FEDERAL RESERVE press release

For Use at 4:30 p.m. May 20, 1988

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 March 29, 1988.

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 March 29, 1988

Domestic policy directive

The information reviewed at this meeting suggested that economic activity was continuing to expand in the current quarter, although the rate of growth was down somewhat from the rapid pace in the fourth quarter. The moderation reflected a considerable slowing in the pace of inventory investment. However, domestic final sales seemed to have picked up sharply in the first quarter; business capital expenditures apparently increased substantially and consumer spending also strengthened, buoyed by higher sales of motor vehicles. The rate of inflation had remained relatively restrained over the course of recent months and wage trends had shown little change.

Growth in industrial production moderated in January and February from a rapid pace in late 1987. After a surge in the second half of 1987, the output of materials edged down. Also, auto assemblies and the production of consumer home goods dropped below their late-1987 levels, apparently reflecting in part an effort to trim or to moderate the growth in inventories. In contrast, the production of business equipment remained quite strong, with gains in nearly all categories. Capacity utilization rates were at relatively high levels in a number of industries. Gains in total nonfarm payroll employment continued strong over the January-February period, led by the service and retail trade sectors. In manufacturing, employment gains were smaller in January and February than during the second half of 1987. The unemployment rate edged down to 5.7 percent in February, its lowest level since mid-1979.

Increased demand for motor vehicles produced a rebound in consumer spending early in the year. That demand appeared to be bolstered by sales incentives programs, strong income growth, and rising consumer confidence. Excluding motor vehicles, nominal retail sales were essentially flat since November, and the saving rate was well above its average for the year preceding the break in the stock market.

Housing activity picked up in February but still was slightly below its fourth-quarter pace. While sales of new and existing homes continued to decline in January, housing starts rose to an annual rate of 1.49 million units in February, with growth stronger in the single-family sector than in the multifamily area.

Available information suggested that business fixed investment was increasing rapidly since late last year, led by large gains in equipment spending. Data on shipments indicated a surge in spending on information-processing equipment. Increases in other equipment categories were smaller but were widespread. Spending on nonresidential structures was relatively weak in early 1988. Inventory investment apparently slowed in the first quarter, reflecting the strength in sales of motor vehicles combined with cutbacks in their production.

The nominal U.S. merchandise trade deficit in January was significantly below the fourth-quarter average, although essentially unchanged from December. Non-oil imports and nonagricultural exports both fell noticeably from their December levels. The current account deficit had narrowed in the fourth quarter, but the improvement was more than accounted for by a sharp increase in capital gains stemming from the depreciation of the dollar and the related revaluation in the book value of direct U.S. investments abroad denominated in foreign currencies. On average, economic growth in major foreign industrial countries continued strong in the fourth quarter and early this year, though it slowed somewhat from the rapid third-quarter pace. Growth was particularly robust in Canada and Japan.

Increases in consumer prices remained relatively moderate in early 1988, reflecting the impact of declining energy prices and a relatively small rise in food prices. At the producer level, prices of finished goods fell slightly in February after fluctuating irregularly in other recent months, largely because of swings in food prices. Commodity prices registered mixed changes during the first quarter. The index of hourly earnings was unchanged in February after increasing in January, and on balance it rose roughly in line with the pace in 1987.

At its meeting on February 9-10, 1988, the Committee had adopted a directive that called for maintaining the slightly reduced degree of pressure on reserve positions that had been sought since late January. These reserve conditions were expected to be consistent with growth in both M2 and M3 at annual rates of about 6 to 7 percent over the period from November through March. With regard to operating procedures, the Committee had agreed that the more normal approach to operations implemented especially since the year-end, which emphasized the provision of reserves rather than money market conditions, remained generally appropriate. Nonetheless, it was understood that some flexibility might continue to be needed in the conduct of operations in light of the still somewhat unsettled conditions in financial markets, the uncertainties in the relationship between reserve and money-market conditions, and the substantial risks of unanticipated economic and financial developments. Taking account of conditions in financial markets, the members had decided that somewhat less or somewhat more reserve restraint would be acceptable, depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, and the behavior of the monetary aggregates. The intermeeting range for the federal funds rate had been left unchanged at 4 to 8 percent.

As contemplated at the February meeting, primary emphasis was placed on achieving reserve objectives during the intermeeting period, although slightly greater than normal attention continued to be given to developments in the money market. In the three reserve maintenance periods ending March 23, adjustment plus seasonal borrowing averaged $238 million. Growth in M2 and M3 remained relatively robust in February and apparently also in March following a rebound in January. Since November both aggregates had expanded at an annual rate of about 7 percent. Growth in M1 slowed considerably over the intermeeting period from a very rapid pace in January. With transaction deposits expanding at a relatively sluggish pace on balance and excess reserves declining, total reserves advanced at a modest rate during the intermeeting period.

