FEDERAL RESERVE press release

For Use at 4:30 p.m. December 22, 1989

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 14, 1989.

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

Attachment

RECORD OF POLICY ACTIONS OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting Held on November 14, 1989

Domestic policy directive

The information reviewed at this meeting suggested that the economy had continued to expand, though unevenly and at a somewhat slower pace than earlier in the year. While the service-producing sector appeared to be growing moderately, manufacturing had been weak, owing to sluggish demand and to strikes and other disruptions to production. Price increases had been smaller since midyear, but there had been no abatement of wage inflation.

Total nonfarm payroll employment increased appreciably in October, but its growth had been more moderate on balance over the past several months, especially in the private sector. Widespread job gains were apparent in the service-producing sector, but manufacturing payrolls declined further as a result of continued weakness in motor vehicles and other durable goods industries. In the public sector, hiring by state and local governments was robust in October and had contributed substantially to total employment growth over the past three months. The civilian unemployment rate remained within the narrow range around 5-1/4 percent that had prevailed since early 1989.

After three months of modest increases on balance, industrial production was depressed noticeably in October by strike activity and other disruptions; adjusted for these temporary influences, production was about unchanged. Output of consumer goods declined as the production of appliances and motor vehicles, particularly light trucks, fell sharply. Production of business equipment dropped substantially, reflecting the strike at a major aircraft manufacturer and the earthquake in northern California. Total industrial capacity utilization dropped in October, mostly because of the effects of temporary disruptions to production.

Retail sales fell appreciably in October from upward revised levels for August and September, as purchases of motor vehicles dropped sharply. Housing starts fell further in September, and the multifamily component registered its lowest level since mid-1982. For the third quarter as a whole, starts were about unchanged from their reduced second-quarter average.

Indicators of business capital spending continued to suggest that growth had moderated from its rapid pace in the first half of the year, primarily as a result of slower growth in outlays for information-processing equipment. Shipments of nondefense capital goods edged lower in September, and orders data suggested that equipment outlays would remain sluggish in coming months. Nonresidential construction activity also fell, largely owing to a decline in commercial structures other than office buildings, and construction permits continued the downtrend evident over the past few months. The sparse data available on business inventories for September indicated that manufacturers' stocks had declined somewhat in that month after a sizable gain on balance over the previous two months. At the wholesale level, inventories fell for a second straight month.

The nominal U.S. merchandise trade deficit increased in August to its highest level thus far this year, as the value of non-oil imports surged. For July and August combined, the value of imports--especially of consumer goods and machinery--was somewhat above the second-quarter level. The quantity of imports rose even more strongly over that two-month period as import prices declined on average. The value of exports in July-August was somewhat below the level in the second quarter; the quantity of exports rose appreciably, but the prices received fell. In most foreign industrial countries, indicators of economic activity suggested that the slower pace of the second quarter had continued in the third quarter. In Germany, however, industrial production had rebounded strongly from its second-quarter decline.

Producer prices for finished goods rose further in October, boosted by sizable jumps in the prices of a variety of food products. Excluding food and energy items, prices for finished goods were little changed. Consumer prices rose slightly in September after registering little change over the previous two months. Energy prices fell further, while a sharp increase in apparel prices contributed to a rebound in the prices of consumer goods. The latest data on labor compensation suggested no easing of labor cost pressures. Average hourly earnings jumped in October, although the year-over-year change remained within the range of recent experience. In the broader-based employment cost index, growth of wages and salaries continued to show a persistent updrift through the third quarter on a year-over-year basis in most industry and occupational groupings; growth of benefits had slowed but remained at a high rate mainly because of rising health insurance costs.

At its meeting on October 3, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that provided for giving particular weight to developments that might require some slight easing during the intermeeting period. The Committee agreed that slightly greater reserve restraint might be acceptable, or slightly lesser reserve restraint would be acceptable, in 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 contemplated reserve conditions were expected to be consistent with growth of M2 and M3 over the period from September through December at annual rates of about 6-1/2 percent and 4-1/2 percent respectively.

