FEDERAL RESERVE press release

For Use at 4:30 p.m. November 8, 1991

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 October 1, 1991.

The record for each meeting of the Committee is made available a few days after the next regularly scheduled meeting and subsequently is published in the Federal Reserve Bulletin and the Board's Annual Report. The summary description of economic and financial conditions contained in each record is based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting Held on October 1, 1991

Domestic Policy Directive:

The information reviewed at this meeting suggested on balance that the economy was continuing to recover from the recession but that its performance was uneven across sectors. Consumer spending was rising, especially for durable goods, but businesses remained cautious about investing in plant, equipment, or inventories. On the production side, the advance in manufacturing activity continued, although the recovery in housing construction appeared to have lost some of the momentum evident through the spring, and little growth was occurring in much of the service-producing sector. The pickup in production had been reflected primarily in a sizable rise in aggregate hours worked rather than in the number of jobs. Increases in prices appeared to be on a gradual downtrend.

In August, total nonfarm payroll employment retraced part of a July decline and on balance was little changed since March. Manufacturing employment registered widespread gains in August, and the factory workweek rose to its highest level in nearly a year. In the private service-producing sector, new hires in health and business services displayed appreciable strength, but the rest of this sector, particularly wholesale and retail trade, remained weak. Jobs in construction continued to decline, and employment reductions occurred in state and local governments for a second straight month. The civilian unemployment rate was 6.8 percent in both July and August.

Industrial production posted a moderate further rise in August after several months of sizable gains. Assemblies of motor vehicles slowed in August when a number of plants were closed temporarily for model changeovers, but output of other consumer durables continued to increase and output of consumer nondurables rebounded. Production of business equipment remained weak and on balance had changed little since spring after dropping sharply in late 1990 and early 1991. Total industrial capacity utilization edged up in August, and over the course of recent months it had retraced only a small part of the decline that occurred between mid-1990 and March 1991. Operating rates in manufacturing had recovered to a somewhat greater extent, reflecting in part the rebound in motor-vehicle assemblies.

Retail sales fell in August, mostly because of a decline in sales of motor vehicles. For July and August together, nonautomotive retail sales were up considerably on balance. After increasing appreciably since January, housing starts rose only slightly further in July and August. The number of permits for construction of single-family homes declined in August and was unchanged from the second-quarter level. In the multifamily sector, construction activity remained near its thirty-year low. Sales of new homes were down in July, while sales of existing homes fell in both July and August.

Shipments of nondefense capital goods, measured in nominal terms, were down on balance over July and August. Taking into account the substantial recent declines in the prices of computing equipment, however, real outlays for business equipment apparently rose on balance over the two months as reduced spending on industrial equipment was more than offset by increased investment in computers and, to a lesser extent, transportation equipment. Recent data on orders and shipments of nondefense capital goods pointed to a further small rise in real outlays for business equipment. The value of nonresidential construction put in place in July was substantially below the second-quarter level, reflecting the continuing decline in office, other commercial, and hotel construction. Available information on new contracts suggested a continuing downtrend in nonresidential construction.

The nominal U.S. merchandise trade deficit widened substantially in July to a rate considerably above its average in the second quarter. In July, the value of imports rose sharply from a low second-quarter average; the rise was concentrated in consumer goods, automobiles, and computers. The value of exports changed little in July from a second-quarter level that was high compared with other recent quarters; the improvement in exports in recent months had been the result of the strong performance of capital goods. The pattern of economic activity in the major foreign industrial countries continued to be mixed. In western Germany and Japan, growth fell sharply in the second quarter and apparently remained slow in the third quarter, while economic activity picked up in some other industrial countries in the second quarter.

Producer prices of finished goods were unchanged over July and August after declining on balance in earlier months of the year. Further reductions in food prices in August, notably prices of fresh fruits and vegetables, offset a rebound in the prices of finished energy goods. Excluding food and energy, the increase in producer prices of finished goods in the twelve months ended in August was little different from the rise over the previous twelve months. At the consumer level, increases in prices were small in July and August because of declines in the prices of food and energy items. Although nonfood, non-energy consumer prices had risen somewhat faster in recent months, the twelve-month change in this index had continued to edge down.

At its meeting on August 20, 1991, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that also provided for giving special weight to potential developments that might require some further easing during the intermeeting period. Accordingly, the Committee decided that somewhat greater reserve restraint might be acceptable or somewhat lesser reserve restraint would be acceptable during the intermeeting period depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at the August meeting were expected to be consistent with a resumption in the growth of M2 and M3 over the balance of the third quarter. However, in view of the declines in these aggregates that had taken place since June, the Committee anticipated that, over the three-month period from June through September, M2 would be little changed and M3 would be down at an annual rate of about 1 percent.