The federal funds rate averaged 6.59 percent for the three full reserve maintenance periods since the February meeting, close to the rate prevailing around the time of that meeting but below the average in January. Most other interest rates rose somewhat on balance during the intermeeting period. The largest increases were in bond markets and they appeared to have been prompted by evidence of more strength in the economy than had been anticipated. Broad indexes of stock prices rose somewhat over the period, but price swings remained sizable on occasion.

Through most of the period since the February meeting the dollar fluctuated in a relatively narrow range. However, it came under downward pressure late in the period following reports suggesting stronger than anticipated growth in U.S. domestic demand that raised questions about the pace of adjustment in the U.S. trade balance. Over the intermeeting period the dollar declined 2-1/4 percent on a weighted-average basis in relation to the other G-10 currencies. The net decline was largely accounted for by a 4 percent depreciation in terms of the pound and 2 percent in terms of the Canadian dollar and the yen, while the mark and other EMS currencies remained little changed in relation to the dollar.

The staff projection prepared for today's meeting suggested more strength in business activity this year than had been forecast earlier. The faster growth was expected to be associated with little change in the unemployment rate from current levels. And while the projection for 1989 now indicated a somewhat reduced rate of growth, higher levels of capacity utilization over the projection period as a whole were associated with marginally higher rates of inflation by late 1988 and for the year 1989. A key adjustment in the forecast was stronger investment spending. The staff continued to anticipate that the external sector would make a substantial positive contribution to business activity in 1988 and 1989.

In the Committee's discussion of the economic situation and outlook, the members generally agreed that the information available since the February meeting pointed to a stronger expansion in business activity than they had anticipated earlier. Unfortunately, recent developments in the view of several members also increased the risks of more pressures on productive resources and more inflation. A number of members noted that the revised staff forecast was in line with their own projections and some also indicated that any deviations were likely to be in the direction of somewhat faster expansion and even higher rates of inflation. A number of other members did not disagree that the risks had shifted and that concerns about a recession had receded, but they also referred to areas of weakness in the economy that implied the potential for relatively moderate growth without adding to price pressures.

In the course of the Committee's discussion, members referred to high or improving levels of business activity in many parts of the country, albeit from depressed levels in some areas or sectors of the economy. Manufacturing was exhibiting particular strength across the nation. Despite some increasing pressures on manufacturing capacity, business executives generally appeared to remain cautious in their plans for new production facilities, apparently reflecting their uncertainties about the outlook for sales growth in both domestic and export markets. However, some businesses were reported to be in the process of reappraising their capacity needs, and with demands for business equipment relatively strong, a number of members concluded that appreciable further growth was likely in overall business-fixed investment. The members differed to some extent in their views on the outlook for consumer spending and business inventory accumulation, but they generally expected at least moderate growth in total domestic final demands.

In the view of some members any strengthening in domestic demand could well give rise to pressures on resources as net exports continued to expand. The outlook for trade remained subject to considerable uncertainty, but further improvement in the trade balance was nonetheless a reasonable prospect. That prospect was supported by reports from businesses of their increased ability to compete internationally. A number of members again commented that long-run adjustment in the trade balance would require a period of relatively moderate growth in domestic purchases as more production was directed to export markets.

Turning to the outlook for inflation, some members reported that an increasing number of business contacts were expressing concern about the prospects for prices and wages. On the positive side, while some deterioration seemed to have occurred recently, inflationary expectations appeared to have diminished on balance since the stock market crash in October. Moreover, aggregate measures of prices and wages had not yet shown any sustained tendency to accelerate. This could indicate that some leeway remained in the economy before a more serious inflation problem emerged. Inflation developments did not depend solely on rates of capacity use but on the overall inflationary and financial climate and on expectations about policy responses to inflation. In particular, responses to rising capacity constraints might be reduced or delayed in light of the downtrend in inflation since the early 1980's. Nonetheless, most members agreed that the risks of more inflation stemming from increased pressures on capacity had increased and represented a key challenge for policymakers. In a still limited number of manufacturing industries, relatively high capacity utilization rates were being reflected in sizable price increases for some metals and other business products, increasing lead times in filling certain orders, and some precautionary ordering in anticipation of future needs. While there was little evidence thus far that the added price pressures extended to finished products or that overall business buying and inventory patterns were being significantly affected, the economy might well be near the point where faster growth in business activity would induce a higher rate of inflation, and in the view of several members there was a potential for a sharp escalation in prices. Members were particularly concerned that any tendency for greater price pressures to become imbedded in more rapid wage increases would make achievement of the ultimate objective of price stability considerably more difficult.

