

# FEDERAL RESERVE press release



For Use at 4:30 p.m.

December 16, 1988

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on November 1, 1988.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS OF THE  
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on November 1, 1988

1. Domestic Policy Directive

The information reviewed at this meeting indicated that the expansion in economic activity had moderated from the vigorous pace evident earlier in the year. Private domestic final demand grew at an appreciably slower pace in the third quarter than in the first half of the year; and other recent statistics, including data on labor market activity, also suggested some slowing in the rate of economic expansion. Information on wage and price developments gave no clear evidence on balance of any change in underlying inflation trends.

Total nonfarm payroll employment increased considerably in the third quarter, but the gains were less than those registered in the first half. In August and September, hiring in all major sectors except government moderated, and employment in manufacturing declined. Despite this broad-based slowing in the growth of private payrolls, the civilian unemployment rate fell to 5.4 percent in September and has remained in a narrow range around 5-1/2 percent since early spring.

Industrial production increased only slightly on balance in August and September after a strong surge earlier in the summer. Output of business equipment continued to advance fairly rapidly while production of consumer goods was sluggish. Total industrial capacity utilization declined slightly in September but was still more than 1/2 percent above the relatively high second-quarter level.

Overall consumer spending in constant dollar terms increased substantially on average in the third quarter, as outlays for services and nondurable goods strengthened while purchases of durables were little changed. However, retail sales weakened in August and September, owing partly to reduced sales of motor vehicles.

Indicators of business capital spending in the third quarter suggested a considerably reduced rate of expansion compared with the first half of the year. Growth of real outlays for business equipment slowed sharply, as investment in information-processing equipment decelerated. Nonresidential construction activity was weak in the first two months of the quarter, with oil drilling and expenditures on commercial and industrial structures other than office buildings contracting further. Inventory investment in the manufacturing and wholesale sectors picked up in July and August, but stocks accumulated about in line with the growth of sales. Retail inventories, reflecting little further change in stocks at auto dealers after a sharp rise in the second quarter, increased much less rapidly. Housing construction had been flat in recent months; the third-quarter pace of starts of single-family homes was unchanged from that of the previous quarter while multifamily starts edged down.

Preliminary data for the nominal U.S. merchandise trade deficit in August showed a larger deficit than in July. However, the average for July and August was slightly lower than the second-quarter rate as exports increased more than imports. Most of the rise in exports was in nonagricultural goods, particularly capital goods and consumer durables; increased imports of consumer goods and food outweighed a slight

reduction in the value of purchases of imported oil. Economic activity in the major foreign industrial economies appeared to have rebounded somewhat in the third quarter, following a pronounced slackening in the second quarter.

Reflecting a decline in gasoline prices at the refinery level, producer prices of finished goods registered a smaller advance in September than in August; however, for the third quarter as a whole, these prices rose more rapidly than during the first half of the year. At the crude materials level, producer food prices continued to rise sharply. Consumer prices increased at a somewhat slower rate in September as declines in energy prices outweighed the passthrough to the retail level of higher wholesale food prices. Excluding food and energy items, consumer prices on a year-over-year basis continued to rise at about the 4-1/2 percent annual rate evident since late 1987. Most measures of labor costs indicated some slowing in the rate of increase over the summer months, after a sharp upward movement in the second half of 1987 and early 1988.

In the foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies had declined from its high level of last summer by the time of the previous Committee meeting on September 20. Following the meeting, the dollar initially fluctuated in a narrow range but later declined appreciably in response to indications of more moderate U.S. economic growth and to information suggesting a slower U.S. external adjustment than the markets had anticipated earlier.

At its meeting on September 20, the Committee adopted a directive calling for no change in the degree of pressure on reserve positions. These reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of about 3 and 5 percent respectively over the period from August to December. The members agreed that somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets.

Adjustment plus seasonal borrowing fluctuated over a sizable range during the intermeeting period, averaging about \$630 million in the two complete reserve maintenance periods since the September meeting. The federal funds rate rose somewhat, with funds trading around 8-1/4 percent and sometimes higher over most of the intermeeting period. Most other short-term interest rates edged higher, perhaps reflecting the firmer federal funds rate as well as increased supplies of Treasury bills and CDs. Interest rates in long-term debt markets declined a little further as indications of more moderate economic expansion and weak energy prices apparently reduced concerns about inflation and buoyed expectations that money market conditions would not be tightened substantially further. Lower bond yields apparently contributed to higher equity prices; some broad indexes of stock prices rose about 3 percent since the September meeting.

