

# 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 December 17, 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 December 17, 1991

Domestic policy directive

The information reviewed at this meeting indicated that the economy was sluggish and that business and consumer confidence remained depressed. Spending for housing and business equipment had been rising, but consumption expenditures had softened, commercial construction activity was still declining, and government spending at all levels was being restrained by budgetary imbalances. Recently, industrial production had fallen, and payroll employment had dropped sharply. Wage and price increases had continued to trend downward.

Total nonfarm payroll employment fell sharply in November after rising somewhat in the third quarter and changing little in October. Declines in employment were widespread: the number of manufacturing jobs decreased in November for a third straight month, and further job losses were reported in construction and in wholesale and retail trade. However, the average weekly hours worked by production or nonsupervisory workers in the private nonfarm sector edged up in November, and the civilian unemployment rate remained at 6.8 percent.

Industrial production fell appreciably in November after changing little in the previous three months. A portion of the November decline reflected a sizable drop in the output of motor vehicles and parts. In addition, however, the production of non-auto consumer goods slackened, and the output of business equipment other than motor vehicles remained near its low of last March; the latter reflected in part the persisting effects of a strike at a major producer of industrial equipment. As in most earlier months of the

year, the production of defense and space products declined. With industrial output down in November, total industrial capacity utilization decreased, and declines in operating rates were widespread across industries.

Real consumer spending had been soft on balance in recent months, reflecting sluggish growth in disposable incomes, weak labor-market conditions, and depressed consumer confidence. Nominal retail sales expanded somewhat in November from a downward revised level for October. The November increase reflected a rebound in sales of nondurable goods other than food and a rise in sales at automotive dealers; sales of durable goods other than autos were about unchanged. Housing starts fell in November, retracing part of a substantial advance in October; on average, starts were appreciably higher in October and November than in the third quarter. Despite low mortgage interest rates and steady house prices, sales of single-family homes in October remained well below their spring levels.

After changing little over the third quarter, shipments of nondefense capital goods registered a sharp rise in October, reflecting a bulge in outlays for computing equipment; shipments of most other types of business equipment remained sluggish. Recent data on orders suggested little growth in aggregate outlays for business equipment over the near term. Nonresidential construction, notably of office and other commercial structures, continued to shrink in October. The vacancy rate for office buildings was still very high, and this along with available information on contracts and commitments suggested that nonresidential construction activity would remain weak for an extended period.

Business inventories turned up sharply in September after many months of liquidation. At the retail level, inventories rose

further in October, with nearly half of the buildup occurring at auto dealers. The additional rise in stocks coupled with declines in sales led to higher inventory-to-sales ratios at many types of retail establishments. Aggregated over all retail establishments other than auto dealers, the ratio of inventories to sales in October was close to the peak posted in early 1991. By contrast, in manufacturing, stocks changed little in October, and the ratio of stocks to sales decreased and nearly reached its low of August 1990. Wholesale inventories were up slightly in October after a sizable decline in the previous month; the inventory-to-sales ratio remained in the narrow range that had prevailed in recent months.

The nominal U.S. merchandise trade deficit widened slightly further in September. For the third quarter, the deficit was somewhat above its average rate over the first half of 1991 but well below its rate in 1990. The value of exports in the third quarter remained close to the record high reached in the second quarter while the value of imports increased appreciably, with most of the rise reflecting larger imports of automotive products and consumer goods. The increase in imports of consumer goods appeared to have contributed to the substantial buildup in retail inventories in the United States, particularly in the month of September. The available data on economic activity in the major foreign industrial countries provided further evidence of relatively weak growth on balance in these countries in the third quarter and gave few indications of a revival in the fourth quarter. The trend toward reduced inflation had continued in most of the industrial countries.

Producer prices of finished goods advanced in November at about the slow pace recorded since midyear; over this period, declines in food prices roughly offset increases in energy prices. At the

consumer level, food and energy prices jumped in November, but the increase in the prices of nonfood, non-energy items was about the same as that registered since midyear and considerably below the 1990 pace. Average hourly earnings of production or nonsupervisory workers in the October-November period increased at about the reduced third-quarter rate; over the past twelve months, average hourly earnings had risen more slowly than in the previous twelve-month period.