In further comments some members noted that an assessment of the economic outlook was complicated by the continuing risks associated with the troubled status of a number of financial institutions and the still somewhat unsettled conditions in financial markets, as evidenced in part by occasionally sharp movements in stock prices. Some members believed that speculative attitudes had intensified recently as reflected for example in increases in corporate merger, acquisition and commercial construction activities that typically involved heavy use of debt financing. Such a development was surprising so soon after the October 1987 disturbances in financial markets, and still growing debt burdens served to increase the vulnerability of the economy to adverse developments. Some members also expressed considerable concern about the outlook for the dollar which had been under downward pressure in the foreign exchange markets. A sizable further decline in the dollar, while it might have favorable implications for the U.S. trade balance, would tend to raise domestic prices and could adversely affect the nation's ability to continue to finance a massive trade deficit, with disruptive effects on domestic financial markets and the domestic economy.

At its meeting in February the Committee had agreed on policy objectives that called for monetary growth ranges of 4 to 8 percent for both M2 and M3 for the period from the fourth quarter of 1987 to the fourth quarter of 1988. The associated range for growth in total domestic nonfinancial debt was set at 7 to 11 percent. The Committee decided not to establish a numerical target for M1 growth; instead, the appropriateness of changes in M1 would be evaluated during the year in the light of the behavior of M1 velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the Committee's discussion of policy implementation for the intermeeting period ahead, nearly all the members favored some increase in the degree of pressure on reserve positions. Most indicated a preference for only a slight move toward restraint, at least at this time, but a few urged somewhat greater tightening. Several commented that a stronger economic outlook in the context of already high capacity utilization rates in a number of industries required timely action to help prevent the business expansion from gathering excessive and unsustainable momentum that would lead to higher inflation. A policy response under emerging circumstances would also serve to confirm the System's commitment to achieving price stability over time and might help to avert an aggravation of inflationary expectations. Moreover, action at this time might preclude the need for more substantial tightening later.

While they favored a slight increase in reserve pressures, a number of members stressed that monetary policy should not overreact to recent developments. The firming should proceed with caution in light of the prevailing uncertainties in the economic outlook and the current absence of evidence in broad measures of prices and wages that rates of inflation were already rising. Other factors cited in favor of a cautious approach included the persisting problems or incomplete recovery in some sectors of the economy and areas of the country, the still sensitive conditions in financial markets, and the troubled status of many financial institutions. In the view of one member, underlying demands in the economy were not likely to be sufficiently robust to pose a threat of greater inflation, and so prospective economic and financial conditions did not warrant any tightening of reserve conditions.

In the course of the Committee's discussion, some members noted that growth of the broader monetary aggregates had remained fairly rapid in February and March. According to a staff analysis, the reserve conditions favored by most members were likely to be associated with some slowing in the expansion of those aggregates, assuming a typically sluggish adjustment of offering rates on retail deposits to changes in short-term market rates. Even so, the analysis suggested that for the year through June growth of both M2 and M3 would still be appreciably above the midpoints of the Committee's ranges for 1988. Some members observed that the near-term outlook for monetary growth was subject to more uncertainty than usual because the impact of new tax laws on mid-April tax payments and related deposit balances could not be fully anticipated. Some concern was expressed regarding the inflationary potential of the recent rates of growth in the broader monetary aggregates, and one member commented that under prevailing circumstances significantly stronger than expected expansion in those aggregates should be resisted, especially expansion that brought the cumulative growth of M2 and M3 to levels above the Committee's ranges by mid-year.

During this meeting the Committee reviewed its operating procedures at some length, including the relative merits of focusing primarily on money market conditions or on a specified degree of reserve pressure in the day-to-day conduct of monetary policy. The considerable emphasis on stabilizing money market conditions in the period after the October collapse of the stock market had given way increasingly to the earlier concentration on achieving reserve position objectives, especially since the year-end. Nonetheless, in keeping with the Committee's instructions as reaffirmed at the February meeting, open market operations had continued to be conducted with some degree of flexibility that involved occasional departures from a normal focus on targeting reserve positions and slightly greater than usual attention to money market conditions. In today's discussion a few members indicated that they favored paying greater attention to money market conditions in the normal course of conducting open market operations. It was noted in support of this view that money market interest rates were a key variable for transmitting monetary policy to financial markets and the economy, and that the variability in those rates that sometimes accompanied the pursuit of a given degree of pressure on reserve positions injected an unneeded element of uncertainty in the decisions of market participants. However, most members were in favor of either retaining the existing emphasis on reserve pressures or completing the process of reinstating the previous approach to reserve management. Short-run variability in money market interest rates was not seen as detracting from the functioning of the market or the implementation of policy since market participants were well aware of the System's procedures, and such fluctuations could reflect important shifts in market expectations or underlying conditions of supply and demand for reserves and credit. The shifts would be masked if the Federal Reserve were to focus more closely on money market conditions in its day-to-day conduct of open market operations. Even so, a majority of the members felt that the uncertain economic outlook and still sensitive conditions in financial markets warranted some continuing flexibility in the conduct of open market operations.

