
Records

Record of Policy Actions of the Board of Governors

Regulation D

Reserve Requirements of Depository Institutions

[Docket No. R-1236]

On October 4, 2005, the Board approved amendments to reflect the annual indexing of the low reserve tranche and of the reserve requirement exemption for use in 2006 reserve requirement calculations. The amendments increase the 3 percent low reserve tranche for net transaction accounts to \$48.3 million (from \$47.6 million in 2005) and the reserve requirement exemption to \$7.8 million (from \$7 million in 2005).

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.

Regulation E

Electronic Fund Transfers

[Docket Nos. R-1210, R-1234,
and R-1247]

On December 30, 2005, the Board approved amendments to clarify the responsibilities of parties in transactions involving electronic check conversion and to require that consumers receive written notification in advance of these transactions. The Board also revised the regulation's official staff commentary to provide guidance on preauthorized transfers from consumers' accounts,

error resolutions, and disclosures at ATMs. The amendments are effective February 9, 2006, and compliance is mandatory by January 1, 2007.

In addition, the Board approved an interim final rule with request for comment that applies the regulation to payroll card accounts established to distribute employee salaries, wages, or other compensation on a recurring basis. The interim final rule is effective July 1, 2007.

Votes for these actions: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.

Regulation H

Membership of State Banking Institutions in the Federal Reserve System

Regulation Y

Bank Holding Companies and Change in Bank Control

[Docket No. R-1193]

On February 28, 2005, the Board approved amendments to the risk-based capital standards for bank holding companies to allow the continued inclusion of trust preferred securities in tier 1 capital, under stricter quantitative limits and qualitative standards. The amendments also revise (1) quantitative limits for the aggregate amount of trust preferred securities and other restricted core capital elements included in tier 1 capital and (2) qualitative standards for capital instruments included in regulatory capital. The amendments are effective

NOTE: Full texts of the policy actions are available via the "Reading Rooms" on the Board's FOIA web page and on request from the Board's Freedom of Information Office.

April 11, 2005, with a transition period for the new quantitative limits ending March 31, 2009.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

[Docket No. OP-1155]

On March 21, 2005, the Board, acting with the other federal banking and thrift regulatory agencies, approved the Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and for Customer Notice. The guidance, which builds on the Interagency Guidelines Establishing Information Security Standards, provides that financial institutions should implement a response program for security breaches involving customer information. As part of their response program, institutions should notify their customers when they determine that misuse of customer information has occurred or is reasonably possible. The guidance is effective March 29, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Regulation J

Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire

Regulation CC

Availability of Funds and Collection of Checks

[Docket No. R-1226]

On November 21, 2005, the Board approved amendments defining “remotely created checks”—checks cre-

ated by a seller or creditor with the account holder’s authorization but without the account holder’s handwritten signature on the check. Such checks are typically used to purchase goods or pay bills by telephone. The Board also approved amendments shifting liability for unauthorized remotely created checks from the paying bank to the depositary bank (in most cases the bank for the seller or creditor that created and deposited the check). The amendments are effective July 1, 2006.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies and Olson. Absent and not voting: Governor Kohn.

Regulation V

Fair Credit Reporting

Regulation FF

Obtaining and Using Medical Information in Connection with Credit

[Docket No. R-1188]

On November 14, 2005, the Board, acting with the other federal bank, thrift, and credit union regulatory agencies, approved interagency rules implementing restrictions in the Fair and Accurate Credit Transactions Act on creditors’ use and sharing of medical information. The rules permit creditors (1) to obtain and use consumers’ medical information in connection with credit determinations when necessary and appropriate for legitimate purposes, consistent with congressional intent to restrict the use of such information for inappropriate purposes, and (2) to share medical information among affiliates under limited circumstances without becoming credit reporting agencies. The amendments, which are substantially similar to interim final rules published by the

agencies on June 10, 2005, are effective April 1, 2006.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.

Regulation BB Community Reinvestment

[Docket No. R-1205]

On March 2, 2005, the Board, acting with the other federal bank and thrift regulatory agencies, approved inter-agency amendments to conform with changes by the Office of Management and Budget in the standards for defining metropolitan and micropolitan statistical areas, by the U.S. Bureau of the Census in designating census tracts, and by the Board in Regulation C (Home Mortgage Disclosure). The amendments, which are identical to the interim final rules published by the agencies on July 8, 2004, are effective March 28, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

[Docket No. R-1225]

On July 18, 2005, the Board approved amendments under the Community Reinvestment Act (CRA) to reduce regulatory burden on intermediate small banks (banks with assets between \$250 million and \$1 billion) and to more effectively encourage bank investment in community development. The amendments exempt intermediate small banks from certain data collection and reporting requirements and provide for the evaluation of those banks' CRA performance under the small-bank lending test and a new, flexible community development test. The amendments also

expand the definition of "community development" to include bank activities in underserved or distressed middle-income rural areas as well as in designated disaster areas. Finally, they clarify the effect of illegal credit practices on a bank's CRA performance rating. The amendments, which are identical to amendments to their regulations adopted by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, are effective September 1, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, and Kohn.

Regulation DD Truth in Savings

[Docket No. R-1197]

On May 19, 2005, the Board approved amendments to the regulation and its official staff commentary to improve the uniformity and adequacy of information provided to consumers when they overdraw their deposit accounts. The amendments, in part, address a specific service, commonly referred to as "bounced-check protection" or "courtesy overdraft protection," that pays checks and allows other transactions in accounts that have insufficient funds. They also (1) expand the regulation's prohibition against misleading advertisements, to address concerns about the marketing of this service, and (2) require additional disclosures about fees and other terms for overdraft services in such materials as advertisements and periodic account statements. The amendments are effective July 1, 2006.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Gov-

ernors Gramlich, Bies, Olson, Bernanke, and Kohn.

Post-Employment Restrictions for Senior Examiners

[Docket No. R-1230]

On November 10, 2005, the Board, acting with the other federal bank and thrift regulatory agencies, approved new interagency rules implementing post-employment restrictions on certain senior examiners contained in the Intelligence Reform and Terrorism Prevention Act. The rules provide that a senior examiner employed by one of the agencies or a Federal Reserve Bank may not knowingly accept compensation, as an employee, officer, director, or consultant, from a depository institution or holding company that he or she examined, or from certain related entities, for one year after leaving the employment of the agency or Reserve Bank. The rules are effective December 17, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.

Rules Regarding Equal Opportunity

[Docket No. OP-1239]

On November 2, 2005, the Board approved an interim final rule with request for comment to clarify the limitations on access to sensitive information by employees who are not U.S. citizens. The interim final rule is effective November 8, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.

Policy Statements and Other Actions

Overdraft Protection Programs

[Docket No. OP-1198]

On February 17, 2005, the Board, acting with the other federal bank and credit union regulatory agencies, approved joint guidance on overdraft protection programs to help depository institutions in the disclosure and administration of their overdraft-protection services.

Votes for this action: Chairman Greenspan and Governors Gramlich, Bies, Olson, Bernanke, and Kohn. Absent and not voting: Vice Chairman Ferguson.

Reserve Bank Withdrawal from Noncash Collection Service

[Docket No. OP-1214]

On February 28, 2005, the Board approved the withdrawal of the Federal Reserve Banks from the noncash collection service, which involves collecting and processing definitive municipal securities issued by state and local governments. The service was terminated in light of declining volume, expected under-recovery of costs in future years, and the availability of alternative service providers and substitutable services. Withdrawal is effective December 30, 2005; items will be accepted for deposit until September 30.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Information Security Standards

[Interagency Compliance Guide]

On November 29, 2005, the Board, acting with the other federal bank and thrift

regulatory agencies, approved publication of a Small-Entity Compliance Guide to help financial institutions comply with the Interagency Guidelines Establishing Information Security Standards. The guide summarizes in plain language the obligations of financial institutions to protect customer information and illustrates how certain provisions of the interagency security guidelines apply in specific situations.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn.

Discount Rates in 2005

Under the Federal Reserve Act, the boards of directors of the Federal Reserve Banks must establish rates on loans to depository institutions at least every fourteen days, subject to review and determination by the Board of Governors.

Primary Credit Rate

Primary credit is the Federal Reserve's main lending program. Primary credit is made available with minimal administration for very short terms as a backup source of liquidity to depository institutions that, in the judgment of the lending Federal Reserve Bank, are in generally sound financial condition. Primary credit is extended at a rate above the federal funds rate target set by the Federal Open Market Committee (FOMC).

During 2005, the Board approved eight increases in the primary credit rate, bringing the rate from $3\frac{1}{4}$ percent to $5\frac{1}{4}$ percent. The Board reached its determinations on the primary credit rate recommendations of the Reserve Bank boards of directors in conjunction with the FOMC's decisions to raise the target federal funds rate from $2\frac{1}{4}$ percent to

$4\frac{1}{4}$ percent and related economic and financial developments. The U.S. economy delivered a solid performance in 2005 despite a further sharp increase in energy prices and devastating hurricanes. The increase in GDP in 2005 was sufficient to further reduce slack in labor and product markets. Core consumer price inflation picked up early in the year, but it subsequently eased and totaled less than 2 percent over the year as a whole. In light of these conditions, the Board and FOMC raised the structure of policy rates at a measured pace. Monetary policy developments are reviewed more fully in other parts of this report (see the section "Monetary Policy and Economic Developments" and the minutes of FOMC meetings held in 2005).

Secondary and Seasonal Credit Rates

Secondary credit is available in appropriate circumstances to depository institutions that do not qualify for primary credit. The secondary credit rate is set at a spread above the primary credit rate. In 2005, the spread was set at 50 basis points.

Seasonal credit is available to smaller depository institutions to meet liquidity needs that arise from regular swings in their loans and deposits. The rate on seasonal credit is calculated every two weeks as an average of selected money-market yields, typically resulting in a rate close to the federal funds rate target.

At year-end, the secondary and seasonal credit rates were $5\frac{3}{4}$ percent and 4.35 percent, respectively.

Votes on Discount Rate Changes

About every two weeks during 2005, the Board approved proposals by the twelve Reserve Banks to maintain the formulas

for computing the secondary and seasonal credit rates. Details on the eight actions by the Board to approve changes in the primary credit rate are provided below.

February 2, 2005. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco to raise the rate on discounts and advances under the primary credit program by $\frac{1}{4}$ percentage point, to $3\frac{1}{2}$ percent. The same increase was approved for the Federal Reserve Bank of St. Louis, effective February 3, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn. Votes against this action: None.

March 22, 2005. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, and San Francisco to raise the rate on discounts and advances under the primary credit program by $\frac{1}{4}$ percentage point, to $3\frac{3}{4}$ percent. The same increase was approved for the Federal Reserve Bank of St. Louis, effective March 23, 2005. The Board also approved identical actions subsequently taken by the directors of the Federal Reserve Banks of Kansas City, effective March 23, 2005, and Dallas, effective March 24, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn. Votes against this action: None.

May 3, 2005. Effective this date, the Board approved actions taken by the

directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco to raise the rate on discounts and advances under the primary credit program by $\frac{1}{4}$ percentage point, to 4 percent. The same increase was approved for the Federal Reserve Bank of St. Louis, effective May 4, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, and Kohn. Votes against this action: None.

June 30, 2005. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco to raise the rate on discounts and advances under the primary credit program by $\frac{1}{4}$ percentage point, to $4\frac{1}{4}$ percent. The same increase was approved for the Federal Reserve Bank of St. Louis, effective July 1, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, and Kohn. Votes against this action: None.

August 9, 2005. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco to raise the rate on discounts and advances under the primary credit program by $\frac{1}{4}$ percentage point, to $4\frac{1}{2}$ percent. The same increase was approved for the Federal Reserve Bank of St. Louis, effective August 10, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Gov-

ernors Bies, Olson, and Kohn. Votes against this action: None.

September 20, 2005. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Richmond, Chicago, Minneapolis, Kansas City, and San Francisco to raise the rate on discounts and advances under the primary credit program by $\frac{1}{4}$ percentage point, to $4\frac{3}{4}$ percent. The Board also approved identical actions subsequently taken by the directors of the Federal Reserve Banks of St. Louis, effective September 21, 2005, and Cleveland, Atlanta, and Dallas, effective September 22, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn. Votes against this action: None.

November 1, 2005. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco to raise the rate on dis-

counts and advances under the primary credit program by $\frac{1}{4}$ percentage point, to 5 percent. The same increase was approved for the Federal Reserve Bank of St. Louis, effective November 2, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn. Votes against this action: None.

December 13, 2005. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, Minneapolis, Kansas City, Dallas, and San Francisco to raise the rate on discounts and advances under the primary credit program by $\frac{1}{4}$ percentage point, to $5\frac{1}{4}$ percent. The same increase was approved for the Federal Reserve Bank of St. Louis, effective December 14, 2005.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, and Kohn. Votes against this action: None. ■

Minutes of Federal Open Market Committee Meetings

The policy actions of the Federal Open Market Committee, contained in the minutes of its meetings, are presented in the Annual Report of the Board of Governors pursuant to the requirements of section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each policy action, and that it shall include in its annual report to 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 summary of the information and discussions that led to the decisions. The descriptions of economic and financial conditions are based solely on the information that was available to the Committee at the time of the meetings.

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 and a summary of the reasons for their dissent is provided.

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System

Open Market Account. In the area of domestic open market operations, the Federal Reserve Bank of New York operates under instructions from the Federal Open Market Committee that take the form of 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 Federal Reserve Bank of New York 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 2005. Changes in the instruments during the year are reported in the minutes for the individual meetings.

Authorization for Domestic Open Market Operations

In Effect January 1, 2005

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

(a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal

Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than \$12.0 billion during the period commencing with the opening of business on the day following such a meeting and ending with the close of business on the day of the next such meeting;

(b) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 65 business days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account;

(c) To sell U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 65 business 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.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal

Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding. The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York and accounts maintained at the Federal Reserve Bank of New York as fiscal agent of the United States pursuant to Section 15 of the Federal Reserve Act, 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 accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 65 business days or less on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

4. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat in exceptional circumstances the degree of

pressure on reserve positions and hence the intended federal funds rate. Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any adjustment.

Domestic Policy Directive

In Effect January 1, 2005¹

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 2¼ percent.

Authorization for Foreign Currency Operations

In Effect January 1, 2005

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

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

and with other international financial institutions:

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

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

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

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

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

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

1. Adopted by the Committee at its meeting on December 14, 2004.

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

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

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

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

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in

the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account ("Manager"), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

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

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

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

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

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3G(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, 2005

1. System operations in foreign currencies shall generally be directed at countering dis-

orderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.

2. To achieve this end the System shall:

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

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

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

3. Transactions may also be undertaken:

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

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

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

4. System foreign currency operations shall be conducted:

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

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

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

Procedural Instructions with Respect to Foreign Currency Operations

In Effect January 1, 2005

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by

the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

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

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

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

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

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

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

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

B. Any swap drawing proposed by a foreign bank exceeding the larger of

(i) \$200 million or (ii) 15 percent of the size of the swap arrangement.

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

Meeting Held on February 1–2, 2005

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, February 1, 2005, at 1:30 p.m. and continued on Wednesday, February 2, 2005, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Mr. Bernanke
Ms. Bies
Mr. Ferguson
Mr. Gramlich
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Santomero
Mr. Stern

Messrs. Guynn, Lacker, Ms. Pianalto and Yellen, Alternate Members of the Federal Open Market Committee

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

Ms. Holcomb, First Vice President, Federal Reserve Bank of Dallas

Mr. Reinhart, Secretary and Economist
Ms. Danker, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter,² Deputy General Counsel

Ms. Johnson, Economist
Mr. Stockton, Economist

Messrs. Connors, Evans, Howard, Madigan, Oliner, Rolnick, Tracy, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

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

Messrs. Slifman and Struckmeyer, Associate Directors, Division of Research and Statistics, Board of Governors

Messrs. Clouse, Reifschneider,³ and Whitesell, Deputy Associate Directors, Divisions of Monetary Affairs, Research and Statistics, and Monetary Affairs, respectively, Board of Governors

Messrs. Elmendorf,³ English, Faust,³ and Leahy,³ Assistant Directors, Divisions of Research and Statistics, Monetary Affairs, International Finance, and International Finance, respectively, Board of Governors

Mr. Simpson, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

2. Attended Tuesday's session only.

3. Attended portion of meeting relating to special topic of a numerical definition of the price-stability objective for monetary policy.

Messrs. Bassett, Lebow,⁴ Ms. Lindner,³ Messrs. Rudd,³ Tetlow,³ and Wood,⁴ Senior Economists, Divisions of Monetary Affairs, Research and Statistics, Research and Statistics, Research and Statistics, and International Finance, respectively, Board of Governors

Mr. Durham,⁴ Economist, Division of Monetary Affairs, Board of Governors

Mr. Luecke, Senior Financial Analyst, 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 Cleveland

Mr. Judd, Executive Vice President, Federal Reserve Bank of San Francisco

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

Messrs. Altig, Dotsey, Ms. Hargraves, and Mr. Wynne, Vice Presidents, Federal Reserve Banks of Cleveland, Philadelphia, New York, and Dallas, 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, 2005 had been received and that these individuals had executed their oaths of office.

4. Attended portion of meeting related to the economic outlook.

The elected members and alternate members were as follows:

Timothy F. Geithner, President of the Federal Reserve Bank of New York, with Christine M. Cumming, First Vice President, Federal Reserve Bank of New York as alternate.

Anthony M. Santomero, President of the Federal Reserve Bank of Philadelphia, with Jeffrey M. Lacker, President of the Federal Reserve Bank of Richmond, as alternate.

Michael H. Moskow, President of the Federal Reserve Bank of Chicago, with Sandra Pianalto, President of the Federal Reserve Bank of Cleveland, as alternate.

Jack Guynn, President of the Federal Reserve Bank of Atlanta as alternate, voting pending the election of the President of the Federal Reserve Bank of Dallas.

Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, with Janet L. Yellen, President of the Federal Reserve Bank of San Francisco, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were selected to serve until the selection of their successors at the first regularly scheduled meeting after December 31, 2005, 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
Timothy F. Geithner	Vice Chairman
Vincent R. Reinhart	Secretary and Economist
Deborah J. Danker	Deputy Secretary
Michelle A. Smith	Assistant Secretary

Scott G. Alvarez	General Counsel
Thomas C. Baxter, Jr.	Deputy General Counsel
Karen H. Johnson	Economist
David J. Stockton	Economist

Thomas A. Connors, Charles L. Evans, David H. Howard, Brian F. Madigan, Loretta J. Mester, Stephen D. Oliner, Arthur J. Rolnick, Harvey Rosenblum, Joseph S. Tracy, and David W. Wilcox, Associate Economists

As customarily occurs at the first regularly scheduled meeting of the year, the Committee reviewed a range of organizational items, covered below.

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account.

By unanimous vote, Dino Kos 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.⁵

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

Authorization for Foreign Currency Operations (Reaffirmed February 1, 2005)

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

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

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

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

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

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

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

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

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

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

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

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

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

6. All operations undertaken pursuant to the preceding paragraphs shall be reported

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

7. The Chairman is authorized:

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

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

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

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

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3G(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 was reaffirmed in the form shown below.

Foreign Currency Directive (Reaffirmed February 1, 2005)

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 IMF Article IV, Section 1.

2. To achieve this end the System shall:

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

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

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

3. Transactions may also be undertaken:

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

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

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

4. System foreign currency operations shall be conducted:

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

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

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

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

Procedural Instructions with Respect to Foreign Currency Operations (Reaffirmed February 1, 2005)

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Opera-

tions 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 I.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.

By unanimous vote, the Authorization for Domestic Open Market Operations was amended and approved in the form shown below. The amendment involved removing from paragraph 1(a) the reference to the limit on the amount by which the System Open Market Account holdings of securities can change between FOMC meetings. This limit had become outdated, as it had been superseded by other, more effective mechanisms for the Committee to oversee Desk operations.