At its meeting on November 5, 1991, the Committee adopted a directive that called for an immediate slight easing in the degree of pressure on reserve positions and that provided for giving special weight to potential developments that might require some additional easing during the intermeeting period. Accordingly, the directive indicated 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 under this directive were expected to be consistent with growth of M2 and M3 at annual rates of around 3 percent and 1 percent respectively over the three-month period from September through December.

Immediately following the November meeting, open market operations were directed toward a slight easing of conditions in reserve markets; this step was taken in conjunction with the reduction in the discount rate from 5 to 4-1/2 percent approved by the Board of Governors on November 6. In early December, as economic indicators continued to point to a faltering recovery and growth of the broad monetary aggregates remained sluggish, an additional slight easing of reserve conditions was carried out. Several technical reductions were

made during the intermeeting period to expected levels of adjustment plus seasonal borrowing to reflect the declining usage of seasonal credit during the autumn. For most of the intermeeting interval, adjustment plus seasonal borrowing tended to run a little below expected levels, averaging slightly more than \$100 million over the three complete reserve maintenance periods. The federal funds rate averaged around 4-3/4 percent over most of the period but softened to around 4-1/2 percent after the second easing action.

Other short-term interest rates declined more than the federal funds rate as market participants reacted to actual and anticipated further easing steps amid growing evidence that the economic recovery had stalled. Expectations of more subdued economic activity contributed to declines in yields on longer-term instruments as well. Yields on intermediate maturity securities dropped almost as much as short-term rates while rates on mortgages, corporate bonds, and long-term Treasuries fell by less. The prime rate was reduced by 1/2 percentage point to 7-1/2 percent early in the intermeeting period. Broad stock price indexes were down slightly.

The trade-weighted value of the dollar in terms of the other G-10 currencies declined further on balance over the intermeeting period. During most of the period, signs of weakness in the U.S. economy and the easings of U.S. monetary policy had a depressing effect on the value of the dollar. The dollar's depreciation was primarily against the mark and other European currencies; the mark was supported by reports of further increases in wage and price inflation in Germany and associated expectations that German monetary policy would be tightened. The dollar declined less against the Japanese yen as evidence accumulated that the Japanese economy was slowing further and some easing was implemented in Japanese monetary policy.

Expansion in M2 picked up in November from a slow pace in October. At least in part this reflected the cumulative effect of earlier declines in short-term market interest rates in lowering the opportunity costs of holding liquid deposits. The somewhat faster expansion of M2 was consistent with the Committee's expectations for M2 growth in the fourth quarter. The more rapid growth of M2 showed through to a limited extent to M3. For the year through November, expansion of both M2 and M3 was estimated to have been at the lower ends of the Committee's annual ranges.

The staff projection prepared for this meeting pointed to a recovery in economic activity. However, a variety of incoming information, notably indications of a depressed state of confidence, weaker than expected consumer spending, and sluggish industrial production suggested a pause in the recovery that might extend into early 1992. By the spring, the cumulative effects of declines in interest rates in recent months would contribute to a resumption of economic growth at a moderate rate, with the risks of a stronger or weaker trajectory for the economy being viewed as about in balance. Increases in residential construction, somewhat larger consumption expenditures, and some pickup in business equipment spending were projected to provide the underpinnings for the resumption of growth. As in earlier forecasts, the continuing downtrend in commercial construction and ongoing adjustments in state and local government spending in response to budget imbalances were expected to have a retarding effect on aggregate demand. At the federal level, projected declines in defense outlays, which would be only partially offset by higher nondefense spending, also would be a source of restraint, at least in the absence of new fiscal initiatives. The substantial though diminishing slack expected in labor and product markets in

coming quarters was projected to induce further declines in the underlying rate of inflation.

