesday, September 24, 1996.

The meeting adjourned at 12:45 p.m.

Donald L. Kohn
Secretary

Meeting held on September 24, 1996

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, September 24, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen

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

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rosenblum, Siegman, Simpson, Sniderman, 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 Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
Mr. Smith,[6] Assistant Director, Division of International Finance, 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
Messrs. Beebe, Davis, Dewald, Eisenbeis, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, St. Louis, Atlanta, and Chicago respectively
Messrs. Bentley, Hetzel, Ms. Krieger, and Mr. Rosengren, Vice Presidents, Federal Reserve Banks of New York, Richmond, New York, and Boston respectively
Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 24, 1996, 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 System account during the period since the meeting on August 20, 1996, and thus no vote was required of the Committee.

6. Attended portion of meeting relating to proposal to amend the Authorization for Foreign Currency Operations.

The Manager also reported on recent developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period August 20, 1996, through September 23, 1996. 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 expansion of economic activity had moderated appreciably from an elevated second-quarter pace. Growth in consumer spending had slowed noticeably, and higher mortgage rates seemed to be exerting some modest restraint on housing demand. While business demand for durable equipment remained strong, spending on nonresidential structures had weakened a little. Business inventory accumulation appeared to have picked up, although the level of inventories remained modest in relation to sales. Employment and production had continued to post sizable gains in recent months, but the increases were somewhat below those recorded earlier in the year. Consumer price inflation, excluding its food and energy components, had edged lower this year despite somewhat larger increases in labor compensation.

Private nonfarm payroll employment grew less rapidly over July and August than it had in the second quarter; aggregate hours worked by private production workers also expanded at a slower pace over the two-month period. Job growth in the services industries was somewhat lower over the two months compared with that of the second quarter. Manufacturing employment changed little on balance over the July–August period, and construction hiring was down considerably in August after a July increase that was a little above the pace of the second quarter. The civilian unemployment rate declined to 5.1 percent in August.

Industrial production also advanced somewhat less rapidly on average in July and August after having recorded strong gains in the previous few months; slower growth was evident in mining and utilities as well as in manufacturing. Smaller increases in the output of motor vehicles and parts accounted for part of the slowdown in the expansion of the manufacturing sector in August; in addition, the output of consumer goods other than motor vehicles remained sluggish, and the production of construction supplies declined significantly after having surged in the second quarter. Elsewhere in manufacturing, business equipment, notably its office and computing component, continued its robust expansion over July and August, and defense and space equipment extended the upturn that had begun in the second quarter. The rate of utilization of total industrial capacity was unchanged on balance from June to August and remained at a relatively high level.

Total retail sales rose slightly over July and August after having declined substantially in June. Decreased outlays at food stores, gas stations, and furniture and appliance stores in August were a little more than offset by a sharp pickup in sales at general merchandisers, apparel stores, and outlets for durable goods other than furniture and appliances. Housing starts rebounded in August from a July drop and for the two months were about unchanged on average from their second-quarter level; however, permits for single-family housing were unchanged in August and had fallen from their second-quarter level. Sales of existing homes weakened in June and July.

Demand for business equipment had remained strong in recent months. Shipments of nondefense capital goods declined in July, retracing part of a substantial second-quarter advance, but recent data on new orders pointed to further increases in business spending for durable equipment, notably office and computing equipment, in coming months. Nonresidential construction activity fell somewhat in July after having decreased a little in the second quarter.

Business inventory investment picked up sharply in July; most of the increase occurred at retail establishments. Manufacturing inventories rose somewhat, with the gain concentrated at manufacturers of producers' durable equipment. The stock–sales ratio for the sector was around its historical low. In the wholesale sector, inventories edged higher in July despite a substantial drop in stocks of farm products, and the inventory–sales ratio for the sector fell to the low end of its range over recent years. Retail stocks expanded considerably at both automotive dealers and non-auto establishments in July. Inventory–sales ratios edged higher in most retail categories, but they remained at relatively low levels.

The nominal deficit on U.S. trade in goods and services widened substantially in July from its June level and also from its average rate for the second quarter. Despite one-time service payments related to the Olympics and larger inflows of imported oil, imports edged down in July from the sharply increased rate recorded for the second quarter; the latter largely reflected the strength of the U.S. economy during the first half of the year. Exports fell considerably more in July than did imports; in addition to decreased exports in such categories as consumer goods, aircraft and parts, automotive products, and other industrial supplies, part of the measured decline may have reflected residual seasonality in the data. Available information suggested that, on balance, the economies of the major foreign industrial countries had strengthened in recent months. In Japan, a mild second-quarter pause after very rapid first-quarter growth had been followed by renewed expansion. Economic activity in Germany had rebounded sharply in the second quarter from a first- quarter contraction, and further expansion appeared to be in train. Although economic growth had been sluggish in Canada and the United Kingdom in the second quarter, recent indicators suggested a pickup in activity in those countries as well. By contrast, France and Italy had experienced little, if any, growth since early in the year.

Consumer price inflation remained moderate on balance over July and August; declines in energy prices offset higher food prices. Excluding food and energy, consumer prices recorded a somewhat smaller advance over the twelve months ended in August than over the previous twelve months. Producer prices of finished goods other than food and energy were unchanged on net over July and August, and this index rose at a significantly slower pace over the twelve months ended in August than over the preceding twelve months. Average hourly earnings of production or nonsupervisory workers rebounded in August, more than offsetting a small July decline. Over the year ended in August, this measure of labor costs increased considerably more than it had over the previous year.

At its meeting on August 20, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

With incoming information generally confirming that economic growth was moderating and that price inflation remained subdued, open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate generally remained close to the level expected with an unchanged policy stance, but most other market interest rates exhibited considerable volatility and rose somewhat on balance over the intermeeting interval. Despite the rise in many market interest rates, equity prices rebounded over the period, and most major market indexes reached record highs.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies appreciated slightly over the intermeeting period. The dollar's rise reflected in part the increase in U.S. long-term interest rates over the period. Declines in market rates abroad, both short- and long-term, also contributed to the dollar's strengthening. In Japan, newly released data led market participants to lower their assessments of the strength of that country's economic expansion and of the prospects of any near-term increase in official interest rates. In Germany, a reduction by the Bundesbank in its repo rate in late August and subsequent statements by Bank officials regarding possible additional declines in official rates appeared to foster market expectations that monetary policy might be eased further.

Growth of M2 and M3 picked up in August from sluggish rates in July but remained below the average increases over the first half of the year. A continuing, rapid runoff in the liquid deposit components of these aggregates was offset in part by solid gains in retail money market funds and small time deposits, whose yields had not declined in step with decreases in market interest rates in early August. For the year through August, both aggregates grew at rates in the upper portions of their respective annual ranges. Expansion in total domestic nonfinancial debt had been moderate on balance over recent months and had remained in the middle portion of its range.