Authorization for Domestic Open Market Operations (Amended February 1, 2005)

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;

(b) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 65 business days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined

by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account.

(c) To sell U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 65 business 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.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding. The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York and accounts maintained at the Federal Reserve Bank of New York as fiscal agent of the United States pursuant to Section 15 of the Federal Reserve Act, 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 accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities in 65 business

days or less on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and such foreign, international, and fiscal agency accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

4. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat in exceptional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate. Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any adjustment.

By unanimous vote, the Committee made several amendments to its rules, statements, and resolutions, including to align the starting dates of Committee membership terms of Presidents with those of Committee officers, and to authorize the Secretary of the Committee, with the concurrence of the General Counsel, to make technical changes to the rules in the future.

By unanimous vote, the Committee amended its Program for Security of FOMC Information on February 1, 2005, to reflect an updating and streamlining of the document.

The Manager of the System Open Market Account reported on recent

developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period December 14, 2004 to February 1, 2005. By unanimous vote, the Committee ratified these transactions.

At this meeting the Committee engaged in a broad-ranging discussion of the pros and cons of formulating a numerical definition of the price-stability objective of monetary policy. A staff presentation on the topic included a review of the potential costs and benefits of introducing such a definition as well as of other countries' experiences. In the subsequent discussion, meeting participants uniformly agreed that price stability provided the best environment for maximizing sustainable economic growth in the long run, but expressed a range of views on whether it would be helpful for the Committee to articulate a specific numerical definition for the Federal Reserve's price-stability objective—either a single figure or a range. Those who believed such a move would be on balance beneficial cited, for example, its usefulness as an anchor for long-term inflation expectations, as a vehicle for enhanced clarity of Committee deliberations, and as an additional tool for communications. Several of those who saw greater potential drawbacks were concerned that such a shift might appear to be inconsistent with the Committee's dual mandate of fostering maximum employment as well as price stability or that it might inappropriately bias or constrain policy at times; in any case, with inflation expectations well-contained over recent years, the benefits

of announcing a specific inflation objective were not likely to be large. The Committee decided to defer further discussion.

The information reviewed at this meeting suggested that the economy expanded at a solid pace in recent months. Consumer spending and the housing market continued to exhibit strength, and business fixed investment grew robustly in the fourth quarter. The pace of inventory accumulation picked up and industrial production accelerated. The labor market showed further signs of improvement. Core consumer prices rose moderately over the past few months, and measures of inflation expectations remained well-anchored.

Moderate increases in payroll employment during November and December pushed the average monthly advance in the quarter well above that of the third quarter. Employment gains were fairly widespread, with hiring in business services, health care, financial activities, and wholesale trade more than offsetting continued sluggishness in manufacturing and a seasonally adjusted decline in retail services during December. Surveys of employers' hiring plans and job openings pointed to continued moderate gains in employment early this year. The average workweek during the fourth quarter was unchanged from the third quarter, and as a result aggregate hours decelerated despite the pickup in employment growth. The unemployment rate held steady at 5.4 percent in December.

Industrial activity accelerated noticeably during the fourth quarter. The pickup of industrial production in December owed largely to increased motor vehicle assemblies and a turnaround in the output of utilities associated with cold weather across the northeast. Production of high-tech goods slowed slightly in the fourth quarter.

Available weekly physical product data suggested that manufacturing production would increase moderately in January. Capacity utilization continued to climb through the end of the year but remained below its longer-run average.

Real consumer spending expanded briskly in December and in the fourth quarter as a whole, with retail sales exhibiting widespread strength across categories. Expenditures on consumer services also continued to post solid increases. A surge in light vehicle sales in December pulled the average rate of sales during the fourth quarter slightly above the third-quarter pace. Real disposable personal income increased at a rapid rate at the end of the year—boosted in part by the special dividend payment by Microsoft; excluding this payment, real disposable personal income rose at a more moderate rate. Measures of consumer confidence remained favorable and consistent with sustained increases in spending.

Residential housing activity remained buoyant in the fourth quarter. A rebound in single-family housing starts in December from a disappointing November brought the fourth quarter pace about in line with that earlier in the year. Sales of new and existing homes slipped some late in the year but remained robust. Mortgage rates had changed little since August and continued to support demand. Construction activity in the multifamily sector weakened a bit in November and December, but indicators of underlying demand pointed to a rebound in starts in January.

Business fixed investment continued to be bolstered by favorable fundamentals, including sustained expansion of business output, the flush cash position of many firms, readily available credit, and a still-favorable cost of capital. Equipment and software spending grew at a solid rate in the fourth quarter,

though not quite as briskly as in the third quarter owing to a deceleration in spending outside the high-tech sector. By contrast, investment in nonresidential structures had edged down in recent months, with expenditures only for drilling and mining operations showing some strength amid flat outlays for manufacturing facilities and a decline in spending on office buildings.

Nonfarm inventories increased a bit more in the fourth quarter than they had in the third quarter. The buildup of inventories was widespread across manufacturers, wholesalers, and retailers as well as across stages of production. Motor vehicle inventories were an exception, as motor vehicle manufacturers sought to reduce stocks of unsold light vehicles. The aggregate inventory-sales ratio outside of motor vehicles likely edged up in the fourth quarter but remained within the range that had prevailed since the middle of last year.

The most recent data suggested that the U.S. international trade deficit widened in the fourth quarter as a result of a broad-based decline in exports of goods and increase in imports of oil and consumer goods. The expansion in economic activity in the major foreign industrialized economies appeared to remain sluggish in the fourth quarter, but the growth of real GDP in Latin America and emerging Asia likely stepped up.

Core consumer prices decelerated over the past few months, while overall consumer prices were buffeted by movements in energy prices. The rate of increase in core prices in the twelve months ending in December was somewhat higher than the very low rate that prevailed during the year-earlier period; the overall index also accelerated, with about half of its advance accounted for by a sharp rise in energy prices. Measures of inflation expectations were little

changed over the intermeeting period. With regard to labor costs, the employment cost index decelerated in the fourth quarter; the slowdown was attributable to wages, which gained only slightly, while benefit costs rose a bit faster than in the third quarter.

At its meeting on December 14, 2004, the Federal Open Market Committee decided to increase its target for the federal funds rate 25 basis points to $2\frac{1}{4}$ percent. In its announcement of this decision, the Committee indicated that the upside and downside risks to the attainment of both sustainable growth and price stability were roughly equal. The Committee also noted that output appeared to be growing at a moderate pace and labor market conditions continued to improve gradually, while inflation and inflation expectations remained well-contained. As a result, the Committee again judged that policy accommodation could be removed at a pace that was likely to be measured, although the path of policy would depend importantly on evolving economic prospects.

The Committee's decision at its December meeting to increase the federal funds rate had been fully anticipated in financial markets, and reaction to the attendant statement was muted. The release of the minutes of the December meeting on January 4, however, triggered a significant upward revision in the anticipated path of monetary policy: Investors apparently read them as expressing more widespread concern among Committee members about inflation pressures than had been the case previously. Market participants viewed the generally favorable incoming data on economic activity as consistent with their expectations of firmer policy. Interest rates on intermediate-term Treasury securities rose in response to the revision to policy expectations, but longer-term yields were little changed over

the intermeeting period. As yields on inflation-indexed Treasury securities rose roughly in line with their nominal counterparts, longer-term inflation compensation remained about unchanged. Risk spreads on corporate bonds were stable at relatively low levels, consistent with favorable indicators of corporate credit quality. Broad stock indexes declined a bit over the intermeeting period. In foreign exchange markets, the dollar ended the period little changed on a trade-weighted basis, appreciating against the major European currencies but falling vis-à-vis other important trading partners.

M2 grew moderately in recent months, its expansion restrained by rising opportunity costs associated with monetary policy tightening. Because changes in interest rates on liquid deposits typically lag those in market interest rates, the growth of that component slowed in the second half of 2004. By contrast, growth of small time deposits, whose yields closely track market rates, picked up. Currency growth was about flat in December.

In the staff forecast prepared for this meeting, the economy was seen as likely to expand at a pace a little above that of its longer-run potential over this year and next, while hiring was expected to firm some more, resulting in a further decrease in the unemployment rate. Household spending was projected to grow at a fairly solid rate, supported by higher employment and somewhat lower energy prices but damped somewhat by lessened stimulus from gains in wealth and the need for households to rebuild savings. After a temporary dip in the level of business investment this quarter related to the expiration of the partial-expensing tax provision, investment outlays were seen as likely to resume vigorous growth in response to steadily rising sales, strong corporate balance sheets,

supportive financial conditions, and an ongoing need to replace or upgrade aging equipment and software. Real net exports were projected to be roughly stable for several quarters, held up by the lagged effect of the lower foreign exchange value of the dollar and some strengthening in foreign demand. Measures of total consumer price inflation were expected to decline over the forecast horizon as energy prices receded, while core inflation was seen as remaining stable in the staff forecast. Tendencies for core inflation to increase because of slightly higher trend unit labor costs and a narrowing margin of resource slack were expected to be offset by the waning contribution of elevated prices for energy and imported goods.

In their discussion of the economic outlook, the meeting participants regarded incoming data since the last meeting as supporting their expectations that, with the further removal of monetary accommodation, GDP would likely grow at a moderate pace consistent with a gradual reduction of remaining economic slack, and inflation would probably continue to be low. Domestic demand had stayed strong through the fourth quarter and should continue to be bolstered by favorable financial conditions. Recent data indicated low and stable rates of core consumer inflation and apparently well-anchored inflation expectations. Against this backdrop, the risks to the outlook for both output and inflation relative to the Committee's goals appeared to remain well-balanced.

In preparation for the Federal Reserve's semi-annual report to the Congress on the economy and monetary policy, the members of the Board of Governors and the presidents of the Federal Reserve Banks submitted individual projections of the growth of GDP, the rate of unemployment, and core con-

sumer price inflation for the years 2005 and 2006. As part of its continuing effort to improve its communications, the Committee had earlier decided to add one year to the forecast period so as to make the projections more useful to the public. The forecasts of the rate of expansion in real GDP were concentrated in the upper part of a 3½ to 4 percent range for 2005; for 2006 the forecasts were in a slightly lower range of 3¼ to 3¾ percent, with a central tendency at 3½ percent. These rates of growth were associated with a civilian unemployment rate in the range of 5 to 5½ percent and a central tendency of 5¼ percent in the fourth quarter of 2005 and 5 to 5¼ percent in the fourth quarter of 2006. The rate of inflation, as measured by the core PCE price index, was expected to remain fairly stable, with forecasts concentrated in the lower portion of a 1½ to 2 percent range for both this year and next.

In their comments about developments in key sectors of the economy, meeting participants noted that, relative to several months ago, many firms now seemed somewhat more confident about the economic outlook. The anticipation of increased sales relative to existing production capacity and also desires to upgrade technology and improve competitiveness were leading firms to increase spending on equipment and software. Gains in capital spending had been quite strong last year, and while some of that spending might have been motivated by the year-end expiration of the partial-expensing provisions of the tax code, participants had seen little evidence to date that there would be a significant slowdown in the growth of spending in the early part of 2005. Low longer-term interest rates on corporate borrowing—reflecting in part narrow credit risk spreads—along with strong corporate profitability and improved

balance sheets were continuing to support fairly brisk growth of capital expenditures. Low longer-term nominal interest rates were partly attributable to well-contained inflation expectations, but low real interest rates, along with slight declines in equity prices so far this year, might reflect lingering caution on the part of businesses about the outlook. Nevertheless, narrow credit spreads and risk premiums, along with abundant liquidity in financing markets, suggested that markets now assigned fairly low odds to significant downside risks.

Solid income gains, low interest rates, and consumer confidence were seen by participants as helping to sustain strong growth of household spending. Some firms had reported that holiday sales were higher than a year earlier and better than expected, while auto sales had responded strongly to incentives in December. The current low measured saving rate seemed mostly explainable by the strength of expected income gains, low interest rates, and the increase in household wealth resulting from the rise in equity and housing prices. Although the saving rate might well drift up over the next couple of years, participants generally thought it likely that consumer spending would continue growing at a strong pace. However, a marked slowing in home price appreciation and possible increases in longer-term interest rates, which would raise financing costs and reduce opportunities to extract equity from homes through refinancings and home equity loans, were seen as downside risks to the prospects for consumption spending and for housing construction.

Several participants mentioned that the low level of measured national saving, which implied a continued need for foreign financing of U.S. investment, and imbalances in the external sector imparted additional uncertainty to

the longer-term economic outlook. The extent to which the federal budget deficit would decline over coming years was an open question. As regards the current account balance, some participants noted that the sharp drop in net exports in November probably reflected transitory factors in large part, as well as reported measurement errors. However, there has been little hard evidence as yet of a strengthening in the growth of spending in our foreign trading partners or of substantial effects on net exports from previous dollar declines. As a result, the external imbalance seemed likely to remain elevated, with a high level of uncertainty surrounding the prospects for and path of adjustment.

A number of participants noted continued modest gains in employment, though some commented that, based on anecdotal information, job growth seemed to have picked up of late. The increase in aggregate demand was expected to be sufficient over coming quarters to allow the rate of unemployment to continue to edge lower even as more people return to the labor force. Participants noted considerable uncertainty about the sustainable rate of resource utilization and about structural productivity growth. One participant suggested that, given the range of uncertainty, output might already be at or close to potential. Others commented that recent studies did not on balance support a conclusion that structural labor market shifts had caused resource slack to be lower than commonly estimated and that the flat pattern of growth in wages and compensation suggested an absence of pressures in labor markets. However, unit labor costs had accelerated over 2004 owing to a tapering off in productivity growth. If that slowing reflected a moderation in structural productivity growth and if firms believed that the associated increases in the

growth rate of labor costs were permanent, these cost pressures might be passed through to consumer prices fairly quickly to preserve profit margins. While participants generally felt that the pace of underlying productivity growth remained robust, careful attention would need to be paid to developments regarding unit labor costs and profit margins.

Despite some pickup in costs, participants thought that the rate of core inflation likely would remain low and stable, assuming further removal of policy accommodation. Elevated price markups and profits, as well as slack in resource use, had helped absorb cost increases and put downward pressure on inflation and would likely continue to do so. Indeed, core inflation measures had eased off, both in the latest readings and on balance over the second half of 2004 relative to the first half. However, several participants suggested the possibility of an upward skew to the distribution of inflation outcomes, especially if there were appreciable further declines in the foreign exchange value of the dollar or in structural productivity growth; already some participants were hearing anecdotal reports from firms of an increased ability to pass cost increases through to product prices, perhaps because of increasing confidence in the outlook for the economic expansion.

In the Committee's discussion of policy for the intermeeting period, all of the members favored raising the target for the federal funds rate by 25 basis points to 2½ percent at this meeting. All members judged that a further quarter-point firming in the target federal funds rate was appropriate in light of current overall accommodative financial conditions and the continuing outlook for solid economic growth and diminished slack in resource utilization. A higher nominal federal funds rate was seen as needed

to contain risks of increased cost and price pressures, but even with this action, the real federal funds rate was generally seen as remaining below levels that might reasonably be associated with maintaining a stable inflation rate over the medium run. The pace of policy moves at upcoming meetings, however, would depend on incoming data.

With regard to the Committee's announcement to be released after the meeting, members concurred that overall economic prospects were similar to those prevailing at the time of the December meeting and that consequently the statement should be altered only to the minor extent required to reflect recent economic developments. They concurred that the statement should note that output appeared to be growing at a moderate pace despite the rise in energy prices, that labor market conditions continued to improve gradually, and that inflation and longer-term inflation expectations remained well-contained. They also agreed again to characterize the risks to sustainable growth and price stability as balanced. All members agreed that the FOMC statement for this meeting should again indicate that policy accommodation could be removed at a pace that was likely to be measured but that the Committee would respond to changes in economic prospects as needed to maintain price stability.

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

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its

long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate at an average of around 2½ percent.

The vote encompassed approval of the paragraph below for inclusion in the statement to be released shortly after the meeting:

The Committee perceives the upside and downside risks to the attainment of both sustainable growth and price stability for the next few quarters to be roughly equal. With underlying inflation expected to be relatively low, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Votes for this action: Messrs. Greenspan, Geithner, Bernanke, Ms. Bies, Messrs. Ferguson, Gramlich, Guynn, Kohn, Moskowitz, Olson, Santomero, and Stern. Vote against this action: None. Mr. Guynn voted as alternate member.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 22, 2005.

The meeting adjourned at 12:35 p.m. on February 2, 2005.

Notation Vote

By notation vote completed on December 31, 2004, the Committee unanimously approved the minutes of the meeting of the Federal Open Market Committee held on December 14, 2004.

Vincent R. Reinhart
Secretary

Meeting Held on March 22, 2005

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 22, 2005, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Mr. Bernanke
Ms. Bies
Mr. Ferguson
Mr. Gramlich
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Santomero
Mr. Stern

Ms. Cumming, Messrs. Guynn and Lacker, Ms. Pianalto and Yellen, Alternate Members of the Federal Open Market Committee

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

Ms. Holcomb, First Vice President, Federal Reserve Bank of Dallas

Mr. Reinhart, Secretary and Economist
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Messrs. Connors, Evans, and Madigan, Ms. Mester, Messrs. Oliner, Rolnick, Rosenblum, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

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

Messrs. Kamin and Slifman, Associate Directors, Divisions of International Finance and Research and Statistics, respectively, Board of Governors

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

Messrs. English and Leahy, Assistant Directors, Divisions of Monetary Affairs and International Finance, respectively, Board of Governors

Mr. Simpson, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Mr. Nelson, Section Chief, Division of Monetary Affairs, Board of Governors

Mr. Carpenter, Senior Economist, Division of Monetary Affairs, Board of Governors

Messrs. Kumasaka and Luecke, Senior Financial Analysts, Division of Monetary Affairs, Board of Governors

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

Mr. Judd, Executive Vice President, Federal Reserve Bank of San Francisco

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

Mr. Elsasser, Vice President, Federal Reserve Bank of New York

The Manager of the System Open Market Account reported on recent

developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period February 2, 2005, through March 21, 2005. By unanimous vote, the Committee ratified these transactions.

The information reviewed at this meeting suggested that the economy was expanding at a solid pace in the first quarter of the year. Employment was improving. Consumer spending still appeared to be growing briskly, and residential construction expenditures continued to move higher. Business spending on equipment and software showed notable gains early in the quarter, and industrial production increased moderately in the first two months of the year. Consumer prices moved higher in January after being unchanged in December.

The labor market continued to improve in February. Private nonfarm payrolls grew at a solid pace, and these gains were widespread across industries. Of particular note, manufacturing employment, which had been declining, edged higher. On balance, surveys of employers and of households pointed to firming labor demand. With the average workweek unchanged, aggregate hours increased moderately in February. Although the unemployment rate in February ticked back up to its December level, the set of available information on the labor market suggested that resource slack was diminishing.

Industrial production posted a moderate gain in February, led by a surge in motor vehicle production. Production of high-tech equipment rose, with the increase in output of communica-

tions equipment far outpacing sluggish growth of computer production. Production of consumer goods, both durable and nondurable, also rose. In contrast, the production of non-high-tech business equipment edged down, and the output of construction and business supplies and materials dropped back. Mining output edged up, but the output of utilities fell for a second consecutive month amid a generally warm winter.

Supported by strong income gains and higher wealth, consumer spending had increased at a robust rate in the last quarter of 2004 and appeared to be on track to post another strong advance in the first quarter of the year. Apart from purchases of motor vehicles, which stepped down early this year after a year-end surge, the increases in outlays had been broad based. On average, real disposable income increased at a vigorous pace in December and January, well above that seen over most of last year. Increases in equity prices and in house values pushed up the wealth-to-income ratio in the fourth quarter, and the saving rate remained low by historical standards.

