FEDERAL RESERVE press release

For Use at 4:30 p.m. May 19, 1989

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on March 28, 1989.

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

Attachment

75th ANNIVERSARY
FEDERAL RESERVE SYSTEM

RECORD OF POLICY ACTIONS OF THE
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on March 28, 1989

1. Domestic Policy Directive

Information reviewed at this meeting suggested that activity in the nonfarm economy expanded appreciably further in the first quarter. Gains in jobs and personal income were sizable in the first two months of the year. The available indicators on domestic demand presented a mixed picture, but preliminary data for January suggested some improvement in the external sector. The latest price data indicated some pickup in inflation from recent trends, only in part reflecting jumps in food and energy prices.

Total nonfarm payroll employment rose markedly further in January and February after strong gains in the fourth quarter. The rise was paced by continuing steady advances in service-producing industries. Appreciable increases in factory and construction jobs also were recorded over the two months, but unusually mild winter weather contributed to a bunching of construction employment gains in January followed by some retrenchment in February. The civilian unemployment rate fell to 5.1 percent in February.

Industrial production was unchanged in February after rising considerably over the previous several months. A reduced rate of automobile assemblies and weakness in the output of materials contributed to the leveling of industrial activity. In other areas, production gains were well maintained for consumer goods, and the output of business equipment rose rapidly following weakness in the fourth quarter. Total industrial capacity utilization edged down in February. Despite appreciable drops in utilization rates in primary metals, petroleum products, and paper, these industries continued to operate at relatively high levels. In manufacturing, the operating rate moderated a bit but remained high. After a weather-related surge in January, housing starts fell in February to a level somewhat below their average in the fourth quarter.

Growth in consumer spending moderated in January and February. Purchases of cars and light trucks fell back considerably, and the unusually warm weather held down expenditures on heating bills. Outlays for goods other than motor vehicles changed little, while purchases of non-energy services posted another sizable rise.

Indicators of business capital spending suggested a rebound from a decline in the fourth quarter. Shipments of nondefense capital goods excluding aircraft were well above the fourth-quarter level in January and February. Nonresidential construction activity rose strongly for a second month in January, with gains recorded in almost all categories of building. Petroleum drilling, which declined through much of last year, appeared to be stabilizing. Inventory investment in the manufacturing sector picked up in early 1989. Much of the rise was recorded in the aircraft industry, where work-in-progress inventories were growing in reflection of booming production, and in nonelectrical machinery, where computer demand had flattened out in the fourth quarter. At the retail level, the pace of non-auto inventory investment generally remained in line with the pattern of sales.

Producer prices of finished goods rose sharply in both January and February, mostly reflecting higher prices for food and energy, but prices of a broad range of other finished goods also increased at a faster rate. Among intermediate materials, prices continued to rise at a substantial pace. Excluding food and energy, consumer prices advanced in January and February at a rate a shade above the average for 1988. Revised data for labor costs in the fourth quarter and the limited data available for early 1989 continued to suggest that these costs remained under upward pressure.

After a considerable increase in the fourth quarter of last year, the nominal U.S. merchandise trade deficit narrowed in January, according to preliminary estimates. The value of imports declined substantially, reflecting an apparent reversal of the strong rise in non-oil imports that had occurred in the fourth quarter. The value of exports also declined, but by less than that for imports, with decreases recorded in almost all major trade categories. Economic growth slackened in most of the major foreign industrial nations in the fourth quarter, but data available so far in 1989 did not indicate further slowing.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose somewhat on balance over the intermeeting period. The dollar was under downward pressure through most of February, partly in response to unexpectedly large increases in U.S. price indexes. After the Federal Reserve Board approved an increase in the discount rate on February 24, the dollar rebounded as U.S. short-term interest rates rose relative to key foreign interest rates.

At its meeting on February 7-8, the Committee adopted a directive calling for no immediate change in the degree of pressure on reserve positions. It was agreed that policy would be tightened promptly if incoming information tended to confirm expectations of growing inflationary pressures. The contemplated reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of about 2 and 3-1/2 percent respectively over the period from December through March.

In the context of incoming data tending to reinforce earlier evidence of mounting inflation, the Manager for Domestic Operations adjusted the provision of reserves in mid-February to incorporate a higher level of adjustment plus seasonal borrowing. Subsequently, on February 24, the Board approved an increase in the discount rate from 6-1/2 percent to 7 percent. The federal funds rate moved up from about 9 to 9-1/8 percent at the time of the February meeting to an average a little above 9-3/4 percent from late February to late March.