The staff forecast prepared for this meeting, which differed little from that for the previous meeting, suggested that the expansion would slow to a rate around, or perhaps a little above, the economy's estimated growth potential. Expansion of consumer spending was forecast to rebound from the sluggish third-quarter rate in light of strong income trends, the favorable effect of the rise in the stock market this year on household wealth, and the generally ample availability of credit. Homebuilding was anticipated to slow somewhat in response to this year's increase in residential mortgage rates but to remain at a relatively high level in the context of sustained income growth and the still-favorable cash flow affordability of home ownership. The expansion of business investment in equipment and structures was projected to slow gradually in response to an easing of pressures on capacity, a prospective slackening in the growth of corporate cash flows, and the rise in long-term interest rates that had occurred this year. Only modest fiscal restraint was anticipated over the forecast period. Inflation, which had been boosted thus far in 1996 by adverse developments in food and energy markets, was projected to remain somewhat above that of recent years, given high levels of resource utilization and a noticeable step-up in labor compensation that would be reinforced by the legislated rise in the federal minimum wage.

In the Committee's discussion of current and prospective economic developments, members commented that the incoming information had been mixed since the August meeting but that on the whole it continued to suggest appreciable slowing in the economic expansion from a rapid and unsustainable pace in the second quarter. Data for many components of final demand, notably in the consumer sector, indicated that economic growth had moderated considerably in recent months. At the same time, supply-side data including employment and industrial production had remained relatively robust, contributing to uncertainty about underlying growth and suggesting that inventory accumulation had picked up during the summer. While the extent of the slowing in the overall expansion remained unclear, there were no indications of serious imbalances in the economy, and the members generally viewed further growth at a pace near that of the economy's potential as a likely prospect. They continued to be concerned, however, about the outlook for inflation, given the high level of production. In that regard, some commented that labor markets appeared to have tightened further in recent months and that wages were rising at a somewhat faster pace. Even so, the rate of price inflation had not picked up and the prospects were good that inflation would remain contained for some time. Whether the factors that had contributed to such a price performance would persist remained a key uncertainty in the economic outlook, and the members generally agreed that the risks continued to be tilted to some extent in the direction of rising price inflation over the forecast horizon.

In their discussion of the outlook for spending in key sectors of the economy, members commented that consumer expenditures were likely to pick up after their summer lull, though probably to a pace appreciably below that in the first half of this year. Favorable factors in the outlook for consumer spending included strong gains in employment and income, the wealth effect stemming from the rise that had occurred in the value of financial assets, and generally buoyant consumer sentiment. The improvement in the consumer sector would tend to be restrained, however, by the increase in consumer debt burdens and the probable satisfaction of much of the pent-up demands for consumer durables during the current expansion. Business fixed investment likewise was expected to provide considerable further stimulus to the economy. Expenditures for business equipment, notably for office and computing equipment, were expected to expand substantially further, and recent weakness in nonresidential construction might well prove to be temporary, judging in part from anecdotal reports of considerable strength in commercial real estate markets in many areas. On the whole, however, the completion of numerous capital spending programs in conjunction with slower projected growth in overall demand could be expected to temper the expansion of business investment over coming quarters. In the housing sector, recent developments were somewhat mixed, but they suggested on balance that housing activity had held up better than expected in the light of increased mortgage interest rates. It was suggested in this regard that the retarding effects of higher rates on fixed-rate mortgage contracts were being blunted to some extent by shifts toward adjustable rate mortgages. Even so, and consistent with the softening already observed in a number of areas, residential construction was thought likely to drift lower over time.

The outlook for inventory investment, as is typically the case, was very difficult to assess. The moderation in the expansion of final demand in recent months, together with still relatively robust growth in employment and production, suggested that inventory investment had picked up since the second quarter. The strength in inventories in July tended to confirm that assessment. However, assuming moderate economic growth in line with current forecasts, there was no reason to anticipate substantial further strengthening in inventory investment over coming quarters. Indeed, the recent rebuilding of inventories after little or no growth earlier in the year made rapid expansion less likely going forward. The members acknowledged, nonetheless, that inventory developments needed to be monitored with care, including such indirect signs as rising pressures on the prices of intermediate goods and tightening delivery schedules that might provide incentives for a rapid buildup. With capacity utilization already at high levels, relatively rapid growth in inventory investment, if it were superimposed on stronger-than-projected expansion in final demand, could portend serious pressures on resources and inflationary consequences for the economy.

In their comments about the outlook for inflation, members observed that the recent behavior of price inflation was a welcome though highly unusual development, given current pressures on resources. The statistical and anecdotal information provided evidence of increasingly tight labor markets that under similar conditions historically had been associated with considerable upward pressure on nominal labor compensation and, in turn, on prices. While wages, and probably total labor compensation, were rising more rapidly this year, the acceleration in the latter still appeared to be held down by worker insecurity and relatively subdued increases in the cost of benefits. Moreover, for a variety of reasons rising labor costs were not currently being passed through to prices, which by several key measures adjusted for their volatile food and energy components exhibited a steady or even a declining trend. Explanations tended to concentrate on the intense competition in many markets, which prevented firms from raising prices to absorb cost increases.

Competitive pressures also were compelling firms to curb cost increases through improvements in their productivity performance. Widespread reports suggested major gains in productivity in numerous industries, induced in recent years by business restructuring and related activities and by large capital investments that had introduced increasingly productive equipment. Although currently available measures of productivity for the economy as a whole showed only weak gains, sectoral disaggregation of the data gave reasons to question the productivity measurements. Productivity had increased fairly sharply in manufacturing, and the slowdown in overall productivity since 1973 had been concentrated in the service areas of the economy. Indeed, measured productivity in noncorporate businesses—largely services—had displayed a negative trend for many years. This result was implausible and suggested considerable error in estimating output and prices for many services. Consequently, it was likely that actual productivity growth was higher than the current measures indicated. By the same token, the rate of price inflation was lower than had been reported, consistent with the findings of a number of studies of distortions in published price data.

The implications for the inflation outlook were not clear-cut. The key question was how long the favorable price behavior would persist. Advances in productivity had boosted profit margins, and high margins were helpful in that they could absorb some portion of any cost increases for a time. However, many business contacts indicated that they would resist squeezes in profit margins, and continued acceleration in costs would eventually feed through to greater price inflation whatever the rate of productivity growth. The behavior of costs and the ability of businesses to pass along any greater increases over time would depend on the extent to which the expansion would slow and how much associated pressure there would be in labor and product markets. In this connection, some members observed that even if the expansion were to slow to a sustained pace around the rate of increase of the economy's potential, price inflation could well trend at least modestly higher at current levels of resource utilization. Others did not disagree that the odds might be tilted marginally in that direction, but they continued to believe that a great deal of uncertainty surrounded the outlook for resource use and, in turn, the relationship between a given degree of pressure on resources and overall price changes. In sum, assuming economic growth generally in line with their forecasts, the critical question for some was when and how much inflation would rise; many others were not persuaded of the inevitability of such an outcome.

