FEDERAL RESERVE press release

For Use at 4:30 p.m.   March 30, 1990

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on February 6-7, 1990.

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 February 6-7, 1990

1. Domestic policy directive

The information reviewed at this meeting suggested continued but sluggish expansion in overall economic activity, with conditions uneven across sectors. Industrial activity remained weak, partly because of the depressing effects of an inventory correction on manufacturing output, while the service-producing sector of the economy continued to grow moderately. Aggregate price measures had increased more slowly over most of the second half of 1989, but unusually cold weather in December put temporary upward pressure on food and energy prices. The latest data on labor compensation suggested no significant change in prevailing trends.

Total nonfarm payroll employment increased substantially in January after growing at a reduced pace on average in previous months. Employment surged in the service-producing sector, and unusually warm weather brought a rebound in hiring in the construction industry. These increases more than offset a large decline in factory jobs associated with sizable short-term layoffs in the motor vehicle and related industries. The civilian unemployment rate remained at the 5.3 percent level that had prevailed over most of 1989.

Partial data for January indicated that industrial production fell sharply. Automobile producers cut back temporarily on assemblies to help reduce bulging inventories of unsold vehicles, and the January thaw in the weather apparently brought a reduction in the generation of electricity that more than reversed a December surge. Abstracting from a number of transitory factors affecting production in recent months, industrial activity had changed little since the third quarter, although recent orders data suggested some underlying support for manufacturing output over the near term. Total industrial capacity utilization remained at a relatively high level in the fourth quarter but was down somewhat from its level a year earlier.

Adjusted for inflation, consumer spending was little changed in the fourth quarter. Strong gains in spending for services offset declines in purchases of consumer goods, especially new cars and light trucks. Although some of the strength in the services category reflected temporarily high energy-related expenditures, spending for medical and transportation services apparently remained strong throughout the fourth quarter. Near the end of the year, consumers responded positively to incentive programs introduced by automakers to reduce bloated inventories, and higher sales of domestically produced cars carried over to January. Residential construction in the fourth quarter was little changed from its third-quarter level, partly because December's unusually cold weather depressed single-family housing starts in that month. Multifamily starts remained at a low level as vacancy rates for such units moved still higher.

Business capital spending, adjusted for inflation, declined in the fourth quarter because of strike activity in the aircraft industry and sharply lower outlays for motor vehicles. Spending for equipment other than motor vehicles and aircraft rose; sizable increases were registered for computers and communications equipment, and moderate gains were evident for a wide variety of heavy machinery. A pickup toward the end of 1989 in new orders for equipment other than aircraft, and the return to work of striking aircraft workers, pointed to some improvement in equipment spending in the current quarter. Nonresidential construction activity apparently weakened a little in the fourth quarter, partly reflecting the persisting high vacancy rates for office and other commercial space. Manufacturers' inventories fell in December after moderate increases in the two previous months; for the fourth quarter as a whole, increases in factory stocks were well below those for previous quarters in 1989. By contrast, nonauto retail stockbuilding accelerated late in the year, and there were reports that inventory-sales ratios at general merchandisers were higher than desired.

The nominal U.S. merchandise trade deficit rose slightly in November from a revised October level. For the two months together, the deficit was up substantially from the averages for both the third quarter and the first nine months of 1989. Total exports for the two-month period were little changed from their third-quarter level as a reduction in exports of aircraft, resulting from strike activity, offset moderate increases in a broad array of other products. Total imports increased rapidly in October-November, with imports of capital goods being especially strong. Indicators of economic activity in major foreign industrial countries were mixed during the fourth quarter of 1989. Growth continued strong in Japan, and most indicators pointed to renewed strength for Germany, Italy, and France. By contrast, growth was sluggish in the United Kingdom and Canada.