Activity in the housing market continued to expand early this year. Starts of single-family homes in January and February were well above their fourth-quarter pace, although indicators of future production pointed to some slowing. Similarly, in the multifamily sector, starts increased substantially in the first two months of the year but appeared poised to moderate this month. Although both new and existing home sales declined somewhat in January, demand continued to be supported by low mortgage rates.

Business spending on equipment and software increased sharply in the fourth quarter and, excluding motor vehicles, appeared to be growing briskly in the first quarter. The expiration at the end of

2004 of the special tax provisions that permitted partial expensing of investment expenditures seemed not to be retarding capital spending. Presumably contributing to the vigor of capital spending were further increases in business output, strong cash positions of corporations, and an attractive cost of capital amid generally low interest rates. Shipments and orders for high-tech equipment remained strong in January. Outside the high-tech sector, shipments posted a sizable and broad-based increase in January, and the rising backlog of orders pointed to further gains in the near future. Spending on nonresidential construction was subdued, as it had been for some time.

Increased inventory accumulation contributed significantly to the rise in economic output in the fourth quarter of last year and appeared likely to make an additional contribution in the first quarter of this year. In January, manufacturers' book-value inventories increased at nearly twice the rate seen in the fourth quarter, while wholesale and retail inventories about kept pace with the advance in the previous quarter. The rapid buildup in inventories left the inventory-to-sales ratio unchanged rather than on the downtrend of recent years. However, the available evidence suggested that firms generally were not uncomfortable with their inventory positions.

The U.S. international trade deficit widened in January, primarily reflecting a surge in imported non-oil goods and services. After a general slowdown in the fourth quarter of last year, indicators for major foreign industrial countries revealed a broad pickup in economic growth in the first quarter, with industrial production rising in Japan and the major euro-area countries. Meanwhile, consumer price inflation across most industrial economies remained subdued.

Among the emerging-market economies, indicators of economic activity were mixed.

Consumer prices edged higher in January after having been flat in December. Core consumer prices rose a bit faster than overall prices, with price increases widespread across commodities and services. Consumer energy prices fell in January but turned back up in February and early March. For the twelve-month period ended in January, overall consumer prices were boosted significantly by higher oil prices, but core consumer price inflation over the same period was fairly subdued. A survey measure of near-term inflation expectations moved up in early March, but long-term expectations had changed little since the end of last year. Producer prices and commodity indexes were broadly higher in January, with the exception of prices for core crude materials. With regard to labor costs, average hourly earnings rose slowly over January and February. Over the preceding year, compensation costs increased moderately, contributing to a small rise in unit labor costs.

At its February meeting, the Committee decided to increase the target federal funds rate 25 basis points, to 2½ percent. In its accompanying statement, the Committee indicated that the upside and downside risks to the attainment of both sustainable growth and price stability were roughly equal. In addition, the Committee noted that the economy appeared to be growing at a moderate rate despite increases in energy prices, that labor market conditions continued to improve gradually, and that inflation and inflation expectations remained well contained. As a consequence, the Committee again judged that policy accommodation could be removed at a pace that was likely to be measured, although the path of policy would

depend importantly on evolving economic prospects.

The Committee's decision to change the target rate was universally anticipated by market participants, as was the tenor of the statement. As a result, the reaction in financial markets was muted. Over the intermeeting period, however, the Chairman's semiannual testimony on monetary policy, higher oil prices, and incoming data that showed a pickup in price inflation led market participants to mark up their expectations for the trajectory of the target federal funds rate. Consistent with the upward revision to policy expectations, yields on Treasury securities rose significantly. Some of the increase in nominal rates likely owed to higher inflation expectations, as inflation compensation, measured from the spread between Treasury nominal debt and comparable inflation-indexed securities, rose. However, staff analysis suggested that the increases were concentrated over the next few years and that long-term inflation expectations were little changed. Risk spreads on most corporate bonds narrowed on balance, significantly so for speculative-grade debt, amid generally strong corporate balance sheets and good credit performance. Broad stock market indexes edged up over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar depreciated slightly, with the declines widespread against the currencies of industrialized countries other than Japan.

M2 growth slowed in the first two months of the year, as the opportunity cost of holding money rose with monetary policy tightening. Rates paid on liquid deposits were little changed, but those on small time deposits tracked market rates more closely. As a result, growth in liquid deposits was depressed, while that of small time deposits was vigorous. Flows into equity and bond

funds picked up in the first two months of the year. In the staff forecast prepared for this meeting, the economy was seen as likely to expand at a rate above the growth of potential this year and next, led by strong business demand for equipment and software. Consequently, labor markets were expected to continue to firm and the unemployment rate to decline gradually. In light of the robust expansion of capital spending thus far this year, the outlook for business investment spending was revised up appreciably, as more of the strength over the latter part of 2004 was attributed to underlying demand and less to the effects of the partial-expensing tax provision. Steadily rising sales, an ongoing need to replace and upgrade software and equipment, and favorable financing costs were all expected to continue to buoy business spending this year and next. Household spending, supported by rising disposable income and, to a lesser degree, by increasing wealth, was projected to expand at a solid rate. Net exports were seen as exerting less of an arithmetic drag on economic growth than in 2004. Measures of overall consumer price inflation were expected to be lower this year than last and to step down again next year as energy prices retreated. Inflation in core consumer prices was seen as being boosted a bit by the effects of higher import and energy costs in the near term but still largely contained by continued strong growth in underlying labor productivity and remaining slack in resource markets.

In their discussion of current conditions and the economic outlook, many participants said that circumstances had changed from those anticipated at the time of the Committee's meeting in early February. In particular, incoming data and anecdotal information indicated that economic activity had appre-

ciably more forward momentum than previously perceived and that inflation pressures could be intensifying. While underlying inflation appeared to have moved up only modestly and nearly all participants thought that core and total inflation going forward would be relatively low, they had become less certain of that outlook for the next few quarters.

Many participants noted that the most recent data and business commentary indicated that investment was running considerably stronger in the first quarter of the year than had previously been anticipated. Underlying trends in capital spending appeared to be more robust than had earlier been recognized, perhaps partly in response to unusually supportive financial conditions, and that strength was thought likely to carry forward. Business contacts were more confident about economic prospects, and that confidence was bolstering firms' willingness to invest. Anecdotal information suggested that firms were investing in part to expand capacity and in part to boost productivity and lower costs. Some investment was being prompted by a need to replace equipment that was becoming obsolete, in part because of the higher level of energy prices. Increased demand was reported for a wide variety of categories of capital goods, ranging from several types of heavy equipment, including trucks, farm machinery, and construction equipment, to software and high-tech equipment. Nonresidential construction, however, remained soft in many regions, damped by relatively high vacancy rates for office buildings and other commercial real estate.

Spending on housing and consumer goods and services was also seen as underpinning economic expansion. With single-family housing starts at record levels, residential investment expendi-

tures apparently continued to be spurred by relatively low interest rates. A few participants cited some evidence of speculative activity in the housing market in several regions. However, recent house price developments were mixed, with reports of incipient softness in some markets, including high-end properties, and overall house price inflation was seen as likely to slow in coming quarters. Consumer expenditures were expected to continue to advance at a solid pace, buoyed by strong gains in personal income, although high energy prices could exert some restraint on spending. The possibility of an appreciable rise in the personal saving rate, which was near its historical low, represented another possible downside risk to consumer spending. The recent sharp slowing in motor vehicle sales, which appeared to be related in part to the paring of purchase incentives and perhaps also to the high level of energy prices, raised some concerns about the expansion of economic activity in some regions.

Some participants mentioned that expansion abroad was apparently strengthening early this year, particularly in emerging-market economies. This development, in turn, was likely to help support U.S. exports. Several participants noted that past declines in the foreign exchange value of the dollar were contributing to U.S. economic activity. Tourism from abroad, for example, was being spurred by relative currency values. At the same time, though, it was recognized that growth in U.S. domestic demand would likely continue to be met in part by imports, tending to trim the increase in domestic output.

U.S. industrial activity was increasing steadily, pushing capacity utilization higher. Production was expanding in a broad range of manufacturing categories, notably including high-tech and

defense industries. Business contacts indicated that the high level of energy prices was spurring coal mining activity. Drilling for oil and gas was also increasing, although extraction was said to be crimped in some instances by a scarcity of experienced rig hands as well as spot shortages of certain key production inputs, such as drilling pipe.

Around the nation, labor markets conditions were reported to be stable to improving, and meeting participants perceived that slack in labor markets was gradually diminishing. In general, business executives indicated that labor was readily available, although again workers with certain skills and in certain occupations, such as trucking, were becoming increasingly difficult to hire. Some commented that the failure of labor force participation to rise as expected as the expansion gained momentum likely portended somewhat weaker labor force growth than previously anticipated; such a development, at the margin, would tend to reduce the expansion of potential output. Still, pressures on prices stemming from labor costs seemed well contained and were expected to remain damped in coming quarters. National data and anecdotal information suggested that wages generally continued to increase moderately. However, health-care expenses were a persistent source of pressure on costs.

Growth in unit labor costs had continued to be held down by growth of output per hour worked, which had continued to perform surprisingly well. Although productivity growth had slowed from the extraordinarily rapid pace that prevailed earlier in the expansion, data for the fourth quarter of 2004, as well as preliminary indications for the first quarter of this year, suggested that gains from efficiency remained substantial. Participants remarked that many business executives were seeking further

advances in productivity through organizational improvements as well as through investment in equipment and software. Regarding the latter, some evidence suggested that rapid technological progress was being sustained, which would continue to drive down the cost of many forms of productive capital and thus boost returns on investment. Moreover, the stronger picture of capital spending that had emerged of late boded well for the performance of productivity going forward. Still, considerable uncertainty persisted about longer-run prospects for productivity growth, unit labor costs, and cost pressures on profits and prices.

Meeting participants commented in particular detail on the inflation situation. They noted with some concern the recent elevated readings on inflation in prices of core personal consumption expenditures, the producer price index, and indicators of prices at earlier stages of production, as well as the sizable further increase in energy prices. Nonetheless, many participants stated that they expected total inflation to diminish and any rise in core consumer inflation to be limited. One source of upward pressure on inflation had been the rise in energy prices, and it seemed reasonable to expect that these prices would level out or even decline mildly, as built into futures prices. Unit labor costs were still being held down by moderate wage growth and rising productivity. Indeed, a few saw a distinct possibility of further positive productivity surprises, representing a downside risk to the inflation outlook. Moreover, the markup of prices over costs in nonfarm businesses remained quite high, and firms would likely be pressed by competition to absorb a portion of any step-up in the growth of unit labor costs, at least if that acceleration were limited in extent and duration. In addition, prices of many

non-energy commodities had risen in recent weeks, but such inputs constituted a relatively small fraction of overall business costs, and, partly for that reason, in the past commodity prices had demonstrated little predictive content for broad inflation rates. While short-term inflation expectations had risen somewhat, longer-term inflation expectations remained well contained. And lastly, monetary policy would be aimed at preserving price stability.

Still, many participants indicated that their uncertainty about the intensity of inflation pressures had risen in response to recent developments and that, in particular, the distribution of possible inflation outcomes was now tilted a little to the upside. Although monthly statistical releases could be quite volatile, the recent data showing consumer inflation a little above previous expectations were of concern. Also, anecdotal indications of price increases were becoming more common across a number of industries. Some business executives reportedly believed that, with aggregate demand expanding robustly and the lower foreign exchange value of the dollar putting upward pressure on import prices, a degree of "pricing power" had returned. Moreover, the recent rebound in spot crude oil prices, and especially the substantial advance in prices of crude oil futures contracts for delivery well into the future, suggested that a significant unwinding of higher energy costs might not be in prospect. Several participants indicated that, in current circumstances, they viewed an upside surprise to inflation as potentially more harmful than an equivalent downside surprise, partly because such an outcome could well impart additional upward momentum to inflation expectations.

In the Committee's discussion of monetary policy for the intermeeting period, all of the members favored

boosting the target for the federal funds rate by 25 basis points to 2¾ percent at this meeting. Monetary conditions evidently were still quite accommodative, economic activity appeared to have more momentum than had previously been perceived, and, while core inflation most probably would stay low, pressures on inflation seemed to have risen. Prospects for legislative action to apply significant fiscal restraint were unclear, even as the expansion became increasingly well established and private demand proved strong and resilient. Although the required amount of cumulative tightening may have increased, members noted that an accelerated pace of policy tightening did not appear necessary at this time, as a degree of economic slack apparently remained, productivity growth would probably continue to damp increases in unit labor costs and prices, and inflation would most likely continue to be contained. In these circumstances, Committee members judged that the measured removal of policy accommodation was appropriate for now.

In discussing the announcement to be released after the meeting, members agreed that it was appropriate to acknowledge the recent evolution in the inflation situation by indicating that "though longer-term inflation expectations remain well contained, pressures on inflation have picked up in recent months and pricing power is more evident. The rise in energy prices, however, has not notably fed through to core consumer prices." Regarding the risks to sustainable growth and price stability, members discussed a proposal to make the Committee's assessment explicitly conditional on an assumption of appropriate monetary policy so as to underscore that maintaining balanced risks would require policy action. It was noted that the Committee's assessment

of balanced risks over the past nine months—a period in which monetary policy had been steadily tightened—necessarily had to be interpreted as based implicitly on an assumption that policy accommodation would be removed. A number of members believed that formulaic language by its nature was too rigid to reflect evolving economic circumstances in a satisfactory manner, especially when developments were subtle or complex, and some of these members believed that the risk assessment should be discontinued. All the members ultimately approved making the risk assessment in the policy announcement following this meeting explicitly conditional on appropriate policy.

Members also focused on the issue of whether to reiterate the judgment expressed in the Committee's recent statements that "... policy accommodation can be removed at a pace that is likely to be measured." Some expressed the view that such language could constrain future policy inappropriately; while these concerns were not new, they were now felt to be more pressing, as the odds that the Committee might need to step up the pace of policy firming were thought to have increased. Members noted, however, that the existing "measured pace" language was clearly conditional on the economy evolving in a way that promised a gradual return to high levels of resource utilization and on inflation remaining low, and thus believed that the wording did not rule out either picking up the pace of firming or pausing in the process of removing policy accommodation should circumstances warrant. They also noted that the language had not precluded a notable increase in medium- and longer-term interest rates over the intermeeting period as markets extended the expected gradual increase in policy rates. Some

discomfort was expressed with language that related so explicitly to the likely trajectory of future policy action. But it was also averred that the Committee should, to the extent possible, provide information that would help the public anticipate the probable course of monetary policy; providing such information would tend to increase the effectiveness of monetary policy. More generally, members recognized that the Committee's statement would need to evolve over time.

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

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around $2\frac{3}{4}$ percent.

The vote encompassed approval of the paragraph below for inclusion in the statement to be released shortly after the meeting:

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Votes for this action: Messrs. Greenspan, Geithner, Bernanke, Ms. Bies, Messrs.

Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, Santomero, and Stern. Vote against this action: None. Mr. Guynn voted as alternate member .

It was agreed that the next meeting of the Committee would be held on Tuesday, May 3, 2005. The meeting adjourned at 1:25 p.m.

Notation Vote

By notation vote completed on February 22, 2005, the Committee unanimously approved the minutes of the meeting of the Federal Open Market Committee held on February 1–2, 2005.

Vincent R. Reinhart
Secretary

Meeting Held on May 3, 2005

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 3, 2005 at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Ms. Bies
Mr. Ferguson
Mr. Fisher⁶
Mr. Gramlich
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Santomero
Mr. Stern

Messrs. Guynn and Lacker, Mses. Pianalto and Yellen, Alternate Members of the Federal Open Market Committee

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

Mr. Reinhart, Secretary and Economist
Ms. Danker, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Messrs. Connors, Evans, and Madigan, Ms. Mester, Messrs. Oliner, Rosenblum, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

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

Messrs. Freeman, Slifman, and Struckmeyer, Associate Directors, Divisions of International Finance, Research and Statistics, and Research and Statistics, respectively, Board of Governors

Messrs. Clouse and Whitesell, Deputy Associate Directors, Division of Monetary Affairs, Board of Governors

Messrs. English and Leahy, Assistant Directors, Divisions of Monetary Affairs and International Finance, respectively, Board of Governors

Mr. Simpson, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

6. Secretary's note: Advice had been received that Richard W. Fisher had been elected by the directors of the Federal Reserve Banks of Atlanta, Dallas, and St. Louis, as a member of the Federal Open Market Committee for the period commencing April 4, 2005, and that he had executed his oath of office.

- Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors
- Mr. Brady, Section Chief, Division of Monetary Affairs, Board of Governors
- Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors
- Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors
- Mr. Lyon, First Vice President, Federal Reserve Bank of Minneapolis
- Messrs. Eisenbeis, Goodfriend, Hakkio, Rasche, Rudebusch, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Atlanta, Richmond, Kansas City, St. Louis, San Francisco, and Cleveland, respectively
- Mr. Elsasser, Ms. Little, and Messrs. Peach and Todd, Vice Presidents, Federal Reserve Banks of New York, Boston, New York, and Minneapolis, respectively

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. 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 since the previous meeting. By unanimous vote, the Committee ratified these transactions.

By unanimous vote, the Committee voted to extend for one year beginning in mid-December 2005 the reciprocal

currency ("swap") arrangements with the Bank of Canada and the Banco de Mexico. The arrangement with the Bank of Canada is in the amount of \$2 billion equivalent and that with the Banco de Mexico in the amount of \$3 billion equivalent. Both arrangements are associated with the Federal Reserve's participation in the North American Framework Agreement of 1994. The vote to renew the System's participation in the swap arrangements maturing in December was taken at this meeting because of the provision that each party must provide six months prior notice of an intention to terminate its participation.

The information received at this meeting suggested that the growth of economic activity had unexpectedly moderated during the first quarter from the rapid pace seen during the second half of 2004. Gains in private payroll employment over the first quarter were similar to the average for the second half of 2004 but weakened in March, and manufacturing production rose only a little, on balance, over February and March. Consumers appeared to have turned somewhat cautious in their spending, likely a reflection of higher energy prices. Housing starts fell in March after a sustained stretch of very high readings, but home sales continued at a rapid rate throughout the quarter. Growth of capital spending, while strong in the first quarter, was down from the brisk rates of previous quarters. Sharp increases in energy prices pushed up headline inflation, and core measures were also somewhat elevated. Labor costs, however, advanced at a moderate rate. Employment continued to expand in March, although the increase was less than the strong advance in February. Employment declined in manufacturing, retail trade, and temporary help services, but most other sectors registered gains. The average workweek remained

at its recent level, and aggregate hours posted a small gain. The unemployment rate moved down to 5.2 percent in March. Also suggesting a gradual erosion of slack in labor markets were surveys indicating that some employers were finding some jobs requiring special skills harder to fill and that households were experiencing increases in job availability. Nevertheless, survey measures of expected conditions in labor markets softened somewhat in the early months of the year, and the labor market participation rate remained low in March.

Industrial production continued to expand in the first quarter, but the pace was slower than in the final months of 2004. Gains were restrained by a decline in manufacturing output, particularly for motor vehicles and parts, and by a reduction in energy generation at utilities, which was held down by unseasonably warm weather early in the year. Mining output, however, accelerated, as did production in the business equipment and defense and space equipment industries. Capacity utilization in manufacturing edged up on average in the first quarter, but moved down in March and remained a bit below its thirty-year average.

Consumer spending advanced solidly in the first quarter despite some slowing in automobile sales. However, much of that strength was registered early in the quarter, and spending in March was subdued. Measures of consumer confidence declined in the early months of the year but remained well above the lows of two years ago. Other factors underlying consumer spending also remained favorable: Real wages and salaries continued to rise, and the ratio of wealth to income remained high, although it was down a bit because of a decline in equity prices. The personal saving rate stayed low over the first quarter of the year.