In the Committee's discussion of current and prospective economic developments, the members focused on an evident pause in the business recovery and its interaction with very gloomy business and consumer sentiment. A number of factors that had been expected to damp the expansion--including the retrenchment associated with the rebuilding of balance sheets by heavily indebted businesses and consumers and the efforts of many firms to improve efficiency by streamlining operations and reducing employment--had in fact proved to be stronger and more persistent than anticipated. The timing of a renewed expansion in business activity was uncertain, and a number of members commented that the economy might well remain quite sluggish over the months immediately ahead. Nonetheless, considerable progress in business and financial restructuring activities was in train, and the latter together with the stimulus that could be expected from the lagged effects of earlier monetary policy easing actions was likely to lead to a moderate pickup in the economy later in 1992. With regard to the outlook for inflation, many members observed that the statistical and anecdotal evidence pointed to faster progress toward price stability than they had anticipated earlier.

As they had at earlier meetings, the members gave considerable emphasis to current business and consumer sentiment, which they judged to be much more negative than under similar business and employment conditions in the past. The underlying reasons were difficult to ascertain but probably reflected a variety of developments including widespread disappointment over the pace of the economic recovery, related consumer concerns about employment opportunities, and fears associated with heavy debt burdens and the



weakened financial condition of many business and financial institutions. The size of the federal budget deficit was adding to those concerns, and the budgetary problems of many state and local governments were seen as likely to result in higher taxes and spending cutbacks. On the positive side, while the efforts to rebuild balance sheets and to restructure business activities were likely to continue to exert restraining effects on the economy, such developments had favorable implications for the financial health and the competitive strength of the economy over the longer run. Members noted in this connection that a record volume of equity issues was helping to reduce balance sheet leverage and that proceeds from large offerings of debt securities were being used to a considerable extent to pay down short-term liabilities. The sizable decline in interest rates over the course of recent months was easing the debt service burdens of many borrowers, and in a few geographic areas banking institutions were reported to be making funds more readily available. The stock market continued to display appreciable strength, reflecting the drop in interest rates and suggesting investor confidence in the longer-run outlook for the economy. Some members also cited the indications of reviving growth in the broader monetary aggregates as an encouraging if still tentative development.

Turning to developments in key sectors of the economy, the members commented that it was still too early to get a firm indication regarding holiday spending by consumers, though retailers in some parts of the country reported that sales were somewhat better than they had projected. Nonetheless, consumers remained quite cautious nationwide, and some members commented that consumer spending for durable goods might well continue sluggish over the months ahead, especially in a context of widespread consumer concerns about

employment prospects, debt burdens, and softness in real estate prices. Some members also observed that the saving rate was already on the low side and that the risks of a rise in that rate could not be ruled out in the environment that was likely to prevail during the months ahead.

The members did not discern signs of significant strengthening in business expenditures for equipment over the nearer term, though the output of capital goods appeared to be on a slowly rising trend in at least one major capital-producing region. Nonresidential construction activity remained very weak in most parts of the country and high vacancy rates suggested little prospect for improvement in the commercial building sector for an extended period. On the other hand, significant improvement in housing construction was reported in some parts of the country, and housing activity appeared to be holding up reasonably well on a nationwide basis. The declines that had occurred in interest rates would tend over time to stimulate housing and other interest-sensitive sectors of the economy. The outlook for U.S. exports was tempered by more sluggish business conditions in several key countries than had been expected earlier, but exports would be supported by the depreciation in the foreign exchange value of the dollar since mid-1991.

Businesses continued to pursue cautious inventory investment policies. Contacts in most parts of the country described current inventories as lean and many retailers were prepared to accept reduced sales rather than to add to their inventories under prevailing conditions, although some buildup had occurred in recent months in association with weak demands. While rising inventories were not likely to make a major contribution to the anticipated recovery, any

significant firming in final demands probably would be reflected fairly promptly in increased production.

With regard to the outlook for the government sectors, members commented that the massive size of current federal budget deficits greatly limited any flexibility in providing some stimulus through fiscal policy actions. It was noted in this connection that any legislation that was seen as significantly increasing the size of the federal deficits over the longer run could have adverse repercussions on long-term interest rates and business and consumer confidence. Some members also referred to the negative effects on confidence and spending stemming from the budgetary difficulties of numerous state and local governments; at least in some areas, however, capital expenditures by such government entities were being accelerated by lower interest and other costs.