Open market operations during the intermeeting period were directed initially toward maintaining the existing pressures on reserve positions. Subsequently, on September 13, the discount rate was lowered by 1/2 percentage point to 5 percent and part of this decline was allowed to show through to the federal funds rate. Two technical decreases to expected levels of adjustment plus seasonal borrowing were made during the intermeeting period to reflect the abatement of seasonal credit needs. Early in the period, adjustment plus seasonal borrowing averaged nearly $400 million. Later, in part because of the decline in seasonal funding needs, the volume of borrowing slipped below $350 million. The federal funds rate averaged around 5-1/2 percent during the first part of the intermeeting period, but after the discount rate was reduced, the federal funds rate edged down to a little above 5-1/4 percent.

In the period immediately after the August 20 meeting, most other market interest rates rose slightly, reflecting in part the absence of an anticipated easing of monetary policy and data indicating that the expansion might be more robust than expected. Treasury bill rates also were boosted by an unwinding of the flight to quality and liquidity that had been prompted by the attempted coup in the Soviet Union. In subsequent weeks, market rates declined as incoming nonfinancial and monetary indicators were seen by market participants as portending a sluggish expansion, reduced inflation, and an associated easing of monetary policy. The average commitment rate on fixed-rate mortgages reached its lowest level since 1977, and the prime rate was reduced by 1/2 percentage point to 8 percent after the easing of monetary policy in mid-September. The trade-weighted value of the dollar in terms of the other G-10 currencies fell sharply over the intermeeting period; much of the drop retraced the previous run-up associated with the attempted coup in the Soviet Union that began shortly before the August meeting.

After contracting in July, M2 was about unchanged in August and September. M3 declined further in July and August and apparently changed little in September. Both aggregates were somewhat weaker than anticipated at the time of the August meeting. For the year thus far, expansion of M2 and M3 had been at the lower ends of the Committee's ranges.

The staff projection prepared for this meeting pointed to a sustained recovery in economic activity; however, because of persisting weaknesses in some sectors of the economy the pace of the expansion was projected to remain subdued compared with past cyclical experience and the risks of a different outcome seemed to be mostly on the downside. Consumer spending was expected to continue to provide much of the impetus to the expansion, but a swing from inventory liquidation to modest accumulation was projected to supply an additional boost to economic growth during the quarters immediately ahead. As the stimulus from the swing in inventories began to wane during the course of 1992, spending for business equipment was projected to strengthen to some extent. Housing construction also would provide some stimulus over the projection horizon. Further declines in the construction of commercial structures were expected to inhibit the economic expansion. Additionally, real purchases of goods and services by the federal government were assumed to be on a mildly declining trend, and spending by many state and local governments was expected to be constrained by severe budgetary problems. The persisting slack in labor and product markets, while diminishing over time, was projected to restrain the rise in labor costs and to foster some slowing in the underlying trend of inflation.

In the Committee's review of prevailing and prospective economic developments, members observed that the mixed nature of the recent economic information and the uneven economic conditions in different parts of the country made it particularly difficult to assess the overall state of the economy. They generally concluded that, on balance, the evidence was consistent with a continuing though still sluggish recovery in economic activity and that the prospects remained favorable for a sustained expansion at a moderate pace over the next several quarters. Many commented, however, that the risks to the expansion appeared to be tilted at least marginally to the downside. Those risks were felt to stem especially from a variety of financial strains in the economy, and several members also indicated that they were uneasy about the potential implications of the ongoing weakness in broad measures of money and credit. With regard to the outlook for inflation, many of the members expressed confidence that the relatively moderate rate of expansion in economic activity that they anticipated was likely to be associated with appreciable progress in reducing the core rate of inflation over the next several quarters.

In the course of the Committee's discussion, members commented that the anecdotal reports on economic conditions and on business and consumer sentiment continued to have a generally negative tone that did not appear to be fully consistent with the available economic statistics. To a degree, business attitudes seemed to reflect perceptions of little momentum in business activity and related concerns about the outlook for profits. On the positive side, business conditions in some areas were contributing to some optimism, at least among business managers whose activities tended to be limited to local markets, and the performance of the stock market continued to provide evidence of confidence on the part of many investors.

