

FEDERAL RESERVE press release



For Use at 4:30 p.m.

May 17, 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 March 26, 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 March 26, 1991

Domestic policy directive

The information reviewed at this meeting suggested that economic activity had weakened further in the opening months of the year. Production cutbacks were evident in a wide range of industries, and private payrolls had fallen markedly, especially in the goods-producing sector. On the positive side, consumer confidence had rebounded sharply since the cease-fire in the Persian Gulf, retail sales and housing starts had strengthened recently, and exports had continued to expand. Broad measures of prices had slowed or contracted in January and February, but excluding energy and food prices, increases in those measures were higher than in previous months. Wage increases had moderated over the past several months.

Total nonfarm payroll employment fell sharply further in February. The decline was widespread across industries but was particularly pronounced in the durable goods segment of manufacturing. Construction employment edged up in February after a steep drop in January, when the weather was unusually adverse. The only major industry to post a notable job increase was health services. The civilian unemployment rate rose to 6.5 percent in February.

Industrial output declined markedly again in February, with cutbacks evident in a wide range of industries. Production of motor vehicles and parts slackened after being about unchanged on balance over the previous two months; output of other final products continued to fall in February, with the exception of computer equipment which

advanced for a second month. Capacity utilization in most major industries fell further in February; in manufacturing, operating rates were substantially below their 1989 highs.

Shipments of nondefense capital goods increased in February, boosted by a sizable advance in shipments of aircraft and parts; categories other than aircraft were down. New orders for business equipment suggested that spending on such goods would change little in coming months. Nonresidential construction put-in-place edged up in January from a downward-revised level for December but remained below its weak average for the fourth quarter. Available data on contracts, permits, and office vacancy rates pointed to considerable softness in nonresidential construction activity in coming months. Manufacturing and trade inventories rose considerably in January after little net change in the fourth quarter. With shipments and sales down sharply around the turn of the year, the ratio of inventories to sales in manufacturing and trade continued to rise in January.

After declining considerably in previous months, retail sales turned up in February. Sales at general merchandise, apparel, and furniture outlets jumped in February after posting sizable declines over the preceding few months, and purchases of automobiles and light trucks picked up from the very low sales pace in January. Consumer sentiment appeared to have rebounded sharply in early March from the low levels reached after Iraq's invasion of Kuwait. In February, housing starts more than retraced a sharp January decline but were still at a low level; in particular, multifamily construction activity remained very weak. Available data and anecdotal reports indicated that lower home

prices and mortgage rates were stimulating some consumer interest in purchasing homes.

The nominal U.S. merchandise trade deficit increased slightly from December to January but was considerably below its average rate in the fourth quarter. The value of exports picked up in January from the strong fourth-quarter level; the value of imports declined considerably, mostly reflecting a drop in the price of imported oil. Among the major foreign industrial countries, economic activity in the fourth quarter of 1990 expanded more slowly in Germany and Japan, though there had been some tentative indications of a pickup in growth early this year in both countries. By contrast, some weakening in activity apparently had occurred in several other major industrial countries.

Among major components of broad measures of inflation for January and February, food prices rose more slowly or declined on balance and energy prices fell substantially further; however, prices of items other than food and energy rose more rapidly than in preceding months. At the producer level, this pickup reflected in part large increases in prices of motor vehicles. At the consumer level, increases in federal excise taxes on some items and an unusual bunching of price increases at the beginning of the year had boosted prices of nonfood, non-energy goods and services; as a result, the percent change in these prices over the twelve months ended in February was considerably above that for the previous twelve months. Average hourly earnings of production or supervisory workers were little changed over January and February; for the twelve months ended in February, these earnings had increased at a slower pace than in the comparable year-earlier period.

At its meeting on February 5-6, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but for giving special weight to potential developments that might require some easing during the intermeeting period. To reflect the tilt toward easing, the directive indicated that somewhat lesser reserve restraint would be acceptable in the intermeeting period, or slightly greater reserve restraint might be acceptable, 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. The contemplated reserve conditions were expected to be consistent with growth of both M2 and M3 at annual rates of around 3-1/2 to 4 percent over the period from December through March.

After the Committee meeting, open market operations initially were directed at maintaining the existing degree of pressure on reserve positions; subsequently, in early March, in response to information suggesting that economic activity had continued to decline through February, pressures on reserve positions were eased slightly. Adjustment plus seasonal borrowing tended to run at appreciably higher levels than expected over the intermeeting period; this seemed to reflect in part a greater willingness of banks to seek discount-window credit when conditions tightened in the federal funds market. In the early part of the intermeeting period, federal funds averaged a bit above 6-1/4 percent, but by the time of the March meeting the rate had dropped to about 6 percent. The federal funds rate was less volatile around its average level; this evidently reflected not only the change

in attitudes toward use of the window but also the greater experience of banks in operating under the lower reserve requirement ratios put in place late last year and the rebound of required reserve balances from their seasonal low in February.