In the Committee's discussion of policy for the intermeeting period ahead, nearly all the members indicated that they could support an unchanged policy stance and the retention of a bias toward restraint in the directive. The members generally agreed that while the risks were greater that price inflation would rise than that it would fall, higher inflation was not a foregone conclusion and most believed that the uncertainties in the outlook made it prudent to hold monetary policy on a steady course and await further developments. The expansion appeared to be slowing substantially and broad measures of prices, adjusted for fluctuations in their food and energy components, still indicated a steady or even slightly declining inflation trend. In these circumstances, the Committee could wait for more information on the momentum of the expansion and the degree of pressure on resources and its implications for inflation. A delay in adjusting monetary policy was facilitated by its current positioning, which did not appear to be far from a desirable longer-term stance because any pickup in inflation was likely to be relatively small and gradual, and was further supported by the possibility of an excessive reaction in financial markets to a change in the direction of policy. A few members indicated that they could vote for some slight tightening in policy, although they did not feel any urgency about such a move. They observed that the decision was a close one for them, and in light of the uncertainties that were involved, they were willing to join the majority and wait for further evidence bearing on the outlook for inflation. With regard to possible intermeeting adjustments to policy, the members agreed that retaining an asymmetric directive that was biased toward restraint would be consistent with their assessments of the inflation risks in the economy. Accordingly, information suggesting that the odds on higher inflation had risen should be met with a prompt policy firming.

A differing view focused on the desirability of a prompt move toward restraint to curb what were seen as growing inflationary pressures in the economy. Tight labor markets were likely to exert continuing upward pressure on labor costs, barring unexpected weakness in the economy, and at some point those costs would begin to be passed through to prices. In the circumstances, it was important for policy to be forward-looking and to move promptly to head off intensifying inflationary pressures. Potentially, waiting could require more disruptive policy tightening actions later and could risk the credibility of the System's anti-inflation policy.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could accept a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and M3 over coming months.

The Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that growth in economic activity has moderated appreciably from an elevated second-quarter pace. Private nonfarm payroll employment grew less rapidly over July and August than in the second quarter, while the civilian unemployment rate declined to 5.1 percent in August. Industrial production increased somewhat less rapidly on average in July and August than in the prior few months. Total retail sales rose slightly over July and August after having declined substantially in June. Housing starts in July and August were unchanged on average from their second-quarter level. Demand for business equipment has remained strong, while spending on nonresidential structures has changed little on balance in recent months. The nominal deficit on U.S. trade in goods and services widened substantially in July from its average in the second quarter. Increases in labor compensation have been somewhat larger this year, but consumer price inflation, excluding its food and energy components, has edged lower.

Most market interest rates have risen somewhat on balance since the Committee meeting on August 20, 1996. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has appreciated slightly over the intermeeting period.

Growth of M2 and M3 picked up in August, but they continued to expand at rates below those in the first half of the year. For the year through August, both aggregates are estimated to have grown at rates in the upper portions of their respective ranges for the year. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion 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 July reaffirmed the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on a tentative basis to set the same ranges as in 1996 for growth of the monetary aggregages and debt, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, and Yellen. Vote against this action: Mr. Stern.

Mr. Stern dissented because he believed that a modestly more restrictive policy was appropriate. In his view, historical precedents suggested that prolonged periods of taut labor markets were eventually associated with rising inflation. Given prevailing pressures on resources, especially labor, Mr. Stern was concerned about the distinct risk of an acceleration of inflation. Should this acceleration occur, he believed it would prove disruptive to the favorable performance of the economy, and he preferred to begin to address this risk promptly.

Amendment to Authorization for Foreign Currency Operations

At this meeting the Committee considered a proposal to replace the existing twelve-month maturity limit on the investment of foreign currency balances with an eighteen-month average duration limit. The proposal was designed to allow the Manager a wider choice of maturities and hence somewhat greater operational flexibility in the implementation of the System's primary portfolio objectives of liquidity with respect to investments in foreign government securities and limits on overall interest rate and credit risks. At the conclusion of their review, the Committee members voted unanimously to amend section 5 of the Authorization for Foreign Currency Operations to read as follows:

> 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.

Liquidity Management and the Maturity Structure of the SOMA Portfolio

The Committee also reviewed, on a preliminary basis, its current practices with regard to the maturity structure of the System Open Market Account (SOMA) portfolio of Treasury obligations. In its last such review, at its meeting on March 31, 1992, the Committee decided that the enhanced liquidity of the SOMA portfolio that had been achieved should be maintained but that net additions to System holdings should continue to be spread across all maturity areas. In the course of their discussion at this meeting, the members agreed that the primary objective in the management of the SOMA portfolio was to ensure a high degree of liquidity so that prompt and effective adjustments could be made without unduly affecting the market for Treasury securities.

It was agreed that the next meeting of the Committee would be held on Wednesday, November 13, 1996.

The meeting adjourned at 1:40 p.m.

Donald L. Kohn
Secretary

Meeting Held on November 13, 1996

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 Wednesday, November 13, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen

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

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

Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Siegman, Simpson, Sniderman, 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 Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
Mr. Reinhart, Assistant Director, Division of Monetary Affairs, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors
Mr. Moore, First Vice President, Federal Reserve Bank of San Francisco
Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, St. Louis, Atlanta, Richmond, and Chicago respectively
Messrs. Cox and Judd, Vice Presidents, Federal Reserve Banks of Dallas and San Francisco respectively
Ms. Perelmuter, Assistant Vice President, Federal Reserve Bank of New York

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 24, 1996, 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 System account during the period since the meeting on September 24, 1996, and thus no vote was required by 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 September 24, 1996, through November 12, 1996. By unanimous vote, the Committee ratified these transactions.

By unanimous vote, the Committee authorized the renewal for an additional one-year period of the System's reciprocal currency (''swap'') arrangements with foreign central banks and the Bank for International Settlements. The amounts and maturity dates of the arrangements approved for renewal are shown in the table below.

