

# FEDERAL RESERVE press release



For Use at 4:30 p.m.

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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 October 6, 1992.

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 October 6, 1992

The information reviewed at this meeting suggested that economic activity was expanding at a subdued pace. Domestic final sales appeared to have picked up in the third quarter, led by an increase in consumer spending and another sharp gain in business purchases of office and computing equipment, but demand had remained sluggish in most other sectors of the economy. The limited growth in overall demand was being met in part through higher imports, and as a consequence, industrial production and employment had been weak. Recent data on wages and prices continued to suggest that inflation was slowing.

Total nonfarm payroll employment fell somewhat further in September, reflecting a drop in government jobs associated with the end of a federally funded summer jobs program. Employment in the private sector was up in September, as new hiring in the services industry more than offset job losses in manufacturing and construction; employment in other industries was little changed after a sizable decline in August. The civilian unemployment rate edged down to 7.5 percent in September when the labor force registered another decrease.

After a considerable gain in July, industrial production declined appreciably in August, and available information suggested further weakness in September. The decline in industrial output since July partly reflected the disruptive effects of Hurricane Andrew on oil and gas production and of a labor strike on the manufacture of automobiles and parts. However, output of a broad range of other goods also was down. One area of continuing strength was the

production of business equipment, notably office and computing equipment. The utilization of total industrial capacity fell on balance over July and August, retracing a portion of the increase that occurred over the first half of the year.

Real personal consumption expenditures were little changed in August after increasing appreciably in the two previous months; for July and August combined, spending was moderately higher than in the second quarter. In August, outlays for services continued to rise, while expenditures for most major categories of goods declined. Housing starts climbed in August, with starts of single-family homes reaching their highest level since March. By contrast, permit issuance and sales of new and existing homes edged lower in August.

Shipments of nondefense capital goods slowed considerably in July and August, retracing much of the sharp gain recorded in June. Shipments of office and computing equipment slackened on balance over the two months; however, after adjusting for ongoing rapid declines in prices, the underlying upward trend in demand for such equipment remained robust. Recent data on orders and shipments of nondefense capital goods suggested that business outlays for durable equipment, particularly for items other than computers, would grow more slowly in coming months. Outlays for nonresidential construction contracted again in August, with steep decreases occurring for commercial and industrial structures. Data on contracts continued to indicate that spending for new construction would remain sluggish over the months ahead.

Total business inventories rose somewhat further in July following a large increase in June. In manufacturing, inventory stocks were little changed over June and July but were up sharply in August as factory shipments of goods slowed; as a result, the ratio of

inventories to shipments for all manufacturing rebounded to the middle of the range that had prevailed over the previous year. At the wholesale level, inventories were trimmed a little in July after a sizable rise in June, and the stocks-to-shipments ratio remained relatively high. Retail trade inventories expanded at a considerable pace in July, but a rebound in sales lowered the inventory-to-sales ratio somewhat at most types of stores.

The nominal U.S. merchandise trade deficit widened somewhat in July from its average rate in the second quarter. Imports, particularly of capital goods and consumer goods, remained on the fairly strong upward path evident during the first half of the year. Exports increased by a smaller amount in July; exports of agricultural products rose noticeably, but exports of nonagricultural goods were about unchanged from the pace of the previous three quarters. Recent indicators of economic activity in the major foreign industrial countries suggested a continuation of sluggish growth on average in those countries.

Producer prices of finished goods edged up in August in association with a rebound in prices of fresh fruits and vegetables. Abstracting from the volatile food and energy components, the increase in prices of other finished goods over the twelve months ended in August was considerably smaller than the rise over the previous twelve-month period. At the consumer level, prices of nonfood, non-energy items registered another modest increase, and the twelve-month change in this measure also was down substantially from a year earlier. In September, a drop in the average hourly earnings of production or nonsupervisory workers retraced part of a sizable rise in August. Over the twelve months ended in September, these earnings

grew at a significantly slower rate than in the preceding twelve-month period.