Turning to the outlook for key sectors of the economy, members noted that despite reports of quite weak retail sales in some parts of the country, real consumer outlays had been trending upward on an overall basis since the early part of the year, and in the absence of a new adverse shock to consumer confidence, consumers were likely to continue to provide important support to the overall economic expansion. However, the extent of that support might remain somewhat limited because consumer sentiment was still cautious amid concerns about employment opportunities and personal debt burdens. In the circumstances, retailers in many areas anticipated relatively sluggish sales during the upcoming holiday season. In the context of an already low saving rate, the outlook for retail sales would continue to hinge on growth in disposable incomes and the latter in turn would tend to be constrained by the moderate growth that was anticipated in overall economic activity.

The members continued to anticipate that a turnaround from inventory liquidation to at least modest accumulation would stimulate the economy in the quarters ahead. Available data and anecdotal reports suggested that overall nonfarm business inventories had continued to decline through July and probably over the third quarter as a whole. With stocks now at generally low levels, a pickup in final demands, including expected further growth in exports, was likely to foster some tendency to rebuild inventories. Looking further ahead, some concern was expressed that, once the expected swing in inventories began to abate next year in line with the usual cyclical pattern, other sources of economic stimulus might not materialize to the extent needed to support continued economic growth at an adequate pace. On the other hand, some members observed that both the economic statistics and reports from business contacts were consistent with some pickup in business spending for equipment, which could well strengthen further as the recovery matured.

Residential construction also seemed likely to provide some ongoing stimulus to the expansion. While this sector appeared to have lost some momentum during the summer months, declines in mortgage interest rates along with anticipated moderate growth in overall economic activity and incomes pointed to a gradual uptrend in housing construction. The prospective strength of housing activity was viewed as likely to be tempered, however, by continuing weakness in the multifamily market; the latter was adversely affected by high vacancy rates in many local areas and over time by a slower pace of family formations.

Among the negative developments that could be expected to limit the strength of the overall economic expansion was the outlook for commercial construction. Indeed, the overbuilt condition of commercial space in major markets around the country portended an extended period of weak activity in this sector of the economy. There were, nonetheless, anecdotal reports that sale prices of commercial real estate might be stabilizing in some areas and that new and renewal lease prices were no longer declining in some markets and indeed might have begun to edge up. The government sector also was seen as likely to exert some restraint on the overall expansion. Federal government spending for goods and services appeared to have swung into a gradual downtrend associated with cutbacks in defense spending. At the same time, the budgetary difficulties affecting many state and local governments were likely to continue to constrain the overall growth in state and local government spending.

Many of the members referred to the potential impact of financial conditions on the outlook for economic activity. In some important respects, financial developments could be viewed as favorable. Financial markets were receptive to new financing activity as evidenced by the large volumes of stock and bond issuance. Moreover, the balance sheets of many financial institutions were improving; banks, for example, were making considerable efforts to increase their capital, work out problem loans, and rationalize their operations. On the other hand, the balance sheets of many business firms like those of a significant portion of households were burdened by heavy debt loads. Furthermore, many contacts referred to the continuing problems of small and medium size businesses in securing financing to carry on or expand their operations. In this regard, it was difficult to assess the extent to which the weakness in loan extensions through financial intermediaries reflected unwarranted constraints on credit supplies as opposed to a lack of demand from qualified borrowers. Reports from several parts of the country tended to suggest that, while to some extent credit standards had been tightened further this year, lenders remained willing to provide financing to credit-worthy borrowers. On balance, while the members differed in their appraisals of the severity and possible implications of the financing problems of borrowers without access to financial markets, they agreed on the need for careful monitoring of the availability of adequate credit to support a sustained economic recovery.

The members continued to view the outlook for inflation as favorable. The moderate rate of economic expansion anticipated over the forecast horizon was expected to be associated with enough slack in productive resources to accommodate further downward adjustments in the underlying rate of inflation. Competition from foreign producers was likely to remain substantial in many domestic markets. Indeed, overall competitive pressures and resistance to price increases were strong in key markets and provided a promising setting for progress toward price stability. From a different perspective, a number of members observed that the lagging growth in money, at least as measured by M2 and M3, had favorable implications for prices over the longer run. In particular, it was suggested that the restrained growth in money over recent years would tend to foster lower inflation while providing liquidity sufficient to sustain a moderate rate of economic expansion.

In the Committee's discussion of policy for the intermeeting period, all of the members indicated that they were in favor of maintaining an unchanged degree of pressure on reserve positions.