Other short-term interest rates had declined slightly since the Committee meeting on February 5-6; Treasury bill rates dropped by less than rates on private instruments. In longer-term markets, rates on Treasury bonds had risen appreciably while rates on high-grade bonds had changed little and those on lower-rated debt had fallen substantially. The narrowing in spreads of private over Treasury rates appeared to stem primarily from investor assessments of improved prospects for a recovery in U.S. economic activity and in business earnings and thus for reduced strains on borrowers. Stock prices moved up considerably on balance over the intermeeting period.

The trade-weighted value of the dollar in terms of the other G-10 currencies increased very sharply over the intermeeting period. In addition to optimism over the prospects for the U.S. economy in the aftermath of the Persian Gulf war, there was a growing perception by market participants that economic activity in the major trade partners of the United States was growing more slowly or declining and that in consequence interest-rate spreads were likely to move in favor of dollar assets. Political difficulties in the Soviet Union also appeared to affect the German mark adversely.

At least partly in response to earlier declines in interest rates, growth of M2 and M3 strengthened substantially in February and partial data suggested appreciable further growth in March. Such

growth, which was faster than the Committee had anticipated, brought M2 up to the middle portion of its annual range and put M3 near the upper end of its range. Most of the acceleration in M2 reflected rapid expansion in its liquid retail deposit instruments. Offering rates on these accounts had responded in typically sluggish fashion to declines in market interest rates in recent months, and the opportunity costs associated with holding such deposits had narrowed accordingly. The strength in M3 reflected not only the faster growth of M2 but also in part the efforts of some depository institutions, in the wake of the elimination of the reserve requirement on nontransaction accounts, to replace federal funds and Eurodollar borrowings with funds raised through domestic issuance of large certificates of deposit.

The staff projection prepared for this meeting pointed to a turnaround in the economy in coming months. While further declines in activity were likely in the very near term, the rebound in business and consumer confidence following the declaration of a cease-fire in the Persian Gulf, the positive effects of lower oil prices on household purchasing power and of earlier declines in interest rates on housing demand, and the additional gains expected in exports were likely to foster an upturn in the economy before very long. Subsequently, increases in business orders and sales could lead to a further pickup in production, given generally lean inventories and, with some lag, to a rise in business spending for investment goods. On the other hand, the reduced availability of credit and the effects of the overhang of commercial structures on commercial construction activity, along with a moderately restrictive fiscal policy, were expected to continue to exert

some restraint on domestic demand. Against the background of lower oil prices and some added slack 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 discussion of the economic outlook, members saw improving prospects for a recovery in business activity some time in the months ahead, especially in light of the sharp rebound in consumer and business sentiment since the cease-fire in the Persian Gulf war. A variety of financial indicators, including the performance of the stock and bond markets and the foreign exchange markets, along with faster monetary growth suggested both that an upturn in economic activity was widely expected and that liquidity had been made available to support it. Thus far, however, the surge in consumer confidence was not accompanied by appreciable evidence of stronger economic activity, though the February data in two key areas, retail sales and housing starts, were positive after a period of substantial weakness. In the view of many members, the anticipated upswing in economic activity might be relatively sluggish, at least in the early stages of the recovery. Consumers and businesses probably would remain relatively cautious in the context of continuing concerns about employment opportunities as well as heavy debt burdens and tight constraints on credit availability; in addition, confidence was vulnerable to further difficulties in the financial sector. Indeed, there was some risk that the recession could deepen considerably further, but on balance the conditions seemed to be in place for a turnaround in coming months. With regard to the outlook for inflation, members expressed disappointment about the lack of

progress in reducing its underlying rate; however, they remained optimistic that reduced pressures in markets for output as well as for key inputs, indications of some moderation in wage increases, a firmer dollar, and weaker commodity prices all pointed to some subsidence in inflation over coming quarters. The slower average rate of money growth over the course of recent years suggested a monetary policy that had for some time been consistent with a gradual diminution in inflation.

In their reports on developments around the country, members noted that their contacts indicated a sharp rebound in business sentiment since the last Committee meeting, mirroring the marked increase of consumer confidence as the Persian Gulf war drew to a successful close. The effects of this change in attitudes by both producers and consumers were not yet evident in many statistical measures of economic activity, except perhaps in the housing sector and retail sales. Across the nation, regional economic activity remained uneven; it was still declining in some areas, albeit with increasing signs that it might be stabilizing, and appeared to have bottomed out or strengthened a little in other parts of the country. Manufacturing activity in particular remained depressed in many areas, notably those that were dominated by the production of motor vehicles and related parts. Members commented that many businesses, especially in the construction industry, were continuing to report difficulties in obtaining financing, but both loan demand and the availability of financing showed signs of improvement in some areas.

