

FEDERAL RESERVE press release



For Use at 4:30 p.m.

March 29, 1991

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 February 5-6, 1991.

The record for each meeting of the Committee is made available a few days after the next regularly scheduled meeting and subsequently is published in the Federal Reserve Bulletin and the Board's Annual Report. The summary description of economic and financial conditions contained in each record is based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS OF THE
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on February 5-6, 1991

1. Domestic policy directive

The information reviewed at this meeting suggested that economic activity had weakened further. A persisting low level of consumer confidence, related partly to the uncertainties surrounding the Persian Gulf situation, and reduced real disposable incomes continued to depress consumer demand; and business investment spending, especially for structures, remained in a downtrend. With businesses attempting to maintain tight control over inventories as demand weakened, industrial production and nonfarm payroll employment had declined sharply. Broad measures of prices indicated some moderation of inflation toward the end of 1990, largely as a result of lower energy prices. The latest data suggested some deceleration in wages and overall labor costs.

Total nonfarm payroll employment fell sharply in January, and a larger drop than previously reported was now indicated for December. The contraction in employment in January was especially heavy in the construction sector, only partly reflecting unseasonably wet weather in some sections of the country, and widespread job losses were registered in manufacturing, notably in durable goods. The civilian unemployment rate edged higher in January to 6.2 percent.

Industrial output declined markedly in the fourth quarter, and partial data suggested a further drop for January. A sizable portion of the reduction reflected cutbacks in the production of motor vehicles, but output also was down in most other industries. Declines in production were especially large for computers, construction supplies,

and a wide range of non-auto consumer durables. Capacity utilization in manufacturing continued to fall in December; in most industries, operating rates were down substantially from their recent peaks and from their longer-run averages.

Partly reflecting lackluster sales during the holiday season, consumer spending in real terms was soft in the fourth quarter. Outlays for goods were considerably below the levels seen earlier in the year, and while spending for services rose further, the fourth-quarter gain was well below that recorded in previous quarters. Total private housing starts declined substantially further in the fourth quarter; sales of new homes remained weak through year-end, and home prices continued to slip.

Shipments of nondefense capital goods were about unchanged in the fourth quarter. Aircraft purchases remained at the robust third-quarter level, while business outlays for motor vehicles dropped sharply after a third-quarter spike in fleet sales. Outside the transportation sector, equipment spending advanced appreciably, mainly reflecting strong increases in spending for computers. New orders for business equipment pointed to a softening in spending for such goods in coming months. Available data indicated that nonresidential construction activity fell sharply in the fourth quarter. In a period of weak sales, total manufacturing and trade inventories, measured on a constant-cost basis, increased a little further on balance over October and November, and the ratio of stocks to sales rose only slightly, reflecting strong efforts by businesses to keep inventories in line with sales.

In the October-November period, strong exports cushioned to some extent the drop in production and output in the United States; nonagricultural exports were up substantially over the third-quarter average, with substantial increases recorded in all major trade categories except aircraft and computers. Despite the strength in exports, the nominal U.S. merchandise trade deficit for the two months combined was at a higher rate than in the third quarter because of rising oil prices, which brought a sharp increase in the value of oil imports. Growth in most major foreign industrial countries appeared to have slowed somewhat in the fourth quarter. In many of these countries, lower oil prices late in the year had brought some moderation in consumer price inflation.

In December, a sizable decline in producer prices of finished goods more than offset the November rise, as prices of both food and energy products moved sharply lower. For other finished goods, producer prices increased in the fourth quarter at about the moderate pace evident in the three previous quarters. Lower oil prices and a slowing in food price increases also damped the rise in consumer prices in December. Excluding the food and energy components, consumer inflation was a little lower on balance in November and December than in earlier months of 1990. Total compensation costs of private industry workers rose more slowly in the fourth quarter and also increased a bit less for the year than in 1989.