The members were encouraged by evidence that inflationary pressures appeared to be subsiding at a faster pace than they had anticipated earlier. Anecdotal reports suggested very competitive conditions in producer and retail markets and favorable wage patterns. Employee benefit costs were still rising rapidly, notably medical costs, but members cited some examples of promising efforts on the part of medical providers to curb the escalation in their costs. It was suggested that the behavior of commodity prices over the past year was consistent with an outlook for stable producer prices. The members saw little risk of worsening inflationary pressures over the forecast horizon even if the pace of the recovery proved to be somewhat more vigorous than they currently expected; however, some stressed that it was important for monetary policy to sustain the downtrend in inflation over an even longer horizon.

In the Committee's discussion of policy for the period ahead, most of the members indicated that they favored or could accept a directive that called for no immediate change in the degree of pressure on reserve positions but that carried an especially strong presumption that some easing in reserve conditions would be implemented unless improvement in the economy became evident fairly promptly or there was significant evidence of a pickup in M2 growth in the period immediately ahead. Separately, the Board of Governors would need to decide how the discount rate should be structured in order to get the maximum benefits from any easing, given the current state of business and consumer confidence.

The policy discussion focused on the need to foster a sustained, noninflationary recovery. Such an environment would promote continuing balance sheet adjustments and business restructurings that would over time enhance the financial soundness and competitive strength of the economy. For now, however, these activities were having restraining effects on the economy, and there were as yet no clear indications that the recovery was resuming. While the risks of a substantial weakening in the economy were perhaps small, such a development would have severe consequences for the economy and financial institutions. In these circumstances, many of the members believed that some further easing of reserve conditions likely would be called for, especially if indications of some strengthening in the economy or in the growth of the monetary aggregates should fail to materialize in the near future. A number of members also commented that against the background of better-than-expected progress toward price stability, a stalled recovery, and slow monetary growth, the inflation risks of further easing were minimal.

Some members indicated that they saw an advantage in making a more substantial policy move at some point in the period ahead rather than additional limited easing actions of the sort that had been implemented in recent years. In this view, a larger and more visible policy action, which generally was not anticipated in financial markets, would have greater effectiveness in part because it would be more likely to bolster confidence. The level of interest rates and money growth that would be expected to ensue from such an action, against the background of the substantial easing that had already been implemented, should be sufficient to foster expansion and promote the view that further easing would not be needed.

Other members, while not disagreeing that further easing might be desirable, nonetheless expressed reservations about the urgency to ease in the near term and especially the need for a sizable move. These members emphasized that a substantial amount of easing had been implemented over the past several months and that to a considerable extent the effects of such easing had not yet shown through in the economy. A number of these members also expressed the view that monetary policy could do little to offset the restraining effects of the balance sheet adjustments and business restructuring activities that were currently under way. Moreover, a resurgence of inflation pressures as the recovery gathered strength could not be ruled out, and too much easing in the period immediately ahead might have to be reversed later with unsettling consequences.

According to a staff analysis prepared for this meeting, M2 and M3 were likely to continue to grow at a restrained pace over the months ahead in light of sluggish expansion in nominal income and very limited loan growth. A decision to implement somewhat easier reserve conditions would stimulate slightly faster monetary expansion in the

early months of next year, though the broader aggregates would probably remain appreciably below the midpoints of the tentative ranges that the Committee had established for 1992. The members observed that to an important extent the weakness of the monetary aggregates appeared to be related to developments that involved some reduction in the intermediary role of depository institutions and might not have adverse implications for the overall availability of financing in the economy. Some members suggested that a number of indicators, including the behavior of commodity prices, the slope of the yield curve, and trends in the growth of reserves and narrow measures of money, pointed to an adequate availability of liquidity in the economy. Nonetheless, several members expressed concern about the continuing lagging growth in the broad measures of money, and they felt that consideration should be given to an easing of reserve conditions if incoming data were to suggest that the recent pickup was not being sustained.

