FEDERAL RESERVE press release

For Use at 4:30 p.m. February 5, 1993

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 22, 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 December 22, 1992

The information reviewed at this meeting suggested that economic activity was rising appreciably in the fourth quarter. Consumer spending, in association with an apparent upturn in wage income and a surge in confidence, had improved considerably; sizable gains were being registered in the sales and starts of single-family homes; and business spending for capital equipment remained strong. There also had been solid advances in industrial output, and private payroll employment had turned up. Data on wages and prices had been slightly less favorable recently, and on balance they raised the possibility that the trend toward lower inflation might be slowing a little.

Total nonfarm payroll employment expanded for the third consecutive month in November, and the average workweek increased further. A sizable rise in government employment largely reflected temporary hiring to staff polling places during the general election. Private employment also picked up somewhat, despite a decline in construction jobs and weaker-than-usual seasonal hiring in the retail trade sector. A range of service industries recorded further gains in employment, and the number of jobs in manufacturing increased after three months of sizable declines. The civilian unemployment rate fell further in November, to 7.2 percent.

Industrial production recorded another advance in November. Motor vehicle assemblies were about unchanged, but significant gains were evident elsewhere, notably in the production of business equipment, construction supplies, and industrial materials. The output of consumer goods rose slightly further in November; all of the increase was in the production of nondurable goods. Reflecting the higher level of output, total utilization of industrial capacity edged higher in November to a level slightly above that at the end of 1991.

Retail sales, buoyed by strong gains in disposable income and a marked improvement in consumer attitudes, rose sharply in October and posted a further increase in November. Sales of light trucks were up substantially in the October-November period, and sales of a wide variety of other goods, both durable and nondurable, also advanced considerably. Single-family starts rose over October and November to their highest level since February, but starts of multifamily units remained at depressed levels. Sales of new and existing homes continued on an upward trend, although the preliminary estimate for new home sales was down in October.

The limited data available suggested that real business fixed investment was continuing to expand at a brisk pace. Shipments of nondefense capital goods were up on balance over September and October. A decline in shipments of office and computing equipment, which had accounted for most of the gains in shipments since early 1991, was more than offset by a considerable rise in shipments of other items. Among other indicators of spending for durable equipment over the September-October period, sales of heavy trucks rose sharply, and business purchases likely accounted for some of the recent sizable increase in sales of light trucks; on the other hand, shipments of complete aircraft were weak. Nonresidential construction activity turned up on balance in September and October, partly reflecting a steadying of expenditures for office buildings, which had plunged during the summer. At the same time, construction of other commercial structures recovered from a sharp decline in August, while outlays for industrial structures remained weak. A sharp increase in drilling activity occurred in October, apparently in response to higher natural gas prices and the expiration at year-end of a drilling subsidy.

Business inventories were drawn down appreciably further in October. In manufacturing, reductions in stocks were smaller in October than in September. The ratios of stocks to shipments in most industries were at or near the bottom of their recent ranges. In the trade sector, a sharp drop in stocks held by auto dealers more than accounted for an overall decline in retail inventories in October. Aside from auto dealers, a slight increase in retail stocks coupled with a strong increase in sales produced a small decline in inventory to-sales ratios. Wholesale inventories fell again in October, and the inventory-to-sales ratio for this sector was near the low end of the range observed over the past two years.

The nominal U.S. merchandise trade deficit narrowed somewhat in October from its average rate in the third quarter, reflecting both a considerable increase in the value of exports and a decline in the value of imports. Most of the expansion in exports was in capital goods, notably aircraft and industrial machinery, and consumer goods. The reduction in imports was primarily in consumer goods and in passenger cars imported from Canada. Recent indicators generally pointed to continued weakness in the economies of the major foreign industrial countries. During the third quarter, economic activity contracted further in Japan and western Germany and expanded slowly in France and Canada. In the United Kingdom, activity appeared to have changed little.

Producer prices of finished goods fell slightly in November, reflecting sharp declines in the prices of food, gasoline, and fuel oil. Excluding the finished food and energy components, producer prices edged higher and, for the twelve months ended in November, rose at a considerably slower pace than in the comparable year-earlier period. By contrast, at the consumer level, prices of nonfood, non-energy goods increased over October and November at a faster rate than in the previous several months. Consumer prices of apparel, tobacco, and used cars rose sharply in October, and airfares surged in October and November as domestic airlines sought to restore profit margins that had been squeezed by promotions over the summer. Even with these upticks, however, the index of consumer prices excluding food and energy increased considerably more slowly in the twelve months ended in November than in the year-earlier period. Average hourly earnings of private production or nonsupervisory workers also rose more rapidly in November; the strongest gains were in the finance, insurance, and real estate category, but sizable increases were recorded in several other sectors as well. Nevertheless, average hourly earnings rose more slowly over the twelve months ended in November than over the year-earlier period.

