

# FEDERAL RESERVE press release



For Use at 4:30 p.m.

December 21, 1990

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 13, 1990.

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 13, 1990

Domestic policy directive

The information reviewed at this meeting suggested that economic activity was weakening in the fourth quarter. A substantial decline in real disposable income and falling consumer confidence pointed to some softening in consumer demand, and advance indicators of business capital spending signaled considerable sluggishness in investment expenditures. At the same time, businesses appeared to be keeping a tight rein on their inventories, partly through recent sharp cuts in output. Industrial production had turned down after rising moderately during the summer, and recent declines in nonfarm payroll employment and average workweeks indicated some emerging slack in labor markets. Broad measures of prices continued to be boosted by the surge in energy prices, but the trend in labor costs appeared to have improved slightly.

Total nonfarm payroll employment declined further in October. Job losses were widespread across industries but were particularly notable in the manufacturing and construction sectors. Employment also contracted at wholesale and retail trade establishments for the third straight month. In October, the civilian unemployment rate held steady at 5.7 percent while initial claims for unemployment insurance rose steeply.

After rising moderately during the summer, industrial production declined substantially in October. Part of the drop reflected a slower pace of motor-vehicle assemblies; however, reductions

in output were widespread in other industries as well, especially in those producing non-auto consumer goods and construction supplies. Total industrial capacity utilization fell in October after edging up on balance in the previous two quarters.

Consumer spending was estimated to have leveled out in real terms over August and September, when a surge in energy prices caused a substantial drop in real disposable income. Nevertheless, over the third quarter as a whole, the pace of spending was substantially higher than in the previous quarter. Major surveys of consumer attitudes continued to indicate a sharp deterioration in consumer confidence. Total private housing starts edged lower in September; sales of new and existing homes continued to weaken, and the vacancy rate for rental apartments persisted at a high level.

Shipments of nondefense capital goods rose on balance over the August-September period; the gain resulted in part from increases for office and computing equipment. New orders for business equipment pointed to a considerable softening in spending for such goods in coming months. Nonresidential construction activity fell appreciably in August and September, retracing the increases recorded in the two previous months. Persisting high vacancy rates for commercial properties in many areas, financial pressures on builders and their lenders, and the downward trend in construction permits and contracts suggested that nonresidential building activity would remain sluggish. Manufacturing inventories posted only modest increases over the August-September period, and the ratio of stocks to shipments edged lower. At the retail level, non-auto inventories changed little on balance over July and

August, and inventory-sales ratios remained within the range that had prevailed for an extended period.

The nominal U.S. merchandise trade deficit widened slightly in August from the revised July rate; for the two months combined, the deficit was substantially higher than its average rate for the second quarter. In August, a sharp increase in the price of imported oil was only partly offset by a decline in the quantity imported; the value of non-oil imports was little changed from the elevated July level. Exports picked up somewhat in August but remained within the range recorded in the first half of the year. The performance of the major foreign industrial economies had been mixed. In Western Germany and Japan, the pace of economic activity remained robust in the third quarter, and growth in France picked up after a weak second quarter. In Canada and the United Kingdom, by contrast, economic activity appeared to be declining. Measures of consumer price inflation had risen for almost all of the major industrial countries, reflecting mainly the effects of higher energy prices.

Producer prices of finished goods rose sharply in October, boosted for the third consecutive month by the effects of higher oil prices; food prices also advanced and reversed their September decline. Producer prices of non-energy, nonfood finished goods increased in September and October at about the moderate average pace evident in previous months of the year. At earlier stages of processing, the prices of metals and some raw materials had fallen considerably, despite the depreciation of the dollar on foreign exchange markets. Higher oil prices continued to push up consumer prices, which rose in September at

the elevated August rate. Excluding energy and food items, consumer inflation slowed a little in September, but the rate of increase over the first nine months of the year was appreciably above the pace during 1989. The growth in total compensation costs for private industry workers decelerated in the third quarter, reflecting smaller gains in wages and salaries. Measured on a year-over-year basis, twelve-month changes in total labor compensation had fallen a bit below the rates recorded earlier in the year, when increases in payroll taxes and the minimum wage exerted their initial effect on labor costs. Average annual earnings of production or nonsupervisory workers were unchanged in October.

At its meeting on October 2, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions for at least a short period after the meeting. It was presumed that some slight easing would be implemented later in the intermeeting period, assuming passage of a federal budget resolution calling for a degree of fiscal restraint comparable to that under consideration at the time of the meeting and the absence of major unexpected economic or financial developments. After such an easing, the directive provided that slightly greater reserve restraint might be acceptable during the remainder of the intermeeting period or somewhat lesser reserve restraint would be acceptable depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth

of M2 and M3 at annual rates of about 4 and 2 percent respectively over the period from September through December.