The uncertainties about the relationship between borrowing and the federal funds rate that had complicated open market operations for many months persisted during the intermeeting period. Adjustment plus seasonal borrowing continued to fall considerably short of expectations in relation to the federal funds rate and, as contemplated by the Committee, operations continued to be implemented with some flexibility. In light of accumulating indications of additional weakness in borrowing demands relative to earlier patterns, the borrowing assumption was adjusted downward in the maintenance period beginning March 9. This technical adjustment was made to bring the assumed level of borrowing in line with recent experience and with desired overall conditions in reserve markets. Adjustment plus seasonal borrowing averaged about $450 million in the three reserve maintenance periods ending during the intermeeting interval.

The tightening of monetary policy along with growing market concerns about inflation led to sizable increases in interest rates during this period. In short-term markets, rates on most private issues rose nearly 1 percentage point, somewhat more than the increase in the federal funds rate, and the prime rate was raised in two steps of 1/2 percentage point. Rates on Treasury bills moved up appreciably less, at a time when there was no overall growth in the size of the weekly auctions and the supply available for competitive awards was reduced by substantial retail demand through noncompetitive tenders. In longer-term debt markets, yields generally were up about 1/3 to 1/2 percentage point, but yields on fixed-rate mortgages rose somewhat more. Major indexes of stock prices declined somewhat over the intermeeting period.

After weakening appreciably in January, growth of M2 and M3 strengthened in February and was estimated to have picked up further in March. On balance, however, the expansion of both aggregates had remained quite subdued this year, apparently reflecting increases in short-term market rates that had widened the opportunity costs of holding deposits. In addition, the outflows of funds and other adjustments associated with the problems of financially troubled thrift depository institutions probably reduced slightly the growth of the broader monetary aggregates. On average in the first quarter, growth of M2 was a little below the Committee's earlier expectations, while that of M3 was close to expectations. The levels of M2 and M3 in March were estimated to be, respectively, a little below and a little above the lower bounds of the Committee's 1989 ranges for those aggregates. M1 apparently declined on balance in the first quarter, while total domestic nonfinancial debt grew at a rate near the midpoint of the Committee's monitoring range for the year.

The staff projections prepared for this meeting suggested that the expansion in the nonfarm economy was likely to moderate appreciably during 1989. The projections assumed that the drought had ended and that normal growing conditions would prevail in agriculture this year. The staff anticipated somewhat faster increases in consumer prices and further cost pressures over the year ahead, especially because of reduced margins of unutilized labor and other production resources. A monetary policy to contain inflation necessarily would involve slower growth of overall demand and an easing of pressures on resources; to the extent the strength in demand were to persist, such a policy could imply additional pressures in financial markets. On that basis, the staff projected slower growth in consumer spending and in business fixed investment than had occurred in 1988 and some decline in housing construction. Foreign trade was expected to make a smaller contribution to growth in domestic output than in 1988. It was assumed that fiscal policy would become somewhat more restrictive over the year.

In the Committee's discussion of the economic situation and outlook, members focused on recent indicators of business activity that pointed at least tentatively to some moderation in the rate of economic growth. The members agreed that the extent and possible duration of any slowing in the expansion were subject to a great deal of uncertainty, and that more time was needed to assess whether recent developments augured for a sustained period of reduced expansion. The most recent softening in some of the economic data reflected at least in part a normal adjustment to unusual, weather-related strength at the start of the year and thus did not provide a firm basis for concluding that more than a pause, such as often occurs during an expansion, might be involved. Indeed, in the view of many members, the economy retained considerable momentum and there was a substantial risk that without further policy action the expansion might not slow sufficiently to relieve inflationary pressures. Others believed that policy already might have been tightened sufficiently to contain price pressures in 1989 and to permit progress to be made over time in bringing inflation under control. In addition to the indications of possible moderation in the expansion, these members pointed to the sluggish growth of the monetary aggregates and to the recent increases in interest rates and in the exchange value of the dollar as consistent with a less robust economy and a less inflationary environment over time.