Expansion of M2 slowed further in September, and preliminary data suggested that growth remained quite weak in October as earlier

increases in market interest rates and opportunity costs continued to damp demands for liquid deposit components. By contrast, after slow growth in August and September, M3 appeared to have strengthened somewhat in October, in association with a resumption in growth of bank credit. After registering relatively strong expansion in June and July, M1 had increased only slightly on balance in recent months, with total transactions deposits falling marginally.

The staff projection prepared for this meeting suggested that growth of the nonfarm sector of the economy in the current quarter might be near the reduced pace of the third quarter and that expansion in 1989 was likely to remain, on balance, well below the pace of the first half of 1988. The effects of the drought would continue to be reflected in an uneven quarterly pattern of growth of GNP, notably through the first half of next year. To the extent that expansion of final demand at a pace that could foster higher inflation was not accommodated by monetary policy, pressures would be generated in financial markets that would restrain domestic spending. The staff projection, which assumed a slightly restrictive fiscal policy, continued to indicate relatively sluggish growth of consumer spending, sharply reduced expansion of business fixed investment from the pace in the first half of 1988, and restrained housing activity. As in earlier projections, the external sector was expected to contribute importantly to domestic economic growth. The staff now anticipated some marginal easing in aggregate price increases in 1989, in large part because recent declines in crude oil prices portended lower energy prices more generally. However, any decline in inflation would be limited, largely because of continuing

pressures stemming from still strong demands pressing against reduced margins of unutilized labor and other production resources.

In the Committee's discussion of the economic situation and outlook, members welcomed the apparent moderation in the expansion of economic activity toward a pace that might prove to be more sustainable and consistent with progress over time toward price stability. Continuing expansion, but at a more moderate pace than that experienced in the first half of 1988, was viewed as a reasonable expectation, partly in light of the monetary policy tightening that already had been implemented this year. There was no evidence of emerging imbalances in key sectors of the economy that might bring the expansion to an end, although the outlook remained clouded by the nation's outsized trade and federal budget deficits and the financial problems or debt exposure of a number of depository institutions and business firms. In the view of many of the members, the risks of deviations from current expectations continued to be in the direction of greater inflationary pressures. Other members, while concerned about the potential for inflation, felt that the economy already appeared to be on a track consistent with no pickup in inflation and perhaps some improvement next year.

In the course of the Committee's discussion, members noted that despite signs of some slowing in recent months, the expansion in business activity retained appreciable momentum as evidenced, for example, by order backlogs, ongoing strength in business capital spending, and noteworthy improvement in the agricultural sector. Further improvement in the nation's trade balance also appeared likely, and while the gains might be more limited than in recent quarters, they

would help to sustain domestic manufacturing activity. Consumer spending might be supported to some extent by gains in real incomes stemming from reduced energy prices. By most measures, business inventories appeared to be relatively lean and, assuming continued moderate growth in overall final demand, further inventory accumulation might provide a modest fillip to the expansion over the year ahead. On the other hand, members also took note of the relatively sluggish performance of retail sales recently, notably of durable goods, and the continuing weakness of construction activity, including housing. A review of local business conditions continued to indicate an uneven pattern of regional activity, but on balance local developments tended to confirm broader indications of further, though reduced, growth in overall business activity.

With regard to the outlook for inflation, a critical issue in the view of many members was whether overall demand conditions in the economy would be consistent with containing or reducing inflation. A number of members expressed concern that underlying pressures on resources remained strong and that the possibility of greater inflation constituted the major current threat to sustained economic expansion. One observed that the uncertainties in the outlook for inflation were compounded by the prospect that, with production resources at or close to full capacity, even small differences in demand pressures could have a disproportionate effect on the actual rate of inflation next year. However, some members commented that, on the whole, price and wage developments were more favorable than might have been anticipated at current rates of capacity utilization. Recent reports from around the

nation suggested that inflation was not worsening in regional markets, including parts of the country where business activity remained relatively robust. Indeed, there were indications that prices of some business products previously in short supply now were showing some tendency to level off, and there was little or no evidence of faster increases in wages. Moreover, recent developments in financial markets suggested some lessening of inflationary expectations, although the latter remained volatile.