At its meeting on August 18, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward possible easing during the intermeeting period. Accordingly, the directive indicated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint might be acceptable or slightly lesser reserve restraint would be acceptable during the intermeeting period. The contemplated reserve conditions were expected to be consistent with growth in M2 and M3 at annual rates of about 2 percent and 1/2 percent respectively over the six-month period from June through December.

Open market operations during the intermeeting period were directed initially toward maintaining the existing degree of pressure on reserve positions. In early September, operations were adjusted to implement some easing in reserve pressures. This action was taken in response to incoming information that suggested unexpected sluggishness in economic activity and a smaller-than-anticipated pickup in the growth of the broad monetary aggregates. Adjustment plus seasonal borrowing tended to run a little above expected levels during the intermeeting interval, reflecting in part reserve shortfalls that produced sharp increases in borrowing at the end of two reserve maintenance periods. The reserve shortfalls along with quarter-end pressures contributed to a somewhat higher federal funds rate than had been expected following the monetary easing action.

Other short-term interest rates also declined somewhat, while longer-term rates were about unchanged since the Committee meeting on August 18. Short-term debt markets reacted to the Committee's easing action in early September and subsequently to growing expectations of further System easing in the context of continued indications of a sluggish economic expansion. Yields on intermediate-term securities also fell. However, rates on long-term obligations were little changed on balance; the System's policy easing and generally weak economic data tended to reduce bond yields, but long-term debt markets also appeared to reflect growing concerns about the fiscal outlook and increased uncertainty stemming in part from volatility in the foreign exchange markets and policy developments abroad.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies fluctuated widely over the intermeeting period but ended somewhat higher on balance. The dollar weakened considerably early in the period on disappointing reports about the U.S. economy and related expectations of Federal Reserve easing. In mid-September, the dollar moved sharply higher as turmoil in European currency markets prompted some safe-haven buying of dollars and resulted in interest rate reductions in Germany. More recently, reduced tensions within the European Monetary System and heightened expectations of further easing by the Federal Reserve induced renewed declines in the dollar.

Expansion of M2 and M3 resumed in August, though at fairly slow rates, and limited growth appeared to have continued in September. Through September, both aggregates were estimated to have grown at rates somewhat below the lower ends of the ranges established by the Committee for the year. The pickup in the broad aggregates

seemed to reflect the cumulative effects on demand deposits and liquid retail deposits of declines in market interest rates since mid-year and a related drop in opportunity costs. Currency growth strengthened further in August and September, evidently owing in part to further foreign demand. Bank credit growth also picked up in both months in conjunction with an upturn in bank loans.

The staff projection prepared for this meeting indicated that economic activity would expand at a slow pace in the current quarter and that growth would pick up gradually in 1993 to a rate that would remain quite moderate by past cyclical standards. The declines that had occurred in interest rates were expected to boost housing activity to some extent, particularly in the single-family sector. Gains in expenditures for equipment were projected to be large enough to raise business fixed investment despite sluggish spending for nonresidential construction. As employment growth was restored and further improvements in household balance sheets were achieved, consumer spending would strengthen. The projection pointed to some decline in federal government purchases, reflecting further cutbacks in defense expenditures, and weak spending by state and local governments. The persisting slack in resource utilization in this forecast was projected to be associated with additional progress in reducing inflation.

In the Committee discussion of current and prospective economic developments, many of the members expressed disappointment and concern about the sluggish pace of the expansion, and a number commented that the softening in several recent business indicators could portend quite slow economic growth over the months immediately ahead. Business and consumer sentiment was relatively depressed and seemed to have worsened a bit further recently in some parts of the

country. While further deterioration in business activity culminating in an economic downturn could not be ruled out, some of the very latest data had a slightly more positive tone and the members generally continued to view somewhat stronger economic growth as a reasonable prospect for the year ahead. However, no important sector of the economy seemed poised to provide much impetus to business activity, and the timing of the acceleration from the presently sluggish advance remained uncertain. Nonetheless, declines over the third quarter in the foreign exchange value of the dollar and in domestic interest rates--the latter along the entire maturity spectrum--suggested improved conditions for greater expansion. Recently, these more favorable conditions had been reflected in an upturn in money growth and bank lending activity. With regard to the outlook for inflation, the available statistics and anecdotal information continued to indicate appreciable progress toward the goal of price stability.