Producer prices for finished goods jumped in December, largely reflecting higher prices for energy products, most notably for heating oil. Abstracting from food and energy items, producer prices rose faster in December than in November, but the rate of increase in the fourth quarter as a whole remained at the reduced third-quarter pace. At the consumer level, prices rose somewhat more rapidly toward the end of 1989, and food and energy prices apparently increased substantially further in January. Among nonfood, non-energy categories, discounting of apparel and home furnishings was more than offset by a sharp rise in prices of new cars and by another month of sizable price increases for services.

At its meeting on December 18-19, 1989, the Committee adopted a directive that called for a slight easing in the degree of pressure on reserve positions but that provided for giving equal weight to subsequent developments that might require some easing or tightening during the intermeeting period. Accordingly, the Committee agreed that slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period, depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with growth of M2 and M3 over the four-month period from November 1989 to March 1990 at annual rates of about 8-1/2 percent and 5-1/2 percent respectively.

Immediately after the Committee meeting, open market operations were directed toward implementing the slight easing in the degree of pressure on reserve positions called for by the Committee. Reserve conditions then remained essentially unchanged over the rest of the intermeeting period. Adjustment plus seasonal borrowing averaged a little more than $300 million for the intermeeting period; the volume was boosted by reserve shortfalls, borrowing by large banks over the long holiday weekends, and, in the latter part of the interval, borrowing by a sizable bank whose normal access to liquidity had been impaired. The federal funds rate declined from about 8-1/2 percent at the time of the December meeting to around 8-1/4 percent shortly thereafter; except for some firming in the last week of 1989 owing to reserve shortfalls and year-end pressures, the funds rate remained in the vicinity of that lower level. Other private short-term market rates also declined over the period, including a 1/2 percentage point drop in the prime rate to 10 percent, while Treasury bill rates increased somewhat.

Yields on intermediate- and long-term debt instruments rose considerably over the intermeeting period. Some stronger-than-anticipated economic data and rising food and energy prices were interpreted in the financial markets as pointing away from recession and as suggesting little if any moderation in underlying inflation trends. Increases in interest rates abroad probably also had an influence on U.S. interest rates. Stock prices approached new highs at the start of the year but have fallen substantially since then.

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, as monetary conditions abroad tightened somewhat on average while those in the United States eased slightly. The dollar's movements against individual currencies were mixed; most of its depreciation occurred against the German mark, which continued to be buoyed by developments in Eastern Europe, and against related European currencies. On net, the U.S. dollar remained relatively firm against the yen and the Canadian dollar; the latter declined sharply as Canadian short-term interest rates edged lower amid signs of slow growth in the Canadian economy and a consequent easing of inflation pressures.

Growth of M2, measured on a benchmarked and seasonally revised basis, remained relatively strong in the fourth quarter of 1989; for the year, this aggregate expanded at a rate a little below the middle of the Committee's annual range. Partly as a result of further contraction in the assets and associated funding needs of thrift institutions, M3 grew more slowly in the fourth quarter and, for the year, expanded at a rate just below the lower bound of its annual range. In January, both of the broader aggregates increased at slower rates. A sharp drop in transactions deposits damped expansion of M2, even though retail-type savings deposits remained strong and money market funds evidently benefited from funds flowing out of weakening stock and bond markets. Growth of M3 in January slowed by less than that of M2.

The staff projection prepared for this meeting suggested that the economy was likely to expand relatively slowly over the next several quarters. In the near term, production adjustments to eliminate excess inventories, most notably in the motor vehicles industry, were expected to depress manufacturing activity and overall growth; some pickup in the expansion was anticipated after the inventory correction was completed, but final sales were projected to continue growing at a relatively sluggish pace. Homebuilding might rebound somewhat in the near term after being disrupted by December's cold weather, but prevailing interest rates and possible cutbacks in construction lending by thrifts likely would restrain residential construction activity throughout the year. The projection assumed that fiscal policy would be moderately restrictive and that net exports would make little contribution to growth of domestic production in 1990. The expansion of consumer demand would be damped by slow gains in employment and associated limited growth in real disposable incomes. With pressures on labor and other production resources expected to ease only gradually, little improvement was anticipated in the underlying trend of inflation over the next several quarters.