After the Committee meeting, open market operations were directed initially at maintaining unchanged reserve conditions. In late October, against the background of a weakening economy and in light of the conclusion of a budget agreement involving large reductions in the federal deficit over the next several years, pressures on reserve conditions were eased slightly. Over the course of the intermeeting period, several technical adjustments also were made to assumed levels of adjustment plus seasonal borrowing to reflect the declines in seasonal borrowing activity that typically occur during the autumn. Adjustment plus seasonal borrowing fell from about \$500 million in the reserve maintenance period completed immediately after the October meeting to an average of roughly \$250 million thus far in the maintenance period ending the day after this meeting. In the context of more cautious reserve management policies at some banks and some carryover of end-of-quarter pressures, the federal funds rate generally remained near 8-1/4 percent in the early part of the intermeeting period. Subsequently, as end-of-quarter pressures receded, the funds rate edged down to 8 percent; late in the period, after the slight easing of reserve conditions, the funds rate slipped further to 7-3/4 percent or a bit below. Most other market interest rates also declined over the intermeeting period; however, the reductions tended to be greater for Treasury than for private issues, reflecting increased demand for high-grade assets by investors concerned about credit quality. Yields on Treasury bonds rose appreciably shortly after the

October meeting when a budget accord initially failed to receive congressional approval; they more than retraced these increases as prospects for fiscal restraint grew brighter, clearer signs of a softer economy emerged, and investors sought higher quality investments.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined considerably further over the intermeeting period. The long budget stalemate, indications of additional weakness in the U.S. economy, concerns about the U.S. financial system, and associated expectations of an easing in U.S. monetary policy contributed to the drop in the dollar. The decline was intensified by signs that monetary policy remained restrictive in Japan and might tighten in Germany.

In October, M2 grew only slightly after two months of relatively rapid expansion, while M3 was about unchanged. The sluggishness of M2 in October owed partly to a contraction in its transactions and liquid savings components. The managed-liability components of M3 also were weak, reflecting restrained asset growth at banks and stepped-up thrift resolution activity around the end of the quarter. Through October, expansion of M2 was estimated to be somewhat below the middle of the Committee's range for the year and growth of M3 near the lower end of its range. The expansion of total domestic nonfinancial debt appeared to have been near the midpoint of its monitoring range.

The staff projection was prepared against the background of continuing uncertainties associated with the situation in the Persian Gulf region. The staff continued to assume that no major further

disruption to world oil supplies would occur and that oil prices would drop appreciably in the first half of next year. The staff also assumed continuing constraints on the supply of credit, reflected in tighter terms and reduced availability, in response to perceptions of increased credit risks in a relatively weak economy and the problems facing many financial intermediaries. In the near term, higher energy costs would damp real disposable income and consumer spending, and reduced credit availability would be among the factors restraining outlays for business equipment and spending for residential and nonresidential construction. In these circumstances, a mild downturn in overall activity was projected for the near term, but growth was expected to resume during the first half of 1991, aided in part by the assumed decline in oil prices. The staff anticipated that exports would grow relatively rapidly over the next several quarters in association with continued expansion on average in the economies of major foreign industrial nations and the increased international competitiveness of U.S. goods owing to the dollar's depreciation over the past year. As business sales and orders improved, production could be expected to pick up and business investment outlays to rise. The outlook for inflation remained clouded by the uncertainties regarding oil prices, but given the assumption of a sizable decline in the latter and some increased slack in resource utilization, the staff projected a slower rise in prices and labor costs.

In the Committee's discussion of the economic situation and outlook, members focused on the growing indications of a softening economy. Some key measures of business conditions suggested a decline



in the economy, and business and consumer sentiment appeared to have deteriorated appreciably; however, the available data on recent developments were still limited, particularly with respect to consumer and business capital spending, and as a consequence were still inconclusive. Moreover, some developments that typically can contribute to a recession, such as a substantial buildup in inventories, did not seem to be a factor in the current economic situation. Assuming lower oil prices in the months ahead and given the outlook for further strength in exports stemming especially from the substantial decline that had occurred in the foreign exchange value of the dollar, a relatively mild downturn followed by a limited rebound next year was viewed as a reasonable expectation.