Housing starts slowed in March, after exceptional strength in the prior two months. However, a substantial increase in the level of permits in March suggested that starts likely turned back up in April. A similar pattern was observed in the multifamily sector. The thirty-year mortgage rate in the first quarter stayed in a range around its average level for the past two years. Sales of existing homes were rapid throughout the quarter, and sales of new homes rose to another record level in March. House prices continued to rise rapidly over the first quarter, although recent data suggested some slowing.

Growth of business spending on equipment and software moderated substantially in the first quarter from the very high rates of last year, but appeared to retain considerable momentum; strong gains occurred in all major categories except motor vehicles. This performance reflected favorable underlying fundamentals, including solid growth in business output, strong retained earnings, high levels of liquid assets, and favorable borrowing conditions in the form of low interest rates and narrow risk spreads in bond and loan markets. At the same time, construction of nonresidential structures remained quite subdued. Over the first quarter, outlays for manufacturing facilities picked up a bit, but those for office buildings stayed low despite some declines in the office vacancy rate, and spending on commercial structures fell.

Nonfarm inventories accumulated in the first two months of the year at a much faster rate than in the preceding quarter, prompting a small increase in inventory–sales ratios. Inventory gains were especially strong early in the quarter and were concentrated in the manufacturing sector.

The U.S. international trade deficit widened in February as exports held

steady. The value of imported oil jumped sharply, and nonoil imports also rose. Economic indicators for major foreign industrial countries suggested some slowing of growth late in the quarter after a pickup earlier in the year. In Japan, industrial production rose briskly in January before falling back; the euro-area industrial sector evidenced a similar pattern. By contrast, economic activity in China and other developing countries showed greater buoyancy. Consumer price inflation abroad remained subdued.

U.S. consumer price inflation firmed in recent months as energy prices rose sharply. Core consumer prices also rose a bit more rapidly recently, but the increase over the twelve months ending in March was little different than over the year-earlier period. According to survey information, expectations of near-term inflation picked up in March, consistent with the increase in energy prices. As for labor costs, the employment cost index for private industry decelerated over the first quarter from an already moderate pace. The slowing occurred in both the wages and salaries component and the benefits component and was fairly widespread across industry groups.

At its March meeting, the Federal Open Market Committee decided to increase the target level of the federal funds rate 25 basis points, to 2¾ percent. In its accompanying statement, the Committee expressed its perception that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. The Committee also noted that economic output continued to grow at a solid pace despite the rise in energy prices and that labor market conditions continued to improve gradually. While pressures on inflation had picked

up in recent months and pricing power was more evident, longer-term inflation expectations remained well contained. In these circumstances, the Committee believed that policy accommodation could be removed at a pace that would likely be measured but noted that it would respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

The FOMC's decision in March to raise the intended level of the federal funds rate 25 basis points was fully anticipated by the market, as were its retention in the accompanying statement of the "measured pace" language and its assessment that the risks to price stability and sustainable economic growth were balanced. Interest rates, however, rose, reportedly in response to the statement's references to increased price pressures and to more evident pricing power as well as to the Committee's conditioning of its risk assessment on "appropriate monetary policy action." Interest rates rose further the next day following the release of a larger-than-expected increase in the CPI for February. Over subsequent weeks, however, these increases were more than reversed by weaker-than-expected data on consumer spending, consumer sentiment, and output. Further downward pressure on interest rates was exerted by the market's response to the release of the minutes of the March meeting, as attention focused on the reference to Committee members' judgment that an accelerated path of policy tightening was not necessary at that time. Despite generally good first-quarter earnings reports, equity indexes moved down considerably in response to the signs of weaker economic growth. In foreign exchange markets, the dollar rose on balance, apparently due, in part, to disappointing news on employment and output abroad.

M2 expanded in March and April at about the same sluggish pace as it did earlier in the year. The growth of M2 continued to be restrained by increases in its opportunity cost resulting from rising short-term interest rates. Rates paid on its liquid components particularly lagged increases in market rates.

Partly in response to the receipt of weaker-than-expected data for spending and output in the first quarter, the staff marked down somewhat its forecast of economic growth for 2005 and 2006. Even so, the economy was seen as retaining considerable momentum, and growth was expected to pick up some after the first quarter, paced by business spending on equipment and software. Consumption expenditures were seen as likely to expand at a moderate rate and residential investment to slow. With exports forecast to expand a bit more rapidly than imports, the arithmetic net drag on the economy from trade was expected to lessen. Fiscal policy was expected to provide a more moderate impetus to growth this year and next, following the substantial boost estimated for earlier years. Although economic growth was projected to run a bit above the staff's estimate of the economy's potential, the unemployment rate was projected to hold around its current level with improvements in job prospects expected to lure more workers back into the labor force. Inflation was projected to edge lower over the rest of the year and into 2006, reflecting the attenuation of the impact of higher energy prices and the effects of a slowed rate of growth of import prices and remaining slack in resource markets.

In their discussion of current conditions and the economic outlook, meeting participants observed that incoming data over the intermeeting period hinted at possible upside risks for inflation and downside risks for economic growth.

Earlier increases in energy prices seemed to be an important factor contributing to an uptick in core inflation and a slower pace of economic activity. With energy prices leveling out more recently, however, and the behavior of compensation suggesting a lack of pressure in labor markets, underlying inflation appeared to remain contained. The weakness in spending was widespread and could not be completely dismissed, but it had appeared only very recently and could be a product of the inherent noisiness of high-frequency economic data. On balance, economic fundamentals including low interest rates, robust underlying productivity growth, and strengthened business balance sheets were expected to support economic growth at a pace sufficient to gradually eliminate remaining slack in resource utilization. Although the economic outlook generally seemed favorable, there was also broad recognition of greater uncertainty attending the outlook for both inflation and output growth.

Capital expenditures advanced briskly over the first quarter, but at a pace significantly below that registered over the latter half of last year. To some extent, businesses probably had pulled capital outlays forward from this year into 2004 to benefit from the partial-expensing tax provision that expired at year-end, but the unexpected weakness in capital goods orders for February and March seemed hard to attribute to this factor alone. In addition, the prolonged period of elevated spot energy prices, the sense supported by futures markets that these higher prices may persist for some time, and the heightened uncertainty about energy prices going forward, together may have left businesses less confident about the future and wary of longer-term commitments such as expanding plant capacity or taking on new workers. A less buoyant and less certain

economic outlook seemed apparent in financial markets as well, where equity prices had fallen and risk spreads had widened. On balance, though, these financial developments did not appear to signal the onset of a sharp retrenchment in investors' willingness to bear risk, and capital expenditures were seen as likely to remain quite robust, spurred by strong economic fundamentals that included elevated profits, opportunities to raise efficiency by utilizing new technologies, a low cost of capital, and strong corporate balance sheets. Indeed, a substantial weakening in business investment in an environment with such favorable fundamentals would be at odds with the historical record.

Incoming data for the household sector were viewed as mixed. Higher gasoline prices seemed to be sapping consumer confidence and consumer spending. The pace of consumption growth had fallen off appreciably toward the end of the first quarter, and some participants worried about the potential for continued sluggishness in consumer spending if increasingly cautious households sought to raise their saving rate rapidly. On balance, though, strong income growth and low interest rates augured well for household spending. Although housing starts had dropped of late, home sales and other indicators of activity in the residential real estate market remained at very high levels. House price appreciation was expected to moderate over coming quarters, but a number of local real estate markets were still regarded as "hot," with signs of possible speculative excesses in some areas.

The deceleration in final sales over the first quarter had been accompanied by a sizable accumulation of businesses inventories. The available data suggested that stocks had accumulated in a variety of industries, but particularly in the motor vehicle sector where the

inventory of new autos had moved appreciably higher. Although difficult to judge, the inventory buildup was not regarded as likely to have major implications for aggregate manufacturing beyond some modest production cut-backs in the current quarter.

A relatively high proportion of demand had continued to be met by imports. Some concern was expressed that incoming data suggested weaker growth in some of our major trading partners, which posed a downside risk to forecasts for U.S. exports. Moreover, advances in domestic income were expected to contribute to brisk growth in imports. Looking ahead, the U.S. economy was expected to continue to run quite substantial current account deficits, although the impact of past dollar depreciation should work to boost exports and slow the rise in imports to some extent.

Recent energy price developments garnered considerable attention. Declines in energy prices in recent weeks were viewed as welcome, but participants noted that far-dated futures prices for oil remained quite elevated and that persistently high energy prices could trigger a range of deleterious effects on the economy. High energy prices appeared to be taking a toll on household and business confidence and might be beginning to crimp corporate profits. In some cases, firms seemed to be more successfully passing on energy costs to their customers. Indeed, some portion of recent elevated inflation readings probably represented, at least partly, such pass-through effects from higher energy costs. However, while pass-through effects could leave the overall price level higher, their impact on inflation should fade over time, as long as inflation expectations remain well contained. Still, considerable uncertainty surrounded the degree of pass-through

from energy prices to core consumer prices, and pass-through effects might be more pronounced when energy price increases were perceived as more likely to be permanent. Persistently high energy prices were mentioned as a factor that could trim the level of potential output to a small degree over time, possibly contributing to additional upward pressure on consumer prices at the margin.

Participants voiced concerns about recent price trends; they expected inflation to remain contained but also perceived that the risks to that inflation outlook now might be skewed somewhat to the upside. Core measures of price inflation had moved up over recent quarters and particularly so over the last few months. A discernable upcreep was apparent in survey measures of short- and, to a limited extent, long-term inflation expectations over recent months. Moreover, there were risks that the relative stability of long-term survey measures of inflation expectations could simply reflect lags in households' perceptions of changing economic prospects. The success that some businesses seemed to be encountering in passing through cost increases raised the possibility that competitive pressures and resource slack were exerting somewhat less restraint on inflation than had been anticipated.

However, available indicators of wages and benefits had registered only modest growth, suggesting to many that some slack in labor markets persisted. Moreover, market measures of inflation compensation had ebbed in recent weeks, and survey measures of long-term inflation expectations, albeit a touch higher of late, remained in the broad range of recent years. Along with energy prices, import and materials prices apparently had contributed to the recent uptick in inflation, and pressures

on inflation stemming from these three sources were expected to lessen over coming quarters. On balance, measures of core inflation were thought likely to remain in check over the remainder of this year and next.

In the Committee's discussion of monetary policy for the intermeeting period, all members favored raising the target federal funds rate 25 basis points to 3 percent at this meeting. Although downside risks to sustainable growth had become more evident, most members regarded the recent slower growth of economic activity as likely to be transitory. In this regard, the ability of the U.S. economy to withstand significant shocks over recent years buttressed the view that policymakers should not overreact to a comparatively small number of disappointing indicators, especially when economic fundamentals appeared to remain quite supportive of continued solid expansion. To be sure, the Committee had raised its federal funds rate target appreciably over the past year, and, in the view of a few members, a larger-than-expected moderation of aggregate demand in response to this cumulative policy action could not be ruled out. However, all members regarded the stance of policy as accommodative and judged that the current level of short-term rates remained too low to be consistent with sustainable growth and stable prices in the long run. Against the backdrop of the recent uptick in core inflation and in some measures of inflation expectations, members agreed that they should continue along the course of removing policy accommodation at a measured pace conditional on the outlook for inflation and economic growth.

In discussing the statement to be released after the meeting, members agreed that it was appropriate to acknowledge that rising energy prices

seemed to have spurred an increase in core measures of inflation by dropping the reference from the March statement indicating that “The rise in energy prices, however, has not notably fed through to core consumer prices.” They likewise all agreed that mention should be made that, on balance, longer-term inflation expectations remained well contained. Regarding the risks to sustainable growth and price stability, some members noted that the risk assessment conditioned on “appropriate policy” no longer seemed to convey useful information regarding the Committee’s economic and policy outlook. Although some members noted that a case could be made that the risks to inflation were now somewhat skewed to the upside and those to sustainable economic growth perhaps to the downside, the most likely outcome remained one of stable prices and sustainable growth, and the Committee agreed that it should retain a balanced assessment of risks conditional on appropriate policy.

For many, heightened economic uncertainty in the current environment implied greater uncertainty about the range of possible policy outcomes and placed a premium on flexibility in setting policy at upcoming meetings. Some members commented that this greater uncertainty called for eliminating or paring back forward-looking language from the statement—if not at this meeting, then fairly soon. In the event, most members viewed the forward-looking language in the statement—including the characterization of the stance of policy as accommodative as well as the judgment that policy accommodation could be removed at a pace that is “likely to be measured”—as a reasonable characterization of the policy stance and its likely evolution over time. Moreover, a number remarked that the language in its current form was clearly

conditioned on economic developments and therefore would not stand in the way of either a pause or a step-up in policy firming depending on events. In the end, all members agreed to retain the forward-looking language.

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

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 3 percent.

The vote encompassed approval of the paragraph below for inclusion in the statement to be released shortly after the meeting:

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Votes for this action: Messrs. Greenspan and Geithner, Ms. Bies, Messrs. Ferguson, Fisher, Gramlich, Kohn, Moskow, Olson, Santomero, and Stern. Votes against this action: None. Absent and not voting: Mr. Bernanke

It was agreed that the next meeting of the Committee would be held on Wednesday–Thursday, June 29–30, 2005. The meeting adjourned at 1:25 p.m.

Notation Vote

By notation vote completed on April 11, 2005, the Committee unanimously approved the minutes of the meeting of the Federal Open Market Committee held on March 22, 2005.

Vincent R. Reinhart
Secretary

Meeting Held on June 29–30, 2005

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, June 29, 2005 at 2:00 p.m. and continued on Thursday, June 30, 2005 at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Ms. Bies
Mr. Ferguson
Mr. Fisher
Mr. Gramlich
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Santomero
Mr. Stern

Ms. Cumming, Messrs. Guynn and Lacker, Mses. Pianalto and Yellen, Alternate Members of the Federal Open Market Committee

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

Mr. Reinhart, Secretary and Economist
Ms. Danker, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Messrs. Evans, Freeman, and Madigan, Ms. Mester, Messrs. Oliner, Rolnick, Rosenblum, Tracy, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

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

Messrs. Kamin, Slifman, and Struckmeyer, Associate Directors, Divisions of International Finance, Research and Statistics, and Research and Statistics, respectively, Board of Governors

Messrs. Clouse, Wascher, and Whitesell, Deputy Associate Directors, Divisions of Monetary Affairs, Research and Statistics, and Monetary Affairs, respectively, Board of Governors

Messrs. English, Leahy, and Treacy,⁷ Assistant Directors, Divisions of Monetary Affairs, International Finance, and Banking Supervision and Regulation, respectively, Board of Governors

Mr. Simpson, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Mr. Wright,⁸ Section Chief, Division of Monetary Affairs, Board of Governors

7. Attended Wednesday's portion of the meeting.

8. Attended Thursday's portion of the meeting.

Messrs. Bowman,⁸ Gallin,⁷ and Lehnert,⁷ Senior Economists, Divisions of International Finance, Research and Statistics, and Research and Statistics, respectively, Board of Governors

Messrs. Doyle⁷ and Martin,⁷ Economists, Division of International Finance, Board of Governors

Messrs. Kumasaka⁷ and Luecke, Senior Financial Analysts, Division of Monetary Affairs, Board of Governors

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

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

Messrs. Eisenbeis and Judd, Executive Vice Presidents, Federal Reserve Banks of Atlanta and San Francisco, respectively

Messrs. Fuhrer, Goodfriend, and Hakkio, Ms. Perelmuter, Messrs. Rasche, Rudebusch,⁷ Sniderman, and Williams,⁷ Senior Vice Presidents, Federal Reserve Banks of Boston, Richmond, Kansas City, New York, St. Louis, San Francisco, Cleveland, and San Francisco, respectively

Mr. Peach,⁷ Vice President, Federal Reserve Bank of New York

By unanimous vote, the Federal Open Market Committee approved the selection of Richard T. Freeman to serve as associate economist of the Committee until the selection of a successor at the first regularly scheduled meeting after December 31, 2005.

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

System's account in the period since the previous meeting. 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 since the previous meeting. By unanimous vote, the Committee ratified these transactions.

At this meeting the Committee reviewed and discussed staff presentations on the topic of housing valuations and monetary policy. Prices of houses in the United States had risen sharply in recent years, especially in certain areas of the country, to very high levels relative to incomes or rents. In addition to local market factors, a wide range of influences appeared to be supporting home prices, including solid gains in disposable income, low mortgage rates, and financial innovation in the residential mortgage market. Prices might be somewhat above the levels consistent with these underlying factors, but measuring the extent of any overvaluation either nationally or in regional markets posed considerable conceptual and statistical difficulties. Meeting participants noted that the rise in house prices had been accompanied by a modest shift toward potentially riskier types of mortgages, including adjustable-rate and interest-only loans, which could pose challenges to both lenders and borrowers. Nonetheless, financial institutions generally remained in a comfortable capital position, such loans had performed well thus far, much of the associated risk had been transferred to other investors through securitization, and valuations had risen more rapidly than mortgage debt on average—so that loan-to-value ratios had fallen.

The information received at this meeting suggested that the economy was expanding at a moderate pace in the second quarter. Housing activity

remained at a high level, business investment appeared to have improved some after a slowdown of growth in the first quarter, and manufacturing picked up notably in May. Supported by a rebound in motor vehicle purchases, consumer spending appeared on track to post another moderate gain for the quarter. Labor demand continued to expand, and the unemployment rate edged down further in May. Core CPI inflation slowed in April and May, but crude oil prices turned higher again following a decline earlier in the spring.

Averaging through a large gain in April and a more modest increase in May, growth in payroll employment was on par with that over the preceding six months. Payrolls expanded in line with their recent trends in the construction, transportation and utilities, and nonbusiness services sectors, while hiring in financial services slowed a bit, and the manufacturing sector posted further small losses of jobs. The average workweek of production or nonsupervisory workers edged up over the two-month period, helping to boost aggregate hours to the highest level since early 2001. The unemployment rate dipped to 5.1 percent in May. Meanwhile, the labor force participation rate moved up a bit, suggesting that the labor market had strengthened enough to attract some individuals back into the workforce. Survey indicators and the continued relatively low level of initial claims for unemployment insurance also supported the notion of continued improvement in the labor market.

Industrial production declined in April, owing to a dip in utilities output, but widespread gains in manufacturing output in May offset that loss. On net, industrial production was little changed over April and May; capacity utilization generally followed the same pattern as output.

Real personal consumption expenditures appeared to be increasing at a moderate pace this quarter, though a bit below that of the first quarter. Purchases of motor vehicles rebounded smartly after declining in the first quarter. Excluding motor vehicles, however, the expansion of real consumer outlays likely slowed of late, against a backdrop of modest gains in real income. Recent measures of consumer confidence improved from their levels earlier in the spring, when higher gasoline prices and concerns about a slowing in the pace of the economic expansion may have served as restraining influences.

Activity in the housing sector remained robust. Single-family starts averaged more than 1.65 million units at an annual rate in April and May, not much below the very strong first-quarter pace. Sales of both new and existing homes remained at a high level in May. While prices of existing homes continued to increase rapidly, new home prices showed signs of decelerating. Available indicators suggested that, with the ongoing support of low mortgage rates, the housing sector remained strong in June.

Spending on equipment and software registered a solid increase in the first quarter, and the available data suggested that second-quarter spending was continuing at a slightly faster pace. Shipments of nondefense capital goods posted sizable increases in recent months, although gains in orders were more uneven. Broadly speaking, the fundamentals continued to support business investment, with the user cost of capital still low and corporate balance sheets healthy. Outlays for construction of nonresidential structures appeared to have picked up some, but the level of such investment remained subdued. And although spending on commercial structures had moved up in recent months, outlays for office buildings were still at

depressed levels, and expenditures on manufacturing and other facilities were lackluster.