In their review of developments in key sectors of the economy, members emphasized that the timing and strength of the recovery would

depend importantly on how quickly and to what extent the rebound in consumer confidence was translated into increased consumer spending. The performance of the consumer durables sector, notably autos, was a key element in the outlook; while expenditures on durable goods did not appear to have strengthened thus far, developments that might help to stimulate such spending included greater capital gains realized from sales of existing homes and more demand for household durables stemming from a possible pickup in the construction of new homes. Members also reported that automobile dealers had become more optimistic in many areas. However, many members believed that consumer expenditures were likely to be restrained by a combination of negative factors that included concerns about job security and debt burdens. Moreover, the fiscal problems of state and local governments were tending to erode consumer confidence in some parts of the country, and associated fiscal restraint measures would limit the growth in disposable incomes in those areas.

With regard to the outlook for business investment spending, stronger consumer expenditures in coming months should induce more business spending for inventories and, with some lag, for new equipment, especially in light of the recent improvement in business confidence. On the negative side, if a recovery in consumer spending failed to materialize, the upturn in business confidence might well reverse. Such a development could foster a sharp drop in business capital appropriations that in turn would deepen and extend the recession. With regard to construction activity, members commented that problems of overcapacity were likely to limit new nonresidential construction for an

extended period in many areas. On the other hand, signs of renewed buyer interest in housing were widespread, and indeed developments in this sector of the economy were seen by some members as the most encouraging indication of a prospective economic recovery. Some concern was expressed regarding the possibility that persisting constraints on the availability of financing to homebuilders might continue to inhibit homebuilding activity, but given the expected strengthening in the overall economy and the already improving capital positions of many banking institutions, a degree of optimism seemed warranted that such financing might become more readily obtainable in the months ahead.

In the view of many members, the external sector of the economy was likely to make only a small contribution to the domestic expansion in coming quarters. While continuing growth in exports was helping to offset some of the weakness in manufacturing, some members referred to the possibility that further expansion in world demand for U.S. exports might be curtailed by slower growth abroad related to political uncertainties and economic developments in several nations; a partial offset was the potential for large reconstruction expenditures by Kuwait. The recent appreciation of the dollar also would tend to inhibit net exports over time.

Turning to the outlook for inflation, a number of members emphasized that recent increases in producer and consumer prices, excluding their food and energy components, were a disturbing development even though transitory factors helped to account for much of those increases. Concerns about inflation seemed to be echoed in financial markets, judging from the recent rise in long-term interest

rates. At the same time, however, increases in labor compensation had continued to trend down, with relatively high unemployment levels contributing to much reduced pressures on wages in many local areas. In circumstances characterized by strong competitive conditions in most industries and thus widespread pressures on prices and profit margins, many business firms continued to seek ways to limit their labor costs. In this connection, members observed that efforts to hold down employment levels were likely to result in some further increases in unemployment even after a recovery got under way. The appreciation of the dollar in recent months would tend with some lag to moderate inflation pressures over coming quarters. On balance, the members remained optimistic about the prospects for appreciable reductions in the core rate of inflation, given their expectations of some continuing slack in resource use and of monetary expansion at a pace within the Committee's ranges for the year.

In the Committee's discussion of policy for the intermeeting period ahead, all of the members supported a proposal to maintain an unchanged degree of pressure on reserve positions. The System's policy actions over the course of recent months, including two reductions in the discount rate, represented substantial easing on a cumulative basis and most probably had positioned monetary policy to contribute to a satisfactory recovery in business activity. Changing economic and financial conditions could, of course, lead to a reassessment, but for now a steady policy course seemed indicated as the stimulative effects of earlier policy actions, the drop in oil prices, and the rebound in confidence worked their way through the economy. Some members observed

that the most likely direction of the next policy move was not clear at this point and that caution was needed before any action was taken. Prevailing uncertainties suggesting that further easing could not be ruled out included the possibility that consumer spending would not strengthen materially and that business capital spending would continue to weaken. However, if the economy was indeed near its recession trough, additional easing would not be necessary and such a move might add to inflationary pressures later. On the other hand, while a firming of policy clearly would be premature at this point, a number of members commented that the Committee should be alert to the potential need to tighten reserve conditions promptly if emerging economic and financial conditions, including the behavior of the monetary aggregates, threatened progress toward price stability.