Many of the members noted that, while the most likely outcome was a relatively mild and brief downturn, there were risks of a more severe or prolonged contraction in economic activity. The substantial decline that had occurred in business and consumer confidence likely reflected not only the course of events in the Middle East, but perhaps also uncertainty about developments in that area and their implications for oil prices. A cutback in spending that more fully reflected these attitudes could be greater than currently appeared to be underway. Another source of risks that also could be contributing to the decline in confidence was the state of the financial system, including concerns about the condition of many financial institutions, a curtailed supply of credit to many borrowers, and more generally a widespread perception of relatively fragile financial conditions. Bank loan officers appeared to be reacting increasingly to what they perceived as rising credit

risks in a softening economy; their incentives to restrict their lending were strengthened by concerns about the capital positions of their own banks and the possibility that their institutions could face a reduced availability or higher cost of funds. To an important extent, banker attitudes were being influenced by developments in the real estate markets; further, or more widespread, weakening in those markets would add to problem loans in bank portfolios and could foster further cutbacks in bank lending activity more generally. Financial institutions other than banks also were experiencing funding and other difficulties, raising concerns that they might become less willing suppliers of credit. For now, growth in credit and related expansion in money were sluggish but did not seem to be collapsing. Nonetheless, members remained concerned that supplies of credit might prove inadequate to the needs of many qualified borrowers, thereby deepening any downturn and impeding a satisfactory rebound in economic activity.

Members continued to report uneven conditions in different parts of the country and sectors of the economy, but signs of some weakening in business activity were increasing in most areas. Moreover, in keeping with broad survey results, contacts indicated that business and consumer confidence had deteriorated in virtually all parts of the country, including areas that were experiencing at least modest growth in overall business activity. At the same time, conditions were reported to be generally favorable in agriculture, export demands were growing, and on the whole business inventories were indicated to be close to desired levels, at least given current levels of demand.

Members noted that the adverse effects of sharply higher oil prices on disposable incomes and consumer sentiment appeared among other developments to have arrested the growth in real consumer spending in recent months; retail sales, notably of automobiles and other durables, were expected to remain weak and possibly decline over the next several months, although the prospective increase in federal excise taxes on certain luxury items might well boost sales of such goods through year-end at the expense of sales early next year. Members agreed that in the absence of further disturbances in oil markets, growth in real consumer spending could be expected to resume, especially if oil prices were to decline; indeed, such growth was likely to provide a major impetus for some strengthening in the economy next year. Net exports also appeared to be positioned to contribute to expanding business activity as a result of the substantial declines that had occurred in the foreign exchange value of the dollar and sustained expansion in a number of major foreign industrial countries. Business contacts reported that demands from abroad were continuing to buttress manufacturing activity in many areas, although there were indications of some slippage in such demands from some countries. The prospects for business investment remained less promising for a number of reasons, including the uncertain outlook for sales and profits and the weakness in commercial construction associated with earlier overexpansion. With regard to the outlook for fiscal policy, the difficult and extended process of securing the recent budget agreement and the still massive deficits projected for the nearer term appeared to have had an adverse effect at least temporarily on attitudes, and perhaps as a consequence financial markets had not yet

fully recognized the appreciable degree of enforceable restraint that was built into that agreement.

Turning to the outlook for inflation, members referred to accumulating indications that the core rate of inflation, excluding the discernible effects of the surge in energy prices, might have stabilized. There were signs of diminished wage pressures in the aggregate data and the latter were confirmed by reports from several parts of the country. In the context of reduced pressures on productive resources, it now seemed more likely that the effects of higher oil and import prices would not be built into the general price and wage structure. Nonetheless, members cautioned that an extended period probably would be needed before substantial progress was achieved in reducing inflation, given the strength of inflationary expectations.

In the Committee's discussion of policy for the intermeeting period ahead, all of the members indicated that they favored or could support a proposal calling for some slight immediate easing of reserve conditions; one member expressed a preference for somewhat greater easing while another saw advantages in delaying the easing move. The growing signs of a softening economy, the related vulnerability of many business and financial firms to added financial strains, and the increased reluctance of institutional lenders to accommodate less than prime business borrowers suggested that the Committee should remain especially alert during the weeks ahead to signals that some further easing was appropriate. The lack of significant monetary growth over the course of recent months also was seen as pointing in the same direction. However, the weakness in the economy reflected in part an

external shock whose effects could not be entirely offset without exacerbating a still substantial inflation, and the dollar had been under considerable downward pressure in the foreign exchange markets. In this situation, any easing needed to be approached with caution. While there were some differences in emphasis, the members agreed that a limited degree of easing at this juncture would provide some insurance against a deep and prolonged recession without incurring a substantial risk in current circumstances of fostering intensified inflationary pressures.