The book value of manufacturing and trade inventories continued to grow in April, but more slowly than in the first quarter. With these increases, the inventory–sales ratio fell back in April after moving up a little in the first quarter.

After reaching a record high relative to GDP in February, the U.S. international trade deficit narrowed in March, but widened again in April. While the value of exports of goods and services increased in both months, the value of imports of goods and services jumped in April, more than offsetting a decline in March. GDP growth in most major foreign industrial economies picked up slightly in the first quarter, but recent economic indicators for the major foreign economies in the second quarter were mixed.

Consumer prices were about unchanged in May after posting large increases in the previous few months. Consumer energy prices, in particular, reversed part of their earlier run-up. Excluding food and energy, inflation appeared to have moderated slightly from its pace in the early part of the year. Despite this moderation, measures of core consumer price inflation over the past year were somewhat above those for the comparable period a year ago. The producer price index rose sharply in April, but dropped back again in May, driven largely by a swing in the food and energy components. According to recent surveys, both near-term and longer-term inflation expectations had changed little over the past two months, and market measures of inflation compensation had moved lower. With regard to labor costs, growth in hourly compensation in the nonfarm business sector in the first quarter was

estimated to have slowed some after advancing notably in the fourth quarter; the first quarter increase was broadly similar to those posted during the middle of last year.

At its May meeting, the Federal Open Market Committee decided to increase the target level of the federal funds rate 25 basis points, to 3 percent. In its accompanying statement, the Committee expressed its perception that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. The Committee also noted that recent data suggested that the solid pace of spending growth had slowed somewhat, partly in response to the earlier increases in energy prices, but that labor market conditions apparently continued to improve gradually. While pressures on inflation had picked up in recent months and pricing power was more evident, longer-term inflation expectations remained well contained. In these circumstances, the Committee believed that policy accommodation could be removed at a pace that would likely be measured but noted that it would respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

The decision at the May FOMC meeting to raise the federal funds rate target 25 basis points, to 3 percent, to maintain an assessment that risks to the goals of price stability and sustained growth were balanced, and to retain the “measured pace” language was widely expected in financial markets. The publication of the minutes three weeks later also contained few surprises for investors and elicited little market reaction. Market expectations for the future path of policy ended the period higher in the near term but lower at longer horizons. Nominal Treasury yields followed the

shift in policy expectations, with near-term yields higher and longer-term yields modestly lower, on net. Spreads on investment-grade corporate bonds were little changed over the intermeeting period, but spreads on speculative-grade bonds contracted notably. Buoyed by the drop in longer-term interest rates and largely upbeat economic news, major equity indexes rose appreciably over the intermeeting period. The positive economic data also seemed to lift the dollar against major foreign currencies, though the dollar's moves against individual currencies varied widely.

M2 edged lower over April and May as the opportunity cost of holding M2 assets rose further. Liquid deposits were especially weak, owing to the slow adjustment of yields paid on these deposits to increases in market rates. Despite the recent softness in M2, its velocity remained quite low relative to its historical relationships with opportunity cost. Bank credit decelerated sharply in April and May from rapid gains posted in the first quarter, as growth in both securities and loans fell.

In the staff forecast prepared for this meeting, the economy was seen as likely to expand this year and next at a rate just above its potential. The effects of reduced monetary and fiscal policy stimulus were expected to be counterbalanced by continued low long-term interest rates and an abatement of energy-related headwinds. Household spending was expected to firm going forward as real income posts solid gains attributable in part to the ongoing improvement in the labor market. Business investment was projected to benefit from the combination of favorable prospects for sales, supportive financial markets, and the ongoing need to replace or upgrade aging equipment and software. A slightly larger portion of domestic demand was expected to be supplied by

imports over the forecast period. The forecast for consumer price inflation was revised up, with inflation seen as somewhat higher this year than in 2004, reflecting in part higher import prices and the direct and indirect effects of higher energy prices, and only edging lower next year as these price pressures wane.

In their discussion of current conditions and the economic outlook, many meeting participants noted that incoming data had been reassuring about the strength of the expansion. Following some softer readings earlier in the year, incoming spending and production data over the intermeeting period indicated that the expansion remained firm, led by residential and business investment. In addition, labor market conditions continued to strengthen gradually. The economy evidently had been resilient in the face of rising energy prices, and financial conditions remained accommodative, supporting growth going forward. Increases in core consumer prices had slowed of late, though underlying inflation was still seen by most meeting participants as likely to be modestly higher this year than last, impelled in part by the pass-through of a further rise in energy prices. However, the impetus to inflation from the prices of oil and other commodities was expected to wane, and long-term inflation expectations apparently remained well-anchored. With some limited remaining slack in labor markets likely damping growth in compensation, as well as further withdrawal of policy accommodation, core inflation was expected to remain contained.

In preparation for the Federal Reserve's semiannual report to the Congress on monetary policy, the members of the Board of Governors and the presidents of the Federal Reserve Banks submitted individual projections of the growth of GDP, the rate of unemploy-

ment, and core consumer price inflation for 2005 and 2006. The forecasts of the rate of expansion in real GDP were concentrated in the upper part of a 3 to 3¾ percent range for 2005, and the forecasts for 2006 were concentrated at the lower end of a range of 3¼ to 3¾ percent. These rates of growth were associated with a civilian unemployment rate of 5 to 5¼ percent in the fourth quarter of this year and a rate of 5 percent in the fourth quarter of 2006. Forecasts of the rate of inflation, as measured by the core PCE price index, were mainly near the middle of a 1½ to 2¼ percent range this year and somewhat below the middle of a range of 1½ to 2½ percent next year.

In their comments about developments in key sectors of the economy, meeting participants noted that the fundamentals underlying household spending remained firm. With rising home and equity prices buoying household wealth, consumer expenditures continued to advance. Although the recent surge in energy prices was anticipated to impose some drag for a time, consumption spending was expected to grow about in line with income going forward, in an environment of further gradual improvements in labor markets. Increased speculative activity in housing markets was evident in some parts of the country, but robust demand for new homes owed in large part to the ongoing economic expansion and low long-term interest rates.

Business outlays for capital goods continued to rise, and the outlook for investment spending remained solid, supported by increased sales, low interest rates, robust profits, and strong business balance sheets. Anecdotal reports from industry contacts generally pointed to planned increases in investment spending, though in some regions businesses apparently remained cautious

about the outlook. Conditions in the commercial real estate sector, which had been weak for some time, were said to have improved in some parts of the nation.

Several meeting participants expressed some concern about domestic and global imbalances. Large federal budget deficits were expected to persist despite an increase in tax receipts in recent months. These deficits were contributing to a low level of national saving that would, if not corrected over time, ultimately constrain investment and overall economic growth. Moreover, U.S. trade deficits were expected to remain large going forward, reflecting both the low level of U.S. saving and relatively slow growth in some of our trading partners. Uncertainties regarding the nature and timing of the potential correction of these imbalances complicated the assessment of the intermediate-term prospects for the U.S. economy.

In their discussion of developments in asset markets, the participants' comments focused on two related issues: the low level of long-term interest rates and the continued run-up in home prices. Despite substantial cumulative policy tightening over the past year, long-term Treasury yields had moved considerably lower, implying a significant flattening of the yield curve (measured as the spread between long-term and short-term Treasury yields). Lower compensation for inflation accounted for a portion of the decline in longer-term nominal yields, but a larger portion reflected reductions in real yields. Participants cited a variety of factors as possibly contributing to the unusual behavior of long-term rates over this period. For one, investors might have marked down the level of real interest rates seen as likely to be necessary to contain inflation and keep output in line

with potential—perhaps reflecting weak investment demand abroad relative to saving—or even might have come to expect a stretch of sub-par U.S. growth. However, anticipation of slow growth seemed inconsistent with higher stock prices and thin risk spreads in corporate debt markets. The behavior of long-term interest rates could also reflect reduced uncertainty on the part of investors about the economic outlook—as seen in low readings of implied volatility in bond and equity markets. Finally, demands for longer-term U.S. securities by both domestic and foreign investors might have been boosted by special factors. Confidence about the economic outlook and low market interest rates—along with possibly outsized expectations of capital gains in some markets—could also help to account for the high level of home prices the Committee had discussed on the first day of the meeting. It was agreed that considerable uncertainty attended the outlook for both long-term interest rates and home prices.

With regard to any role for monetary policy in responding to possible imbalances in housing or bond markets, meeting participants stressed the importance of the pursuit of their core objectives of price stability and maximum sustainable economic growth. To the extent that an asset price movement threatened the achievement of those objectives, it would of course be taken into consideration in setting policy. However, given the unavoidable uncertainties associated with judgments regarding the appropriate level of and likely future movements in asset prices, a strategy of responding more directly to possible mispricing was seen as very unlikely to contribute, on balance, to the achievement of the Committee's objectives over time.

Participants' views on the inflation outlook were mixed. Thus far in 2005, core consumer price inflation had

been higher than most participants had expected at the start of the year, reflecting, at least in part, the pass-through effects of higher energy, commodity, and import prices. While such shocks could be expected to boost inflation temporarily, some participants expressed concern that, with policy still accommodative, the underlying pace of inflation might be in the process of stepping up, perhaps to a level that was at the upper end of the range that they viewed as compatible with the Committee's price stability objective. The degree of slack remaining in labor and resource markets was very uncertain, and unit labor costs in the nonfarm business sector had moved notably higher in recent quarters. Trend unit labor costs could also be boosted by slower growth in structural productivity; while recent evidence was not conclusive, some participants thought the underlying pace of productivity growth might well fall back in coming quarters following the substantial gains seen in recent years. And with higher energy prices already eating into profit margins at firms outside the energy sector, increases in unit labor costs might be more likely to be passed through into prices.

While agreeing that inflation developments had to be watched carefully, other meeting participants emphasized that recent core inflation data had been relatively restrained, and anecdotal reports suggested that pricing power at many firms remained quite limited. Moreover, readings from futures markets suggested that oil prices would likely flatten out, so their effect on inflation should gradually ebb. Similarly, prices of other commodities and imports, which had surged for a time, were now moderating. Survey and market measures of long-term inflation expectations did not suggest that the earlier higher inflation readings were going to persist. Finally, while the

degree of slack in labor markets was uncertain, total labor compensation had probably been boosted temporarily around the turn of the year by special factors, and the recent behavior of a range of other indicators of labor costs appeared consistent with some remaining slack that would likely tend to restrain inflation pressures. Moreover, anecdotal reports of labor market conditions continued to point to shortages of labor only for certain, mostly skilled, occupations.

In the Committee's discussion of monetary policy for this meeting, all members agreed on a 25 basis point increase in the target federal funds rate to 3¼ percent. Economic growth remained firm, while rising energy, and possibly labor, costs threatened to put upward pressure on inflation. Even with this action, the federal funds rate remained below the level members anticipated would prove necessary in the long run to contain inflation pressures and keep output near potential. However, the pace and extent of future policy moves would depend on incoming data.

In considering the statement to be released following this meeting, members concurred that it should note that even with the rise in oil prices, the expansion remained firm and labor markets continued to improve gradually. All also thought that the statement should note the continued pressures on inflation, while mentioning that long-term inflation expectations remained well contained. With policy still seen as accommodative, members agreed that the statement should retain an assessment that the risks to both sustainable economic growth and price stability were balanced, conditional on appropriate policy action. Members also agreed that the statement language indicating that "policy accommodation can be

removed at a pace that is likely to be measured" correctly characterized the outlook for policy for now. The members concurred that at this stage in the expansion, with margins of slack resources narrowing and inflation somewhat higher, the Committee needed to be particularly alert to signs of a further increase in inflation. Such an increase could be particularly problematic because it might impart upward momentum to inflation expectations that would be costly to reverse. In any case, additional tightening would probably be necessary, but views differed on the amount of tightening that would likely be required to keep inflation contained and bring output in line with potential. However, members agreed that there was no need to make such an assessment at this time, and that the appropriate pace and degree of cumulative policy adjustment would depend on economic developments going forward. With the forward-looking language in the statement clearly conditioned on the outlook, it was not seen as limiting the Committee's flexibility in responding to such developments.

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

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 3¼ percent.

The vote encompassed approval of the paragraph below for inclusion in the

statement to be released shortly after the meeting:

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Votes for this action: Messrs. Greenspan and Geithner, Ms. Bies, Messrs. Ferguson, Fisher, Gramlich, Kohn, Moskow, Olson, Santomero, and Stern. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 9, 2005.

The meeting adjourned at 1:25 p.m.

Notation Vote

By notation vote completed on May 23, 2005, the Committee unanimously approved the minutes of the meeting of the Federal Open Market Committee held on May 3, 2005.

Vincent R. Reinhart
Secretary

Meeting Held on August 9, 2005

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 9, 2005 at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Ms. Bies

Mr. Ferguson
Mr. Fisher
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Santomero
Mr. Stern

Messrs. Guynn and Lacker,
Meses. Pianalto and Yellen,
Alternate Members of the Federal
Open Market Committee

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

Ms. Danker, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Messrs. Connors and Madigan,
Ms. Mester, Messrs. Rosenblum,
Tracy, and Wilcox, Associate
Economists

Mr. Kos, Manager, System Open
Market Account

Mr. Struckmeyer, Associate Director,
Division of Research and
Statistics, Board of Governors

Messrs. Clouse and Whitesell, Deputy
Associate Directors, Division of
Monetary Affairs, Board of
Governors

Messrs. English and Gagnon, and
Ms. Liang, Assistant Directors,
Divisions of Monetary Affairs,
International Finance, and
Research and Statistics,
respectively, Board of Governors

Mr. Skidmore, Special Assistant to the
Board, Office of Board Members,
Board of Governors

Mr. Small, Project Manager, Division
of Monetary Affairs, Board of
Governors

- Mr. Wright, Section Chief, Division of Monetary Affairs, Board of Governors
- Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors
- Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors
- Mr. Connolly, First Vice President, Federal Reserve Bank of Boston
- Mr. Judd, Executive Vice President, Federal Reserve Bank of San Francisco
- Messrs. Hakkio, Rasche, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Kansas City, St. Louis, and Cleveland, respectively
- Ms. Mosser and Messrs. Porter, Tallman, and Tootell, Vice Presidents, Federal Reserve Banks of New York, Chicago, Atlanta, and Boston, respectively
- Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis
- Mr. Hetzel, Senior Economist, Federal Reserve Bank of Richmond

The Manager of the System Open Market Account reported on recent developments in the foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. 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 since the previous meeting. By unanimous vote, the Committee ratified these transactions.

The information received at this meeting suggested that final demand had expanded at a solid pace in the second quarter, led by a surge in net exports and another robust gain in residential investment, while business investment and consumer spending rose at moderate rates. The labor market continued to improve gradually in June and July. Core CPI and PCE prices decelerated in recent months, after notable increases earlier in the year. Crude oil prices continued to rise, reaching record levels in nominal terms over the intermeeting period.

Payroll employment grew in June and July at a pace that was roughly on par with that over the preceding six months. Hiring in the services and construction sectors remained strong, but the manufacturing sector posted further small job losses. With employment increasing and the average workweek of production or nonsupervisory workers unchanged over these two months, aggregate hours continued to firm. The unemployment rate dipped to 5.0 percent in June and held steady at that rate in July. Initial claims for unemployment insurance remained at low levels.

Industrial production picked up in June. A jump in utilities output, apparently owing to unseasonably warm weather, accounted for more than half of the gain. Motor vehicle production also rose a good bit, but the pace of production growth in the high-tech sector was sluggish, reflecting a decline in the output of communications equipment. Overall capacity utilization moved up to its highest level since December 2000.

Real personal consumption expenditures increased at a moderate pace in the second quarter, buoyed by a surge in purchases of motor vehicles that appeared to be due largely to the extension by an automaker of its "employee discount" program to the general pub-

lic. Excluding spending on motor vehicles, the growth of real personal consumption expenditures slowed slightly in the second quarter. Survey measures of consumer confidence continued to be quite favorable in July.

Activity in the housing sector remained robust. In June, starts of single-family homes maintained the strong pace of earlier this year. Both new and existing home sales jumped. Mortgage rates remained low, and house prices apparently continued to rise briskly.

Business spending on equipment and software posted a solid increase in the second quarter, boosted by a surge in outlays for transportation equipment. Excluding this volatile component, business spending on equipment and software decelerated markedly in the second quarter. Spending on nonresidential construction remained subdued. Nonetheless, fundamentals appeared to continue to support business investment, with the user cost of capital still low and corporations experiencing strong cash flows and holding ample liquid assets.

Real nonfarm inventories edged down in the second quarter, after a substantial rise in the first quarter. The strong pace of motor vehicle sales contributed to the runoff of inventories in the second quarter. Outside the automobile sector, real nonfarm inventories continued to rise, but at a much slower pace than earlier in the year. The inventory–sales ratio for the nonfarm business sector declined further from an already low level, continuing its long-term downward trend.

The U.S. international trade deficit narrowed in May as the value of exports of goods and services rose slightly and the value of imports declined, partly reflecting a sharp drop in the value of oil imports. GDP growth in a number of major foreign industrial economies appeared to have slowed a bit in the second quarter.

Consumer prices were about unchanged in June after posting notable increases earlier in the year. Consumer energy prices reversed a small part of their previous run-up, and core consumer inflation remained low. The producer price index was unchanged in June. The annual revisions to the national income and product accounts, which were released in early August, included a substantial upward revision to core PCE inflation for 2004, from 1.6 percent to 2.2 percent, reflecting changes to the nonmarket-based components of the index. Survey measures of near-term inflation expectations edged down in July, and longer-term inflation expectations firmed only a touch. The employment cost index for private industry workers again rose at a modest pace in the second quarter, and increases in compensation per hour in the nonfarm business sector slowed somewhat from the rapid rate of the first quarter.

At its June meeting, the Federal Open Market Committee decided to increase the target level of the federal funds rate 25 basis points, to 3¼ percent. In its accompanying statement, the Committee indicated that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. In addition, the Committee noted that the expansion remained firm, that labor market conditions continued to improve gradually, and that, although pressures on inflation had remained elevated, longer-term inflation expectations remained well contained. In these circumstances, the Committee believed that policy accommodation could be removed at a pace that would likely be measured but noted that it would respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

The Committee's decision at its June meeting to raise the intended level of the federal funds rate 25 basis points, to maintain an assessment that risks to the goals of price stability and sustained growth were balanced assuming appropriate monetary policy action, and to retain the "measured pace" language was widely expected in financial markets. Over the intermeeting period, however, investors appreciably marked up their expectations for the path of policy, primarily in response to incoming economic data suggesting more strength in spending and output than had been anticipated. Nominal Treasury yields increased in line with the revision to policy expectations. Yields on inflation-indexed Treasury securities rose a touch less than their nominal counterparts, leaving inflation compensation only slightly higher. Spreads on investment-grade corporate bonds were little changed over the intermeeting period, but those on speculative-grade bonds declined markedly, ending the period close to the very low levels reached earlier this year. Major equity indexes advanced, supported by strong corporate earnings reports. The trade-weighted foreign exchange value of the dollar depreciated slightly over the intermeeting period. The People's Bank of China announced a change to its exchange-rate regime, including an immediate 2.1 percent appreciation of the renminbi versus the dollar.

M2 continued to grow sluggishly on balance over June and July. Small time deposits, whose rates of return adjust relatively quickly to changes in market rates, expanded briskly. However, liquid deposits and retail money market mutual funds were little changed on net over these two months. Despite the recent slow growth of M2, its velocity remained low relative to the level that would be expected based on its his-

torical relationship with opportunity cost. The growth of bank credit was restrained in June by a runoff in securities holdings but picked up in July.