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 growth of economic activity slowed substantially in the third quarter, and the limited information available for the period since then indicated continued moderate expansion. A marked softening in the growth of consumer expenditures accounted for much of the slowing in the third quarter, but slight weakening

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Term (months)	Maturity date
Austrian National Bank	250	12	12/04/96
Bank of England	3,000	↑	12/04/96
Bank of Japan	5,000		12/04/96
Bank of Norway	250		12/04/96
Bank of Sweden	300		12/04/96
Swiss National Bank	4,000		12/04/96
Bank for International Settlements:			
Swiss francs	600		12/04/96
Other authorized European currencies	1,250		12/04/96
Bank of Mexico	3,000		12/13/96
Bank of Canada	2,000		12/15/96
National Bank of Belgium	1,000		12/18/96
National Bank of Denmark	250		12/28/96
Bank of France	2,000		12/28/96
German Federal Bank	6,000		12/28/96
Bank of Italy	3,000		12/28/96
Netherlands Bank	500	↓	12/28/96

in housing demand, net exports, and federal purchases of goods and services also exerted retarding effects. On the other hand, a sizable increase in inventory investment, greater strength in business demand for durable equipment, and an upturn in spending on nonresidential construction helped foster moderate further economic growth in the third quarter. Employment posted sizable increases over the third quarter and rose substantially further in October, but on balance the gains were somewhat below those recorded earlier in the year. Industrial production had weakened somewhat recently. Consumer price inflation had picked up this year because of larger increases in food and energy prices. Increases in labor compensation, though moderating in the third quarter, also had been somewhat larger this year.

Private nonfarm payroll employment increased considerably in October after a small rise in September; private payroll growth had moderated on balance since midyear but nevertheless had remained substantial. In October, job gains were large in service industries; construction employment registered another moderate gain; and manufacturing payrolls edged up after a sizable September loss. The civilian unemployment rate in October was unchanged at 5.2 percent.

Industrial production appeared to have declined appreciably in October after having grown briskly on balance over earlier months of the year. Much of the slackening in October resulted from work stoppages in the motor vehicles industry, but the output of other industries also apparently decreased slightly on balance. The drop in production was accompanied by a slight decline in capacity utilization in manufacturing.

Total retail sales rose appreciably in September after having changed little on net over July and August; for the third quarter as a whole, total retail sales edged higher after having expanded briskly in the first half of the year. September sales totals were boosted by strong spending at automotive dealers, food stores, and nondurable goods outlets. However, expenditures for furniture, appliances, and other non-auto durable goods fell, and apparel sales weakened a little further. Housing starts declined in September from the unusually high level recorded in August, and permits moved lower for a second straight month. Home sales were mixed, with sales of new homes well sustained in September while those of existing homes continued on a downtrend.

Growth of business fixed investment surged in the third quarter. Outlays for durable equipment picked up sharply, and new orders for business equipment remained on an upward trend. Sales of computers and communications equipment increased rapidly, but demand for other capital goods was up only slightly during the quarter. In the transportation sector, expenditures on motor vehicles and aircraft strengthened while sales of heavy trucks continued to drift lower. Spending on nonresidential structures more than reversed a second-quarter decline; however, incoming data on contracts pointed to a continuation of the pattern of somewhat slower growth recorded thus far in 1996.

The pace of inventory investment picked up markedly after midyear, but inventory–sales ratios nonetheless remained relatively low. In manufacturing, inventories rose moderately in the third quarter, more than offsetting a small rundown in stocks in the previous quarter; stock–shipments ratios for most industries remained near the low end of their recent ranges. In the wholesale sector, inventories declined sharply in September after having edged down in the previous two months, and the aggregate inventory–sales ratio for the sector fell to the low end of its range over recent years. At the retail level, substantial inventory accumulation occurred over the July–August period (latest data). Although stock–sales ratios rose slightly, inventories remained relatively well aligned with sales.

The nominal deficit on U.S. trade in goods and services narrowed somewhat in August from a high rate in July; however, for the two months combined, the deficit was considerably wider than its average rate for the second quarter. Exports declined appreciably over the July–August period, with most of the decrease occurring in nonmonetary gold and aircraft. Imports rose only marginally on balance over the two months. The limited available information suggested that, on average, economic activity in the major foreign industrial countries expanded moderately in the third quarter.

Consumer price inflation had picked up on balance this year as a result of sizable increases in food and energy prices. Over August and September, however, increases in food prices were offset by a net decline in energy prices, and overall consumer prices rose more moderately. For the twelve months ended in September, the advance in consumer prices of items other than food and energy was a little smaller than it had been over the previous twelve months. At the producer level, price inflation also was moderate over August and September despite appreciable increases in the prices of food and energy items; producer prices of items other than food and energy rose considerably less over the twelve months ended in September than they had over the previous twelve months. Growth in the employment cost index for private industry workers slowed considerably in the third quarter after having trended up over the first two quarters of the year; however, this measure of labor compensation was up slightly over the twelve months ended in September compared with the previous twelve months. Average hourly earnings of production and nonsupervisory workers were unchanged in October, but the twelve-month rise in this index through October was a bit larger than the increase over the previous twelve months.

At its meeting on September 24, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

With incoming information continuing to suggest moderate economic growth and subdued price inflation, open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions, and the federal funds rate generally remained close to the level expected with an unchanged policy stance. Market participants had anticipated some tightening of monetary policy at the September 24 meeting, and the announcement of an unchanged policy led to an immediate decline in interest rates, with the larger decreases occurring at the shorter end of the yield curve. Interest rates, especially those at intermediate and longer maturities, dropped further over the remainder of the period in response to information indicating that price and labor cost pressures were lower than market participants had expected. Equity markets responded to the declines in interest rates as well as to favorable earnings reports, and most major indexes reached record highs.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated slightly on balance over the intermeeting period. Interest rates in the foreign industrial countries fell somewhat less on average than did U.S. interest rates. The dollar changed little against the German mark and most other major continental European currencies, but it rose against the yen as prospects for a significant supplemental budget package in Japan waned in the aftermath of the recent elections in that country. The dollar declined against the pound sterling in response to the release of favorable data on the U.K. economy as well as an unexpected increase in the Bank of England's minimum lending rate.

M2 grew at a slower pace in September and October than it had over earlier months of the year; the weaker expansion resulted from a continuing rapid runoff in its liquid deposit components. Nonetheless, M2 was estimated to have grown for the year through October at a rate in the upper half of the Committee's annual range. By contrast, M3 expanded at a substantially faster rate in September and October than it had earlier in the year, reflecting a surge in its large time deposit and other managed liability components to meet business demand for bank loans. For the year through October, M3 was estimated to have grown at a rate around the top of its annual range. Total domestic nonfinancial debt had expanded moderately on balance over recent months and had remained in the middle portion of its range.

The staff forecast prepared for this meeting suggested that the expansion would continue at a rate close to, or perhaps a little above, the economy's estimated growth potential. Consumer spending was projected to rebound in the current quarter and subsequently to expand at a moderate pace in line with the projected increase in disposable income; the favorable effect on household wealth of the rise that had occurred in stock prices and the ample availability of credit for most borrowers were expected to balance continuing consumer concerns about the adequacy of their savings and the restraining effect of high household debt burdens. Homebuilding was forecast to decline slightly further in response to the previous backup in residential mortgage rates but to stabilize at a relatively high level in the context of continued income growth and a generally favorable cash flow affordability of home ownership. Business spending on equipment and structures was projected to grow less rapidly in light of the anticipated moderate growth of sales and profits. On balance, the external sector was expected to exert a small restraining influence on economic activity over the projection period. A slight degree of fiscal restraint was anticipated over the forecast horizon. Continued pressure on resources, especially in labor markets, pointed to a likely underlying tendency toward higher inflation over the projection period; however, it was expected that improved supply conditions in food and energy markets, as well as planned technical changes, would damp increases in the consumer price index relative to the elevated 1996 rate.