In their review of specific developments bearing on the economic outlook, members reported that the expansion continued to display considerable vigor in many regions of the country, while at least modest overall improvement was occurring in some previously depressed areas. At the same time, many business contacts around the country provided indications of marginally less ebullient business conditions or business expectations. Manufacturing continued to bolster economic activity in many regions and was in turn buttressed by sales in export markets. Another positive factor was the apparent absence of excessive inventories in most industries relative to current sales. Some members referred to strength in the agricultural sector, although concerns about drought conditions were growing in some regions. With regard to developments pointing to reduced economic expansion, several members referred to signs that the growth in consumer spending had moderated, but it also was noted that the recent softness in the major automobile component had followed a spurt in late 1988 and might be reversed later. Some slowing in the growth of consumer spending was deemed to be desirable to assure satisfactory economic performance, given the need to ease inflationary pressures on labor and capital resources while accommodating continuing gains in exports. In addition, the rise in mortgage rates together with reduced investor demand had dimmed the outlook for housing, although unusual weather early this year made developments in this sector of the economy especially difficult to assess. Prospects for business investment were tempered by ongoing indications of weak construction activity in many areas and by some softness in new orders for business equipment. However, overall spending on business equipment was being well maintained and some rebound in total business fixed investment appeared likely after the slowdown in the latter part of 1988. On the whole the expansion, while apparently moderating, showed few signs of the kinds of imbalances that might lead to substantial or cumulative weakening.

The members recognized that the appreciation of the dollar over the past year, a byproduct of reliance on monetary policy to resist inflationary pressures, would help to damp price increases. On the other hand, a stronger dollar implied slower progress in reducing the nation's trade deficit. Nonetheless, many domestic industries remained competitive in world markets at current dollar exchange rates, and further growth in exports was seen as a reasonable expectation, at least over the quarters immediately ahead.

As at earlier meetings, the members gave considerable attention to the outlook for inflation. Recent large increases in key price indexes were disappointing, if not entirely unexpected, and depending on the performance of the volatile food and energy sectors, the rate of inflation might well remain relatively high over the near term. Labor market conditions remained tight in many areas, especially for skilled workers, and many business contacts reported pressures on both labor and non-labor costs. There also were indications that businesses were finding it less difficult to pass on rising costs by increasing prices, although efforts to meet competitive pressures by curbing costs were continuing. At the same time, historical experience suggested that a sustained pickup of inflation was unlikely in light of the reduced rate of money growth that had been experienced for an extended period, especially if such growth were to continue to be relatively restrained.

In the Committee's discussion of policy implementation for the intermeeting period ahead, a majority of the members expressed a clear preference for maintaining unchanged conditions of reserve availability. They emphasized the uncertainties surrounding the current business outlook and the desirability of waiting to see if the tentative indications of some slowing in the expansion signaled the start of a sustained period of slower economic growth and reduced inflationary pressures. Because of the usual lags in the impact of monetary policy on the economy and prices, the full effect of the firming in 1988 had not yet been felt, much less the effect of the substantial further policy tightening this year. Other members, while willing to accept an unchanged policy for now, preferred an immediate move to further restraint. They gave more weight to the possibility that the current slowing of the expansion might be inadequate to restrain inflationary pressures, and they felt that additional restraint should be implemented promptly to provide better assurance that sufficient monetary restraint was in place.

Most members endorsed the view that, in the absence of unexpected developments, policy implementation should resist any perceptions that monetary policy might be easing. A number also commented that they would not oppose some further small rise in money market interest rates. More generally, a majority of the members felt that policy implementation over the intermeeting period should be adjusted more readily and promptly toward greater restraint than toward ease. Some who preferred an immediate move to more restraint indicated that such an understanding would make an unchanged policy acceptable to them at this time. Other members preferred not to bias the approach to intermeeting adjustments although all but one could accept an asymmetric directive. A number of members urged caution in implementing any policy change; in particular, they wanted to avoid reacting to a single new piece of information and preferred instead to wait for evidence to accumulate on the possible need for a further tightening of policy.