In their discussion of the economic situation and outlook, the Committee members generally agreed that continuing growth in economic activity remained a reasonable expectation for the year ahead. Several observed that, on the whole, recent indicators of business conditions provided some assurance that the expansion was no longer weakening and indeed that a modest acceleration might be under way from the considerably reduced growth experienced in the fourth quarter. The members acknowledged that there were considerable risks, stemming mainly from the financial side, of a weaker than projected expansion, and some did not rule out the possibility of a downturn. In the latter connection, several commented that they had observed a sense of unease and fragility in the business and financial communities arising from such factors as declining profit margins, heavy debt burdens, and problems in certain sectors of the financial markets that were contributing to greater caution on the part of lenders and a reduced availability of credit to some borrowers. With regard to the outlook for inflation, members remained generally optimistic that moderating pressures on labor and other resources would lead in time to a lower rate of inflation. However, most members saw little prospect that significant progress, if any, would be made in reducing the underlying rate of inflation in the quarters immediately ahead. Indeed, in part because of temporary pressures in the food and energy sectors, key measures of inflation might well register larger increases in the near term before turning down later.

In keeping with the usual practice at meetings when the Committee establishes its longer-run ranges for growth of the monetary and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared projections of economic activity, the rate of unemployment, and inflation for the year 1990. In making these forecasts, the members took account of the Committee's policy of continuing restraint on demand to resist any increase in inflation pressures and to foster price stability over time. For the period from the fourth quarter of 1989 to the fourth quarter of 1990, the forecasts for growth of real GNP had a central tendency of 1-3/4 to 2 percent, a pace close to that experienced in 1989 excluding the direct effects of the rebound in farm output after the drought in 1988. Estimates of the civilian rate of unemployment in the fourth quarter of 1990 were concentrated in a range of 5-1/2 to 5-3/4 percent. The associated pressures on prices resulted in projected increases in the consumer price index centered on rates of 4 to 4-1/2 percent for the year, compared with a rise of 4-1/2 percent in 1989. Forecasts for growth of nominal GNP had a central tendency of 5-1/2 to 6-1/2 percent. The forecasts assumed that changes in the foreign exchange value of the dollar would not be of sufficient magnitude to have a significant effect on the economy or prices during 1990.

In the Committee's discussion of developments bearing on the economic outlook, the members emphasized that despite indications of continuing growth in overall business activity, there were obvious areas of weakness in the economy, notably in manufacturing across much of the nation and in construction in many localities. Business sentiment appeared to have deteriorated in some areas, perhaps more than was justified by actual developments. While local business conditions were clearly uneven, business activity was generally characterized as growing on an overall basis in the various regions, including recent evidence of a modest pickup in some previously depressed parts of the country.

With regard to individual sectors of the economy, the outlook for retail sales was clouded to some extent by the uncertain prospects for motor vehicles and the financial problems being experienced by some major retailers; nonetheless, in the context of expected further gains in disposable incomes, many members expected overall consumer spending to be relatively well maintained. Business inventories probably were falling in the current quarter, largely reflecting sharp declines in stocks of motor vehicles, but once the correction in that industry was completed, some renewed increases in overall inventory investment were anticipated in line with expanding sales. Current indicators suggested that business fixed investment might be reasonably well maintained, but it also was noted that overbuilding of commercial real estate in many areas would restrain overall nonresidential construction and more generally that depressed profits and cash flows could limit gains in business investment. Concerning the outlook for residential construction, conditions in local housing markets varied markedly and the prospects for the nation were difficult to assess. Negative developments included higher mortgage interest rates, a reduced availability of financing for many developers, and the overhang of large inventories of housing units held by the Resolution Trust Corporation (RTC). Nonetheless, housing demand was holding up in many areas and booming in a few, and on balance most members expected little change this year in overall expenditures for residential construction. A number commented that the prospects for exports were relatively bright; foreign demand was reported to be robust for many types of goods, and overall exports would be given some impetus over time by the depreciation of the dollar over the past several months.