In the forecast prepared for this meeting, the staff raised its projection for economic growth over the remainder of 2005 in light of incoming data suggesting greater near-term momentum in aggregate demand. At the same time, however, it trimmed the growth rate forecast for 2006, reflecting the effects of higher energy prices, higher long-term interest rates, and the somewhat slower growth of productive capacity implied by the annual revisions to the national accounts. The output gap was predicted to be essentially closed by the end of this year. Inventory investment was projected to resume contributing to GDP growth over the second half of this year, after the sharp swing toward inventory runoffs in the second quarter. Growth in consumer spending was expected to firm in the third quarter, buoyed by motor vehicle spending, before falling back in the fourth quarter. With housing starts essentially flat, residential investment was projected to decelerate substantially over the remainder of this year. Business investment was predicted to continue to rise at a moderate pace, benefiting from still-accommodative financial conditions and the ongoing need to replace depreciating equipment and software. The recent improvement in the trade balance was expected to be transitory. Notwithstanding recent benign readings on inflation, the forecast for core PCE inflation was raised somewhat, owing in part to the recent further rise in energy prices and, in light of the revisions to historical data, a higher assumed trajectory for the nonmarket component of core PCE prices.

In their discussion of current conditions and the economic outlook, meeting

participants noted that aggregate spending appeared to have picked up in recent months by more than anticipated and that current estimates of slack were narrower than those reviewed at the June meeting. In addition, high and rising energy prices were adding to pressures on overall inflation, and energy price increases probably would feed through, at least temporarily, to core measures of inflation. Nonetheless, core inflation recently had been relatively low and inflation expectations remained well contained. Moreover, participants thought that some slowing in final sales was likely later this year as net exports resumed their decline and purchases of automobiles fell back with the expiration of special discount programs. In these circumstances, it appeared that, for now, continued removal of policy accommodation at a measured pace still would likely be sufficient to keep inflation contained, but participants also recognized that the pace and cumulative extent of policy adjustment going forward would depend importantly on economic developments.

In the household sector, the path for spending was expected to be bolstered in the near term by still-low interest rates, solid growth in disposable income, and ongoing increases in wealth. However, elevated energy prices were seen as likely to be a significant drag on consumption and, on net, household spending was expected to advance at a moderate pace. Housing sales and construction activity generally remained strong across the country, but meeting participants noted anecdotal evidence of some cooling in housing markets in certain areas. And at least some banks were reportedly beginning to apply somewhat tighter standards in real estate lending and becoming more cautious in their promotion of nontraditional mortgage products. Participants generally

anticipated that the pace of home price appreciation would slow over time, though the timing and extent of that slowing, as well as its implications for consumer spending, were quite uncertain.

Participants indicated that business investment had been evolving roughly in line with their expectations. Strong fundamentals, including low interest rates, wide profit margins, and a high level of liquid assets, were seen as supporting expenditures on software and equipment going forward. Inventory investment declined in the second quarter, with much of the falloff concentrated in the motor vehicle industry, where sales had been boosted sharply by the introduction of special discount programs. Inventories now seemed to be coming in line with the trend in final demand and were anticipated to expand along with sales later this year.

Participants viewed the increases in market interest rates over the intermeeting period as an appropriate response to the stronger economic outlook. A few participants voiced concerns that still-low interest rates and insufficient recognition by investors of the dependency of the Committee's policy expectations on economic data were continuing to foster an inappropriate degree of risk-taking in financial markets. Another participant mentioned, however, that recent sluggish growth of the monetary aggregates suggested that the stance of policy was not overly accommodative. Moreover, with a higher proportion of mortgages now tied to short-term rates, it was noted that increases in short-term rates could have a somewhat larger-than-usual effect on spending. On balance, current financial conditions, which embedded expectations of future policy tightening, were generally seen as likely to be consistent with sustained moderate economic growth and containment

of pressures on inflation in coming quarters.

Regarding the federal budget, a recent narrowing of the deficit was noted, but the improvement appeared to be attributable to cyclical factors and to increases in the level of tax collections that were not likely to be repeated. Few signs were evident that greater fiscal discipline in the budget process would emerge any time soon. As a result, federal deficits were expected to continue to act as a considerable drain on national saving over the longer run.

Although net exports had been significantly higher over the second quarter than had been expected, participants did not see this development as signaling the beginning of a sustained improvement in the trade and current account balances. The strong advance in exports and weakness in imports in the second quarter seemed largely attributable to special factors. Continued brisk import growth appeared likely to be sustained for the foreseeable future by gains in domestic demand.

Participants discussed at length the factors affecting costs and prices. Although uncertainties about the underlying pace of productivity increases, trends in labor force participation, and the level of potential output complicated the inflation outlook, higher energy prices and reduced resource slack were seen as pointing to elevated inflation pressures. While recent monthly readings indicated that core inflation had been subdued, a number of participants noted that underlying core inflation appeared to be running at a pace around the upper end of the range they viewed as consistent with price stability—an assessment that was reinforced by the recent upward revisions to historical data on core PCE inflation. Participants commented that an increase in inflation from recent rates could have especially

adverse effects on longer-run economic performance.

While most participants viewed the risks to inflation as having ticked up over the intermeeting period, many also cited factors that, in concert with the likely continued removal of policy accommodation, would tend to hold inflation pressures in check. For example, few indications had emerged recently that businesses had enjoyed any significant increase in pricing power, and the continuing expansion of global trade was seen as an important factor limiting firms' ability to pass through cost increases. In these circumstances and with markups at relatively high levels, a substantial proportion of any increases in business costs might well be reflected in narrower profit margins. Moreover, the recent relatively low monthly readings on core inflation and modest wage pressures, at least by some measures, suggested that some slack remained in resource utilization. Despite the rise in oil prices and quickening pace of economic activity, both market- and survey-based measures of inflation expectations seemed to remain quite well anchored.

In the Committee's discussion of monetary policy for the intermeeting period, all of the members favored raising the target federal funds rate by 25 basis points to 3½ percent at this meeting. Even with this action, the federal funds rate would remain below the level that members anticipated would prove necessary to contain inflation pressures and keep output near potential, and thus in all likelihood further policy action would be required. However, the pace of future policy moves, although likely to be measured, as well as the extent of those moves, would depend on incoming data.

In discussing the statement to be released after the meeting, members

agreed that it was appropriate to highlight the apparent strengthening in aggregate spending. Policymakers exchanged views on the characterization of labor market conditions in light of recent employment reports and other indicators, but members ultimately concurred that the description of labor markets as “improving gradually” remained appropriate. Members agreed that it was appropriate to acknowledge the recent relatively low monthly rates of core inflation, but also to emphasize that inflation pressures remained elevated. As in past meetings, there was some discussion about the desirability of including forward-looking language in the statement, but members agreed to retain the forward-looking language for now.

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

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 3½ percent.

The vote encompassed approval of the paragraph below for inclusion in the statement to be released shortly after the meeting:

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can

be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Votes for this action: Messrs. Greenspan and Geithner, Ms. Bies, Messrs. Ferguson, Fisher, Kohn, Moskow, Olson, Santomero, and Stern. Vote against this action: None. Absent and not voting: Mr. Gramlich.

It was agreed that the next meeting of the Committee would be held on Tuesday, September 20, 2005.

The meeting adjourned at 1:00 p.m.

Notation Vote

By notation vote completed on July 20, 2005, the Committee unanimously approved the minutes of the meeting of the Federal Open Market Committee held on June 29–30, 2005.

Vincent R. Reinhart
Secretary

Meeting Held on September 20, 2005

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 20, 2005 at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Ms. Bies
Mr. Ferguson
Mr. Fisher
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Santomero
Mr. Stern

Messrs. Gynn and Lacker,
Ms. Pianalto and Yellen,
Alternate Members of the Federal
Open Market Committee

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

Mr. Reinhart, Secretary and Economist
Ms. Danker, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Assistant General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Messrs. Connors, Evans, Freeman,
and Madigan, Ms. Mester,
Messrs. Oliner, Rosenblum, and
Wilcox, Associate Economists

Mr. Kos, Manager, System Open
Market Account

Messrs. Slifman and Struckmeyer,
Associate Directors, Division of
Research and Statistics, Board
of Governors

Messrs. Clouse and Whitesell, Deputy
Associate Directors, Division of
Monetary Affairs, Board of
Governors

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

Mr. Simpson, Senior Adviser, Division
of Research and Statistics, Board
of Governors

Mr. Skidmore, Special Assistant to the
Board, Office of Board Members,
Board of Governors

Mr. Small, Project Manager, Division
of Monetary Affairs, Board of
Governors

Mr. Durham, Senior Economist,
Division of Monetary Affairs,
Board of Governors

Mr. Luecke, Senior Financial Analyst,
Division of Monetary Affairs,
Board of Governors

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

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

Mr. Eisenbeis, Executive Vice
President, Federal Reserve
Bank of Atlanta

Messrs. Elsasser, Fuhrer, Hakkio,
Rasche, Sniderman, Weinberg,
and Williams, Senior Vice
Presidents, Federal Reserve
Banks of New York, Boston,
Kansas City, St. Louis, Cleveland,
Richmond, and San Francisco,
respectively

Mr. Potter, Assistant Vice President,
Federal Reserve Bank of
New York

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

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. 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 since the previous meeting. By unanimous vote, the Committee ratified these transactions.

The information reviewed at this meeting suggested that, before the land-fall of Hurricane Katrina on the Gulf Coast, expansion of economic activity had been solid, led by robust gains in housing and buoyant consumer spend-

ing. While business investment appeared to be losing some momentum, labor markets continued to improve, and increases in core CPI and PCE prices were modest after notable increases earlier in the year. Only limited data bearing on the likely economic effects of the hurricane were available. Oil and gasoline prices, however, were on the rise, spiking to record levels in the days immediately following the hurricane.

Payroll employment grew at a good pace in August, and the average increase over the most recent three months was largely on par with the advances made since the fourth quarter of last year. Employment gains were widespread across industries, with the exception of the manufacturing sector, which continued to post small job losses. With employment increasing and the average workweek of production or nonsupervisory workers unchanged in August, aggregate hours continued to firm modestly. The unemployment rate dipped to 4.9 percent in August, its lowest level since August 2001. Given the increase in the labor-force participation rate reported for the month, the employment–population ratio rose to its highest level in three years. Initial claims for unemployment insurance jumped in the latest available week, however, as workers in the Gulf Coast region began to file claims.

Industrial production increased only slightly in August; the staff estimated that the curtailment of activity as a result of Hurricane Katrina shaved 0.3 percent from the index. Petroleum refining and crude oil and natural gas extraction were especially hard hit by the storm. The output of utilities declined in August after surging earlier in the summer in response to unseasonably warm weather. Higher production of motor vehicles and parts boosted manufacturing output. After slowing in the second quarter,

the pace of production in the high-tech sector accelerated somewhat in recent months, owing to increased output of communications equipment and semiconductors. Overall capacity utilization through August remained close to its highest level since December 2000.

Real personal consumption expenditures, boosted by motor vehicles purchases in response to employee-discount programs, were robust during the summer. Spending on goods outside the automobile sector and on services was moderate. Strong overall spending along with lackluster real income growth put downward pressure on the saving rate. Survey measures of consumer confidence early in August were generally consistent with solid increases in spending, but confidence fell appreciably in the period immediately after the storm.

Activity in the housing sector remained brisk. Starts of new single-family homes in July were slightly above their average level for the first half of the year. New home sales advanced further in July, and existing home sales stayed elevated. Mortgage rates remained low and supported demand. Prices of existing homes again rose briskly, while price appreciation for new homes moderated somewhat.

Although real outlays for equipment and software increased solidly in the second quarter, available data on orders and shipments suggested some softness in the third quarter. Amid continued rapid expansion in business output, favorable financing conditions, and ample cash balances, the fundamentals stayed positive. Real spending on nonresidential construction remained lackluster despite incremental improvements in nonresidential property market conditions this year.

Investment in real nonfarm inventories excluding motor vehicles slowed markedly in the second quarter, and

partial data for July suggested that real stockbuilding continued to be subdued. The slower rate of inventory accumulation suggested that firms had largely completed the stockbuilding that had been prompted by earlier low ratios of inventories to sales.

The U.S. international trade deficit narrowed somewhat in July, as the value of exports of goods and services rose slightly and the value of imports declined. The value of oil imports increased strongly in July but that rise was offset by decreases in imports of services and of non-oil goods. GDP growth in foreign industrial economies picked up, on balance, in the second quarter, but performance across economies was mixed.

Core consumer price inflation remained benign in July and August. However, the surge in energy prices considerably boosted overall consumer price inflation over those months. Gasoline prices in particular rose steeply in August, and survey data pointed to a larger increase in early September. Producer price inflation was subdued. One survey of households in early September indicated that near-term inflation expectations jumped and that longer-term inflation expectations edged higher. With regard to labor costs, the employment cost index for private industry workers rose at a modest pace in the second quarter, and the twelve-month change in this index declined from that of a year earlier. Average hourly earnings rose only moderately over the past twelve months.

At its August meeting, the Federal Open Market Committee decided to increase the target level of the federal funds rate 25 basis points, to 3½ percent. In its accompanying statement, the Committee indicated that, with appropriate monetary policy action, the upside and downside risks to the attainment of

sustainable growth and price stability should be kept roughly equal. In addition, the Committee noted that, despite high energy prices, aggregate spending appeared to have strengthened, labor market conditions continued to improve gradually, and longer-term inflation expectations remained well contained, although pressures on inflation had stayed elevated. In these circumstances, the Committee believed that policy accommodation could be removed at a pace that would likely be measured but noted that it would respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

The Committee's decision at its August meeting was widely expected in financial markets and evoked little price reaction. Over the intermeeting period, however, investors marked down their expectations for the path of policy, partly in response to the devastation caused by Hurricane Katrina. Nominal Treasury yields decreased about in line with the revision to policy expectations. Yields on inflation-indexed Treasury securities fell a bit more than their nominal counterparts, leaving inflation compensation slightly higher. Spreads on investment-grade corporate bonds were little changed over the intermeeting period, but those on speculative-grade bonds increased from very low levels. Major equity indexes appeared to be supported by lower interest rates and posted modest gains despite the increases in energy prices. The trade-weighted foreign exchange value of the dollar depreciated slightly over the intermeeting period.

M2 grew moderately, on balance, in August. Liquid deposits edged higher, but retail money market mutual funds contracted, on net. Small time deposits, whose rates of return adjust relatively quickly to changes in market rates, con-

tinued to expand rapidly. The growth of bank credit surged, as loans expanded briskly.

In the forecast prepared for this meeting, the staff lowered its projection for economic growth over the remainder of 2005 in light of the economic dislocation associated with Hurricane Katrina. At the same time, however, the staff increased the growth rate forecast for 2006 to reflect the boost to economic activity from the rebuilding effort. By 2007, the level of output was expected to move back to the path it would have followed in the absence of the storm. The staff revised upward its forecast of overall inflation for 2005 and of core inflation for 2006, reflecting the effects of higher energy prices, but lowered its projection for overall inflation slightly for 2006. It was recognized that there were considerable near-term uncertainties and that many data series in coming months would be influenced by the effects of the storm.

In their discussion of the economic situation and outlook, meeting participants agreed that output and employment appeared to have been growing at a good pace before Hurricane Katrina's landfall. Business fixed investment had been a little softer than expected, but household spending had been especially strong. Participants agreed that the widespread devastation in the Gulf Coast region and the dislocation of many people would hold down indicators of spending for a time. But they also were of the view that aggregate demand and output would likely rebound before long, fueled in part by private spending to rebuild and outlays by the federal government to assist in the recovery. With growth of the economy expected to recover, meeting participants were concerned that price pressures, which had been elevated before the storm, could climb further, primarily as a

result of additional increases in energy prices.

Meeting participants recognized that Hurricane Katrina would have significant effects on the U.S. economy, but the size and timing of those effects were uncertain. Economic activity in the Gulf Coast region would be disrupted by the destruction of capital and the displacement of a large population, perhaps for an extended period. Moreover, damage to infrastructure for extracting and processing oil and natural gas was expected to be substantial, with significant near-term implications for energy prices and the national economy, and the projected track of Hurricane Rita raised additional concerns. In that environment, the prices of crude oil, natural gas, and gasoline likely would remain elevated and subject to considerable volatility, particularly given the limited spare capacity available in energy extraction and refining industries. Participants noted that very substantial rebuilding would probably be underway soon, supported importantly by government programs. The pace at which reconstruction activity would take place, however, was uncertain, as it depended in part on factors that were still difficult to assess, such as how quickly the affected areas could again be made habitable. On balance, participants thought that there would likely be a significant shift in the timing of aggregate economic activity over the next several quarters but probably little effect on the economy's intermediate-term growth prospects. Several participants voiced concern that the effects of the hurricane were likely to add to already considerable pressures on prices.

For the nation as a whole, participants noted that household spending had been fairly robust before the hurricane, supported by strong advances in income and continuing gains in wealth that

reflected in part further large increases in home prices. Most anecdotal information supported the indications from available data that activity in housing markets generally remained brisk. The termination of some inducements to purchase motor vehicles was expected to retard expenditures on consumer durables in the latter part of this year. The reduction in real disposable incomes caused by large increases in consumer energy prices was also anticipated to restrain consumer spending, with business contacts indicating that retail outlets that typically serve lower- and middle-income households could see particular weakness. The reduction in spending as a result of higher energy prices and hurricane-related dislocations could be augmented by a weakening of consumer attitudes. Many of the restraining effects were thought likely to dissipate over time, however. Retail energy prices were likely to retrace at least a portion of the post-hurricane increase, and consumer confidence should rebound. Moreover, demands for consumer durables, as well as housing, would receive support as hurricane victims repaired or replaced lost property, with help from insurance payments and government transfers. Although uncertainties about the outlook for spending had increased, it appeared that, over time, consumption would probably expand at a moderate pace—perhaps a little below the pace of income growth once the increases in house prices slowed to more historically typical rates.

Meeting participants noted that, even prior to the hurricane, business fixed investment had been somewhat weaker than expected. The softness was somewhat puzzling, as sales were growing, business balance sheets appeared quite strong in the aggregate, profitability was high, and financing was readily available and relatively inexpensive for most firms. Although the apparent sluggish-

ness could reflect only short-term fluctuations in volatile data series, some evidence suggested that it may also have stemmed from concern among business executives about the effects of high energy prices. The anecdotal information on commercial real estate markets was mixed, with some districts reporting firming markets while activity elsewhere was said to remain subpar.

With regard to fiscal policy, meeting participants noted that federal outlays would increase sharply in order to assist with recovery and reconstruction efforts in the aftermath of the hurricane. The eventual size of the increment to federal outlays was unclear, but it was likely to be quite large. The substantial step-up in government spending would add to federal deficits that were already large and underscored the worrisome loss of fiscal discipline evident in recent years. The expansion of federal spending implied an increase in fiscal stimulus at a time when the margin of unutilized resources in the overall economy was probably thin.

Participants' concerns about inflation prospects generally had increased over the intermeeting period. The surge in energy prices, in particular, was boosting overall inflation, and some of that increase would probably pass through for a time into core prices. This posed the risk that there could be a more persistent influence on inflation should inflation expectations rise. Indeed, some recent survey evidence on such expectations had been troubling, and widening federal deficits were mentioned as a factor that could further stir inflationary concerns. Measures of labor costs were giving conflicting signals, with some indexes indicating that growth in labor compensation remained relatively low but another showing appreciably more rapid increases. Anecdotal information continued to point to shortages of certain types of labor, such as truck drivers,

and some business contacts reported difficulties in hiring more generally, a development that had prompted some firms to boost wages. Underlying productivity growth to date apparently had remained robust but, at this stage of the business cycle, gains in productivity could not necessarily be counted on to stay strong. The prices of a number of intermediate goods, including a wide range of petrochemical products and building materials, were subject to upward pressure, reflecting high crude oil prices, production disruptions in the energy sector, and elevated demands for materials in anticipation of rebuilding in the Gulf Coast region. Still, core inflation in recent months had been quite damped, and market-based measures of longer-term inflation expectations had risen only modestly of late. It was observed that, after the early 1980s, the pass-through of energy prices into core inflation had been quite limited, suggesting that, in current circumstances, core inflation could stay relatively low and overall inflation would probably drop back if inflation expectations remained contained.