At its meeting on November 17, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that included some 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 of M2 and M3 at annual rates of about 3-1/2 and 1 percent respectively over the three-month period from September through December.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. One small technical decrease was made during the period to expected levels of adjustment plus seasonal borrowing to reflect the usual pattern of diminishing needs for seasonal credit. Because of settlement-day pressures, actual borrowing along with the federal funds rate tended to average a little above expected levels.

Changes in other short-term interest rates were mixed over the intermeeting period. In the market for Treasury securities, bill rates were essentially unchanged while bond yields fell despite the emergence of a more robust economic picture. Tending to offset the effects of the latter on long-term rates was the tenor of statements emanating from the incoming Administration, which were viewed by market participants as reducing the likelihood of a large fiscal stimulus package. The recent step-up in the size of bill auctions and the potential for some shortening of the maturity of Treasury debt issues under the new Administration also might have contributed to the flattening of the Treasury yield curve. Market expectations of year-end pressures sharply boosted interest rates on very short term private paper for a time; however, concerns about year-end pressures subsequently abated, and much of the rise in rates was retraced. Most three- to six-month private rates fell on balance over the period; the lower rates likely were associated with lessened expectations of year-end pressures but also might have reflected perceptions of reduced credit risks in a strengthening economy. Buoyed by the prospects for a stronger economy and the declines that had occurred in bond yields, most major indexes of stock prices reached record highs.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was essentially unchanged on balance over the intermeeting period. The dollar moved moderately higher over the first half of the period in response to incoming data suggesting that the prospects for sustained economic growth in the United States were improving while the economic outlook for Japan and Germany was deteriorating somewhat. Later in the period, the dollar gave up its gains, partly as a result of strong anti-inflationary statements from Bundesbank officials that damped market expectations of near-term monetary easing in Germany. The relative stability of the dollar contrasted sharply with the rekindling of exchange rate pressures among a number of European currencies.

The growth of M2 slowed in November, and on average it had expanded at a moderate pace in recent months; the limited available data indicated a further reduction in growth of this aggregate in December. The recent behavior of M2 largely reflected a sharp falloff in the expansion of demand deposits associated with a backup in money market rates in previous months and a likely slowing in the rate of increase in mortgage refinancing activity. M3 expanded at a relatively slow rate in November and appeared to be declining in December. For the year, both M2 and M3 apparently grew at rates a little below the lower ends of the annual ranges established by the Committee.

The staff projection prepared for this meeting suggested a continuing expansion in economic activity that would be associated with gradual reductions in the margins of unemployed or underutilized labor and capital resources. The pickup in economic activity in recent months, through its positive effects on confidence and incomes, was expected to provide greater momentum to the economy in the near term. However, this impetus would in part be offset by weaker export demand as a result of slower growth abroad and the higher level of the dollar; the earlier backup in long-term interest rates, only part of which was retraced in recent weeks, also would have a restraining effect. Consumer spending, which had outpaced income growth in the second half of 1992, was projected to expand more in line with incomes in coming quarters. Residential construction was expected to strengthen gradually as concerns about employment security receded and incomes improved. Spending increases on business equipment were expected to be sustained in part by continuing efforts to improve productivity, and investment in industrial building and in commercial structures other than office buildings would begin to pick up in 1993. While recognizing the possibility of a stimulative fiscal initiative in 1993, the staff retained for this forecast the assumption in several recent forecasts that fiscal policy would be mildly restrictive. The persisting, though diminishing, slack in resource utilization over the forecast period was expected to be associated with additional progress in reducing inflation.

In the Committee's discussion of current and prospective economic developments, the members cited growing indications of a somewhat stronger expansion than had seemed to be under way earlier and a marked improvement in business and consumer confidence, especially over the past month or two. Although substantial uncertainties still surrounded the outlook, these developments provided encouraging support for forecasts of continued economic growth at a pace sufficient to reduce gradually margins of unutilized resources. The expansion now seemed to have gathered fairly broad-based momentum that might be reinforced over the quarters ahead by business efforts to build up inventories in the context of generally low inventory-to-sales ratios. Moreover, the improving financial condition of many households and business firms, notably banking institutions, was a promising development that should reduce constraints on economic growth over coming quarters. The possibility of expansionary fiscal measures was another source of potential short-term stimulus to the economy, though one surrounded by substantial uncertainty with respect to the nature, size, and timing of any fiscal initiatives and the longer-run consequences. On the negative side, many of the members stressed what they regarded as a worsening outlook for U.S. exports; they also noted the continuing weakness in commercial construction, defense spending, and the retarding effects on employment of ongoing downsizing and restructuring by many business and financial firms. With regard to the outlook for inflation, some of the recent reports on prices and wages had been less favorable than earlier. However, against the background of continuing though diminishing slack in production resources, favorable trends in productivity, and restrained growth in the broad measures of money the members generally continued to anticipate further progress toward price stability over the forecast horizon.