Turning to the outlook for inflation, members noted that broad measures of labor compensation did not suggest any lessening of pressures. Unit labor costs appeared to be rising at a faster pace recently than the underlying rate of inflation, squeezing profit margins. Commodity prices displayed mixed changes but generally remained on a high plateau. Business contacts and broader surveys indicated a widespread expectation that the current rate of inflation would continue. Moreover, with higher social security taxes and a rising minimum wage adding to labor costs and earlier increases in producer food and energy costs not yet fully transmitted to retail prices, some measures of inflation were expected to show sharper increases over the near term. On the other hand, reports from a number of business contacts indicated that input prices, especially for raw materials, had stabilized or declined in recent months. More generally, a number of members commented that continued limited growth in business activity at a time of uncertainties and concerns associated with various financial problems and declining real estate values in many areas should contribute to some restraint in overall inflationary behavior.

Against the background of the members' views on the economic outlook and in keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee reviewed the ranges that it had established on a tentative basis in July 1989 for growth of the monetary and debt aggregates in 1990. The tentative ranges, which were unchanged from those for 1989, included expansion of 3 to 7 percent for M2 and 3-1/2 to 7-1/2 percent for M3, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The monitoring range for growth of total domestic nonfinancial debt had been set at 6-1/2 to 10-1/2 percent, also unchanged from 1989.

With regard to M2, on which much of the discussion was focused, a majority of the members concluded that retention of the tentative range of 3 to 7 percent would best assure the flexibility that the Committee was likely to need to implement its policy objectives during the year. A staff analysis prepared for this meeting indicated that, were interest rates to remain near recent levels, a somewhat higher rate of M2 growth than had occurred in any of the past three years was likely to be consistent with some reduction in the expansion of nominal GNP. According to this analysis, the lagged effects of earlier declines in market interest rates would continue to boost M2 growth in the first part of 1990, and the velocity of M2 was likely to fall for the year as a whole. To the extent that the projected weakness in M2 velocity turned out to be correct, it implied M2 growth toward the upper end of the tentative range on the basis of the central tendency of the members' forecasts of nominal GNP.

Given this outlook, an unchanged range for M2 still left considerable leeway for the Committee to embark on a more aggressive policy to restrain inflation, should developments during the year suggest an intensification of inflationary pressures or provide an opportunity to tilt the implementation of policy toward greater restraint and faster progress against inflation without impairing the forward momentum of the economy. Thus, although the Committee recognized that over time lower ranges and slower M2 growth would be compatible with price stability, retention of the current range did not signal a diminished determination to move toward the objective of price stability.

Preferences for slightly higher or somewhat lower ranges for M2 also were expressed. The arguments in favor of a higher range focused on the risks of a weaker economy than was anticipated currently and the related desirability of more maneuvering room for an easing of short-run policy if such were needed to help avert a cumulative deterioration in economic activity. In those circumstances, faster monetary growth would not be inconsistent with the Committee's long-term commitment to price stability. Other members believed that a somewhat reduced range would allow adequate growth in M2 to sustain moderate expansion in economic activity and would provide a desirable signal of the System's commitment to an anti-inflationary policy. In this connection, the credibility of the System's anti-inflationary policy was seen as an important channel for reducing inflationary expectations directly and thereby lessening the economic costs and time needed to achieve price stability. These members expressed concern that growth around the upper end of a 3 to 7 percent range might well preclude any progress in reducing inflation this year and might make it more difficult to achieve such progress later. For some of these members, however, a 3 to 7 percent range would be acceptable if its upper limit was viewed as a firm constraint on actual growth and if a clear explanation was made of the Committee's commitment to achieve price stability over time.