In the Committee's discussion, members commented that most recent developments bearing on the outlook for economic growth and inflation had been favorable. The information on economic activity since the September meeting had confirmed earlier indications of appreciable slowing in the expansion to a sustainable pace close to the economy's potential. The outlook remained subject, as usual, to considerable uncertainty, but many of the members observed that underlying trends in key sectors of the economy along with generally supportive financial conditions seemed consistent with further moderate economic expansion. In this regard, several focused on what they saw as the promising prospects for a rebound in the growth of consumer expenditures following weak expansion in the third quarter; the pickup would help sustain moderate economic growth over the nearer term despite some anticipated retrenchment in inventory accumulation. With respect to the outlook for inflation, members emphasized that despite widespread indications of tight labor markets, the increase in wages had been muted and somewhat less than anticipated, and there was no broad evidence of rising price inflation. Indeed, many major measures of inflation had exhibited a slight downtrend since 1993. Looking ahead, views differed to some extent regarding the most likely course for inflation. Several members indicated that, while recent developments were encouraging, they continued to see the risks as tilted toward some rise, even assuming that the expansion settled into a pattern of growth near the economy's potential as they anticipated and resource utilization remained near current levels; other members felt that the risks surrounding the forecasts for both economic growth and price inflation had become more evenly balanced, but more evidence was needed before a firm judgment could be reached.

In their review of developments in key sectors of the economy, members said that they anticipated a pickup in consumer spending from its much reduced rate of growth in the third quarter. While the factors relating to the prospects for consumer expenditures did not all point toward greater strength, members tended to focus on those favoring an upturn. These included persisting growth in employment and incomes and clearly upbeat consumer sentiment as evidenced by recent surveys and anecdotal reports. Financial factors also seemed likely on balance to accommodate continuing growth in consumer spending, in particular the marked increases that had occurred in the value of stock holdings and a still-ample availability of credit to most households. Supporting evidence included anecdotal reports from retailers in a number of areas who were experiencing sizable gains in sales and seemed optimistic about the outlook for the upcoming holiday season. Among the developments that would tend to limit growth in consumer spending, members emphasized that the level of consumer indebtedness had strained the liquidity of many households. The growth of consumer credit was now exhibiting a moderating trend, possibly pointing to restrained spending by many households because of already heavy debt service burdens and generally tightening credit standards for consumer loans. Other negative factors cited in the outlook for consumer expenditures were the possibility of a correction in the stock market and the probable satisfaction of much of the earlier pent-up demand for consumer durables. In balancing these conflicting influences, the members generally concluded that a pickup in the growth of consumer spending to a moderate pace was a likely prospect for this critical sector of the economy.

Business fixed investment was expected to provide further but diminished impetus to the expansion. This view took account of the continued availability of debt and equity financing on favorable terms but also of expectations of a more moderate growth trend in sales and the substantial buildup that had already occurred in stocks of equipment and structures. With regard to the latter, some overbuilding of commercial and other structures characterized conditions in a number of areas. Nonetheless, members reported considerable nonresidential building activity in several parts of the country, and nationwide such activity was expected to help sustain modest growth in overall nonresidential construction in coming quarters.

Recent data, supported by anecdotal reports from several though not all parts of the country, suggested that residential building activity was slowing somewhat, apparently in lagged response to earlier increases in mortgage interest rates. However, in the context of the partial reversal recently of the previous increases in mortgage rates and sustained growth in employment and incomes, the housing sector was viewed as likely to exert only a minor constraint on overall economic activity over the forecast horizon. Another somewhat negative factor in the outlook for economic activity was the prospect of some widening in the nation's trade deficit over the projection period.

Fiscal policy currently remained on a mildly restrictive course, but the range of potential developments was especially wide, injecting an element of considerable uncertainty in the economic outlook. Legislation affecting the federal budget could have marked beneficial or adverse effects not only directly on spending and incomes but also on business and consumer confidence and financial markets.

The growth of nonfarm business inventories in the third quarter had exceeded earlier expectations, but members commented that the sizable rise appeared to have been largely voluntary and the overall level of inventories was still historically low in relation to sales. Against this background, inventory accumulation was likely to continue but at a slower pace in the current quarter. Beyond the near term, inventory investment was expected to become a more neutral factor in the performance of the economy, given the absence of incentives to build stocks relative to sales in a period of moderate growth in projected demand. The members recognized, however, that the prospective behavior of inventories remained subject to substantial uncertainties.

In their discussion of the outlook for inflation, members again focused on developments in labor markets and the extent to which rising cost pressures in those markets might be passed through to higher prices. The statistical and anecdotal information generally continued to point to tight labor markets and to a somewhat faster rise in labor compensation costs this year. Even so, the increases in such costs were still falling short of those that would have been anticipated on the basis of historical experience under similar labor market conditions. Moreover, the advance in the overall employment cost index in the third quarter, while perhaps understated to some extent, was appreciably below expectations. At the same time, business firms generally were not raising their prices sufficiently to compensate for faster increases in their labor costs, to the extent that the latter were occurring, evidently because of the persistence of intense competition in most markets. Indeed, with the notable exception of the overall consumer price index, the rate of inflation as measured by various broad price indexes had tended to ease marginally or at worst to stabilize over the past two years. Prices of farm commodities and industrial materials had declined considerably recently.

Despite the recent encouraging reports on labor compensation and prices, the members agreed that the risks of rising inflation could not be dismissed, and several continued to view slightly higher inflation as a likely if not inevitable prospect. Much would depend, of course, on the strength of the economic expansion and the associated degree of pressure on resources, notably in labor markets which appeared to have comparatively little slack in relation to other producer resources. It was suggested in this regard that restrained increases in labor compensation in comparison with historical experience probably were a transitory phenomenon, though one could not predict when a more normal relationship would re-emerge. A related concern was whether the tightness in labor markets would ease sufficiently and quickly enough to prevent inflation pressures from escalating significantly. Some members mentioned a number of favorable factors in the outlook for inflation that tended to attenuate such concerns, such as reduced pressures on food prices as a result of better-than-expected harvests and improved supply conditions in markets for energy. Relatively restrained monetary growth in recent months also was cited as a development consistent with subdued inflationary pressures. Moreover, the view was advanced that recent developments in bond markets could be read as suggesting some decrease in inflationary expectations. On balance, while the members expressed varying degrees of concern that tight labor markets and attendant increases in wages might at some point lead to rising price inflation, they agreed that there was little or no evidence of such a development at this point and the outlook was far from certain.

