

FEDERAL RESERVE press release



For Use at 4:30 p.m.

December 20, 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 November 5, 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 November 5, 1991

1. Domestic Policy Directive

The information reviewed at this meeting suggested that economic activity had turned sluggish after registering considerable gains around midyear. Consumer spending for goods had been lackluster recently, and businesses remained cautious about investing in increased production capacity or inventories. Industrial production had flattened out, nonresidential construction had moved sharply lower, and housing construction had lost much of its forward momentum. Price inflation evidently remained on a gradual downtrend.

After falling sharply in the first half of the year, total nonfarm payroll employment rose slightly in the third quarter and was unchanged in October. Sizable job gains in the services sector, notably in health and business services, were offset by losses elsewhere. Manufacturing employment declined further; durable goods industries bore all of the loss. Job cutbacks in construction and retail trade were larger in October than they had been in recent months. Also, the small September increase in average weekly hours worked by production or nonsupervisory workers was reversed in October. The civilian unemployment rate edged back up to 6.8 percent.

Industrial production was little changed over August and September after sizable gains in earlier months; available data indicated that production would remain flat in October. Sluggishness had been evident in most components of the index since July; abstracting from the output of motor vehicles and parts, which had been subject to wide swings, the production of consumer goods and construction supplies had been rising much less rapidly since midyear

while the output of business equipment had not expanded much since reaching its low last March. Total industrial capacity utilization edged lower in September.

Real personal consumption expenditures advanced considerably further in the third quarter, partly reflecting a sharp rise in purchases of motor vehicles. However, outlays for non-auto goods weakened in August and September, and partial data for October suggested a slowing in sales of motor vehicles in that month. In addition, indicators of consumer confidence, which had remained at subdued levels since the end of the war in the Persian Gulf, had deteriorated significantly in October. Housing starts declined in September after rising substantially on balance in earlier months of this year. Sales of both new and existing houses had dropped recently despite lower mortgage rates and favorable price developments.

Shipments of nondefense capital goods rose for a second straight month in September. For the third quarter as a whole, real business spending for computers, aircraft, and motor vehicles registered a sizable gain while outlays for industrial machinery fell further. Recent data on orders pointed to some further moderate expansion in business spending for equipment in the near term. Nonresidential construction continued to contract at a rapid rate as outlays for all major types of structures, but particularly for commercial buildings, fell sharply. Available information on new contracts and commitments suggested that the rate of decline for non-office construction activity might slow in coming months.

The pace of inventory liquidation by businesses slowed in July and August from the substantial second-quarter rate. Ratios of inventories to sales edged down at manufacturing and non-auto retail firms. In September, stocks held by manufacturers increased.

The nominal U.S. merchandise trade deficit widened appreciably in August. For the July-August period, the trade deficit was significantly larger than its average rate in the second quarter, reflecting a strong expansion in the value of imports and a small reduction in the value of exports. The increase in imports was entirely in consumer goods and automotive products; other major trade categories registered small declines. Part of the drop in exports resulted from a partial reversal of a sharp second-quarter increase in exports of aircraft and parts. Indicators of economic activity in the major foreign industrial countries suggested continued weak growth on balance in the third quarter. The rate of growth in western Germany and Japan was considerably slower in the second and third quarters than earlier in the year, although capacity utilization rates remained high in both countries. In some other major countries, economic activity was slowly and unevenly recovering from a period of recession.

Producer prices of finished goods were little changed in September; a firming of prices of finished energy goods was offset by lower food prices. For finished goods other than food and energy, producer prices had advanced thus far in 1991 at a pace appreciably below that for 1990. At the consumer level, the September rise in prices was larger than the increases in the prior few months. Excluding food and energy items, consumer prices advanced in September at the same elevated rate as in the previous three months; however, for 1991 to date, nonfood, non-energy consumer prices had increased at a slightly slower pace than in 1990. Total hourly compensation for private industry workers rose at a somewhat slower rate in the third quarter than in the first half of the year. For the year to date,

wage increases had slowed appreciably, but benefit costs had continued their rapid rise.