In the course of the Committee's discussion, the members gave a great deal of emphasis to the uncertainties that surrounded the economic outlook, including potential developments abroad. Several members commented that against the background of a relatively weak expansion, the recent volatility in some domestic financial markets and in the foreign exchange market tended to underscore the risks of developments that could have adverse effects on the economy. Another key uncertainty related to the ongoing restructuring of business firms and of business and consumer balance sheets. Those activities were continuing to divert financial flows from spending to savings or debt reduction, and prior experience provided little basis for determining when such restructuring might come closer to being completed and flows of funds redirected on balance into more normal spending channels.

Nonetheless, the members drew considerable encouragement from the substantial progress that already had been made by business firms in improving their balance sheets and by many lenders, notably banking institutions. While some banks clearly were continuing to experience financial difficulties, many had pared their problem assets and strengthened their capital positions. Moreover, a growing number of reports suggested that banks were intensifying their efforts to find creditworthy borrowers, though when such efforts might become more general was another source of uncertainty.

Consumer spending seemed to have been reasonably well maintained in most parts of the country, including indications of some growth in a number of areas where overall business activity appeared to be moving sideways or even edging lower. At least in some parts of the country, retailers were expressing moderate optimism with regard to their prospective sales during the upcoming holiday season. Even so, very cautious consumer attitudes, associated especially with concerns about employment prospects, seemed likely to restrain overall growth in consumer spending over the next several months. Indeed, barring unanticipated economic developments leading to a major strengthening in employment opportunities, continuing efforts by many households to improve their financial positions could be expected in the context of an already low saving rate to limit the contribution of the consumer sector to faster economic growth for some considerable period.

In their comments about developments in other key sectors of the economy, members also cited single-family housing construction as a source of some stimulus in many regions. The manufacturing of related building materials had exhibited a corresponding pickup recently. Other construction activity, notably that of office

structures, remained weak, but there were reports of some improvement or continuing growth in the construction of industrial facilities and public works projects in some parts of the country. In the energy sector, a firming of gas prices was encouraging somewhat greater production. On balance, there was little current evidence that construction, other than in the single-family sector, would provide significant impetus to the overall expansion in the year ahead. Likewise, flagging demand was curtailing the production of aircraft and inducing at least temporary cutbacks in auto assemblies. In addition, the foreign trade sector was not expected to add significantly to demands on the U.S. economy despite the decline in the foreign exchange value of the dollar. While the latter had fostered large increases in tourism from abroad in a number of areas and some domestic producers reportedly were gaining market share, recessions or weak expansion in major foreign trading nations were likely to limit the growth in foreign demand for U.S. goods.

The fiscal outlook remained uncertain. The large federal deficit was still tending to preclude the adoption of spending or tax reduction programs that would increase fiscal stimulus, but some members suggested that continued sluggishness in the economy might well overcome current inhibitions against new initiatives. In any event, defense spending was on a clear downtrend and was exerting an adverse effect on overall economic activity in many parts of the country. At the state and local government levels, severe fiscal problems probably would continue to curb spending and force many jurisdictions to raise taxes so long as a relatively weak economy continued to hold down revenues.

With regard to the outlook for inflation, the members were encouraged by the further indications of a disinflationary trend in

prices and wages, and they saw little likelihood that upward pressures on prices would emerge over the next year or two even in the context of some pickup in the expansion of economic activity. While medical, tuition, and some other costs were rising at relatively rapid rates, members cited widespread examples of very strong competitive pressures in markets for goods, including key agricultural products, and ongoing efforts by firms to cut costs in the face of steady or even declining prices in the markets for their products. Nonetheless, business contacts still seemed to anticipate rising inflation at some point for the economy generally if not in their own industries, and long-term interest rates still appeared to embody higher rates of inflation.