In the Committee's discussion of monetary policy for the intermeeting period, nearly all members favored raising the target federal funds rate 25 basis points to 3¾ percent at this meeting. Although uncertainty had increased, in the Committee's judgment the fundamental factors influencing the longer-term path of the economy probably had not been affected by the hurricane, but the upside risks to inflation appeared to have increased. Even after today's action, the federal funds rate would likely be below the level that would be necessary to contain inflationary pressures, and further rate increases probably would be required. Moreover, the uncertainties about near-term economic prospects resulting from Hurricane Katrina would probably not be reduced

materially in coming weeks. Indeed, underlying economic trends would be particularly difficult to assess over the next several months as a result of the direct, and presumably temporary, effects of the storm and its aftermath on the incoming data. A pause in policy tightening at this meeting had the potential to mislead the public both about the Committee's perceptions of the fundamental strength and resilience of the economy and about its commitment to fostering price stability.

In discussing the statement to be released after the meeting, members agreed that it would be appropriate to characterize the macroeconomic effects of Hurricane Katrina, while significant, as essentially temporary. Members also believed that the statement should again note that both monetary policy accommodation and robust underlying productivity growth were continuing to support economic activity. Although energy prices had the potential to add to inflation pressures, and inflation expectations had recently exhibited some signs of increasing, members agreed that the risks to inflation, as well as those to growth, remained essentially balanced under an assumption of appropriate policy action. The Committee also agreed to reiterate its previous expectation that ". . . policy accommodation can be removed at a pace that is likely to be measured." However, some sentiment was expressed to consider changes to forward-looking aspects of the statement at upcoming meetings, in part because of the considerable reduction in monetary policy accommodation that had already been accomplished.

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

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 3¾ percent.

The vote encompassed approval of the paragraph below for inclusion in the statement to be released shortly after the meeting:

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Votes for this action: Messrs. Greenspan and Geithner, Ms. Bies, Messrs. Ferguson, Fisher, Kohn, Moskow, Santomero, and Stern. Vote against this action: Mr. Olson.

Mr. Olson dissented because he preferred that the Committee defer policy action at this meeting, pending the receipt of additional information on the economic effects resulting from the severe shock of Hurricane Katrina.

It was agreed that the next meeting of the Committee would be held on Tuesday, November 1, 2005.

The meeting adjourned at 1:15 p.m.

Notation Vote

By notation vote completed on August 29, 2005, the Committee unanimously approved the minutes of the

meeting of the Federal Open Market Committee held on August 9, 2005.

Vincent R. Reinhart
Secretary

Meeting Held on November 1, 2005

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, November 1, 2005 at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Ms. Bies
Mr. Ferguson
Mr. Fisher
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Santomero
Mr. Stern

Messrs. Guynn and Lacker,
Ms. Pianalto and Yellen,
Alternate Members of the
Federal Open Market Committee

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

Mr. Reinhart, Secretary and Economist
Ms. Danker, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Messrs. Connors, Freeman, and
Madigan, Ms. Mester,
Messrs. Oliner, Rosenblum,
Tracy, Rolnick, and Wilcox,
Associate Economists

Mr. Kos, Manager, System Open
Market Account

- Messrs. Slifman and Struckmeyer, Associate Directors, Division of Research and Statistics, Board of Governors
- Mr. Whitesell, Deputy Associate Director, Division of Monetary Affairs, Board of Governors
- Mr. English, Assistant Director, Division of Monetary Affairs, Board of Governors
- Mr. Simpson, Senior Adviser, Division of Research and Statistics, Board of Governors
- Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors
- Mr. Nelson, Section Chief, Division of Monetary Affairs, Board of Governors
- Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors
- Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors
- Mr. Werkema, First Vice President, Federal Reserve Bank of Chicago
- Mr. Eisenbeis, Executive Vice President, Federal Reserve Bank of Atlanta
- Messrs. Fuhrer, Hakkio, Rasche, Rudebusch, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, St. Louis, San Francisco, and Cleveland, respectively
- Mr. Krane and Ms. Mucciolo, Vice Presidents, Federal Reserve Banks of Chicago and New York, respectively
- Mr. Hetzel, Senior Economist, Federal Reserve Bank of Richmond

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. 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 since the previous meeting. By unanimous vote, the Committee ratified these transactions.

The information reviewed at this meeting suggested that the economy had a good deal of forward momentum in the third quarter. Although recent hurricanes caused considerable damage and disruption, particularly in the energy sector, economic activity outside the Gulf region appeared to have been well maintained. In September, hiring in other regions remained in line with its pace over the preceding twelve months, and excluding the estimated effects of the hurricanes and a strike by Boeing machinists, industrial production increased briskly. In addition, residential construction remained buoyant. Consumer spending, however, showed some signs of weakening. Although consumer spending was strong for the third quarter as a whole, it softened in September, and survey measures of consumer confidence slumped noticeably. Despite the large increase in consumer energy prices since midyear, core price inflation was restrained through September.

Hurricane Rita caused further disruption to energy production in the Gulf area, which had not yet fully recovered from Hurricane Katrina. Energy production in October was still below pre-hurricane levels, although progress had been made in reopening shut-down energy facilities. Rising imports, along with more-subdued consumption of

gasoline and other petroleum products, helped to offset the effect on energy prices of some of the output losses in refined products. In addition, to address the low level of gasoline inventories and more-immediate retail demands, domestic refiners sharply increased the share of gasoline in their output of total refined product. Wholesale and retail gasoline prices spiked soon after Rita's landfall but had since declined to pre-hurricane levels. Spot prices for natural gas soared with the hurricanes and remained at elevated levels.

Payroll employment fell in September, held down by substantial job losses associated with Hurricane Katrina. Employment in the areas unaffected by the hurricane increased at a rate in line with the average pace over the previous twelve months. The largest employment loss occurred in the leisure and hospitality category, an industry particularly hard hit by the storm. The average workweek was unchanged in September, so with employment lower, aggregate hours declined slightly. The unemployment rate rose 0.2 percentage points to 5.1 percent. The labor force participation rate held steady, but the number of individuals reporting that they had a job but were not at work because of bad weather surged. More recently, weekly data on initial claims for unemployment insurance suggested that the job losses associated with the hurricane were subsiding.

Industrial production fell substantially in September, but excluding the effects of hurricane-related disturbances and the Boeing strike, industrial production was estimated to have risen at a brisk pace. The hurricanes caused the index for oil and natural gas extraction and refining to plummet in September, and they also significantly affected petrochemical production. Manufacturing output fell noticeably in the shipbuild-

ing, food manufacturing, paper, and plywood industries. In the transportation equipment category, motor vehicle production climbed notably, but the machinists' strike at Boeing caused the company to cease nearly all commercial aircraft production during the month. High-tech output—led by strong gains in the production of semiconductors and communications equipment—surged in September. Manufacturing capacity utilization dropped substantially in September, but was still noticeably above its year-earlier level.

Real consumer spending increased at a moderate rate in the third quarter as a whole, although it declined in August and September after having risen substantially earlier in the summer. The softening in spending of late reflected in part the diminishing boost to light vehicle sales from manufacturers' programs offering employee discounts to nonemployees. Spending on other goods and services was also sluggish, likely because of the direct effects of the dislocation of households by the hurricanes, high energy prices, and falling consumer confidence. Consumer sentiment in October, as measured by both the Michigan Survey and the Conference Board's indicator, dropped a little further after plunging in September. The personal saving rate remained slightly negative in September.

Residential construction continued at a robust pace. In September, new single-family homes were started at a rate a bit above their elevated average rate in the first half of the year, and permit issuance jumped to a new high. New home sales remained substantial in August, but they were below July's elevated level. Although they remained low by historical standards, both the thirty-year fixed mortgage rate and the one-year adjustable rate had moved up a bit in recent months and were notably above

the levels seen at the beginning of the year. The average selling price of existing homes rose in the twelve months ending in September at about the same rapid clip as a year earlier, but the average selling price of new homes rose more slowly over the past few months.

Real outlays for equipment and software were sluggish in the summer, but a broad-based pickup in orders for and shipments of nondefense capital goods excluding aircraft in August suggested some firming. Investment fundamentals remained relatively solid, including continued expansion in business sales, a declining cost of capital, and corporate balance sheets that were flush with cash. Surveys of executive sentiment squared well with the fundamentals: Although business leaders expressed some misgivings about the overall macroeconomic environment, their stated capital spending intentions pointed to increasing investment. Vacancy rates for nonresidential properties continued to edge lower, but they remained elevated for office and industrial properties, and real spending on new construction had yet to improve materially.

Business investment in real nonfarm inventories was subdued over the summer. Although inventory-to-sales ratios moved down some in July and August, businesses did not appear dissatisfied with their level of stocks. For example, September results from the Institute for Supply Management survey indicated that respondents viewed their customers' current inventory situation as reasonably well aligned with demand.

The U.S. international trade deficit widened somewhat in August, as a surge in imports of goods and services was partially offset by a sizable gain in exports. The growth in imports reflected both a marked increase in oil imports and a rise in nonoil goods; imports of services were little changed. The

increase in exports was driven by higher merchandise exports, although exports of services also advanced a bit. GDP growth in foreign industrial economies appeared to have continued at a moderate pace in the third quarter.

Soaring energy prices have boosted overall measures of consumer price inflation in recent months. However, measures of core consumer price inflation were much more restrained. The twelve-month change in core consumer prices through September was about unchanged from its year-earlier level. One survey of households in October found that expectations for inflation over the coming year rose to a level well above the readings that had prevailed over the spring and summer, presumably in response to rising energy prices. However, median expectations for inflation over the next five to ten years were only a little above the average range reported in recent years. With regard to labor costs, the employment cost index for private industry workers rose at a moderate pace in the third quarter, up somewhat from its second-quarter pace, but the twelve-month change in the index declined from that of a year earlier. Hourly compensation in the nonfarm business sector was estimated to have also risen at a moderate rate in the third quarter.

At its September meeting, the Federal Open Market Committee decided to increase the target level of the federal funds rate 25 basis points, to 3¾ percent. In its accompanying statement, the Committee indicated that, with appropriate monetary policy action, the upside and downside risks to the attainment of sustainable growth and price stability should be kept roughly equal. The Committee noted that the widespread devastation in the Gulf region from Hurricane Katrina, the associated dislocation of economic activity, and the boost to

energy prices would set back spending, production, and employment in the near term. However, the Committee judged that these unfortunate developments did not pose a more persistent threat to the overall economy. Rather, monetary policy accommodation, coupled with robust underlying growth in productivity, was providing ongoing support to economic activity. Although higher energy and other costs had the potential to add to inflation pressure, core inflation had been relatively low in the preceding few months and longer-term inflation expectations remained contained. In these circumstances, the Committee believed that policy accommodation could be removed at a pace that would likely be measured but noted that it would respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

With investors putting only small odds on a pause in the tightening cycle following Hurricane Katrina, there was little market reaction to the Committee's decision at the September meeting. However, the expected path for monetary policy shifted up in subsequent weeks, as incoming data indicated that output had been expanding briskly prior to the hurricanes and that the disruptions to economic activity from the hurricanes were likely to be less severe than initially feared. This upward pressure on interest rates may have been amplified by comments from a number of Federal Reserve officials that were read as stressing inflation concerns. Nominal Treasury yields rose in line with the shift in the outlook for monetary policy. Despite a large increase in the overall consumer price index for September, measures of inflation compensation calculated using yields on nominal and inflation-protected Treasury securities were about unchanged over the intermeeting period, although they remained

a bit above the levels seen before Hurricane Katrina. As broad indexes of investment- and speculative-grade corporate bond yields moved largely in line with Treasury yields over the period, spreads were little changed. Major stock price indexes fell moderately and the trade-weighted foreign exchange value of the dollar appreciated slightly over the intermeeting period.

Domestic nonfinancial debt appeared to have advanced briskly in the third quarter. Growth in household debt was estimated to have edged down in the third quarter because of a slowing in mortgage debt growth but remained elevated. Household bankruptcies surged in the weeks immediately before bankruptcy reforms went into effect on October 17. The debt of nonfinancial businesses rose in the third quarter at a rate comparable to the increases seen in the first half of the year. Bank loans to businesses continued to advance briskly, and the results of the October Senior Loan Officer Opinion Survey showed some further easing of lending terms and standards for such loans. M2 expanded at a fairly solid rate in September. The increase in September was in part attributable to a boost to currency and liquid deposits resulting from Hurricane Katrina. Growth in nominal output in the third quarter exceeded that of M2, implying a further rise in velocity.

In the forecast prepared for this meeting, the staff continued to project moderate economic growth for the second half of 2005. Output growth was expected to pick up in 2006, as the boost from hurricane-related rebuilding activity more than offset the effects of somewhat tighter financial conditions, and then slow in 2007, as the impetus from rebuilding waned. The near-term forecast again entailed a marked downshift in headline inflation as energy prices fall back consistent with readings from

futures markets. Favorable incoming data led the staff to reduce its forecast for near-term core inflation a bit. The outlook continued to be for core inflation to pick up modestly over coming quarters owing to the lagged effects of higher energy prices but then to return to near current levels in 2007 primarily as the result of the restraining influence of falling energy prices.

In their discussion of the economic situation and outlook, meeting participants saw the economy as continuing to grow at a solid pace, notwithstanding the disruptive effects to economic activity and employment from the hurricanes. However, the near-term outlook continued to be subject to considerable uncertainty given the difficulties in assessing the net effects of the downturn in consumer confidence and the rise in energy prices through the summer, on the one hand, and the rebuilding from hurricane damage, on the other. Although oil and gasoline prices had fallen in recent weeks and core inflation had remained benign, some businesses had reported increased ability to pass through cost increases in the environment of higher headline inflation. On balance, meeting participants remained concerned about heightened inflation pressures.

Meeting participants generally saw accumulating evidence as supporting the view that the disruptions to aggregate economic activity and employment from the hurricanes were likely to be limited and temporary. In areas that had been devastated by the hurricanes, recovery of energy production and the rebuilding of homes and businesses might take longer than had been expected, in part because of a slow return of evacuees. However, in regions just outside those that were most severely damaged, recovery was already well underway, and the pace of economic activity had strengthened, in some cases owing to

spending by relocated households. Reconstruction along the Gulf Coast would likely pick up substantially in the next couple of quarters.

In the household sector, spending seemed to have held up fairly well, aside from a drop in purchases of autos. Some participants noted, however, that the erosion of consumer confidence, still-elevated gasoline prices, and the prospect of higher heating bills might augur weakness ahead. The housing market had remained robust, although a slowing in house price gains in some areas and recent declines in home equity lending at banks could be indicating that the long-expected cooling in the housing market was near. Motor vehicle purchases had slowed substantially in October, but that seemed to owe primarily to the end of discount programs that had generated a surge in auto spending over the summer. Over the longer-term, with house price gains moderating and perhaps greater perceived needs to invest for retirement purposes, the household saving rate was likely to rise gradually.

Growth in business investment spending seemed to remain moderate overall, but anecdotal reports suggested that a number of firms had boosted their plans for capital spending. Moreover, construction spending and commercial real estate investment seemed to be picking up in some areas. Significant problems persisted amongst U.S. nameplates in the auto sector, however. The rise in longer-term real interest rates and some widening of private credit spreads in recent months were seen as perhaps having a little restraining effect on the investment outlook.

Economic growth in the near term was likely to be boosted by additional fiscal stimulus, in part to support recovery and rebuilding from the hurricanes. Strong demand from overseas was evidently boosting exports this year by

more than the increase in imports, with the nation's external accounts thereby providing a small net positive contribution to growth in domestic production. Next year, however, the arithmetic contribution to growth from net exports was seen as likely to return to negative territory.

While participants noted some recent favorable data on core inflation and labor costs, upside risks to the outlook for underlying inflation remained a key concern. Wage gains had remained modest relative to continued strong productivity growth, suggesting that labor costs were not putting much upward pressure on prices. Indeed, core inflation continued to be subdued, and in recent weeks gasoline prices had unwound a significant portion of their steep increases. Nevertheless, there was a risk that the large cumulative rise in energy and petroleum product prices through the summer would be transmitted to core consumer prices. A number of firms had been reporting a greater ability to pass through increases in energy and other costs to customers, though evidently more so to other businesses than to consumers. A survey measure of the near-term inflation expectations of households had risen notably, but intermediate- and longer-term inflation expectations implied by Treasury security yields had remained fairly stable. It was noted, however, that longer-term expectations of inflation remained contained in the context of an increase in the extent of additional monetary policy tightening expected in financial markets.

In the Committee's discussion of monetary policy for the intermeeting period, all members favored raising the target federal funds rate 25 basis points to 4 percent at this meeting. The economy seemed to be growing at a fairly strong pace, despite the temporary dis-

ruptions associated with the hurricanes, and underlying economic slack was likely quite limited. In that context, all members believed it important to continue removing monetary policy accommodation in order to check upside risks to inflation and keep inflation expectations contained, but noted that policy setting would need to be increasingly sensitive to incoming economic data. Some members cautioned that risks of going too far with the tightening process could also eventually emerge. Nonetheless, all members agreed to indicate at the conclusion of this meeting that a continued measured pace of policy firming remained likely.

In their ongoing discussion of the Committee's communication strategy, participants expressed a variety of perspectives about how the policy statement issued at the end of FOMC meetings might evolve over time. Several aspects of the statement language would have to be changed before long, particularly those related to the characterization of and outlook for policy. Possible future changes in the sentence on the balance of risks to the Committee's objectives were also discussed. Participants noted that any forward-looking elements of the statement should clearly be conditioned on the outlook for inflation and economic growth. For this meeting, members concurred that the current statement structure could be retained, as it accurately conveyed their near-term economic and policy outlook.

In view of the continued rapid pace of observed productivity gains, members agreed that the statement to be released after the meeting should again indicate that robust underlying productivity growth and monetary policy accommodation were supporting the economic expansion. Those influences were expected to be augmented by planned rebuilding and recovery activity in

hurricane-affected areas. While gasoline prices had recently moved lower, the cumulative rise in energy prices and other costs was seen as having the potential to add to inflation pressures. However, core inflation had been subdued in recent months and longer-run inflation expectations remained contained. Against that backdrop, the risks to the objective of price stability, as well as that for sustainable growth, remained in balance, given appropriate monetary policy actions.

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

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 4 percent.

The vote encompassed approval of the paragraph below for inclusion in the statement to be released shortly after the meeting:

The Committee perceives that, with appropriate monetary policy action, the upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal. With underlying inflation expected to be contained, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Votes for this action: Messrs. Greenspan and Geithner, Ms. Bies, Messrs. Ferguson,

Fisher, Kohn, Olson, Moskow, Santomero, and Stern. Votes against this action: None

It was agreed that the next meeting of the Committee would be held on Tuesday, December 13, 2005.

The meeting adjourned at 1:15 p.m.

Notation Vote

By notation vote completed on October 7, 2005, the Committee unanimously approved the minutes of the meeting of the Federal Open Market Committee held on September 20, 2005.