At its meeting on October 1, 1991, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and for giving special weight to potential developments that might require some easing during the intermeeting period. Accordingly, the directive indicated that slightly greater reserve restraint might be acceptable or slightly lesser reserve restraint would be acceptable during the intermeeting period 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 a resumption in the growth of both M2 and M3; these aggregates were expected to expand at annual rates of around 3 percent and 1-1/2 percent respectively over the three-month period from September through December.

Over most of the intermeeting period, open market operations were directed toward maintaining the existing degree of pressure on reserve positions. At the end of October, however, a slight easing of reserve conditions was implemented; this action was taken in response to signs of a weaker-than-expected economic recovery and flagging consumer and business confidence. Just before the intermeeting period, adjustment plus seasonal borrowing had averaged around \$340 million. During the period, several technical decreases were made to expected levels of adjustment plus seasonal borrowing to reflect the usual autumn pattern of ebbing seasonal credit needs. By the end of the intermeeting period, following the slackening of seasonal funding needs and the easing of reserve conditions, the volume of borrowing

had declined to around \$125 million. The federal funds rate remained near 5-1/4 percent during most of the intermeeting period but slipped to about 5 percent after the easing of reserve conditions.

Over the early weeks of the intermeeting period, other short-term interest rates declined somewhat as market participants interpreted incoming data as indicating a sluggish economy. At the same time, long-term rates moved considerably higher in response to the release of disappointing statistics on consumer prices and concerns stemming from discussions of possible measures of fiscal stimulus that would increase the federal deficit and borrowing needs. Subsequently, short-term rates fell further and long-term rates retraced a portion of their rise as markets reacted to information suggesting additional economic weakness and reduced pressure on labor costs, and to actual as well as prospective further easing of monetary policy. The prime rate remained unchanged at 8 percent over the period, but primary-market yields on mortgages fell to their lowest levels since 1977. Most stock price indexes were slightly higher on balance.

The trade-weighted value of the dollar in terms of the other G-10 currencies fluctuated in a fairly narrow range over the intermeeting period but declined slightly on balance. The dollar was generally higher over the first half of the period but then weakened in response to growing evidence of a sluggish U.S. economy and consequent market anticipation of an easing of U.S. monetary policy. The dollar was up a little against the mark, in large part reflecting concerns that the Soviet Union might default on its foreign debt, much of which is owed to or guaranteed by the German government. The yen

was strong on balance, in part because of continuing indications of growing Japanese trade surpluses.

M2 expanded slowly in October after shrinking on balance over the previous three months. The turnaround was consistent with the Committee's expectations for the fourth quarter and reflected in part the rapid growth in the liquid-deposit components of this monetary aggregate. As the Committee also had expected, the pickup in M2 showed through to M3, which posted its first monthly increase since May. For the year through October, expansion of both M2 and M3 was estimated to have been at the lower ends of the Committee's annual growth ranges.

The staff projection prepared for this meeting pointed to a continuing recovery in economic activity, but recent reports on business and consumer confidence combined with other information had led to an appreciable markdown in the projected rate of expansion for the current quarter and to a lesser markdown for the first quarter of 1992. Economic growth was projected to pick up by the spring of next year, but as in earlier staff forecasts, it was expected to remain subdued in comparison with past cyclical experience and the risks of a different outcome continued to be seen as predominantly on the downside. Increases in the construction of single-family housing and in business spending for equipment, along with a shift from inventory liquidation to limited accumulation, were expected to give impetus to the expansion during 1992. As in earlier forecasts, real federal government purchases were projected to fall somewhat next year, with defense expenditures more than accounting for the decline, and fiscal adjustments at the state and local levels and a continuing decline in commercial construction were expected to be persisting sources of restraint on aggregate demand. Significant though diminishing

slack in labor and product markets was projected to induce a further decline in the underlying rate of inflation over the next several quarters.

In the Committee's discussion of current and prospective economic developments, the members commented on widespread indications of deteriorating business and consumer confidence and on evidence that the recovery in business activity had weakened since early summer. Nonetheless, despite quite negative anecdotal reports from many parts of the country, the members generally concluded that the available economic data appeared consistent with continuing, albeit sluggish, expansion in overall economic activity. Views differed to some extent with regard to the risks to a continuing recovery. A number of members expressed concern about the potential for some further softening, especially in light of the vulnerability of the expansion stemming from the troubled condition of many financial institutions and the heavy debt burdens of numerous business firms and individual households; other members saw the risks as more evenly balanced and perhaps even tilted marginally to the upside. While the performance of the economy was likely to remain relatively lackluster over the nearer term and the risks of a downturn would be greatest during the next quarter or two, many of the members judged a resumption of growth next year at a pace broadly in line with the staff forecast to be a reasonable expectation. In this regard, some noted that much of the stimulus from the easing in monetary policy over the course of recent months had not yet been felt in the economy. Many of the members emphasized that the prospects for appreciable progress toward price stability were quite favorable, though some expressed reservations about the extent of the progress that could be expected over the forecast horizon.