At its meeting in late June, the Committee reviewed the basic policy objectives that it had set for growth of the monetary and debt aggregates in 1988 and it established tentative objectives for expansion of those aggregates in 1989. For the period from the fourth quarter of 1987 to the fourth quarter of 1988, the Committee reaffirmed the ranges of 4 to 8 percent set in February for growth of both M2 and M3. The monitoring range for expansion of total domestic nonfinancial debt in 1988 was left unchanged from its February specification of 7 to 11 percent. For the year to date, M2 had grown at an annual rate somewhat below, and M3 at a rate somewhat above, the midpoints of their annual ranges. Expansion of total domestic nonfinancial debt appeared to have moderated to a pace marginally below the midpoint of its range. For 1989 the Committee agreed on tentative reductions to ranges of 3 to 7 percent for M2 and 3-1/2 to 7-1/2 percent for M3. The monitoring range for growth of total domestic nonfinancial debt was lowered to 6-1/2 to 10-1/2 percent for 1989. It was understood that all the ranges for next year were provisional and that they would be reviewed in February 1989 in the light of intervening developments. With respect to M1, the

Committee reaffirmed in June its earlier decision not to set a specific target for growth in 1988 and it also decided not to establish a tentative range for 1989.

In the Committee's discussion of policy implementation for the period immediately ahead, the members generally agreed that the current relatively balanced performance of the economy and the uncertainties surrounding the outlook argued for an unchanged policy at this point. Some commented that the apparent strength of underlying inflationary pressures might require further monetary restraint later, but for now they favored or could accept a steady policy course. Other members were more persuaded that, in the context of the recent evidence of slower economic growth, monetary policy already appeared to be on a course that would promote progress in reducing inflation. From the perspective of the growth of the monetary aggregates and reserves as well as interest rates developments, monetary policy had been fairly restrictive for some months and further restraint needed to be approached with some caution. At the same time, members stressed the continuing need to sustain the System's commitment to its long-run objective of controlling inflation, including the desirability of making clear that the current rate of inflation was unacceptable.

In the course of the Committee's discussion, the members took account of a staff analysis which concluded that the maintenance of unchanged reserve conditions was likely to be associated with relatively slow monetary growth over the balance of the year. Some pickup in the growth of M2 and M3 was anticipated from the very sluggish performance of September and October, but further adjustments of asset portfolios to

previous increases in interest rates and opportunity costs were likely to limit the rise. In addition, reductions in compensating balances in response to earlier increases in market interest rates were expected to be more pronounced late in the year, though such adjustments would have their major impact on M1 growth. Concurrently, expansion of M3 and to a lesser degree M2 might be buttressed to some extent as banks undertook to secure funds to underwrite a perhaps substantial portion of the initial cash needed to finance the recent surge in merger and buyout activities. Although members observed that any easing of reserve conditions to stimulate monetary growth would not be desirable at this point, some indicated that they would become increasingly concerned if very weak monetary growth were to persist in the context of sluggish expansion in economic activity.

With regard to possible adjustments in the degree of reserve pressure in the intermeeting period, a majority of the members believed that operations should be adjusted more readily toward further tightening than toward any easing. Some indicated that they viewed the incorporation of such an understanding as a key element of an acceptable directive, given their assessment of the inflationary risks in the economic outlook. Most of the other members indicated that they could accept such a directive, although they were less inclined than they had been previously to bias it toward further restraint; in this view, the direction of any potential adjustment in policy implementation was less certain than earlier, given the recent performance of the economy and behavior of the monetary aggregates. One member felt that the risks of some further weakness in the economy were sufficiently strong that a

continued bias toward possible tightening during the intermeeting period was not acceptable.