In the Committee's consideration of possible adjustments in policy implementation during the intermeeting period, some members felt that the risks of more inflation argued for giving particular attention to developments that might call for somewhat tighter reserve conditions. A majority of the members believed, however, that there should be no presumption about the likely direction of intermeeting adjustments, if any, in the implementation of policy. While these members generally agreed that the economic risks were in the direction of more inflation, they preferred not to weight the directive toward possible further tightening in light of the firming that was already contemplated at this meeting and the considerable uncertainties that they saw in the economic and financial outlook. One member proposed placing more emphasis on the behavior of the monetary aggregates as a factor that might trigger some firming during the intermeeting period, but other members preferred the current emphasis, partly because any surge in money growth over the weeks ahead might reflect temporary developments related to mid-April tax payments. Some consideration was given during the discussion to an upward adjustment in the intermeeting range for the federal funds rate, especially since federal funds could trade well into the upper half of the Committee's range following the decision made at today's meeting. However, the members concluded that increasing the range under current circumstances could be misread as implying a greater move towards restraint than the Committee intended.

At the conclusion of the Committee's discussion, all but one of the members indicated their acceptance of a directive that called for a slight increase in the degree of pressure on reserve positions. With regard to the Committee's operating procedures, a majority continued to endorse the view that some flexibility might be desirable in the day-to-day conduct of open market operations in light of the still somewhat unsettled conditions in financial markets and the uncertainties surrounding the economic outlook. Taking account of conditions in financial markets, the members indicated that somewhat greater or somewhat lesser reserve restraint would be acceptable depending on the strength of the business expansion, indications of inflation, the performance of the dollar in foreign exchange markets, and the behavior of the monetary aggregates. The reserve conditions contemplated by the Committee were expected to be consistent with growth in both M2 and M3 over the period from March through June at annual rates of about 6 to 7 percent. As at previous meetings, the Committee decided not to indicate any expectation regarding the growth of M1 over the months ahead. The members agreed that the intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 4 to 8 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 some moderation in the expansion of economic activity in the current quarter from the rapid pace in the fourth quarter; the continuing expansion has been supported by a sharp pickup in domestic final sales while the accumulation of inventories appears to have slowed. Total nonfarm payroll employment rose substantially over the first two months of the year, although employment growth slowed somewhat in the manufacturing sector. The civilian unemployment rate fell slightly to 5.7 percent in February. Growth in industrial production moderated in early 1988 from a brisk pace during the second half of 1987. Consumer spending strengthened in January and February, buoyed by higher sales of motor vehicles. Indicators of business capital spending pointed to substantial gains in the first quarter. Housing starts rebounded in February but were still somewhat below the reduced fourth-quarter average. The nominal U.S. merchandise trade deficit changed little in January and was significantly below the fourth-quarter average. In recent months the rise in consumer and producer prices has been relatively modest on balance, reflecting developments in food and energy prices, and wage trends have shown little change.

Most interest rates were up somewhat on balance since the Committee's meeting in February, with the largest increases concentrated in bond markets. The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies fluctuated in a relatively narrow range over most of the intermeeting period, but declined somewhat in recent days.

After strengthening in January, growth of M2 and M3 remained relatively robust in February and in the first part of March. Thus far this year expansion of these two aggregates appears to have been in the upper portion of the ranges established by the Committee for 1988. M1 has grown moderately on balance since the fourth quarter. Expansion in total domestic nonfinancial debt appears to be continuing at a pace close to that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability over time, 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 February established growth ranges of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic nonfinancial debt was set at 7 to 11 percent for the year.

With respect to M1, the Committee decided in February not to establish a specific target for 1988. The behavior of this aggregate in relation to economic activity and prices has become very sensitive to changes in interest rates, among other factors, as evidenced by sharp swings in its velocity in recent years. Consequently, the appropriateness of changes in M1 this year will continue to be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to increase slightly the degree of pressure on reserve positions. The Committee agrees that the current more normal approach to open market operations remains appropriate; still sensitive conditions in financial markets and uncertainties in the economic outlook may continue to call for some flexibility in operations. Taking account of conditions in financial markets, somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. The contemplated reserve conditions are expected to be consistent with growth in M2 and M3 over the period from March through June at annual rates of about 6 to 7 percent. 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 4 to 8 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, and Parry. Vote against this action: Ms. Seger.

Ms. Seger dissented because she did not believe that economic and financial developments warranted any tightening of reserve conditions. She did not see a significant risk of more inflationary pressures on productive resources stemming from prospective demands in domestic and export markets. She remained concerned about the downside risks in the economy, the fragility in financial markets, especially the stock market, and the weakened condition of many depository institutions.