Several members referred to the continuing adjustments by financial institutions and many business firms to the financial excesses of the past decade and the greater-than-expected downward pressure that these adjustments appeared to be exerting on the expansion. The efforts to reduce debt exposure and rebuild equity positions were necessitated by the effects on balance sheets of the contraction in the value of a variety of assets, notably in the structurally troubled sectors of the economy such as commercial real estate, and the failure of other assets to appreciate as expected. The rebuilding of balance sheets augured well for the future financial health and stability of the economy, but members commented that an extended period would be required before that process could be completed. In the interim, the retrenchment that was involved implied reduced propensities to spend and constrained growth in business activity. One facet of the adjustment process was greater caution on the part of institutional lenders. Many business borrowers continued to complain about the difficulty of obtaining credit, while institutional lenders stressed the lack of demand from qualified borrowers.

In the course of the Committee's review of business developments in different regions, members continued to report uneven conditions ranging from modest growth to some further decline in regional activity, but business and consumer sentiment was described as almost universally negative. It was unclear to what extent the drop in confidence reflected the disappointing pace of the economic recovery so far or was a harbinger of further weakening in economic activity. ~~Members commented~~ that surveys of consumer confidence had to be viewed with caution because they had tended in the past to be coincident rather than leading indicators of economic activity. More

generally, bearish sentiment, though perhaps more muted, had not been an unusual occurrence in the early stages of past business recoveries.

While the potential sources of economic stimulus were subject to uncertainty and recent developments heightened concerns that the rate of economic expansion would remain below a desirable pace for an extended period, the members generally anticipated that improvement in key areas of the economy, notably certain interest-sensitive sectors and business inventories, eventually would provide the impetus needed to promote at least moderate growth in overall business activity. In the critical area of consumer demand, members observed that consumer caution reflected not only concerns about employment prospects and, in the case of many households, relatively heavy debt burdens, but also appeared to stem from actual or perceived declines in the market value of residences. Consumer expenditures on services were continuing to grow, though at a relatively slow pace, but spending on goods had edged lower over the course of recent months and many retailers reported that they expected very weak sales during the approaching holiday season. With regard to the longer-term outlook for consumer expenditures, some pickup in interest-sensitive spending for durable goods was seen as a likely prospect that would have feedback effects on the demand for inventories and production.

According to available data and reports from around the country, inventories generally appeared to be near acceptable levels, and members continued to anticipate that a further swing from inventory liquidation to modest accumulation would provide some stimulus to the economy over the year ahead. The members recognized that a number of developments argued against a typical surge in inventory investment during the recovery, including the now widespread practice of "just-in-time" inventory management. Nonetheless, despite

sluggish demand, the pace of inventory liquidation appeared to have slowed in the third quarter, and there were scattered reports of efforts by some manufacturers to increase their inventories.

The construction of new housing also appeared likely to play a positive, though possibly limited, role in helping to sustain the recovery. Recent indicators of home sales and housing starts were disappointing, but the demand for new single-family homes would respond over time to the declines that had occurred in mortgage interest rates. Some of that demand might be postponed, however, until borrowers were persuaded that interest rates had bottomed out. On the negative side, commercial construction activity would probably remain depressed for an extended period as excess capacity in many parts of the country gradually was absorbed. With regard to business spending for new equipment, real outlays were indicated to have risen, especially for computers, and this sector could be expected to provide ongoing strength, especially once the expansion was well under way.