After the Committee meeting, open market operations were directed initially toward maintaining the existing degree of pressure on reserve positions. For a few days after the steep drop in stock prices on October 13, while financial markets remained highly sensitive and volatile, the Manager for Domestic Operations followed an accommodative approach in supplying reserves. Around the same time, a decision was made under the provisions of the October 3 directive to implement a slight easing of reserve conditions on a more permanent basis; a further slight easing was effectuated during the first part of November. These decisions were made in light of information that suggested some increase in the risk of a pronounced weakening in the growth of business activity. To reflect a decline in seasonal borrowing, several technical reductions also were made during the period in the assumed level of adjustment plus seasonal borrowing used in constructing the target paths for the provision of reserves, and actual borrowing fell from about $635 million in the first full maintenance period after the early October meeting to around $200 million in the week prior to this meeting. The federal funds rate declined from slightly above 9 percent at the time of the October meeting to around 8-1/2 percent more recently.

Most short- and intermediate-term interest rates fell by amounts comparable to the decline in the federal funds rate, though Treasury bill rates dropped by less as a result of disruptions and supply pressures associated in part with delays in debt-ceiling legislation. Yields on most bonds and fixed-rate mortgages also fell somewhat less than the federal funds rate. Rates on lower quality bonds rose appreciably, and stock prices were considerably lower on balance in this period. In the days following the October 13 break in stock prices, the Committee held a number of telephone conferences to assess developments in financial markets. At these and a subsequent consultation, the Committee also discussed the decisions to ease reserve conditions during the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly further on balance over the intermeeting period. During the first part of the period, the dollar had appreciated somewhat despite substantial intervention sales of dollars by central banks and increases in official interest rates in a number of major industrial countries. Following the drop in stock prices in mid-October, the dollar moved lower. Expectations of further increases in interest rates abroad and of lower rates in the United States apparently contributed to the dollar's decline.

Expansion of the monetary aggregates picked up in October. A surge in demand deposits in early October contributed to considerable strength in M1. The effects of this acceleration were offset to an extent by slower expansion of the retail-type components of M2, possibly reflecting the waning effects of earlier declines in market interest rates on the opportunity costs of holding liquid savings-type deposits included in M2. The faster growth of M3, while remaining well below that of M2, reflected an accelerated issuance of large-denomination CDs by banks to help finance substantially stronger expansion of bank credit. Runoffs of assets at capital-deficient thrift institutions and associated declines in RPs and large-denomination CDs continued to restrain growth of M3. For the period from the fourth quarter of 1988 through October, growth of M2 was within the lower half of the Committee's annual range, while expansion of M3 was near the lower end of its range.

The staff projection prepared for this meeting suggested that the economy was likely to grow at a slower pace over the next several quarters. The outlook for the near term was clouded by uncertainties associated with the effects of a major hurricane, a severe earthquake, and a strike at a large manufacturer of aircraft. On balance, those developments were projected to curb overall growth somewhat in the current quarter but to provide a temporary boost in the first quarter of next year. The projection assumed that the budget deficit would decline moderately and that net exports would make little contribution to domestic growth in 1990. Consumer demand was expected to buoy the near-term expansion of the economy, reflecting the strong growth of the real income of consumers in recent months and indications of a continued high level of consumer confidence. Over the rest of the projection period, however, steadily mounting slack in labor markets was expected to exert a restraining effect on consumer demand. The projection continued to indicate substantial slackening in the expansion of business capital spending from the pace in the first half of this year. With pressures on labor and other production resources expected to ease only marginally, little improvement was anticipated in the underlying trend of inflation over the next several quarters.