While the economy was subject to an unusual array of problems and related uncertainties, the members generally felt that monetary policy was on the right course under currently prevailing and immediately forseeable economic and financial circumstances. In particular, insofar as could be judged at this point, the present policy stance provided an appropriate balance between the risks of a faltering economic expansion and the risks of little or no progress toward price stability. The easing steps in recent months and the associated declines in interest rates, including mortgage rates, appeared to have supplied more monetary stimulus than had yet shown through to the economy. Several members commented, however, that the Committee needed to remain particularly alert to indications of renewed weakening in business activity, especially given the current financial fragilities in the economy and the likely difficulty of reviving the economy in the event of another downturn. Other members gave somewhat more weight to the need to avoid over-stimulating the economy; a failure to take advantage of the apparent momentum toward lower inflation would have seriously adverse consequences on longer-term debt markets and the outlook for sustained economic growth. The members agreed that a steady policy course was desirable for now while the Committee assessed the economy's responses to its earlier easing actions.

In the course of the Committee's discussion, the members expressed varying degrees of concern about the continuing weakness in the broader monetary aggregates and overall credit growth. It was clear that a significant restructuring of household and business balance sheets was occurring that partly involved adjustments to the unusually rapid buildup of debt during the 1980's and that such restructuring was being reflected in the behavior of the broader monetary aggregates. Resolutions of insolvent thrift institutions, which in recent months had resumed in volume, also were acting to depress M2 as well as M3. In addition, the more liquid components of the monetary aggregates were growing relatively strongly. Under these circumstances, slow growth in broader money and credit did not necessarily indicate that monetary policy was being too restrictive by damping the expansion of incomes or curtailing demands for goods and services. Moreover, a staff analysis prepared for this meeting indicated that some recovery in the growth of these aggregates could be expected over the balance of 1991, assuming an unchanged degree of pressure in reserve markets. Nonetheless, many of the members felt that the behavior of M2 and M3, whose growth for the year to date was at the bottom of the Committee's ranges, needed to be monitored with special care and, at least in one view, that some further easing measures might be desirable in the near term to improve the prospects that monetary expansion for the year would be within the Committee's ranges.

Turning to possible adjustments to the degree of reserve pressure during the intermeeting period, a majority of the members indicated a preference for a directive that was biased at least marginally toward easing. Such a bias was called for in this view by the downside risks in the economy, though a number of these members also felt that there should be no strong presumption that any easing would be undertaken during the intermeeting period ahead. The other members indicated that they could support an asymmetric directive toward ease though they preferred a symmetric intermeeting instruction, especially in the context of the further stimulus that could be expected to result over time from the earlier monetary easing actions.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for maintaining the existing degree of pressure on reserve positions. They also noted their preference or acceptance of a directive that included a slight bias toward possible easing during the intermeeting period. Accordingly, the Committee decided that slightly greater reserve restraint might be acceptable during the intermeeting period or slightly lesser reserve restraint would be acceptable depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with growth of M2 and M3 at annual rates of around 3 percent and 1-1/2 percent respectively over the three-month period from September through December.

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 has been mixed, but it suggests on balance that economic activity has been expanding at a moderate pace. Total nonfarm payroll employment changed little over July and August, and the civilian unemployment rate was 6.8 percent in both months. Employment in manufacturing continued to advance in August, and industrial production posted a further rise after several months of sizable gains. Consumer spending increased considerably on balance in July and August. Recent data on orders and shipments of nondefense capital goods point to a small increase in real outlays for business equipment, but nonresidential construction has remained weak. Housing starts rose only slightly further in July and August after increasing appreciably on balance since January. The nominal U.S. merchandise trade deficit widened substantially in July and was considerably above its average rate in the second quarter. Increases in consumer prices have been small in recent months, owing to declines in food and energy prices.

Most interest rates have declined further since the Committee meeting on August 20. The Board of Governors approved a reduction in the discount rate from 5-1/2 to 5 percent on September 13. The trade-weighted value of the dollar in terms of the other G-10 currencies fell sharply over the intermeeting period; much of the drop retraced the previous run-up associated with the attempted coup in the Soviet Union that began shortly before the August Committee meeting.

After contracting in July, M2 was about unchanged in August and September. M3 declined further in July and August and is indicated to have changed little in September. For the year thus far, expansion of M2 and M3 has been at the lower end of the Committee's ranges.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in July reaffirmed the ranges it had established in February for growth of M2 and M3 of 2-1/2 to 6-1/2 percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4-1/2 to 8-1/2 percent for the year. For 1992, on a tentative basis, the Committee agreed in July to use the same ranges as in 1991 for growth in each of the monetary aggregates and debt, measured from the fourth quarter of 1991 to the fourth quarter of 1992. With regard to M3, the Committee anticipated that the ongoing restructuring of thrift depository institutions would continue to depress the growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint might 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 September through December at annual rates of about 3 and 1-1/2 percent, respectively.

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

Votes against this action: None.