At its meeting on December 18, the Committee adopted a directive that called for an initial slight reduction in the degree of pressure on reserve positions and for giving particular weight to

potential developments that might require some further easing later in the intermeeting period. To reflect the tilt toward further easing, the directive indicated that, subsequent to the initial move, somewhat lesser reserve restraint would be acceptable, or slightly greater reserve restraint might be acceptable, during the intermeeting period depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The Committee also noted that open market operations might need to take account of a possible reduction in the discount rate early in the intermeeting period. The contemplated reserve conditions were expected to be consistent with expansion of M2 and M3 over the period from November through March at annual rates of about 4 and 1 percent respectively.

Immediately after the Committee meeting, the Board of Governors approved a reduction in the discount rate from 7 to 6-1/2 percent; afterwards, open market operations were directed at allowing part of this decline to show through to short-term interest rates more generally. Another easing step was taken in early January in response to weak money growth and considerable softness in the economy. Subsequently, on February 1, the Board approved a further reduction in the discount rate to 6 percent; this action was taken in response to indications that economic activity was slackening further, growth in money and credit continued sluggish, and inflation pressures were abating. In this instance, open market operations permitted the full reduction in the discount rate to be reflected in money market rates.

Adjustment plus seasonal borrowing fluctuated widely over the intermeeting period; borrowing was well above expected levels during much of the period as banks adapted to the phase-out of the reserve requirement on nonpersonal time deposits and net Eurocurrency liabilities; the phase-out reduced required reserve balances to levels that at times proved to be insufficient for the clearing needs of many banks.

The federal funds rate averaged around 7-1/4 percent just before the December meeting. Late in the intermeeting period, after the two cuts in the discount rate and the monetary easing through open market operations, the federal funds rate averaged a little above 6-1/4 percent. Over the intermeeting period, however, the funds rate was unusually volatile; key factors behind this volatility included the phase-out of the nontransaction reserve requirement, balance-sheet adjustments undertaken near year-end, and some reserve projection misses near the ends of maintenance periods. Other short-term interest rates also fell considerably over the intermeeting period; private money market rates declined more than Treasury bill rates, reflecting a reduction in the pronounced risk premiums that had been built into private short-term rates ahead of year-end. Yields in longer-term markets were unchanged to down slightly, and broad indexes of stock prices rose appreciably on balance over the period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies advanced in the early part of the intermeeting period as market participants sought a safe haven for their funds in the face of diminishing prospects for a peaceful

settlement in the Persian Gulf region. The dollar also was buoyed, especially against the German mark, by market perceptions that political conditions were deteriorating in the Soviet Union. The early successes of the Allied forces in the Gulf war brought a reduction in safe-haven demands, and the dollar began to decline in the latter half of January. After an increase in the German Bundesbank's official lending rates and the reduction the next day in the Federal Reserve's discount rate, the dollar dropped sharply. On balance, the dollar was down somewhat over the intermeeting period.

Growth of M2 remained sluggish in December and January, running at a pace below the path expected by the Committee; expansion of M3 picked up in January from the very slow pace of previous months. The continuing weakness in M2 despite an appreciable narrowing in opportunity costs appeared to reflect in part heightened concerns about the financial condition of many depository institutions in the wake of the closing of privately insured banks and credit unions in Rhode Island and the failure of the Bank of New England. For the year 1990, M2 and M3 grew at rates in the lower portions of the Committee's ranges. Expansion of total domestic nonfinancial debt appeared to have been near the midpoint of its monitoring range for the year.

The staff projection prepared for this meeting, which was assembled against the background of the outbreak of hostilities in the Persian Gulf region, pointed to some further decline in economic activity in the near term. The length and intensity of the war was a matter of conjecture, but the projection was based on the assumption that the war would end within the next few months and would have little

further effect on world oil supplies and the level of oil prices. The projection also assumed that constraints on the supply of credit would persist to some degree through the rest of the year. In the near term, concerns emanating from the war, reduced credit availability, and financial fragility were expected to continue to damp consumer and business confidence and, by depressing private domestic demand, to push manufacturing activity still lower. Subsequently, economic growth was expected to resume in association with the support provided by further gains in exports, the stimulative effects of sharp declines in oil prices and short-term interest rates, and some improvement in consumer and business sentiment as the war drew to a close. Increases in business orders and sales could be expected to bring a prompt pickup in production, given lean inventories, and with some lag a rise in business spending for investment goods other than commercial structures; severe problems of excess supply were expected to inhibit any recovery in commercial construction for an extended period. With oil prices lower and some added slack expected in resource utilization, the staff projected a slowing in the pace of increases in prices and labor costs in coming quarters.