Turning to the ranges for M3 and debt, most of the members indicated that they favored or could accept reductions from the tentative ranges that had been adopted in July 1989 for this year. Some reduction in the range for M3 was thought to be consistent with an unchanged range for M2 for technical reasons associated with the restructuring of the thrift industry and related shrinkage in thrift institution balance sheets. Declines in thrift institution assets and associated funding needs, including liabilities in M3, now seemed likely to be larger in 1990 than had been anticipated last summer, reflecting continued efforts of solvent institutions to meet capital standards as well as the closing of insolvent institutions. Beyond that, while a reduction in the M3 range, especially if it was limited, might have little implication for policy, many members believed that the Committee should take advantage of every opportunity to reduce its ranges toward levels that were consistent with price stability. With regard to the monitoring range for total domestic nonfinancial debt, the members expected the expansion of such debt to moderate for a fourth year in 1990, in large measure because of anticipated reductions in debt creation associated with corporate merger and acquisition activities but also because of some probable ebbing in the growth of household debt. The prospect of slower growth of debt was welcome, given concerns about strains associated with highly leveraged borrowers and high debt servicing obligations.

A few members indicated a preference for retaining the somewhat higher ranges for M3 and debt that had been adopted on a tentative basis for this year. In their view, lowering those ranges would tend to send potentially confusing signals, raising questions as to why the M2 range was not reduced also. Also, disparate adjustments in the ranges for the various aggregates could foster an unwarranted impression of the precision with which the Committee felt it could evaluate the ranges.

The members generally agreed that setting 1990 target ranges for M2 and particularly for M3 was rendered more difficult by uncertainty about developments affecting thrift institutions, especially given the relatively limited basis in past experience for gauging the likely impact of such developments. The establishment of an appropriate range for the growth of nonfinancial debt also was complicated by uncertainty about the extent to which Treasury borrowing would be used to carry the assets of failed thrift institutions as opposed to funding from financial-sector sources through the RTC. With these questions adding to the usual uncertainty about the relationship of movements in the aggregates to broad measures of economic performance, the Committee decided to retain the 4 percentage point width of the ranges. It also agreed that the implementation of policy should continue to take into account, in addition to monetary growth and its velocity, indications of inflationary pressures in the economy, the strength of business activity, and developments in domestic and international financial markets.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored or could accept the M2 range for 1990 that had been established on a tentative basis in July 1989 and reductions of one percentage point and 1-1/2 percentage points respectively in the tentative ranges for M3 and nonfinancial debt. Accordingly, the Committee approved the following paragraph relating to its 1990 ranges for inclusion in the domestic policy directive:

> 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 this meeting established ranges for growth of M2 and M3 of 3 to 7 percent and 2-1/2 to 6-1/2 percent respectively, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The monitoring range for growth of total domestic nonfinancial debt was set at 5 to 9 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progess toward price stability, movements in their velocities, and developments in the economy and financial markets.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Johnson, Kelley, and LaWare. Votes against this action: Mr. Hoskins, Ms. Seger, and Mr. Stern.

Messrs. Hoskins and Stern dissented because they wanted a lower range for M2. They were concerned that growth around the upper end of a 3 to 7 percent range would not be compatible with progress in reducing the rate of inflation this year. An upper limit of 6 percent would be preferable and would provide adequate room in their view for policy to foster sustained economic expansion. Mr. Hoskins also stressed the desirability of a predictable and credible monetary policy, which he believed should include persistent reductions in the ranges to levels that would be consistent with stable prices. The favorable effects of such a policy on inflationary expectations would tend to lessen the costs and also accelerate the achievement of price stability.

Ms. Seger dissented because she believed that the M2 range should be raised to at least 3-1/2 to 7-1/2 percent. In her view the considerable downside risks to the expansion called for some added room to accommodate the possible need for a more stimulative policy and somewhat faster M2 growth than was contemplated by an unchanged range. In particular, a shortfall in aggregate demands during the first half of the year might well require some easing of policy aimed at countering developing weakness in the economy. In such circumstances, M2 growth somewhat above 7 percent would not be inconsistent with the Committee's anti-inflation objective. She could accept unchanged ranges for growth of M3 and nonfinancial debt, given the outlook for somewhat slower expansion of both aggregates in relation to M2 than the Committee had anticipated in July 1989.