The statistical evidence of a stronger expansion was bolstered by anecdotal reports of improving business conditions across much of the nation. Confidence also appeared to be rising in most areas and indeed seemed to be leading the statistics. Some members observed, however, that representatives of many larger business firms did not seem to share the ebullient mood of their smaller business counterparts, possibly reflecting the still active retrenchment efforts of many large firms and growing indications for some of weakening markets abroad. There also were significant geographic exceptions to the improving business climate, notably in areas that were substantially affected by cutbacks in defense spending, business consolidation and cost-cutting activities, and underlying weakness in the energy industry. On balance, regional weakness in parts of the country such as southern California tended to be masked in the overall economic statistics by what were increasingly robust business conditions in the rest of the nation.

Personal consumption expenditures had posted relatively good gains over the past several months, and retail sales were displaying considerable strength in the ongoing holiday season according to anecdotal reports from around the country. Further growth in consumer expenditures was expected to provide a key underpinning for continuing economic expansion. A development that might well be buttressing consumer spending was the improvement in existing home sales and the related capital gains that were tending to supplement the recent strengthening in disposable incomes. Nonetheless, the contribution of the consumer sector was likely to be constrained by a number of factors despite the recent surge in consumer confidence. In particular, an already low saving rate and still substantial household debt burdens would tend to restrain the growth in consumption expenditures. Moreover, it seemed likely that gains in employment would continue to be relatively limited, owing to further business restructuring activities and related improvements in productivity that would tend to hold down the demand for new workers. Even so, the pace of business hiring could be expected to quicken as existing workers were utilized more fully and the practical limits to increasing output through overtime work were reached.

Continuing efforts to improve productivity were seen as likely to stimulate appreciable further expansion in business fixed investment. Much of that expansion was expected to take the form of substantial further growth in outlays for business equipment, especially if an investment tax credit were to be enacted. At the same time, investment in nonresidential structures was projected to stabilize for the nation as a whole next year after declining in recent years. In this connection, members drew some encouragement from anecdotal reports that prices, rental rates, and other terms relating to the value of commercial real estate seemed to be bottoming out in several depressed markets, though a turnaround involving significant new construction was unlikely for an extended period in many of those markets. The outlook for housing construction was more promising, especially for the single-family sector. Housing activity had strengthened at least marginally in recent months in many parts of the country, and the conjunction of reduced mortgage rates and some projected increase in incomes was expected to support at least a gradual uptrend in housing construction.

With regard to fiscal policy, members noted that the bond markets had responded favorably in recent weeks to indications that the incoming Administration would give emphasis to reducing the federal budget deficit over time. Indeed, the prompt enactment of legislation to achieve that objective undoubtedly would bolster business and consumer confidence as well as bond markets with favorable effects on the economy. Some members cautioned, however, that those effects would tend to be negated to the extent that lower federal spending was offset by legislated increases in required spending by business firms to finance worker benefits and other programs; such spending would reduce profits and incentives to expand and ultimately would boost costs and prices. In any event, the course of fiscal legislation remained highly uncertain in terms of its size, structure, and timing and thus its near- and longer-term effects on the economy.

Many of the members saw a substantial risk that lagging exports could exert a significant constraint on the domestic expansion. There were increasing indications of a weaker economic performance in many foreign countries, which were reinforced by recent anecdotal reports from contacts at domestic firms engaged in international business activities. However, while the risks for prospective economic activity abroad seemed to be tilted to the downside, stimulative policy responses by foreign authorities--some of which had already been initiated--might well alter developing trends. For now, though, diverging business trends in the United States and foreign nations in association with the rise that had occurred in the dollar over the course of recent months pointed to a worsening trade balance for the United States.

The members generally anticipated further progress toward price stability, although some now expected somewhat less improvement than they had earlier. In the view of many members, key factors underlying a favorable inflation outlook included the persisting, though decreasing, slack in the utilization of production resources associated with the moderate expansion expected in overall economic activity and the slow growth that had occurred for an extended period in the broad measures of money. While recent data on consumer prices and wages had a somewhat less favorable tenor, price competition remained vigorous in markets for many goods and developments in long-term debt markets suggested some shift in expectations toward lower inflation. It also was noted that ongoing cutbacks in work forces by many employers, including the widely publicized reductions by some major corporations, were tending to limit demands for higher wages. Another important influence was the strong competition from foreign suppliers in the context of sluggish demands in their own markets and the rise in the foreign exchange value of the dollar. Rapid increases in the narrow measures of money and reserves also were cited as possibly signifying a risk on the other side if such increases persisted--that is, that monetary policy might soon be accommodating renewed inflationary pressures.