In the Committee's review of economic developments, members commented that the outbreak of war in the Persian Gulf region had heightened the already substantial uncertainties bearing on the outlook for the economy. A relatively mild recession followed by a moderate upturn in economic activity was still regarded as a reasonable expectation, assuming that the war would not be prolonged and that oil prices would remain at substantially reduced levels. However, the risks

clearly were on the downside, and a very sluggish recovery or indeed a deep and relatively long recession could not be ruled out. Business and consumer confidence, a critical factor underlying the economic outlook, already was quite negative and was subject to further erosion stemming from financial strains and credit constraints in the domestic economy as well as from unpredictable developments in the Middle East. On the positive side, members saw growing indications of some moderation in underlying inflation pressures; and in light of the increasing slack in labor and capital markets and the slower growth of money over a period of years, they believed that considerable progress in reducing inflation was likely to be made in the year ahead.

In conformance with the practice at meetings when the Committee establishes its long-run ranges for growth of the money and debt aggregates, the Committee members and the Federal Reserve Bank presidents not currently serving as members had prepared projections of economic activity, the unemployment rate, and inflation for the year 1991. For the period from the fourth quarter of 1990 to the fourth quarter of 1991, the forecasts for growth of real GNP had a central tendency of 3/4 percent to 1-1/2 percent. These forecasts assumed an upturn in economic activity later in the year and subsequent expansion at a pace that was consistent with continued progress toward price stability. Estimates of the civilian rate of unemployment in the fourth quarter of 1991 were concentrated in a range of 6-1/2 percent to 7 percent. On the assumption that oil prices would remain near their recent levels and in the context of reduced pressures on resources, all of the members expected a sizable decline in the rate of inflation from the

pace in 1990; as measured by the consumer price index, the central tendency of their projections was in a range of 3-1/4 percent to 4 percent for the year, compared with an actual rise of 6-1/4 percent in 1990. Forecasts of growth in nominal GNP had a central tendency of 3-3/4 percent to 5-1/4 percent.

In their comments about the prospects for business activity, the members gave considerable attention to the uncertainties and concerns that were exerting a depressing effect on business and consumer confidence. The rapidly evolving situation in the Middle East undoubtedly was contributing an element of caution to spending plans, but the problems of many financial institutions and the financial difficulties of heavily indebted business firms and individuals were adding to the generally somber economic climate. Not only had financial problems affected attitudes, but constraints on the availability of credit to many borrowers with limited or no access to alternative sources of financing were having a retarding effect on business activity and could limit the vigor of the expected expansion. Many financial problems were the legacy of financial excesses of the past decade, notably those associated with the financing of speculative real estate ventures and highly leveraged restructurings of business firms. While some progress was being made in addressing such problems, a good deal of time undoubtedly would be needed before many troubled lending institutions again became important suppliers of new credit and before many business firms were able to access credit sufficient to support increases in spending. Such financial difficulties were likely to have continuing effects on business and consumer attitudes and to constrain

business activity to some extent even if there were a relatively prompt end to the hostilities in the Middle East. Nonetheless, members pointed to a number of promising developments bearing on the prospects for the economy, notably the substantial declines that had occurred in interest rates, including key long-term rates, the sharp drop in oil prices, and the improved competitive position of U.S. businesses in world markets stemming from the depreciation of the dollar. Members also noted that despite the generally negative sentiment in the business community and among many consumers, the performance of the stock market, including the shares of banking organizations, had been surprisingly strong; while such a development had to be interpreted with caution in terms of its implications for future business activity, it suggested that many investors viewed the economic outlook with some degree of optimism.