In the Committee's discussion of policy for the intermeeting period ahead, all the members indicated that they could support an unchanged policy stance and the retention of a bias toward restraint in the directive. The slowing of the expansion to a sustainable pace near the economy's growth potential and the recent surprisingly favorable inflationary developments suggested lower risks of strengthening price pressures and provided the Committee with a desirable opportunity to pause and observe further developments bearing on the course of economic activity and inflation. Indeed, to the extent that inflation expectations had declined recently, short-term interest rates, which had changed little in nominal terms, had edged higher in real terms, implying slightly greater monetary restraint and reducing the odds that inflation would pick up.

With regard to possible adjustments to policy during the intermeeting period, all the members indicated that they could support a proposal to retain the current bias toward restraint. Several viewed such a bias as desirable because they continued to believe that the risks remained tilted, at least to some extent, toward rising inflation over time. In the circumstances, an asymmetric directive would best reflect their views even if, as seemed likely, intermeeting developments did not prompt a policy tightening adjustment. Other members commented that a shift to a symmetric directive might be viewed as more consistent with the apparently diminished inflationary pressures. They agreed, however, that such a shift would be premature in the currently uncertain environment and might signal, inaccurately, that the Federal Reserve was less concerned about the possibility of a a modest upward trajectory in price inflation.

At the conclusion of the Committee's discussion, all the members indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and retaining a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and relatively strong expansion in M3 over coming months.

The Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that growth in economic activity slowed substantially in the third quarter, and the limited available information indicates continued moderate expansion more recently. Private nonfarm payroll employment increased appreciably on balance over September and October. The civilian unemployment rate remained at 5.2 percent in October. Industrial production, which continued to rise in the third quarter, appears to have declined in October owing in important measure to work stoppages in the motor vehicles industry. Total retail sales turned up in September after slumping earlier in the summer. Housing starts fell in September from the exceptionally high level registered in August. Outlays for business equipment were strong in the third quarter and new orders continued to trend upward; business spending on nonresidential structures posted a moderate advance. Inventory investment was substantial in the third quarter, but inventory–sales ratios remained relatively low. The nominal deficit on U.S. trade in goods and services widened considerably in July–August from its average rate in the second quarter. Increases in labor compensation, though moderating in the third quarter, have trended up this year; consumer price inflation also has picked up this year, owing to larger increases in food and energy prices.

Market interest rates have moved lower since the Committee meeting on September 24, 1996, with the largest declines occurring in intermediate- and long-term maturities. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated slightly over the intermeeting period.

Growth of M2 in September and October remained below its pace in the first half of the year, while expansion of M3 was substantially higher over those two months. For the year through October, M2 is estimated to have grown at a rate in the upper half of the Committee's annual range, and M3 at a rate around the top of its range. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion 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 July reaffirmed the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on a tentative basis to set the same ranges as in 1996 for growth of the monetary aggregages and debt, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and relatively strong expansion in M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 17, 1996.

The meeting adjourned at 12:25 p.m.

Donald L. Kohn
Secretary

Meeting Held on December 17, 1996

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 17, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Mr. Meyer
Ms. Phillips
Ms. Rivlin
Mr. Stern
Ms. Yellen
Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

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

Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Reinhart, Assistant Director, Division of Monetary Affairs, 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, Davis, Eisenbeis, and Goodfriend, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, Atlanta, and Richmond respectively
Messrs. Gavin, Kos, and Rosengren, Vice Presidents, Federal Reserve Banks of St. Louis, New York, and Boston respectively
Mr. Evans, Assistant Vice President, Federal Reserve Bank of Chicago

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on November 13, 1996, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets since the meeting on November 13, 1996. There were no transactions in foreign currencies for System account during this period, 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 from November 13, 1996, through December 16, 1996. By unanimous vote, the Committee ratified these transactions.

The Committee members discussed certain changes in the procedures for conducting domestic open market operations that the Manager of the System Open Market Account had proposed for implementation at the beginning of 1997. The changes included advancing the normal time for initiating daily operations by one hour to between 10:30 a.m. and 10:45 a.m. Moving to the earlier time would place Desk operations closer to the period during the day when the financing market was most active and thus in a position to accommodate a larger volume of System transactions when necessary. As at present, the Manager might choose to undertake Desk operations at other times during the day when special circumstances dictate. The Manager also indicated that the normal time for domestic operations might be moved to an even earlier hour after expedited procedures were developed for assembling the necessary statistical information on a timely basis for such operations. In the interest of making information about System operations available more promptly to market participants and the broader public, the Desk also would begin at the start of 1997 to announce the par amount of its market transactions shortly after the completion of the operations. With respect to purchases of Treasury coupon securities for System account, the Desk had adopted about one year ago the practice of making such purchases in separate maturity tranches but might at its option in the future spread such purchases over a number of weeks rather than over the course of several days. This more flexible timing would allow the Desk to inject reserves into the banking system through outright operations as the need arose without waiting for that need to accumulate to particularly high levels.

All the members who commented endorsed the changes, with several noting that they were appropriate responses to evolving market circumstances. Because the new procedures did not involve any alterations in the Committee's current directives, authorizations, or rules, a formal vote was not required.

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 economic activity had continued to expand at a moderate pace in recent months. Consumer spending had rebounded from its summer lull, but housing demand was somewhat weaker on balance and the growth of business spending on durable equipment had slowed from a very rapid pace. Although inventory investment had picked up, stocks in most sectors had remained well aligned with sales. Both industrial production and employment had recorded sizable advances. Increases in labor compensation had trended up this year, and consumer price inflation also had picked up, but the faster rise in overall consumer prices owed entirely to larger increases in food and energy prices.

Private-sector demand for labor remained solid in November. Private nonfarm payroll employment increased appreciably further in November after an October surge, and the average workweek of private production or nonsupervisory workers retraced more than half of its October decline. Service industries recorded another large gain in employment despite a sharp drop in payrolls at help-supply firms, and the number of jobs in retail trade expanded further in November after a steep rise in October. In the goods-producing sector, employment in construction and manufacturing rose moderately. The civilian unemployment rate increased slightly, to 5.4 percent, in November.

Industrial production rose sharply in November after a small October decline. A rebound in motor vehicle assemblies from the disruptive effects of work stoppages accounted for much of the increase in production in November, but output from utilities also surged in response to unusually cool weather. The production of nondurable consumer goods and business equipment other than motor vehicles also was up significantly in November, while the manufacture of consumer durables and defense and space equipment decreased further. Reflecting the strong advance in production, the utilization of total industrial capacity picked up considerably in November.

Consumer spending increased appreciably on balance in recent months after a lackluster performance in the summer. Total retail sales fell in November but nonetheless were considerably above their average in the third quarter. The November decline reflected weakness in auto sales; retail spending on other items, notably nonauto durable goods, rose significantly further. Spending on services picked up in October (latest data) following a relatively weak third quarter. Housing starts rebounded in November after having declined in September and October. Single-family starts in November were a little below the average pace of previous months in the year, while multifamily starts surged to a level not seen since late 1990. By contrast, sales of both new and existing homes dropped again in October (latest data).