Turning to policy implementation for the intermeeting period ahead, a majority of the members favored steady reserve conditions. Given indications of some pickup in activity from the latter part of 1989, such a policy offered the best prospects at this point of reconciling the Committee's objective of acceptable and sustained economic growth with that of some reduction over time in inflationary pressures on labor and other resources. A tightening of policy might have some advantages in terms of moderating monetary growth and improving inflationary expectations, but in this view such a policy would incur too much risk of creating financial conditions that could lead to a weaker economy. Conversely, significantly lower interest rates could have inflationary consequences in an economy that already was operating at relatively high employment levels, partly through their effects on the dollar in the foreign exchange markets. Conditions in the economy and in financial markets, both in the United States and abroad, suggested that monetary policy needed to convey a sense of stability.

Other members acknowledged that adjustments in monetary policy needed to be made with a special degree of caution in current circumstances, but on balance they assessed the risks and the related advantages and disadvantages of a change in policy somewhat differently. In one view, the risks of a recession argued for a prompt adjustment toward somewhat less monetary restraint, especially given the need to bolster relatively interest-sensitive sectors of the economy such as housing and motor vehicles. A differing view focused on the desirability of a somewhat tighter policy at this juncture, particularly in light of the outlook for relatively little progress against inflation as the business expansion tended to strengthen. One member gave special emphasis to the desirability of limiting M2 growth to a path closer to the middle of the Committee's range for 1990 to help assure that progress would be made this year in moderating inflationary pressures.

In the Committee's consideration of possible adjustments to the degree of reserve pressure during the intermeeting period, a majority of the members supported a directive that did not contain any bias toward tightening or easing. They felt that a symmetric instruction was consistent at this point with their general preference for a stable policy and that an intermeeting adjustment should be made only in the event of particularly conclusive economic or financial evidence, including a substantial deviation in monetary growth from current expectations. One member who preferred a slightly tighter policy indicated that an unchanged policy that was biased toward restraint would be acceptable.

Members noted that seasonal borrowing was likely to turn up from its January lows so that some increase in the total of adjustment plus seasonal borrowing would be associated with a given degree of reserve restraint and a given federal funds rate. It was understood that some increase in the borrowing assumption would be made at the start of the intermeeting period and that further adjustments might be made later during the period, subject to the Chairman's review. In keeping with the usual practice, persisting borrowings by troubled depository institutions that had not been classified as extended credit would be treated as nonborrowed reserves in setting target growth paths for reserves. More generally, in light of the uncertainties that were involved, the Manager would continue to exercise flexibility in his approach to the borrowing assumption.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored or could accept a directive that called for an unchanged degree of pressure on reserve positions. Some firming or some easing of reserve conditions would be acceptable during the intermeeting period depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 7 and 3-1/2 percent respectively over the three-month period from December to March. 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 6 to 10 percent.

At the conclusion of the Committee's 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 is continuing to expand despite weakness in the industrial sector. Total nonfarm payroll employment increased substantially in January after growing at a reduced pace on average in previous months; a surge in the service-producing sector and a weather-related rebound in construction were only partly offset by a large decline in the manufacturing sector. The civilian unemployment rate was unchanged at 5.3 percent. Partial data suggest that industrial production in January was appreciably below its average in the fourth quarter. Adjusted for inflation, strong gains in consumer spending on

services in the fourth quarter offset declines in consumer purchases of goods, especially motor vehicles. Unusually cold weather depressed housing starts appreciably in December, and residential construction in the fourth quarter was little changed from its third-quarter level. Business capital spending, adjusted for inflation, declined in the fourth quarter as a result of lower expenditures on motor vehicles and strike activity in the aircraft industry; spending on other types of capital goods was strong, however, and new orders for equipment picked up toward the end of the year. The nominal U.S. merchandise trade deficit widened in October-November from the third-quarter rate. Consumer prices had risen somewhat more rapidly toward the end of 1989, and prices of food and energy apparently increased substantially further in January. The latest data on labor compensation suggest no significant change in prevailing trends.