Turning to current and prospective developments in different parts of the country and sectors of the economy, members reported further indications of some softening in business conditions in several regions, including areas where business activity previously had been relatively well maintained in comparison with national trends. Much of the weakness tended to be concentrated in manufacturing, primarily the production of motor vehicles and associated inputs and of other durable goods, and in construction. At the same time, however, there were indications that business conditions were no longer deteriorating in some areas and might indeed be improving somewhat with attendant gains in local business confidence. The outbreak of war seemed to be having little effect thus far on overall domestic manufacturing activity,

though some firms were reported to have increased their production of defense-related goods.

The prospects for consumer spending remained the key uncertainty in the outlook for overall economic activity. It was unclear at this point how consumers would respond to unfolding developments in the Middle East. There were widespread reports that retail sales had dropped sharply after the outbreak of hostilities in mid-January, but that development seemed to represent at least in part a temporary reaction associated with the diversion of attention to the reporting of military events. Indeed, there were indications or at least expectations among businessmen that consumer behavior would return to a more normal pattern, though perhaps tending to the weak side, in the period ahead. For the present, however, consumer sentiment clearly remained depressed, and many anxious consumers seemed unwilling, or at least reluctant, to make discretionary purchases. As a consequence business contacts, such as those in the motor vehicles industry, remained concerned about the outlook for sales at least for the nearer term. Over time, the end of hostilities in the Middle East would improve consumer confidence, and the drop in oil prices, if sustained, would have a positive effect on consumer purchasing power.

A significant rebound in consumer spending was likely to be followed fairly promptly by increased production of consumer goods, given generally lean business inventories, and with some lag by greater output of producer equipment. At the same time, construction activity would probably remain depressed in light of the high vacancy rates in existing commercial structures across the country and the weakness in

residential real estate markets in many areas. Construction expenditures by state and local governments also appeared likely to be restrained, given the financial problems of many of these governments, but members noted that some major public works projects had been financed or were under way in a few areas.

Members continued to anticipate further expansion in exports stemming importantly from the nation's improved competitive position associated with the substantial decline in the foreign exchange value of the dollar. Views differed to some extent, however, with regard to the strength and potential contribution of the export sector to domestic economic activity. Some members stressed that relatively depressed economic conditions in a number of major foreign industrial nations were likely to limit U.S. exports to those countries. Moreover, developments in the Middle East already had curbed foreign sales of some domestic goods, notably agricultural products. At the same time, many manufacturing firms continued to report receptive export markets, and production for such markets was helping to offset weakness in domestic demand. However, a substantial further decline in the foreign exchange value of the dollar would not be a welcome development; such a decline, should it occur, might well foster higher domestic bond yields and could give rise to protectionist reactions abroad to the detriment of further gains in U.S. exports.

With regard to the outlook for inflation, the members saw favorable prospects for considerable progress in the year ahead. There were growing indications that the core rate of inflation would trend down. Currently available statistics might not yet be fully capturing

the extent of the underlying improvement in inflation, though it already was clear that some downward adjustment was occurring in the crucial area of wages. With regard to future prospects, several members stressed that the slowing in monetary growth over a period of years was likely to be reflected increasingly in lower inflation. The slack in labor and capital resources probably would have a restraining effect on underlying inflation pressures over the next several quarters. Evidence of such a development included indications of strong competition in markets for a wide range of products and reports of adjustments in the pricing policies of many business firms. The members recognized that the effects of earlier declines in the dollar on the prices of imported goods and competing domestic products would tend to maintain some upward pressure on the overall price level for a time; however, they assumed for the purpose of their forecasts that there would not be any further change in the value of the dollar of a magnitude that would affect domestic prices over the projection horizon and that oil prices would remain near recent lower levels.