In their discussion, members took account of a staff analysis that pointed to weaker monetary growth in the current quarter than had been anticipated at the time of the previous meeting. The slower expansion in M2 and M3 appeared to reflect the tightening supply of credit through depository institutions and the associated damping of asset expansion and funding needs at those institutions. In addition, slower projected growth in nominal GNP in the current quarter implied reduced demands for money and credit. Some members commented that the projected expansion of both M2 and M3 within the Committee's ranges for the year suggested that monetary policy on balance had been on an appropriate course. However, the recent weakness in monetary growth was becoming a matter of increasing concern and was an important consideration for some members in their support of some easing of reserve conditions.

In regard to possible intermeeting adjustments in the degree of reserve pressure, most of the members indicated a preference for retaining the current bias in the directive toward potential easing. In

support of this view, it was noted that in prevailing circumstances an intermeeting move, if any, was more likely to be toward some easing than the reverse. A few members questioned, however, whether such a bias was desirable in light of the slight easing that the members already contemplated, especially since any additional move would represent the third easing action by the Committee in a relatively short period. In the circumstances, it was understood that a tilt toward ease in the directive would not imply any commitment to a second easing action during the intermeeting period; in particular, the potential desirability of any additional easing would need to be assessed in the light of market reactions to the initial action, especially the behavior of the dollar in the foreign exchange markets.

At the conclusion of the Committee's discussion, all of the members indicated their acceptance of a directive that called for a slight reduction in the degree of pressure on reserve positions. The directive also called for giving weight to potential developments that might require some slight further easing during the intermeeting period. Accordingly, slightly greater reserve restraint might be acceptable during the intermeeting period or somewhat lesser reserve restraint would be acceptable depending on progress towards price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets.

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 a weakening in economic activity. Total nonfarm payroll employment declined further in October,

reflecting sizable job losses in manufacturing and construction; the civilian unemployment rate held steady at 5.7 percent. Industrial production declined sharply in October after rising moderately during the summer. Consumer spending is estimated to have flattened out in real terms over August and September when a surge in energy prices caused a substantial drop in real disposable income. Advance indicators of business capital spending point to considerable softening in investment in coming months. Residential construction weakened further in the third quarter. The nominal U.S. merchandise trade deficit widened substantially in July-August from its average rate in the second quarter as imports strengthened. Markedly higher oil prices have boosted consumer and producer prices in recent months. The latest data on labor costs suggest some slight improvement from earlier trends.

Most interest rates have fallen somewhat since the Committee meeting on October 2. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined considerably further over the intermeeting period.

In October, M2 grew only slightly after two months of relatively rapid expansion, while M3 was about unchanged. Through October, expansion of M2 was estimated to be somewhat below the middle of the Committee's range for the year and growth of M3 near the lower end of its range. Expansion of total domestic nonfinancial debt appears to have been near the midpoint of its monitoring 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 range it had established in February for M2 growth of 3 to 7 percent, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The Committee in July also retained the monitoring range of 5 to 9 percent for the year that it had set for growth of total domestic nonfinancial debt. With regard to M3, the Committee recognized that the on-going restructuring of thrift depository institutions had depressed its growth relative to spending and total credit more than anticipated. Taking account of the unexpectedly strong M3 velocity, the Committee decided in July to reduce the 1990 range to 1 to 5

percent. For 1991, the Committee agreed on provisional ranges for monetary growth, measured from the fourth quarter of 1990 to the fourth quarter of 1991, of 2-1/2 to 6-1/2 percent for M2 and 1 to 5 percent for M3. The Committee tentatively set the associated monitoring range for growth of total domestic non-financial debt at 4-1/2 to 8-1/2 percent for 1991. 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 slightly 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 somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of both M2 and M3 over the period from September through December at annual rates of about 1 to 2 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Hoskins, Kelley, LaWare, Mullins, Ms. Seger, and Mr. Stern. Votes against this action: None.

At this meeting, the Committee reviewed its practice of including a sentence in the operational paragraph of the directive that referred to the possibility of a Committee consultation to be called at the Chairman's discretion during an intermeeting period in the event that the federal funds rate fluctuated persistently outside a relatively wide range. That range had been set at 4 percentage points for many years and was a legacy of now outdated operating procedures that had been in place in the early 1980's. The members agreed that under current procedures the directive sentence in question served no real purpose, at least in its present form, in terms of providing guidance for holding intermeeting consultations. Such consultations are based on



understandings that vary over time, depending on surrounding circumstances. Accordingly, all of the members favored or found acceptable a proposal calling for deletion of the sentence. The members noted that the deletion would have no implications for the implementation of monetary policy or for the Committee's understandings or procedures with respect to what reserve market, financial, or economic conditions would call for consultations between meetings.

At the conclusion of this discussion, the members voted to delete the sentence incorporating the federal funds range from the operational paragraph.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Hoskins, Kelley, LaWare, Mullins, Ms. Seger, and Mr. Stern. Votes against this action: None.