Vincent R. Reinhart
Secretary

Meeting Held on December 13, 2005

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 13, 2005 at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Ms. Bies
Mr. Ferguson
Mr. Fisher
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Santomero
Mr. Stern

Ms. Cumming, Messrs. Guynn and Lacker, Mses. Pianalto and Yellen, Alternate Members of the Federal Open Market Committee

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

Mr. Reinhart, Secretary and Economist
 Ms. Danker, Deputy Secretary
 Ms. Smith, Assistant Secretary
 Mr. Alvarez, General Counsel
 Mr. Baxter, Deputy General Counsel
 Ms. Johnson, Economist
 Mr. Stockton, Economist

Messrs. Connors, Freeman, and
 Madigan, Ms. Mester,
 Messrs. Oliner, Rosenblum, Tracy,
 and Wilcox, Associate Economists

Mr. Kos, Manager, System Open
 Market Account

Messrs. Slifman and Struckmeyer,
 Associate Directors, Division of
 Research and Statistics, Board
 of Governors

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

Messrs. English and Sheets, Assistant
 Directors, Divisions of Monetary
 Affairs and International Finance,
 respectively, Board of Governors

Mr. Simpson, Senior Adviser, Division
 of Research and Statistics, Board
 of Governors

Mr. Skidmore, Special Assistant to the
 Board, Office of Board Members,
 Board of Governors

Mr. Small, Project Manager, Division
 of Monetary Affairs, Board of
 Governors

Mr. Zakrajšek, Section Chief, Division
 of Monetary Affairs, Board of
 Governors

Mr. Kumasaka, Senior Financial
 Analyst, Division of Monetary
 Affairs, Board of Governors

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

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

Messrs. Fuhrer, Hakkio, Rasche,
 Sniderman, Weinberg, and
 Williams, Senior Vice Presidents,
 Federal Reserve Banks of Boston,
 Kansas City, St. Louis, Cleveland,
 Richmond, and San Francisco,
 respectively

Mr. Cunningham, Ms. Mosser, and
 Mr. Sullivan, Vice Presidents,
 Federal Reserve Banks of Atlanta,
 New York, and Chicago,
 respectively

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

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting. 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 since the previous meeting. By unanimous vote, the Committee ratified these transactions.

The information reviewed at this meeting suggested that the economy continued to expand at a solid rate in the fourth quarter. Industrial production rebounded, and employment growth appeared to have recovered smartly from the depressing effects of recent hurricanes. Although some scattered signs of cooling of the housing sector had emerged, the pace of construction activity and sales remained brisk. More broadly, spending by consumers and businesses was well maintained. Core consumer price inflation remained subdued, even though some of the increase in energy costs had apparently passed

through to prices of final goods and services.

Private nonfarm payrolls grew rapidly in November after a small gain in October. Construction employment posted another large increase, probably owing in part to hurricane-related activity. Broad-based gains in durable goods industries augmented manufacturing employment, and employment in the related industries of temporary help services and wholesale trade increased as well. With employment rising but the average workweek of production or nonsupervisory workers falling slightly, aggregate hours slipped in November—albeit to a level above that of their third-quarter average. The unemployment rate held steady at 5 percent, and the labor force participation rate was also unchanged. Survey measures of individuals' expectations of future labor market conditions improved in November, largely reversing post-Katrina declines.

Industrial production rebounded in October after having been held down in September by hurricanes and by a strike at Boeing. The resumption of commercial aircraft production boosted manufacturing output and more than offset a fall in the production of motor vehicles and parts. Large output gains in hurricane-affected industries—such as segments of the food, rubber and plastics, and paper industries—also contributed to the increase in manufacturing output. The growth of high-tech output slowed slightly in October, mainly as a result of smaller increases in the production of semiconductors. In contrast, production of communication equipment—particularly data networking equipment—accelerated. With many energy facilities in the Gulf region still closed, output at mines, which is defined to include oil and gas extraction,

slipped further in October. Manufacturing capacity utilization moved up again in October and was only a touch below its long-run average.

Real personal consumption expenditures appeared to be increasing solidly over the course of the fourth quarter, led by improvements in the fundamental determinants of consumer spending. Real disposable personal income was bolstered by gains in employment and falling retail energy prices, while continued brisk advances in house prices and the recent strengthening of equity prices contributed importantly to increases in household wealth. Consumer sentiment picked up in November and early December; some survey measures of confidence returned to the range seen during the first half of the year. The personal saving rate—while still slightly negative—moved up in October.

Activity in the housing market remained brisk despite a rise in mortgage interest rates. Starts of new single-family homes dropped back somewhat in October from September's very strong pace, but permit issuance remained elevated. New home sales reached a new high in October, and existing home sales eased off only a little from the high levels recorded during the summer. Other available indicators of housing activity were on the soft side: An index of mortgage applications for purchases of homes declined in November, and builders' ratings of new home sales had fallen off in recent months. In addition, survey measures of homebuying attitudes had declined to levels last observed in the early 1990s.

Real outlays for equipment and software posted a solid gain in the third quarter. Although business purchases of motor vehicles declined in October and November, growth in investment in non-transportation equipment appeared to

have been well maintained in the fourth quarter. Rising business sales, a declining cost of capital, and ample financial resources in the corporate sector continued to foster a favorable environment for capital spending, a sentiment echoed in executive surveys, which generally pointed to widespread increases in planned capital outlays. Real spending on nonresidential construction improved materially in the third quarter, boosted by substantial gains in drilling and mining expenditures.

Real nonfarm inventories ran off in the third quarter as automakers pared their motor vehicle stocks. But even outside the motor vehicle sector, inventory investment was relatively restrained, and partial data for October suggested that real stockbuilding continued to be subdued. The level of stocks appeared reasonably well aligned with sales.

The U.S. international trade deficit reached a new record in September. A surge in imports was accompanied by a fairly sizable drop in exports, part of which was due to a steep falloff in aircraft exports as a result of the strike at Boeing. The jump in the value of imports was driven by strong growth in most categories of goods and, to a lesser extent, growth in services; increases in the dollar value of imports of oil and of industrial supplies—especially natural gas—were particularly strong, a reflection of higher prices. Foreign industrialized economies expanded robustly in the third quarter, and available indicators for the fourth quarter appeared promising, on balance.

Core consumer price inflation was moderate in recent months, although some signs of pass-through of higher energy costs were evident, especially in transportation services. Consumer energy prices had retreated notably from their elevated post-hurricane levels. Wholesale and retail gasoline prices

dropped as gasoline inventories rebounded. And spot prices for natural gas fell sharply through mid-November amidst unusually temperate weather, plentiful inventories, and declining prices of competing fuels; unusually cold weather in early December, however, caused spot prices to move back up to their October levels. Presumably in response to falling retail energy prices, one survey of households in November and early December showed a marked retreat in expectations for inflation over the coming year. Longer-term inflation expectations also edged down, but stayed a touch above the narrow range observed in recent years. Although recent increases in energy costs had pushed up producer prices in some sectors, overall producer price inflation remained subdued. With regard to labor costs, the twelve-month change in the employment cost index for private industry workers in September was well below its year-ago increase. Hourly compensation in the nonfarm business sector also appeared to have slowed a bit recently.

At its November meeting, the Federal Open Market Committee decided to increase the target level of the federal funds rate 25 basis points, to 4 percent. In its accompanying statement, the Committee indicated that, with appropriate monetary policy action, the upside and downside risks to the attainment of sustainable growth and price stability should be kept roughly equal. The Committee also noted that elevated energy prices and hurricane-related disruptions in economic activity had temporarily depressed output and employment. However, monetary policy accommodation, coupled with robust underlying growth in productivity, was providing ongoing support to economic activity. And although the cumulative rise in energy and other costs had the poten-

tial to add to inflation pressures, core inflation had been relatively low in recent months, and longer-term inflation expectations remained contained. In these circumstances, the Committee believed that policy accommodation could be removed at a pace that was likely to be measured but noted that it would respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.

Market participants widely anticipated the Committee's decision at its November meeting, and the policy announcement evoked little reaction in financial markets. Over the intermeeting period, investors marked up slightly their expectations for the path of monetary policy in light of stronger-than-expected data on spending and production. Nominal Treasury yields changed little, on net, but measures of inflation compensation at longer horizons—which are calculated using yields on nominal and inflation-protected securities—declined somewhat. Credit spreads on both investment- and speculative-grade corporate bonds were about unchanged over the intermeeting period. Major equity price indexes posted substantial gains, spurred by the perception that the economy had retained considerable momentum with limited inflation pressures. In foreign exchange markets, the trade-weighted value of the dollar was about unchanged over the intermeeting period.

The expansion of domestic nonfinancial debt appeared to have moderated a little from its brisk third-quarter pace. Consumer credit dipped in October, and nonfinancial firms' net borrowing in the form of bank loans, commercial paper, and bonds was a bit below the third-quarter pace. Household bankruptcies hovered at very low levels in recent weeks after soaring to unprecedented

heights just before the implementation of more-stringent bankruptcy rules in mid-October. Hurricane relief payments apparently boosted M2 in October, but that aggregate decelerated in November, partly reflecting the continued rise in the opportunity cost of holding liquid deposits.

The staff forecast prepared for this meeting suggested that growth of economic activity would slow from this year's pace, but remain solid, with output staying near the economy's potential over the next two years. Although hurricane-related rebuilding would boost activity, especially in the near term, this stimulus increasingly would be countered by higher interest rates, the anticipated waning of the positive wealth effect associated with large earlier gains in equity and house prices, and reduced impetus from fiscal policy. Both overall and core consumer price inflation were projected to move higher in the first half of next year, reflecting the effects of higher energy prices, but then to trend lower as those effects ebb.

In their discussion of the economic situation and outlook, meeting participants noted that incoming data over the intermeeting period had been encouraging with regard to both economic growth and inflation. The economic expansion had shown considerable resilience in the face of higher energy prices and hurricane-related disruptions, suggesting greater underlying strength than had been apparent at the time of the November meeting. At the same time, incoming inflation data had been benign, indicating relatively modest pass-through of higher energy prices to core inflation to date; subdued gains in compensation and strong growth in productivity were holding down business costs; and inflation expectations, which had jumped after the hurricanes, had fallen back. Nonetheless, with growth

solid and prices of energy products still well above levels earlier in the year, possible increases in resource utilization had the potential to add to pressures on prices, especially in the absence of some further firming of policy.

In their discussion of major sectors of the economy, meeting participants noted that, while light vehicle sales had slowed in the fall, consumer spending outside the auto sector appeared to have remained vigorous. Holiday sales were said to be off to a good start in many parts of the country. The substantial recovery in measures of consumer confidence after their sharp declines in the aftermath of the hurricanes had reduced meeting participants' concerns about a significant pull-back in spending. Going forward, consumer outlays were expected to be supported by further advances in employment and income.

Meeting participants discussed tentative signs that activity was beginning to slow in the housing sector. Reports from contacts in many parts of the country suggested somewhat less ebullient market conditions, and measures of confidence of homebuyers and builders had fallen back noticeably. A downshift in attitudes regarding the outlook for the housing sector could have significant market effects, in part by damping the demand for houses by investors and speculators. A slowing of house price increases, by restraining the expansion of consumption, and a moderation in the pace of new building were expected to reduce the growth of aggregate demand somewhat in coming quarters. To date, however, the national data on home prices, sales, and construction activity did not suggest a significant weakening in the sector.

Business investment spending had accelerated some since midyear. In part, the pickup may have reflected an increase in business confidence as the

economy proved resilient in the face of this year's substantial adverse shocks. Participants noted that the improved performance of investment suggested that the expansion was becoming more balanced, with strengthening business spending potentially offsetting some moderation in the growth of household spending from the elevated rates of recent years.

Economic activity also could be buoyed by developments in other sectors of the economy. Increased federal government outlays were expected to boost output a little next year. Supportive financial conditions and an apparent increase in confidence had contributed to a pickup in growth abroad. Despite possible firming of monetary policy by some foreign central banks and the rise in the foreign exchange value of the dollar owing to global demands for dollar assets, a good portion of the recent strength in foreign economic growth was expected to persist and provide support for U.S. exports.

In their discussion of prices, participants indicated that their concerns about near-term inflation pressures had eased somewhat over the intermeeting period. Recent data suggested that, thus far, indirect effects of elevated energy prices on core inflation had been muted. Moreover, energy prices generally had fallen back on balance since earlier in the fall, and much of the increases in inflation expectations posted in the aftermath of the hurricanes had reversed. Participants noted that robust competition—including that from foreign producers—and further substantial gains in productivity were helping to contain cost and price pressures. Moreover, measures of labor compensation showed only moderate gains while relatively wide profit margins could allow firms to absorb somewhat larger increases in labor and other costs without boosting

prices. Nonetheless, surveys and anecdotal reports suggested that some firms were successfully passing at least a portion of their increased costs on to customers, and many participants remained concerned that elevated energy prices could put pressure on core inflation. Also, in the view of a number of participants, the economy was possibly producing in the neighborhood of its potential, and the persistent strength in spending of late suggested that resource markets could tighten further and inflation pressures build. Under these circumstances, and with policy having been accommodative for some time, inflation expectations could rise if monetary policy were not seen as responding to contain such risks.

In the Committee's discussion of monetary policy for the intermeeting period, all members favored raising the target federal funds rate 25 basis points to 4¼ percent. With spending apparently retaining considerable momentum, and with the indirect effects of increased energy prices still threatening to raise core inflation at least for a time, the Committee thought that additional policy firming at this meeting was appropriate to keep inflation and inflation expectations in check. Committee members generally anticipated that policy would likely need to be firmed further going forward. In that process, the Committee would need to be mindful of the lags in the effect of policy firming on the economy. However, it would also have to take account of the effects of the sustained period of favorable financial conditions on asset prices and aggregate demand as well as the resulting possibility of further increases in resource utilization and pressures on prices. Views differed on how much further tightening might be required. Because the Committee's actions over the past eighteen months had significantly reduced the

degree of monetary policy accommodation, members thought that the policy outlook was becoming considerably less certain and that policy decisions going forward would depend to an increased extent on the implications of incoming economic data for future growth and inflation.

The Committee agreed that several changes in the wording of the announcement to be released after today's meeting would be appropriate. The federal funds rate had been boosted substantially, and, in the view of some members, it was now likely within a broad range of values that might turn out to be consistent with output remaining close to potential. In these circumstances, the Committee thought that policy should no longer be characterized as accommodative. Members concurred that the statement should note that the expansion remained solid despite elevated energy prices and hurricane-related disruptions. While inflation and long-term inflation expectations remained contained, the Committee agreed that the announcement should indicate that possible increases in resource utilization, as well as elevated energy prices, had the potential to add to inflation pressures and that "some further measured policy firming is likely to be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance." Although future action would depend on the incoming data, this characterization of the outlook for policy was seen by most members as indicating that, given the information now in hand, the number of additional firming steps required probably would not be large. Some members thought that the word "measured" was no longer necessary, but its retention for this meeting was seen as potentially useful to preclude a possible misinterpretation that the Committee now saw a sig-

nificant possibility of adjusting policy in larger increments in the near future. Wording of the announcement along these lines was not expected to have a substantial effect on market expectations for policy, though such effects were especially difficult to judge given the extensive changes being made to the statement. The members agreed that the announcement should end by noting that policy will respond to changes in economic prospects as needed to foster the Committee's objectives.

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

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 4¼ percent.

The vote encompassed approval of the paragraph below for inclusion in the

statement to be released shortly after the meeting:

The Committee judges that some further measured policy firming is likely to be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

Votes for this action: Messrs. Greenspan and Geithner, Ms. Bies, Messrs. Ferguson, Fisher, Kohn, Olson, Moskow, Santomero, and Stern. Votes against this action: None

It was agreed that the next meeting of the Committee would be held on Tuesday, January 31, 2006.

The meeting adjourned at 1:00 p.m.

Notation Vote

By notation vote completed on November 21, 2005, the Committee unanimously approved the minutes of the meeting of the Federal Open Market Committee held on November 1, 2005.

Vincent R. Reinhart
Secretary

Litigation

During 2005, the Board of Governors was a party in three lawsuits or appeals filed that year and was a party in ten other cases pending from previous years, for a total of thirteen cases; in 2004, the Board had been a party in a total of seventeen cases. None of the lawsuits or appeals filed in 2005 raised questions under the Bank Holding Company Act. As of December 31, 2005, five cases were pending.

Litigation under the Financial Institutions Supervisory Act

Bazy v. Board of Governors, No. 05-1320 (D.C. Circuit, filed August 12, 2005), was a petition for review of an interlocutory order in an administrative enforcement proceeding. On August 24, 2005, the court dismissed the case on the motion of the petitioner.

Board of Governors v. Thomas, et al., No. 1:04-CV-0777 (N.D. Georgia, filed March 19, 2004), was an injunctive action in which, in 2004, the court ordered eighteen individuals to deposit funds into the court's registry to satisfy civil money penalties the Board was seeking against them in a separate administrative enforcement proceeding. On July 13, 2005, the court granted the Board's motion to dismiss the preliminary injunction issued on the Board's behalf so that the deposited funds could instead be transferred to the United States Bankruptcy Court, Middle District of Florida, Tampa Division, which had issued judgments against the same eighteen defendants in an adversary proceeding brought by the court-appointed trustee.

Ulrich v. Board of Governors, No. 03-73854 (9th Circuit, filed October 24, 2003), and *Diehl McCarthy v. Board of Governors*, No. 03-73997 (9th Circuit, filed October 28, 2003), were petitions for review of orders of prohibition issued by the Board on October 15, 2003. On April 27, 2005, the court denied the petitions for review. 129 Fed. App'x. 386 (9th Cir. 2005).

Other Actions

Inner City Press/Community on the Move v. Board of Governors, No. 05-6162 (2nd Circuit, filed November 21, 2005), is an appeal of the district court's order (No. 04-CV-8337, 380 F. Supp. 2d 211 (S.D.N.Y. 2005)) granting in part and denying in part the Board's motion for summary judgment in a Freedom of Information Act case. On December 5, 2005, the Board filed a cross-appeal in the matter.

Price v. Greenspan, No. 05-5361 (D.C. Circuit, filed September 29, 2005), is an appeal of an order of the district court (No. 04-CV-0973, 374 F. Supp. 2d 17 (D.D.C. 2005)) dismissing an employment discrimination action.

Barnes v. Greenspan, No. 04-CV-1989 (CKK) (D. District of Columbia, filed November 15, 2004), is a case under the Age Discrimination in Employment Act.

Fakolujo v. Federal Reserve System, et al., No. 05-304 (E.D. Pennsylvania, filed October 15, 2004, in the Court of Common Pleas, Philadelphia County, Pa., and removed to federal court on January 21, 2005), was an action for

wrongful denial of insurance claim. The action was dismissed by agreement of the parties on April 15, 2005.

Jones v. Greenspan, No. 04-CV-1696 (RMU) (D. District of Columbia, filed October 4, 2004), is an employment discrimination action. On December 13, 2005, the district court granted in part and denied in part the Board's motion to dismiss and for summary judgment.

Texas State Bank v. United States, No. 04-5126 (Federal Circuit, filed July 28, 2004), was an appeal from a decision of the United States Court of Federal Claims dismissing an action challenging on constitutional grounds the failure to pay interest on reserve accounts held at Federal Reserve Banks. On September 21, 2005, the court affirmed the lower court's dismissal of the action. 423 F.3d 1370 (Fed. Cir. 2005). The petitioner's request for rehearing and rehearing *en banc* was denied on December 13, 2005.

Sciba v. Board of Governors, No. 04-CV-1011 (D. District of Columbia, filed

June 21, 2004), was a case brought under the Freedom of Information Act. On September 30, 2005, the court granted the Board's motion for summary judgment.

Artis v. Greenspan, No. 01-0400 (D. District of Columbia, filed February 22, 2001), is an employment discrimination action. An identical action, No. 99-2073 (EGS) (D. District of Columbia, filed August 3, 1999), was consolidated with this action on August 15, 2001.

Fraternal Order of Police v. Board of Governors, No. 98-3116 (D. District of Columbia, filed December 22, 1998), was an action seeking a declaratory judgment regarding the Board's labor policy governing Federal Reserve Banks. On July 28, 2005, the district court granted the Board's motion for summary judgment and dismissed the action. 391 F. Supp. 2d 1 (D.D.C. 2005). ■