Against the background of the members' views on the economic outlook and in keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee reviewed the ranges for growth of the monetary and debt aggregates in 1991 that it had established on a tentative basis in July 1990. The tentative ranges included expansion of 2-1/2 percent to 6-1/2 percent for M2 and 1 percent to 5 percent for M3, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt had been set provisionally at

4-1/2 percent to 8-1/2 percent for 1991. The ranges for M2 and non-financial debt involved reductions of 1/2 percentage point from those that were reaffirmed in July for the year 1990; the M3 range for 1990 had been lowered by 1-1/2 percentage points in July and no further reduction had been made in the tentative M3 range for 1991.

In the Committee's discussion of the ranges for 1991, which mainly focused on M2, most of the members indicated a preference for affirming the ranges that had been established on a tentative basis in July. Insofar as could be judged under present circumstances, the tentative ranges offered in this view the best prospects of balancing and accommodating the Committee's objectives of a prompt recovery in business activity and continuing progress toward reducing inflation. Many of the members conceded that in light of the current uncertainties surrounding the relationship between money growth and economic performance, somewhat higher or somewhat lower ranges also were defensible. For example, it was unclear to what extent the relatively slow growth of M2 in relation to that of nominal income, allowing for the effects of movements in interest rates, would persist during the year ahead; a return to a more normal pattern in this relationship would have a substantial effect on the rate of M2 growth that was consistent with a satisfactory economic performance. The Committee needed to be prepared to revise those ranges at mid-year as interim economic or financial developments might warrant. Members also noted the risk that market participants might misinterpret the implications of any changes in the ranges for the conduct of monetary policy during the year.

Increasing the ranges could raise questions about the System's commitment to its anti-inflationary goals, while lowering them, especially in the context of already weak money growth, could lead to concerns about the System's objective of fostering an upturn in business activity. Moreover, a reduction in the M2 range might have to be reversed later if the behavior of money resumed a more normal pattern in relation to income; such a reversal would interrupt the Committee's practice of gradually reducing its growth ranges and could have adverse repercussions on the credibility of the System's anti-inflationary policy. Accordingly, most of the members concluded that the tentative range for M2, which already incorporated a reduction from 1990, represented an appropriately balanced approach, based on current expectations with regard to the behavior of velocity, to promoting the Committee's objectives.

Expressing a differing opinion, two members indicated that they preferred a somewhat higher range for M2, in part to provide a better signal of the System's determination to cushion the recession and foster a quick recovery in business activity. The midpoint of the higher range would call for some make-up of the shortfall in M2 growth from the midpoints of the ranges established for this aggregate in recent years. Moreover, growth of M2 at or near the bottom of the tentative range would pose an unacceptable risk of inadequate monetary stimulus that could fail to cushion possible further deterioration in the economy. On the other hand, a preference was expressed for a somewhat lower range to underline the System's commitment to price stability. The midpoint of such a range would not imply a change from the average growth of recent

years, and the upper end would trigger a prompter policy response should the recovery be stronger than anticipated with potential inflationary implications.

With regard to M3, all of the members favored adoption of the tentative range that had been set provisionally in July. While that range was unchanged from that for 1990, as revised at midyear, it incorporated a substantial reduction from the M3 ranges of previous years. The members anticipated that growth of M3 would remain below that of M2 as a consequence of the continuing restructuring of thrift depository institutions this year and the likelihood of restrained growth in bank credit. However, the effect on overall credit growth seemed likely to be attenuated by the continuing rechanneling of credit extensions through financial markets or lenders other than depository institutions. In the circumstances, a relatively low range for M3 was expected to prove consistent with the Committee's goals for the economy.

All of the members found acceptable the monitoring range of 4-1/2 percent to 8-1/2 percent that the Committee had established on a provisional basis for growth of total domestic nonfinancial debt in 1991. That range, which represented a further step in a series of annual reductions, took into account the prospect that federal borrowing was likely to be robust in 1991, owing in part to borrowing associated with outlays by the Resolution Trust Corporation but more generally to the likely weakness of federal revenues in a year of relatively sluggish economic activity. On the other hand, growth in borrowing by domestic nonfederal sectors was expected to moderate. Demands for credit would be held down by limited expansion in domestic spending and the increased

caution on the part of both businesses and households in taking on debt, while the terms and conditions set by many suppliers of credit would remain tight.