Interest rates have risen in intermediate- and long-term debt markets since the Committee meeting on December 18-19; in short-term markets, the federal funds rate has declined, and other short-term rates show mixed changes over the period. 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; most of the depreciation was against the German mark and related European currencies, and there was little change against the yen.

Growth of M2 slowed in January, almost entirely reflecting a drop in transaction deposits. Growth of M3 also slowed in January as assets of thrift institutions and their associated funding needs apparently continued to contract. For the year 1989, M2 expanded at a rate a little below the middle of the Committee's annual range, and M3 grew at a rate slightly below the lower bound of its annual range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 3 to 7 percent and 2-1/2 to 6-1/2 percent respectively, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The monitoring range for growth of total domestic nonfinancial debt was set at 5 to 9 percent for the year. 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. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint or slightly 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 December through March at annual rates of about 7 and 3-1/2 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 6 to 10 percent.

Votes for the paragraph on short-term policy implementation: Messrs. Greenspan, Corrigan, Angell, Boehne, Johnson, Kelley, LaWare, and Stern. Votes against this action: Messrs. Boykin and Hoskins and Ms. Seger.

While taking account of the various elements of weakness and fragility in the economy, Mr. Boykin dissented because he preferred a policy directive tilted toward increased reserve pressures should economic and financial conditions warrant. This view was based on his concerns regarding the lagged effects of policy actions and the risks of delaying decisions until there was full confirmation of inflationary pressures. In this context, Mr. Boykin expressed his preference for dealing promptly with inflation if the Committee wished to make progress toward its long-stated goal of lowering the rate of inflation.

Mr. Hoskins dissented because he preferred some firming of reserve conditions. He recognized that there was some financial fragility in the economy, but he believed that underlying inflation pressures were relatively strong and that the balance of risks pointed to a need for greater monetary restraint to curb such inflation. He emphasized the desirability of tightening monetary policy gradually to reduce monetary growth to a pace closer to the midpoint of the Committee's range for the year.

Ms. Seger's dissent reflected a preference for some easing of reserve conditions at this point. In her view, even a limited decline in interest rates would provide timely assistance to relatively weak, interest-sensitive sectors of the economy such as housing and motor vehicles and would tend to sustain the expansion itself without adding to inflation risks in the economy.

2. Review of Continuing Authorizations

The Committee followed its customary practice of reviewing all of its continuing authorizations and directives at this first regular meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning January 1, 1990. The Committee reaffirmed the authorization for foreign currency operations, the foreign currency directive, and the procedural instructions with respect to foreign currency operations in the forms in which they were currently outstanding.

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

3. Authorization for Domestic Open Market Operations

On the recommendation of the Manager for Domestic Operations, the Committee amended paragraph 1(a) of the authorization for domestic open market operations to raise from $6 billion to $8 billion the limit on intermeeting changes in System account holdings of U.S. government and federal agency securities. The increase was the first permanent change in the limit since March 1985 when it was raised from $4 billion to $6 billion. The Manager indicated that temporary increases had been authorized more frequently in recent years and that the existing limit also was approached more often during intermeeting intervals when no temporary increase was requested. A permanent increase to $8 billion would reduce the number of occasions requiring special Committee action, while still calling needs for particularly large changes to the Committee's attention. The Committee concurred in the Manager's view that a $2 billion increase would be appropriate.

Accordingly, effective February 6, 1990, paragraph 1(a) of the authorization for domestic open market operations was amended to read as follows:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U. S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U. S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U. S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than $8.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

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