In the Committee's discussion of short-run policy for the period until the next meeting, all of the members expressed a preference for maintaining an unchanged degree of pressure on reserve positions; all also indicated that they could support a shift from the tilt toward ease incorporated in recent directives to a symmetrical directive that would not include any bias with regard to possible adjustments to the degree of reserve restraint during the intermeeting period. Improved prospects for moderate economic growth argued for maintaining the Committee's current stance in reserve markets, and they also warranted a shift toward a more balanced approach to possible intermeeting changes in policy. At the same time, the still considerable uncertainties surrounding the economic outlook, including some lingering questions about the sustainability of the expansion, indicated the desirability of a cautious approach to any policy changes. In this connection, several members referred to the swings in the outlook that had characterized the current expansion, including the recent reversal of sentiment regarding the strength of the expansion, and the associated risks of premature or misdirected policy moves.

The members observed that the next policy move might be in either direction. For example, the need for some easing could not be ruled out should the expansion again appear to be faltering. Substantial weakness in the monetary aggregates over coming months would be one factor to be weighed in assessing the economic outlook, though velocity developments also would have to be taken into account. On the other hand, a stronger economic performance might raise questions as to the need for a tightening move at some point during the year ahead as a means of maintaining progress toward price stability while continuing to encourage maximum sustainable economic expansion. If a tightening move were to be needed, it would be desirable to implement such a move before inflation pressures showed through in the actual price statistics in order to avoid sharp and potentially disruptive tightening actions later. One member expressed concern about the risk of maintaining an overly stimulative monetary policy for too long, with adverse consequences for inflation; while not prepared to tighten policy at this point, he indicated a preference for biasing the directive toward restraint.

In the course of this discussion, the members took account of a staff analysis that pointed to quite sluggish growth in M2 and M3 over the months ahead and to a marked slowing in the expansion of M1. The broader monetary aggregates were expected to continue to be affected by the various factors that had inhibited their growth over the past two years and that had induced a substantial diversion of credit flows from banking institutions into capital market instruments. Moreover, some special factors that had boosted the growth of the broader aggregates in recent months, such as the enlarged volume of mortgage refinancing activity, would tend to dissipate in the months immediately ahead, assuming no significant change in mortgage interest rates. While the atypically slow growth of the broader aggregates during the current economic recovery did not under prevailing circumstances have the usual implications for the performance of the economy, given the concomitant and unusual rise in their velocities, several members nonetheless expressed concern about the persistence of the lagging growth. A few were more concerned about the behavior of the narrower measures of money such as M1 or the monetary base whose growth had been unsustainably rapid over much of 1992, though these now gave some indications of moderating. There was general agreement that the performance of the various monetary aggregates should continue to be monitored with special care.

At the conclusion of the Committee's discussion, all of the members indicated their support of a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy 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, the Committee decided that slightly greater 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 M2 growth at an annual rate of about 1-1/2 percent and with M3 about unchanged 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 suggests that economic activity has been rising appreciably in the current quarter. Total nonfarm payroll employment has increased slightly since September, and the average workweek has moved higher. The civilian unemployment rate fell further in November to 7.2 percent. Industrial production posted solid gains in October and November. Retail sales increased sharply in October and rose further in November. Residential construction activity appears to have increased from the third-quarter pace. Indicators of business fixed investment have been mixed recently, but on balance they suggest further growth. The nominal U.S. merchandise trade deficit narrowed somewhat in October from its average

rate in the third quarter. Recent data on wages and prices suggest on balance a possible slowing in the trend toward lower inflation.

Changes in short-term interest rates have been mixed since the Committee meeting on November 17 while bond yields have edged lower. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was essentially unchanged on balance over the intermeeting period.

Over the course of recent months, M2 has expanded at a moderate pace, while M3 has continued to expand at a very slow rate. More recently, both aggregates have weakened somewhat. Both appear to have grown at rates a little 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 nonfinancial 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 or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with M2 growing at a rate of around 1-1/2 percent and M3 about unchanged in the period from November through March.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Hoenig, Jordan, Kelley, LaWare, Lindsey, Melzer, Mullins, Ms. Phillips, and Mr. Syron.
Votes against this action: None.