Growth of business fixed investment appeared to have slowed to a moderate pace in the fourth quarter after a sharp rise in the previous quarter. Shipments of nondefense capital goods fell in October, reversing a sizable September gain; however, recent data on orders pointed to further increases in business spending for equipment, especially for communications equipment where shipments already were at a high level. Business investment in transportation equipment evidently weakened, as sales of heavy trucks remained sluggish and production shortfalls held back fleet sales of light vehicles. By contrast, nonresidential construction continued to expand at a solid rate in October, with building activity particularly strong in the office, other commercial, institutional, and industrial categories.

Business inventory investment picked up sharply in October from the slow September pace, but total stocks remained at a low level in relation to sales. Most of the October increase occurred at the wholesale level; inventories of farm products turned up sharply after months of sizable drawdowns, and petroleum stocks were built up from unseasonably low levels. Despite the October rise, the ratio of wholesale inventories to shipments remained at the lower end of its range over recent years. In manufacturing, stocks increased at a pace in line with shipments, and the aggregate inventory–shipments ratio stayed at a very low level. Retail inventories were up moderately in October. The inventory–sales ratio for the sector was unchanged and remained in the middle of its range over recent years.

The nominal deficit on U.S. trade in goods and services was somewhat larger in September than in August; exports decreased slightly in September while imports were little changed. For the third quarter, the deficit widened substantially from its rate in the second quarter as exports fell and imports rose moderately. Nearly all of the decline in exports reflected lower sales of aircraft and gold. Increases in imports were widespread but they were largely offset by declines in imports of gold and semiconductors. Economic growth picked up in most of the major foreign industrial countries in the third quarter, but available indicators generally suggested some slowing of growth in the fourth quarter. In Japan, by contrast, economic activity had been sluggish in the third quarter but appeared to have picked up more recently.

Consumer price inflation in October and November was lifted slightly by sizable advances in energy prices and, to a lesser degree, increases in food prices; however, consumer prices for items other than food and energy rose modestly during the two months. The rise in core consumer prices over the twelve months ended in November was somewhat smaller than it had been over the previous twelve months, although the total index registered a bigger advance as a result of larger increases in food and energy prices. At the producer level, prices of finished energy goods rose sharply in October and November while prices of finished foods advanced less rapidly. Excluding food and energy, prices of finished goods edged lower on balance over October and November, and in the twelve months ended in November, these prices rose substantially less than in the previous twelve months. Average hourly earnings of production and nonsupervisory workers were up considerably in November after having edged down in October. The twelve-month rise in this index was somewhat larger than the advance over the previous twelve months.

At its meeting on November 13, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward the possible firming of reserve conditions during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and relatively strong expansion of M3 over coming months.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. However, the federal funds rate tended to average a little above the level expected with an unchanged policy stance in apparent response to scattered operating problems and occasional unexpectedly large clearing needs at banks. Other short-term interest rates registered small mixed changes since the November 13 meeting; Treasury bill rates drifted lower, partly because of heightened demands for safety and liquidity as asset markets became more volatile during the period, while year-end pressures boosted rates on private instruments with maturities in early 1997. At longer maturities, yields drifted lower over most of the intermeeting period in response to incoming data that suggested economic growth would remain moderate and inflation subdued, but they rebounded late in the period in response to the release of firmer economic data and growing concerns regarding the sustainability of current domestic asset prices. Despite these concerns, most major indexes of equity prices advanced further on balance.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose slightly over the intermeeting period. The dollar rose even more against the German mark and the French franc amid increased market apprehension that the European Monetary Union's common currency, the euro, will not be as strong a currency as the mark. The dollar also might have been boosted by statements by French and German officials that suggested the dollar was undervalued against their currencies.

Expansion of the broad monetary aggregates was relatively strong in November. Growth of M2 picked up, reflecting a sharp increase in demand deposits and smaller runoffs in other checkable deposits. Inflows to retail money market funds remained substantial. Expansion of M3 moderated somewhat from its brisk pace in October as growth in business demands for credit slowed and banks reduced their reliance on large time deposits and other managed liability components. For the year through November, M2 was estimated to have grown at a rate in the upper half of the Committee's annual range, and M3 at a rate a little above the top of its range. Total domestic nonfinancial debt expanded moderately on balance over recent months and remained in the middle portion of its range.

The staff forecast prepared for this meeting suggested that the expansion would be sustained at a pace close to the economy's estimated growth potential. Consumer spending was projected to increase at a rate generally in line with the anticipated rise in disposable income; the favorable effects on household wealth of the advance that had occurred in stock prices and the ample availability of credit for most borrowers were expected to balance the damping effects of continuing consumer concerns about the adequacy of their savings, the security of their jobs, and the extent of their debt burdens. Homebuilding was forecast to decline somewhat but to stabilize at a relatively high level in the context of continued income growth and the generally favorable cash–flow affordability of home ownership. Business spending on equipment and structures was projected to expand less rapidly in light of some anticipated slowing in the growth of sales and profits. Fiscal policy and the external sector were expected to continue to exert small restraining influences on economic activity over the projection period. Consumer price inflation, excluding the relatively volatile food and energy components of the price index, was forecast to rise slightly over 1997 and 1998 in the context of anticipated high resource use and an accompanying appreciable pickup in the growth of labor compensation that would be augmented by the legislated rise in the federal minimum wage. Somewhat larger increases would have been projected in consumer price inflation in the absence of anticipated technical measurement changes to the index.

In the Committee's discussion of current and prospective developments, members commented that the information received during the relatively short interval since the previous meeting had not materially altered either their assessment that the economy was performing quite favorably or their forecasts of further growth at a pace averaging near the economy's potential. The economy currently displayed fairly solid underpinnings, with few imbalances of the kind that historically had tended to create problems. Against the background of generally supportive financial conditions and a high degree of consumer and business confidence, further economic growth was thought likely to be sustained by appreciable increases in consumer spending and business investment. The overall pace of the expansion was expected to be restrained to an extent, however, by declining federal government outlays for goods and services and ongoing weakness in net exports.

Despite the prospects for moderate economic growth, members observed that the risks on inflation still seemed to be tilted toward some rise over time. Measures of core inflation had displayed little trend and even some decline over the past year. However, wage increases had moved higher over that period, a development suggesting the possibility that labor markets might be tighter than could be sustained over the long term. At some point accelerating labor compensation costs, were they to continue, likely would spill over into higher inflation. Such an outcome remained subject to a great deal of uncertainty, however, in light of the relatively benign behavior in recent years of both wages and prices in comparison with historical experience at prevailing levels of resource utilization.