At the conclusion of the Committee's discussion, all but one member indicated that they favored or could accept a directive that called for maintaining the current degree of pressure on reserve conditions and that provided for remaining especially alert to potential developments that might require some firming during the intermeeting period. Accordingly, somewhat greater reserve restraint would be acceptable, or slightly lesser reserve restraint might be acceptable, over the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 2-1/2 percent and 6 percent respectively over the three-month period from September to December. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was left unchanged at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting indicates that the expansion in economic activity has moderated from the vigorous pace earlier in the year. Total nonfarm payroll employment grew considerably in the third quarter but the gains were less than those registered in the first half of the year and employment in manufacturing declined in August and September. The civilian unemployment rate fell to 5.4 percent in September, remaining in the narrow range that has prevailed since early spring. Industrial production advanced only slightly on balance in August and

September after a sharp increase in July, while housing construction has been flat in recent months. Consumer spending increased substantially on average in the third quarter but apparently slowed in recent months. Indicators of business capital spending suggest considerably slower expansion in the third quarter, following very rapid growth in the first half of the year. Preliminary data for the nominal U.S. merchandise trade deficit in August showed a greater deficit than in July, but the average for July-August was slightly less than the second-quarter rate. The latest information on prices and wages suggests little if any change from recent trends.

Interest rates in long-term debt markets have declined a little further since the Committee meeting on September 20, while rates in short-term markets have edged higher. The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies declined appreciably over the intermeeting period from the high level of last summer.

Expansion of M2 has slowed considerably in recent months; growth of M3 moderated in August and September but appears to have strengthened somewhat in October. Thus far this year, M2 has grown at a rate somewhat below, and M3 at a rate somewhat above, the midpoint of the ranges established by the Committee for 1988. M1 has increased only slightly on balance in recent months after registering relatively strong growth in June and July. Expansion of total domestic nonfinancial debt for the year thus far appears to be at a pace somewhat below that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability over time, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in late June reaffirmed the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth of total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and 3-1/2 to 7-1/2 percent for M3. The Committee set the associated monitoring range for

growth of total domestic nonfinancial debt at 6-1/2 to 10-1/2 percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed its decision in February not to establish a specific target for 1988 and also decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 2-1/2 and 6 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, LaWare, and Parry.  
Vote against this action: Ms. Seger.

Ms. Seger indicated that while an unchanged policy was acceptable to her at this point, she did not want to bias the directive toward potential tightening. In her view current indications of slower economic growth and the lagged effects of earlier policy tightening actions pointed to relatively slow expansion and reduced inflationary pressures over the year ahead. In these circumstances, she would not want to react more promptly or vigorously to indications of greater strength or price

pressures in the economy, which might well prove to be temporary, than to evidence of a weakening economy.

In the period following the Committee meeting on November 1, it became increasingly evident in the implementation of policy that depository institutions had reduced their demands on the discount window; in this period, a significantly lower level of adjustment plus seasonal borrowing was being associated with a slightly higher federal funds rate than had been anticipated at the time of the meeting. To take account of this change in behavior, but also in light of recent information suggesting that the economic expansion retained considerable strength, the Manager for Domestic Operations adjusted the reserve paths to incorporate a lower level of borrowing, with the expectation that federal funds would continue to trade in the slightly higher range that had prevailed recently. This adjustment in open market operations was discussed with the Committee on November 22, 1988. The members agreed that the factors relating to the apparent change in the relationship between borrowing and the federal funds rate, and the broader implications for the conduct of open market operations, would be reviewed further at the December meeting.

## 2. Authorization for Domestic Open Market Operations

Effective November 2, 1988, the Committee approved a temporary increase of \$4 billion, to \$10 billion, in the limit between Committee meetings on changes in System Account holdings of U.S. government and federal agency securities that is specified in paragraph 1(a) of the Authorization for Domestic Open Market Operations. The increase was effective for the intermeeting period ending with the close of business on December 14, 1988.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, LaWare, Parry, and Ms. Seger.  
Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that the usual leeway of \$6 billion for changes in System Account holdings would probably not be sufficient over the intermeeting period because of seasonal increases in currency in circulation and in required reserves.

3. Change in Terms of Certain Members to Calendar-Year Basis

The Committee amended its "Rules of Organization" to advance from March 1 to January 1 of each year the start of the terms of office of the Federal Reserve Bank presidents who serve one-year terms as Committee members or alternate members. The change will be effective starting with the calendar year 1990. Because the Committee's objectives for monetary growth are established on a calendar-year basis, the Committee believed that it would be appropriate to have all the members responsible for carrying out those objectives during the year participate in the vote to establish them at the start of the year. The Committee emphasized that this change was essentially procedural in nature, given the continuity of its decision-making process. The Full Employment and Balanced Growth Act of 1978 requires that the Committee's monetary growth objectives for the calendar year be transmitted to Congress by February 20 of each year.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, LaWare, Parry, and Ms. Seger. Votes against this action: None.