In the Committee's discussion of policy for the intermeeting period ahead, the members generally agreed that current uncertainties made an assessment of the economic outlook and the determination of an appropriate course for monetary policy particularly difficult. While the members' preferences for policy implementation ranged from the maintenance of unchanged reserve conditions to an immediate easing move, a majority indicated that they could support a policy prescription of maintaining unchanged reserve conditions for the present while biasing the directive strongly toward possible easing during the intermeeting period.

Members who favored an unchanged policy stance argued that despite the softness in a number of recent economic indicators they could see no currently persuasive evidence of a cumulative deterioration in the economy. Moreover, earlier monetary policy easing actions had provided a substantial amount of stimulus to the economy that would continue to exert its effects over time. Real short-term interest rates were at very low levels, and intermediate-term rates

had declined considerably since mid-year. The reductions in interest rates had greatly facilitated the progress already achieved by business firms and households in restructuring their debts and reducing their debt service burdens, thereby strengthening the financial underpinnings of the economy. The dollar recently had been subject to considerable volatility in the foreign exchange markets, and there was some risk that an easing of monetary policy at this time might tend to destabilize it. These members concluded that the present stance of monetary policy continued to reflect an appropriate balancing of the need to sustain progress toward price stability while encouraging an acceptable rate of economic growth.

Members who favored an immediate easing of policy believed that the outlook for the economy and prices argued for a policy move at this time. These members acknowledged that a good deal of uncertainty surrounded the economic outlook. However, there were some risks that an already sluggish economy might weaken further. In the circumstances, a prompt easing move would be a desirable and prudent course, particularly in a situation where they saw a minimal risk that inflation would be deflected from its downward trend. In the view of some of these members, continued expansion in the broad monetary aggregates at rates below the Committee's ranges suggested that financial conditions were not yet conducive to a pickup in business activity that was sufficiently robust to reduce margins of underutilized resources. An easing in monetary policy seemed to be widely anticipated in financial markets, and a failure to take action at this time might well result in an undesirable backup in market interest rates, thus further weakening the outlook.

A majority of the members noted that they could support an unchanged directive that included a decided presumption of some easing

if indications of stronger economic activity failed to emerge or the recent firming in money and credit flows showed signs of ebbing materially. It was anticipated that any decision to ease reserve conditions during this period would be coordinated with the consideration of a reduction in the discount rate by the Board of Governors. Two members felt strongly that a directive calling for unchanged reserve conditions should also provide for an unbiased intermeeting instruction. While such a directive would not rule out an intermeeting adjustment--in either direction--it would require more substantial evidence of changing or unexpected economic or financial information before a policy action was implemented. Several members, including some who favored an immediate easing of policy, expressed some discomfort about the extent to which the Committee might be seen as reacting to individual pieces of incoming data rather than to an accumulation of information and analysis regarding the course of the economy and prices.

In the course of the discussion, members commented that the pickup in the growth of the broad monetary aggregates in August and September was a reassuring development, even though the rates of expansion were still quite sluggish. According to a staff analysis prepared for this meeting, the growth of both aggregates was likely to remain quite limited over the balance of the year and to fall somewhat short of the lower bounds of the Committee's ranges for 1992 as a whole. Despite the lingering effects of earlier declines in short-term interest rates, the projected expansion of M2 and especially that of M3 would be expected to remain below the growth of nominal GDP, and the velocity of these monetary aggregates would continue to display unusual strength in comparison with past patterns. The persistence of slow growth in the broader aggregates probably would involve further

decreases in deposit offering rates and shifts of funds to higher yielding alternatives such as bond and stock mutual funds, with little effect on consumer spending or overall economic activity. The members nonetheless recognized the need to assure adequate monetary expansion for a growing economy and noted that money growth appreciably below current expectations would be a matter of increasing concern. A differing view focused on the growth of M1 and reserves, which had been very rapid since the latter months of 1991. In this view, the outsized growth in narrow measures of money was indicative of a quite stimulative monetary policy, but given the long lags that were involved, the inflationary consequences of such growth, if allowed to continue, might not become evident until much later, perhaps not until well into 1994.