At the conclusion of the Committee's discussion, all but one of the members indicated that they favored or could accept the ranges for 1991 that the Committee had established on a tentative basis at its meeting in July 1990. In keeping with the Committee's usual procedures under the Humphrey-Hawkins Act, the ranges would be reviewed at midyear, or sooner if deemed necessary, in light of the behavior of the aggregates and ongoing economic and financial developments. The Committee approved the following paragraph for inclusion in the domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote a resumption of sustainable growth in output, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 2-1/2 to 6-1/2 percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt was set at 4-1/2 to 8-1/2 percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress its growth relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Keehn, Kelley, LaWare, Mullins, Parry, and Ms. Seger.

Vote against this action: Mr. Forrestal

Mr. Forrestal dissented because he wanted to retain the 1990 range of 3 to 7 percent for M2 growth in 1991. He was concerned that monetary growth in 1990 was the lowest since monetary targeting began. Moreover, in the current recessionary environment, the 3 to 7 percent range with its somewhat higher minimum growth rate would provide a better basis for conveying and implementing the Committee's goals of fostering a prompt upturn in economic activity and subsequent expansion at a sustained and acceptable pace. In addition, the midpoint of this range appeared to be consistent with continued progress toward price stability.

In the Committee's discussion of policy for the intermeeting period ahead, all of the members endorsed a proposal to maintain unchanged conditions in reserve markets at least initially following this meeting. In reaching their decision, members took into account the considerable easing of monetary policy that had been implemented in a series of steps over the course of recent months, including the reduction in the discount rate and related decrease in money market interest rates within the last few days. The System's policy actions, in the context of a weakening economy and moderating cost pressures, had induced a considerable decline in interest rates, but sufficient time had not yet elapsed for the effects of the lower rates to be felt in the economy or indeed to any measurable extent in the growth of the monetary aggregates. A number of members also commented on the possibility that further easing so soon after the recent policy moves could result in undesirable downward pressure on the dollar in foreign exchange markets. In these circumstances, while views differed with regard to the

potential need for further easing moves, the members agreed that for now it was desirable to pause and assess the course of the economy and the effects of past policy actions.

As they had at other recent meetings, many of the members expressed concern about the very sluggish expansion of M2 and M3 over the past several months. This weakness in monetary growth in turn appeared to be associated with the current constraints on the availability of credit from depository institutions and the shortfalls in aggregate spending and income. According to a staff analysis prepared for this meeting, a steady policy course was likely to be consistent with some acceleration in monetary growth over the first quarter because earlier declines in market interest rates had reduced the opportunity costs of holding deposit accounts and the staff assumed some strengthening of aggregate spending over the balance of the quarter. The incomplete data available thus far for the latter part of January tended to support this staff analysis. The members recognized that the short-run behavior of these monetary measures needed to be interpreted with caution and that easing reserve conditions too much would incur the risk of stimulating a sharp rebound in monetary growth and in inflationary pressures once the economic recovery had gathered some momentum. Nonetheless, several members emphasized the desirability of giving relatively high priority to achieving satisfactory rates of growth in reserves and money, especially under prevailing economic and financial conditions.