In their comments concerning the outlook for inflation, members observed that many of the recent statistical indicators and especially the anecdotal evidence from around the country provided the basis for considerable optimism that progress was being made toward price stability. Developments on the financial side, including low levels of business and consumer borrowing and an extended period of limited monetary growth, reinforced expectations of an ongoing movement toward stable prices. Members also noted that the information on wages was consistent with a downtrend in labor costs despite still substantial upward pressures on employee benefit costs. Some members cautioned, however, that an appreciable inflationary risk remained in the economy. While inflationary expectations might well be waning, as evidenced in part by the behavior of equity markets, the

level of long-term interest rates suggested that inflation concerns had not disappeared.

In the Committee's discussion of an appropriate policy for the intermeeting period ahead, a majority of the members indicated that they could support a proposal to ease reserve conditions slightly at this time and to bias the directive toward possible further easing later in the intermeeting period. The members recognized that monetary policy had been eased considerably over the course of recent months, including a decision to reduce reserve pressures at the end of October, and that all of the stimulus from the earlier actions had not yet been felt in the economy. Nonetheless, in the view of many members further modest easing was desirable at this point to provide some added insurance against the downside risks in the economy. Such a policy move would help counter the deterioration in business and consumer confidence, and it might also encourage some decline in longer-term interest rates. Under current economic and financial conditions, this easing would pose negligible risks of deflecting inflation from its downward path. Continuing weakness in the monetary aggregates reinforced the need for easier reserve conditions.

There was considerable discussion regarding the possible advantages of a somewhat stronger move at this juncture. A one-half percentage point reduction of the discount rate was pending at several Federal Reserve Banks, but the Board of Governors had not yet made a decision with regard to those proposals. It was noted during this discussion that the Federal Reserve had tended to implement its easing of monetary policy since the spring of 1989 through a series of small policy actions. That approach generally appeared to have been appropriate, but a number of members expressed concern that further small moves would lack the visibility that was needed in present

circumstances. If reserve pressures were to be reduced only modestly, this action should be accompanied in the view of many members by Board approval of the pending discount rate proposals to signal clearly that monetary policy was moving against the weakening tendencies in the economy. An accompanying reduction in the discount rate also was seen as providing further encouragement to a drop in the prime rate.

Other members expressed reservations about the need for substantial easing, and two indicated that they could not support any easing through open market operations at this time. Some questioned whether monetary policy actions could have a constructive influence on business and consumer confidence under prevailing circumstances. Indeed, appreciable further easing, or any easing, would incur too much risk of reviving inflationary concerns with adverse consequences for longer-term debt markets. While none of these members wanted to rule out the potential need to ease monetary policy significantly further, they preferred to pause and wait for additional evidence before such action was taken, especially given the further stimulus that could be anticipated from previous easing moves. Concern also was expressed that the Committee might not recognize the need to reverse its course and tighten policy on a timely basis should inflationary pressures tend to revive later.

Members noted that the expansion of M2 appeared to have resumed in October, though at a pace that kept the aggregate only at the bottom of the Committee's range for the year. According to an analysis prepared by the staff for this meeting, M2 was likely to continue to expand slowly over the balance of the year, despite the effects of earlier policy easing actions, and for the year as a whole M2 growth was expected to average close to the lower end of the Committee's range. Some members commented that an easing in reserve

conditions would not only improve slightly the odds that M2 growth would end the year within the Committee's range but would also help to put M2 on a desirable growth path by early next year. While the relationship between money growth and economic activity was subject to substantial uncertainty in the short run, they saw a marked advantage, in terms of the continuity of monetary policy and its credibility, for the Committee to more aggressively foster growth of M2 within the annual range.

With regard to possible adjustments to the degree of reserve pressure during the intermeeting period, most of the members who favored some immediate easing of reserve conditions also supported a directive that remained biased toward further easing. However, some also indicated that if the Board were to approve the pending proposals to reduce the discount rate, the intermeeting instruction should then be viewed as symmetrical.

The members discussed at some length the appropriate timing of the Committee's easing action. Starting that afternoon and continuing over the next two days, the Treasury would be conducting its quarterly auctions of notes and bonds. In view of this, an immediate policy move would come as a surprise to many participants in financial markets, although such a move shortly after the auctions was widely anticipated. An immediate move, even in the easing direction, could have an adverse effect on some Treasury market participants, with potentially unsettling consequences for current and future Treasury financings. The members agreed that in general it was preferable to avoid policy moves during Treasury refundings, but most felt that the contemplated easing move should not be delayed for any significant period. They concluded that, on balance, it would be less misleading to take action immediately rather than to wait until the

Treasury auctions were completed later in the week. It was noted in this connection that a prompt easing of reserve conditions, and any accompanying Board action to approve a lower discount rate, would become known to outside observers after the auction of the shorter-term Treasury note but before the auctions of the intermediate- and long-term Treasury issues.