The members took account of a staff projection which indicated that with unchanged reserve conditions, expansion of M2 and M3 was likely to remain subdued during the second quarter, although such growth probably would be somewhat faster than in the current quarter. The expansion in these monetary aggregates was likely to continue to be held back by the relatively slow adjustment of offering rates on liquid deposit accounts in response to the increases that had occurred in market interest rates. Additionally, developments at thrift institutions might continue to depress growth of the broad aggregates, but probably by less than in the first quarter, assuming no new developments that aggravated depositor concerns. On a cumulative basis from the fourth quarter to June, the projection implied expansion of M2 at a rate just below the lower bound of the Committee's 3 to 7 percent range for the year, while expansion of M3 would be in the lower half of the Committee's 3-1/2 to 7-1/2 percent range. A number of members stressed that slow monetary growth was a desirable development in current circumstances, but some also expressed concern that the slowing could be overdone.

In light of the tightening of reserve conditions that had occurred since the February meeting and the related increase in the federal funds rate, the members decided to raise the intermeeting range for the federal funds rate by 1 percentage point to 8 to 12 percent.

Such an increase implied that the expected federal funds rate would average closer to the middle of the range. That range provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded.

At the conclusion of the Committee's discussion, all but one member indicated that they favored or could accept a directive that called for maintaining the current degree of pressure on reserve positions and that provided for giving particular weight to potential developments that might require some firming during the intermeeting period. Accordingly, some added reserve restraint would be acceptable, or some slight lessening of reserve pressure might be acceptable, over the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 3 percent and 5 percent respectively over the three-month period from March to June. It was understood that operations would continue to be conducted with some flexibility in light of the persisting uncertainty in the relationship between the demand for borrowed reserves and the federal funds rate.

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 activity in the nonfarm economy has expanded appreciably further in the current quarter. After strong gains in the fourth quarter, total nonfarm payroll employment rose markedly further in January and February. The civilian unemployment rate fell considerably to 5.1 percent in February. Industrial

production was unchanged in February after rising substantially over the previous several months. After a weather-related surge in January, housing starts fell in February to a level somewhat below their average in the fourth quarter. Growth in consumer spending moderated in January and February. Recent indicators of business capital spending suggest a rebound after a decline in the fourth quarter. The nominal U.S. merchandise trade deficit was larger in the fourth quarter than in the third quarter; the preliminary estimate of the deficit for January was smaller than the average for the fourth quarter. The latest information on prices suggests some pickup in inflation from recent trends.

Interest rates in both short- and long-term markets have risen considerably since the Committee meeting in early February. On February 24 the Federal Reserve Board approved an increase in the discount rate from 6-1/2 to 7 percent. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies rose somewhat on balance over the intermeeting period.

Growth of M2 and M3 strengthened in February and apparently picked up further in March; over the first quarter such expansion was about in line with Committee expectations. M1 appears to have declined marginally since December.

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 February established ranges for growth of M2 and M3 of 3 to 7 percent and 3-1/2 to 7-1/2 percent, respectively, measured from the fourth quarter of 1988 to the fourth quarter of 1989. The monitoring range for growth of total domestic nonfinancial debt was set at 6-1/2 to 10-1/2 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of movements in their velocities, developments in the economy and financial markets, and progress toward price level stability.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign

> exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, 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 March through June at annual rates of about 3 and 5 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 8 to 12 percent.

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

Ms. Seger supported the decision to keep policy unchanged in the period immediately ahead, but she could not accept a directive that allowed intermeeting adjustments to be made more readily in a firming than in an easing direction as new information became available. The lagged effects of the substantial tightening that had been implemented earlier coupled with current indications of slower economic growth suggested that policy already had been tightened enough to lead to lower inflation over time. Under current circumstances, further firming carried substantial risks to interest-sensitive sectors of the economy, the level of the dollar in foreign exchange markets, and the continued growth of the economy.

2. Authorization for Domestic Open Market Operations

Effective March 29, 1989, the Committee approved a temporary increase of $2 billion, to $8 billion, in the limit between Committee meetings on changes in System Account holdings of U.S. government and federal agency securities that is specified in paragraph 1(a) of the

Authorization for Domestic Open Market Operations. The increase was effective for the intermeeting period ending with the close of business on May 16, 1989.

> Votes for this action: Messrs. Greenspan, Corrigan, Angell, Guffey, Heller, Johnson, Keehn, Kelley, LaWare, Melzer, Ms. Seger, and Mr. Syron. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that the usual leeway of $6 billion for changes in System Account holdings might not be sufficient over the intermeeting period because of seasonal increases in currency in circulation and in required reserves and a large rise in Treasury balances at the Federal Reserve Banks after the tax payment date in mid-April.