In the Committee's discussion of developments in major sectors of the economy bearing on the outlook for business activity, members noted that consumer spending had picked up as expected after a lull during the summer months. Survey data and anecdotal reports suggested that consumer confidence was currently high, and there were widespread indications of robust retail sales during the early weeks of the holiday season, though holiday sales were always difficult to read at this stage. Thus far, however, sales of motor vehicles had not strengthened to the extent that was anticipated after full production was restored following a work stoppage at a major manufacturer. Members cited a number of factors—the rise in consumer debt burdens, tightening consumer credit standards, continued worker concerns about job security, and the satisfaction of earlier pent-up demands—that were tending to inhibit the growth in consumer spending and perhaps helped to explain why the sharp increases in stock market wealth had not been accompanied by stronger growth in such spending. The behavior of the stock market injected an additional note of uncertainty into the forecast for consumer spending and the economy more generally. The rise over recent years had been extraordinary and had brought market valuations to fairly high levels relative to earnings and dividends. In these circumstances, the members recognized the need to monitor with special care price movements in the stock market and asset markets more generally for their implications for consumer and other spending. On balance, favorable employment and income conditions seemed likely to foster a level of consumer spending that would provide key support for sustained economic expansion.

The members anticipated smaller though still sizable gains in business fixed investment over the year ahead. Slowing growth in profit levels and cash flows was likely to retard spending for many types of business equipment, but favorable prices, advancing technology, and readily available financing probably would continue to foster rapid expansion in office, computing, and communications equipment. The outlook for nonresidential construction remained uneven across the country, but such construction seemed likely to edge higher on balance over the next several quarters. Members noted in this regard that the construction of office buildings had strengthened in a number of urban areas. Business inventories currently seemed on the whole to be at desired and sustainable levels in relation to sales. In the circumstances, inventory accumulation was projected to remain moderate and, barring unexpected surges or declines in final sales, was not likely to be a significant factor affecting the course of the economy.

The recent information on residential construction was mixed. Weakness in late summer and early fall evidently reflected the effects of earlier increases in mortgage interest rates, but some measures of housing activity in November indicated unexpected strength. In addition, reports from around the country pointed to uneven conditions ranging from further strength to some emerging weakness in regional housing markets. On balance, the statistical and anecdotal information was interpreted, by some members at least, as consistent with a tendency for housing activity to stabilize. In this view, a level of housing construction somewhat below the peak reached earlier in 1996 was likely to be sustained, buoyed in part by the recent decline in mortgage interest rates and the continuing rise in consumer incomes and favorable consumer sentiment.

A modest degree of fiscal restraint seemed likely over the next two fiscal years. Some members expressed optimism with regard to the prospects for an agreement between the President and the Congress that would provide a basis for reaching a balanced budget by the year 2002. Such an agreement would need to include controversial constraints on the growth of entitlements, but its achievement would have favorable effects on financial markets and on business and consumer sentiment more generally, thereby tending to offset at least in part any direct effects of reduced federal spending on aggregate demand.

Members anticipated that the external sector of the economy would continue to exert some restraint on domestic economic activity, though perhaps to a lesser extent than over the past year. In particular, the growth of U.S. exports was expected to accelerate somewhat in association with some strengthening on average in the economies of the nation's key trading partners. The economic recovery in Mexico from its earlier financial crisis was already providing a considerable boost to exports from some parts of the United States.

Inflation had remained subdued, but the members continued to view the risks as tilted toward increases in the future. Labor compensation costs clearly were rising at a faster pace in the context of persistently tight labor markets, and an upturn in core price inflation seemed quite possible at some point in the absence of some easing of pressures in labor markets. However, the members recognized that the increase in wage inflation had been significantly less than would have been anticipated on the basis of historical relationships with labor market conditions, and price performance also had been more favorable than those relationships would have suggested. In the circumstances, there was a good deal of uncertainty regarding the outlook for inflation, including the potential degree of utilization in labor markets, the associated pressures on labor costs, and the ability of firms to pass higher labor costs into prices in markets that generally continued to be described as highly competitive. With the economy operating in the neighborhood of its sustainable potential, relatively minor differences in overall economic growth could have a significant effect over time on whether inflation would tend to trend up or down.

In the Committee's discussion of policy for the intermeeting period ahead, all the members supported a proposal to maintain an unchanged policy stance while also retaining a bias toward restraint in the directive. An unchanged policy was warranted by the quite satisfactory performance of the economy and inflation and the uncertainties surrounding the outlook. Thus, while the longer-term risks might point toward rising inflation, there were reasonable prospects that inflation would remain contained, and any pickup in inflation, should it occur, was likely to be limited at least for a time. In the circumstances, the members concluded that watchful waiting remained the prudent course for policy as they continued to assess ongoing developments. Because the risks of waiting did not appear to be substantial at this juncture, anticipatory tightening was not yet called for.

In the Committee's discussion of possible adjustments to policy during the intermeeting period, members agreed that the retention of an asymmetric directive toward tightening was consistent with their view that the risks remained biased toward higher inflation. Accordingly, while they were not suggesting that policy should be especially quick to react to incoming information over the intermeeting period, they did view the next policy move as more likely to be in the direction of some firming than toward easing. In this connection, some members emphasized that it would be especially important for the Committee to act promptly to counter any tendency for price inflation to rise and for higher inflation expectations to become embedded in financial markets and economic decisionmaking more generally.

At the conclusion of the Committee's discussion, all the members indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and that retained a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with relatively strong expansion in M2 and M3 over coming months.

The Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting suggests that economic activity has continued to expand at a moderate pace. Private nonfarm payroll employment increased appreciably further in November, although the civilian unemployment rate edged up to 5.4 percent. Industrial production rose sharply in November, in part because of a rebound in motor vehicle assemblies that had been depressed earlier by work stoppages. Consumer spending has posted appreciable gains over recent months after a summer lull. Housing starts rebounded in November after declining in September and October. Business fixed investment appears to be growing moderately after a sharp rise in the third quarter. The nominal deficit on U.S. trade in goods and services widened substantially in the third quarter from its rate in the second quarter. Increases in labor compensation have trended up this year, and consumer price inflation also has picked up owing to larger increases in food and energy prices.

Short-term market interest rates have registered mixed changes since the Committee meeting on November 13, 1996, while long-term yields have risen slightly. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen slightly over the intermeeting period.

Growth of M2 picked up in November, while expansion of M3 moderated somewhat from its brisk pace in October. For the year through November, M2 is estimated to have grown at a rate in the upper half of the Committee's annual range, and M3 at a rate a little above the top of its range. Total domestic nonfinancial debt has expanded moderately on balance over recent months and has remained in the middle portion 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 July reaffirmed the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997, the Committee agreed on a tentative basis to set the same ranges as in 1996 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with relatively strong expansion in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, Mr. Stern, and Ms. Yellen. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, February 4–5, 1997.

The meeting adjourned at 12:40 p.m.

Donald L. Kohn
Secretary