In the Committee's discussion of the economic situation and outlook, members commented that broad economic indicators and local conditions in different parts of the country pointed on balance to a sustained expansion in business activity, though at a somewhat slower pace than in recent quarters. Views differed to some extent regarding the risks of a different outcome, reflecting uncertainties concerning developments in key sectors of the economy such as business investment and net exports and in the demand for housing and consumer durables, notably motor vehicles. While some members regarded those risks as about evenly balanced in both directions, a number stressed that a period of minimal growth or even a downturn in activity could not be ruled out; others saw greater odds that the rate of economic growth and levels of resource utilization might be closer to the economy's potential. With regard to the outlook for inflation, several members observed that the prospects for significant progress were limited for the next several quarters, especially in light of the tendency for increases in labor costs to remain in a relatively high range. Other members expressed greater confidence that appreciable progress would be made, partly in the context of reduced growth in economic activity.

In their discussion of specific developments relating to the outlook for overall business activity, members noted that economic conditions had softened in some parts of the country, with manufacturing tending to weaken more generally, particularly in the automotive and automotive-related sectors. Many business contacts appeared to be less optimistic about prospects for sales and more cautious about investment decisions. Real estate markets and nonresidential construction ranged from quite weak to moderately strong in different sections of the country. On balance, local business conditions were characterized by steady activity or slow growth in many regions to continued fairly vigorous expansion in some others.

With regard to broad indicators of economic performance, members cited the continuing weakness but absence of further deterioration in new orders. Order backlogs, while below earlier highs, appeared consistent with sustained production. From a different perspective, it was noted that commodity prices remained high and did not suggest a slowdown in economic activity. Business investment was an area of major uncertainty in the economic outlook. Developments that could have adverse implications for investment included a squeeze on profit margins from rising costs, both interest and labor expenses, on the one hand and from competitive pressures that restrained price increases on the other. On the foreign side, the earlier appreciation of the dollar had arrested the improvement in the nation's trade balance, but further gains still might be forthcoming at current dollar levels, given expectations of relatively strong growth in business activity in foreign industrial countries. Such a development would have favorable implications for the manufacturing sector and for the domestic expansion more generally.

Views on the outlook for inflation differed to some extent, depending in part on somewhat varying expectations with regard to the level of business activity and associated pressures on production resources. Several members continued to expect that, in light of the behavior of labor costs, little or no progress would be made in reducing inflation over the quarters ahead, even assuming relatively slow growth in business activity. Labor markets might be softening in some areas, but data on labor compensation showed no changes from earlier trends, and some members remained concerned that underlying demand conditions would be associated with persisting upward pressures on labor costs. Other members were more optimistic. They noted that the behavior of prices had been better than might have been anticipated in recent quarters, apparently reflecting a variety of factors that were tending to arrest the momentum of inflation, including ongoing efforts to hold down costs in the context of strong competition in international and domestic markets.

In the Committee's discussion of policy for the weeks immediately ahead, nearly all of the members supported a proposal to maintain unchanged conditions of reserve availability. A majority favored and the others could accept a related suggestion to retain the current asymmetry toward ease that had been incorporated in recent directives. While current indicators of economic activity suggested a somewhat weaker expansion, most of the members agreed that a steady policy course was desirable at this point, especially in light of the stimulus provided by recent easing actions, whose effects on the economy would be felt only with some lag. In reconciling concerns about a cumulative weakening in the economy against a desire for progress in the fight against inflation, a steady policy seemed to give reasonable prospects for achieving both sustained expansion and declining inflation. Some members commented that these objectives could be attained with less pressure in credit markets if the federal budget deficit were to turn more definitely downward.

In the course of the Committee's discussion, a number of members observed that, as a result of the pickup in M2 over the course of the past several months, growth of the monetary aggregates seemed consistent with the Committee's long-run goals, and thus money growth did not in itself suggest the need for any current adjustment in reserve conditions. According to a staff analysis prepared for this meeting, growth of M2 was likely to remain relatively brisk, assuming unchanged reserve conditions and steady interest rates. Growth of this aggregate would be buoyed by the further decline that had occurred recently in market interest rates and in the related opportunity costs of holding M2 balances, and for the year as a whole M2 was likely to expand at a rate just below the midpoint of the Committee's range for 1989. M3 was projected to continue to grow at a slower pace than M2, reflecting the ongoing though waning effects on some M3 components of the disposition of assets by undercapitalized thrift institutions and the funding made available through RTC resolutions; for the year, the growth of M3 was projected to be somewhat above the lower bound of the Committee's range.