In the course of the Committee's discussion the members reviewed a proposal to amend the wording of the statement in the operational paragraph of the directive that related to possible intermeeting adjustments to the degree of reserve pressures. While several members expressed a slight preference for retaining the current statement, which contained an ordering of the factors considered by the Committee in guiding intermeeting policy adjustments, and a few preferred to delete the listing of factors altogether from the sentence, all of the members indicated that they could support a proposed alternative. That alternative would make clearer the Committee's focus on its long-term goals by inserting a reference to those goals at the beginning of the sentence and would refer in a more general way to the immediate economic, financial, and

monetary developments that might prompt an intermeeting adjustment. This new wording implied less focus in the directive itself on the ranking of the factors, but the understandings reached at meetings regarding their relative importance would continue to be explained fully in the policy record. The members agreed that the revised statement should be reviewed every year or more often if warranted by changing economic or financial conditions.

At the conclusion of the Committee's discussion, all but one of the members indicated that they favored or could accept a directive that would call initially for maintaining the existing degree of pressure on reserve positions. The members also noted their preference or acceptance of a directive that included a marked bias toward easing during the intermeeting period. 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, slightly greater reserve restraint might be acceptable or somewhat lesser reserve restraint would be acceptable during the intermeeting period. 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 1-1/2 percent respectively over the four-month period from November through March.

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 continues to portray a sluggish economy and a depressed state of business and consumer confidence. Total nonfarm payroll employment fell sharply in November; however, the average workweek in the private nonfarm sector edged up and the civilian unemployment rate remained at 6.8 percent. Industrial production fell in November, partly reflecting a sizable drop in motor vehicle assemblies. Consumer spending has been soft on balance in recent months. Real outlays for business equipment

appear to be rising slowly, and nonresidential construction has continued to decline. Housing starts were appreciably higher on average in October and November than in the third quarter. The nominal U.S. merchandise trade deficit widened slightly further in September; the deficit in the third quarter was substantially larger than in the second quarter. Wage and price increases have continued to trend downward.

Interest rates have declined appreciably since the Committee meeting on November 5. The Board of Governors approved a reduction in the discount rate from 5 to 4-1/2 percent on November 6. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined further over the intermeeting period; the dollar depreciated primarily against the mark and other European currencies.

Expansion in M2 and M3 edged up in November from a slow pace in October; the slightly faster growth reflected a strengthening in the most liquid components of the aggregates. For the year through November, 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 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 somewhat 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 November through March at annual rates of about 3 and 1-1/2 percent, respectively.

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

Vote against this action: Mr. LaWare.

Mr. LaWare dissented because he did not favor the inclusion in the directive of a strong presumption that monetary policy would be eased further during the intermeeting period. While future developments might call for further easing, he preferred not to prejudge that need but to wait and assess the effects of the considerable easing actions undertaken earlier. In his view, the main barrier to a satisfactory economic performance was a crisis in confidence that was not likely to be alleviated by further incremental easing. In present circumstances, a steady policy could provide a firm signal that the downward drift in interest rates associated with a long series of small easing actions had come to an end. This signal might well prove to be beneficial to the economy as interest-sensitive decisions to spend no longer were postponed in anticipation of still lower interest rates. He recognized that lower interest rates could alleviate heavy debt service burdens, but he was concerned about the effects of a further decline in interest rates on the value of the dollar in foreign exchange markets.

At a telephone conference on December 20, 1991, the Committee discussed the approval by the Board of Governors of a 1 percentage point reduction in the discount rate, effective that day,

and the implications of that action for the implementation of the Committee's policy with regard to the degree of pressure to be sought in reserve markets. It was noted during this discussion that the limited data received since the Committee's meeting on December 17 continued to point to a very sluggish economy. In keeping with the Committee's decision at its recent meeting, it was deemed appropriate to direct open market operations toward allowing part of the reduction in the discount rate to be reflected in the federal funds rate. Members commented that the substantial cut in the discount rate and the accompanying adjustment in open market operations were likely to have a favorable effect on financial markets and the behavior of the monetary aggregates and in conjunction with the ongoing effects of earlier easing actions would provide the financial basis for a resumption of sustainable economic growth. In light of the substantial size of these actions, it would be appropriate to view the directive as symmetrical with regard to any further changes in policy over the remainder of the intermeeting period.