In the course of the Committee's consideration of possible intermeeting adjustments to the degree of reserve pressure, most of the

members expressed a preference for continuing to tilt the directive toward possible easing during the weeks ahead. In this view, the downside risks to the economy and the potential for inadequate monetary growth made it likely that any intermeeting adjustment would be in the direction of easier reserve conditions. Several members also noted that the Committee needed to place a high premium on avoiding any tendency for the weakness in the economy to cumulate because they were more concerned about the severe consequences of a potentially deep and prolonged recession than those of a sharp rebound in the economy, especially given current financial strains and fragilities in the economy. Accordingly, the Committee should be willing to ease in response to evidence of additional weakness in the economy and abatement of inflationary pressures; the need for further easing might be signaled in part by a continuing shortfall in monetary growth. In following such a policy, however, a number of members stressed that the Committee would need to be prepared to tighten policy promptly down the road in the event that inflationary pressures should threaten to re-emerge. A few members, while acknowledging the potential need for some easing, preferred not to bias the directive in either direction. In this view, there were considerable risks of overreacting to indications of a weakening economy, particularly since conditions for a recovery in economic activity already appeared to be in place and weak data for the period at the start of the Persian Gulf war might well reflect what would prove to be a short-lived development.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. They also noted their preference or acceptance of a directive that gave special weight to potential developments that might require some easing during the intermeeting period. Accordingly, the Committee decided that slightly greater reserve restraint might be acceptable during the intermeeting period or somewhat lesser reserve restraint would be acceptable depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with some pickup in the growth of M2 and M3 to annual rates of around 3-1/2 percent to 4 percent over the three-month period from December to March.

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

The information reviewed at this meeting suggests further weakening in economic activity. Total nonfarm payroll employment fell sharply further in December and January, reflecting widespread job losses that were especially pronounced in manufacturing and construction; the civilian unemployment rate rose to 6.2 percent in January. Industrial output declined markedly in the fourth quarter, in part because of sizable cutbacks in the production of motor vehicles, and partial data suggest a further drop in January. Consumer spending has remained soft. Advance indicators of business capital spending point to considerable weakness in investment in coming months. Residential construction has declined substantially further in recent months. The nominal U.S. merchandise trade deficit narrowed in November, as the value of imports declined more than that of exports; the average deficit for October and November exceeded that for the third quarter. Increases in consumer prices

moderated and producer prices changed little in November and December, largely as a result of a softening in energy prices. The latest data suggest some further deceleration in wages and overall labor costs.

Short-term interest rates have fallen considerably since the Committee meeting on December 18, while rates in longer-term markets are unchanged to down slightly. The Board of Governors approved a reduction in the discount rate from 7 to 6-1/2 percent on December 18 and a further reduction to 6 percent on February 1. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined somewhat on balance over the intermeeting period.

Growth of M2 remained sluggish in December and January; expansion of M3 picked up in January from the very slow pace of recent months. For the year 1990, M2 and M3 expanded at rates in the lower portions of the Committee's ranges for the year. Expansion of total domestic nonfinancial debt appears to have been near the midpoint of its monitoring range for the year.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote a resumption of sustainable growth in output, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 2-1/2 to 6-1/2 percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt was set at 4-1/2 to 8-1/2 percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress its growth relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and

domestic financial markets, slightly greater reserve restraint might or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of both M2 and M3 over the period from December through March at annual rates of about 3-1/2 to 4 percent.

Votes for the paragraph on short-run policy implementation: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, Parry, and Ms. Seger.

Votes against this action: None.

2. Agreement to "Warehouse" Foreign Currencies

At its meeting on March 27, 1990, the Committee approved an increase, if requested by the Treasury, from \$10 billion to \$15 billion in the amount of eligible foreign currencies that the System would be prepared to "warehouse" for the Treasury and the Exchange Stabilization Fund (ESF). The purpose of the warehousing facility is to supplement the resources of the Treasury and the ESF for financing their purchases of foreign currencies. System holdings of foreign currencies under the facility had risen to \$9.0 billion, based on acquisition costs, in March 1990, but subsequent ESF repayments had reduced the total to \$4.5 billion by November 1, 1990.

At this meeting, the Committee decided to reduce the limit to \$10.0 billion. Such a limit would provide an adequate cushion of unused capacity and thus maintain operational flexibility to respond on short notice to unanticipated developments.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Keehn, Kelley, LaWare, Mullins, Parry, and Ms. Seger.

Votes against this action: None.