Turning to the instruction in the directive relating to possible adjustments in the degree of reserve pressure during the intermeeting period, a majority of the members expressed a preference for retaining the existing asymmetry that would permit any adjustments to be made more readily toward easing than toward firming. In this view, current tendencies toward weakening in the economy outweighed the sources of strength, and some further easing might be needed if the incoming information on business activity suggested more softening than most members currently expected. In these circumstances, an easing would be consistent with the Committee's long-run inflation objective. Other members, who saw the risks to the expansion as more evenly balanced, indicated a preference for a symmetric instruction in the directive; however, they could accept retention of the bias toward ease contained in the October 3 directive. Some of these members nonetheless stressed the desirability of not overreacting to possible indications of slower economic growth in the period ahead for fear of creating financial conditions and stimulating monetary growth that would prove to be inconsistent with the Committee's long-run goal of price stability. In light of these considerations and in the context of the recent easing actions, the members generally endorsed or found acceptable a proposal to approach with caution any further easing in the weeks ahead.

At the conclusion of the Committee's discussion, all but one of the members indicated that they preferred or could accept a directive that called for maintaining the existing degree of pressure on reserve positions and that provided for giving greater weight to developments that might require some slight easing during the intermeeting period. Accordingly, slightly greater reserve restraint might be acceptable during the intermeeting period, while some slight easing of 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 by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 7-1/2 percent and 4-1/2 percent respectively over the three-month period from September to December. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was left unchanged at 7 to 11 percent.

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

> The information reviewed at this meeting suggests continuing expansion in economic activity, though at a somewhat slower pace than earlier in the year. Total nonfarm payroll employment increased appreciably in October, but on balance its growth has been more moderate over the past several months, especially in the private sector. The civilian unemployment rate has remained around 5-1/4 percent. Strike activity and other disruptions depressed industrial production noticeably in October. Retail sales fell appreciably in October, reflecting a sharp drop in purchases of motor vehicles, but some upward revisions were made for August and September. Housing starts fell further in September and for the third quarter as a whole were about unchanged from their reduced second-quarter average. Indicators of business capital spending suggest slower growth after a substantial increase in the first half of the year. The nominal U.S. merchandise trade deficit widened in August from its July

rate as non-oil imports increased markedly. Consumer prices have risen more slowly on balance since midyear, partly reflecting sharp reductions in energy prices, but the latest data on labor compensation suggest no significant change in prevailing trends.

Most interest rates have declined appreciably since the Committee meeting on October 3. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly on balance over the intermeeting period.

M2 continued to grow fairly briskly in October, largely reflecting strength in its M1 and other liquid components; thus far this year M2 has expanded at a pace somewhat below the midpoint of the Committee's annual range. Growth of M3 picked up in October but has remained much more restrained than that of M2, as assets of thrift institutions and their associated funding needs apparently continued to contract; for the year to date, M3 has grown at a rate around the lower bound of the Committee's annual range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 3 to 7 percent and 3-1/2 to 7-1/2 percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 6-1/2 to 10-1/2 percent for the year. For 1990, on a tentative basis, the Committee agreed in July to use the same ranges as in 1989 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of 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, 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 7-1/2 and 4-1/2 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 7 to 11 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Johnson, Keehn, Kelley, LaWare, Melzer, and Syron. Vote against this action: Ms. Seger.

Ms. Seger dissented because she felt that a further easing of monetary policy was needed at this time. In her view, the persisting weakness in the manufacturing sector, most notably in motor vehicles, along with a likely softening in construction activity and capital expenditures posed a substantial risk to the economy. In these circumstances, a moderate easing of policy could help forestall a slide into recession in the months ahead without adding to inflationary pressures.