At the conclusion of the Committee's discussion, a majority of the members indicated their acceptance of a directive that called for maintaining the existing degree of pressure on reserve positions and an understanding that there would be a marked bias toward possible easing during the intermeeting period. Two of the members expressed a strong preference for a symmetric directive with regard to possible intermeeting policy adjustments, while two others were firmly persuaded of the desirability of an immediate increase in reserve availability to strengthen the growth of M2. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, it was decided that slightly greater monetary restraint might be acceptable or slightly lesser monetary restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with growth in M2 and M3 at annual rates of

about 2 and 1 percent respectively over the three-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 suggests that economic activity is expanding at a subdued pace. Total nonfarm payroll employment declined somewhat further in September, but the civilian unemployment rate edged down to 7.5 percent. Industrial production is estimated to have declined appreciably since July. Real personal consumption expenditures appear to have risen moderately in the third quarter. Data on housing have been mixed, but on balance they continue to suggest a gradual uptrend in housing expenditures. Recent data on orders and shipments of nondefense capital goods indicate slower growth in outlays for business equipment, while expenditures for nonresidential construction have been weak. The nominal U.S. merchandise trade deficit widened somewhat in July from its average rate in the second quarter. Incoming data on wages and prices suggest that inflation is slowing.

Short-term interest rates have declined somewhat, while longer-term rates are about unchanged since the Committee meeting on August 18. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies fluctuated widely over the intermeeting period but ended the period higher on balance.

Expansion of M2 and M3 resumed in August, though at fairly slow rates, and limited growth appears to have continued in September. Through September both aggregates were estimated to have grown at rates somewhat below the lower ends of the ranges established by the Committee for the year.

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 on June 30-July 1 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 1991 to the fourth quarter of 1992. The Committee anticipated that developments contributing to unusual velocity increases could persist in the second half of the year. The monitoring range for growth of total domestic non-financial debt also was maintained at 4-1/2 to 8-1/2 percent for the year. For 1993, the Committee on a tentative basis set the same ranges as in 1992 for

growth of the monetary aggregates and debt measured from the fourth quarter of 1992 to the fourth quarter of 1993. 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. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 2 and 1 percent, respectively.

Votes for this action: Chairman Greenspan, Vice Chairman Corrigan, Messrs. Angell, Hoenig, Kelley, Mullins, Ms. Phillips, and Mr. Syron.

Votes against this action: Messrs. Jordan, LaWare, Lindsey, and Melzer.

Messrs. Jordan and Lindsey preferred immediate action by the Committee to increase the availability of bank reserves sufficiently to achieve the Committee's pre-announced target growth for M2 in 1992. Such reserve provision would likely be associated with further declines in short-term market interest rates. They believed that this policy action by the Committee should be accompanied by an announcement of reductions of the upper and lower limits of the range for M2 growth in 1993. They felt that it was important to make clear that near-term action to increase M2 expansion was not an abandonment of the long-term objective of non-inflationary monetary growth.

Messrs. LaWare and Melzer dissented because they did not want to bias the directive toward possible easing during the intermeeting period. In their view, a variety of indicators,

including the level of short-term interest rates and the growth of reserves, suggested that monetary policy already was positioned to foster an expansion in economic activity consistent with the economy's long-run potential. Moreover, further easing at this time would incur a substantial risk of destabilizing the dollar in the foreign exchange markets. In these circumstances, they favored a steady monetary policy that was not disposed to react to near-term weakness in economic data and that allowed more time for the effects of earlier easing actions to be felt in the economy. Mr. Melzer also expressed concern that the progress already made toward achieving price stability might be jeopardized if very rapid growth in M1 were to continue.