Many of the members commented that in current economic and financial circumstances the strengthening in M2 growth in February and March was a welcome development following an extended period of limited expansion. The faster growth tended to support expectations of a near-term recovery in economic activity. It also might be indicative of some rebound of public confidence in depository institutions. The growth of M2 for the year to date was near the middle of the Committee's annual range, but if the most recent rate of M2 growth was to continue for some time, this might signal the need to tighten reserve conditions to forestall a potential intensification of inflationary pressures. However, according to a staff analysis prepared for this meeting, monetary growth was likely to moderate somewhat over the second quarter as the effects of earlier declines in market interest rates on opportunity

costs and desired money holdings tended to dissipate. On the assumption of an unchanged degree of pressure on reserve positions, the staff projected the cumulative expansion of M2 to be only slightly above the midpoint of the Committee's range at midyear.

Members expressed a range of views regarding possible intermeeting adjustments to the degree of reserve pressures, but a majority preferred--and all could accept--a directive that did not contain a bias toward tightening or easing. A symmetric directive represented a shift from previous directives that had been tilted toward easing since mid-1990, and it was consistent with an assessment that the risks to the economy had shifted in recent weeks and were now more evenly balanced. Further declines in economic activity would not be surprising--nor should they necessarily be seen as calling for additional ease, given the lags in policy effects. Under current circumstances, policy adjustments should be made only in the event of particularly conclusive evidence, which might include a significant deviation in monetary growth from current expectations, that the recession might be deeper or the rebound less robust than anticipated. Other members expressed a preference for retaining a directive that was biased toward possible easing. Some of these members believed that, despite the improved prospects for a recovery, there were still marked risks of a prolonged recession and of a weak upturn, and in these circumstances the Committee should react relatively promptly to indications that the economy was not moving toward a turnaround. One member expressed a slight preference for biasing the directive toward restraint. In this view, the possibility of a continuing or even a

deepening recession could not be ruled out, but the greater risks were in the direction of too much ease and of persisting or increasing inflation; consequently, the directive should envision any easing as a remote prospect.

At this meeting, the interaction between changes in the discount rate, as approved by the Board of Governors, and open market operations, as implemented under the current operating procedures and directives of the Committee, also was discussed. The principal issue related to the extent to which changes in the discount rate should show through to the federal funds rate that would be expected in the implementation of open market operations. In recent years, changes in the discount rate usually had been allowed to pass through automatically to the federal funds rate; there had been some exceptions involving instances where only partial pass-throughs had been permitted and where the change in the discount rate had been intended to conform the latter to movements that had already occurred in the federal funds rate. In general, however, both rates had tended to move together over time, and appropriately so, as adjustments to both policy instruments are made in the context of the same economic and financial developments. Members agreed that in general the existing practice should be continued, but that consultation among members of the Committee would be particularly appropriate in circumstances where changes in the discount rate perhaps should not be permitted to show through entirely to market rates, or where their showing through would result in quite sizable changes in money market rates in the period between meetings.

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. The members also noted that they preferred or could accept a directive that did not include a presumption about the likely direction of any intermeeting adjustments in policy. Accordingly, the Committee decided that somewhat greater reserve restraint or somewhat lesser reserve restraint might be acceptable during the period ahead depending on progress toward price stability, trends in economic activity, 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 reduction in the growth of M2 and M3 from their recent pace to annual rates of around 5-1/2 and 3-1/2 percent respectively over the three-month period from March through June.

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 that economic activity weakened further in the opening months of 1991. In February, total nonfarm payroll employment fell sharply further, especially in manufacturing, and the civilian unemployment rate rose to 6.5 percent. Industrial output also declined markedly again in February, with cutbacks evident in a wide range of industries. Advance indicators point to further weakness in business fixed investment in coming months, notably in nonresidential construction. On the other hand, after declining considerably in previous months, retail sales turned up in February; consumer sentiment appears to have rebounded sharply in recent weeks. Housing starts jumped in February, retracing a sizable decline in January but remaining at a low level. The nominal U.S. merchandise trade deficit increased somewhat in January but was considerably below its average rate in the fourth quarter. Energy prices fell substantially further in January and

February, but prices of other consumer goods and services rose more rapidly than in preceding months. Wage increases have moderated in recent months.

Short-term interest rates have declined slightly since the Committee meeting on February 5-6. In longer-term markets, rates on Treasury bonds have risen appreciably, owing at least in part to heightened expectations of a recovery in U.S. economic activity. Risk premiums on corporate debt instruments have declined, and stock prices have moved up considerably on balance. The trade-weighted value of the dollar in terms of the other G-10 currencies increased very sharply over the intermeeting period.

Growth of M2 and M3 strengthened substantially in February, reflecting rapid expansion in liquid retail deposits; partial data suggest appreciable further growth in March.

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 its meeting in February 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, somewhat greater reserve restraint or somewhat 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 March through June at annual rates of about 5-1/2 and 3-1/2 percent, respectively.

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

Votes against this action: None.