At the conclusion of the Committee's discussion, all but two of the members indicated that they favored or could accept a directive that called for an immediate slight easing in the degree of pressure on reserve positions. These members also noted their acceptance of a directive that included a bias toward possible easing during the intermeeting period. Accordingly, the Committee decided that slightly greater reserve restraint might be acceptable during the intermeeting period or slightly lesser reserve restraint would be acceptable 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 growth of M2 and M3 at annual rates of around 3 percent and 1 percent respectively over the 3-month period from September through December.

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 portrays a sluggish economy and a marked deterioration in business and consumer confidence. Total nonfarm payroll employment was unchanged in October after rising slightly over the third quarter, and the civilian unemployment rate edged back up to 6.8 percent. Industrial production has been flat in recent months. Consumer spending increased considerably through the summer, in part because of a sizable rise in expenditures on motor vehicles; sales of motor vehicles slowed in October, however. Real outlays for business equipment--especially for computers--have been rising,

but nonresidential construction has continued to decline. Housing starts and home sales have weakened recently. The nominal U.S. merchandise trade deficit in July-August was significantly above its average rate in the second quarter. Wage and price increases have continued to trend downward.

Short-term interest rates have declined somewhat further since the Committee meeting on October 1, while bond yields are about unchanged to slightly higher on balance. The trade-weighted value of the dollar in terms of the other G-10 currencies declined on balance over the intermeeting period.

Expansion in M2 and M3 resumed in October, albeit at a slow pace. For the year through October, expansion of both M2 and M3 is estimated to have been at the lower ends of the Committee's ranges.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February 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 also was maintained at 4-1/2 to 8-1/2 percent for the year. For 1992, on a tentative basis, the Committee agreed in July to use the same ranges as in 1991 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1991 to the fourth quarter of 1992. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate 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 decrease somewhat 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 slightly lesser reserve restraint would 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 3 and 1 percent, respectively.

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

Votes against this action: Messrs. Angell and Kelley.

Mr. Angell dissented because he was concerned about the impact of further easing on inflation expectations and consequently on long-term interest rates. In his view, the prospect for a robust and long-lasting recovery is dependent on the completion of adjustments in business pricing practices, household savings, and balance sheets more generally. Monetary policy actions that are perceived as a shift from a focus on price-level stability to one on short-term economic growth may well abort the needed adjustments. In his view, credible price-level targeting would provide assurance, particularly given the somewhat precarious short-term business outlook, that monetary policy would act to counter either deflation or inflation. The consequence would be to foster a considerable downward thrust in long-term interest rates and to set the stage for sustained expansion.

Mr. Kelley dissented because he believed that a steady policy course was appropriate, at least for now, in the context of the ongoing stimulus that could be anticipated from the System's earlier easing actions. In his view, the outlook for continuing expansion in economic activity remained favorable, and he saw considerable risks in further easing at this time. In particular, he was concerned that a policy easing move would stimulate inflation expectations with adverse implications for long-term interest rates and the performance of

interest-sensitive sectors of the economy. Further, he did not believe that many of the factors that are importantly inhibiting economic expansion could be constructively addressed by a more accommodative position. He also feared that the dollar would come under downward pressure in foreign exchange markets with only slight benefits for exports but added inflation pressures in the domestic economy.

2. Authorization for Domestic Open Market Operations

The Committee approved a temporary increase of \$2 billion, to a level of \$10 billion, in the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities. The increase amended paragraph 1(a) of the Authorization for Domestic Open Market Operations and was effective for the intermeeting period ending with the close of business on December 17, 1991.

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

Votes against this action: None.

The Manager for Domestic Operations advised the Committee that the current leeway of \$8 billion for changes in System Account holdings might not be sufficient to accommodate the potentially large need to add reserves over the intermeeting period ahead to meet an anticipated seasonal bulge in currency in circulation and required reserves.