FEDERAL RESERVE press release

For Use at 4:30 p.m.

July 2, 1992

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 May 19, 1992.

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

Attachment

RECORD OF POLICY ACTIONS OF THE
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on May 19, 1992

1. Domestic Policy Directive.

The information reviewed at this meeting was mixed, but it suggested on balance that economic activity was expanding at a moderate pace. Retail spending and homebuying apparently had softened after sharp gains early in the year, but recent data on contracts and orders pointed toward some firming in business capital spending. Industrial production and employment had firmed in recent months. Incoming data on prices and labor costs suggested little change from recent trends.

Total nonfarm payroll employment continued to increase in April, with more than half of the job gains occurring in service industries, notably in health and business services. In addition, employment in retail trade establishments registered a relatively strong rise, the number of manufacturing jobs increased for a third straight month, and state and local governments added more workers. By contrast, construction employment was down slightly in April and had changed little on balance since the beginning of the year. The civilian unemployment rate edged down to 7.2 percent in April, and initial claims for unemployment insurance fell somewhat further.

Industrial production rose appreciably further in April, and in the three months ending with that month, industrial output retraced most of the decline that had occurred between October and January. The April advance reflected in part some further recovery in motor vehicle assemblies as well as another solid gain in the production of industrial equipment, especially office and computing equipment. Output of construction supplies also advanced more rapidly, and the production of consumer goods other than automobiles increased slightly further. Total industrial capacity utilization continued to rise in April but was still well below its pre-recession high.

Retail sales rebounded in April after a sizable decline in March; for the two months combined, retail spending was little changed following strong gains in the first two months of the year. Purchases of nondurable goods, particularly general merchandise items, were down on balance for the March-April period, while spending for durable goods rose further. Single-family housing starts fell considerably for a second month in April. The declines followed sizable increases earlier in the year that appeared to have reflected lower mortgage rates, unusually warm winter weather, and the prospect of a tax credit for first-time homebuyers. Starts in the multifamily sector in April reversed the jump in March. Vacancy rates for multifamily units remained at historically high levels.

Business fixed investment apparently firmed in the first quarter after declining moderately over the preceding several quarters. Shipments of nondefense capital goods rose somewhat further in the first quarter, largely as a result of continued growth in outlays for office and computing equipment. Recent data on orders pointed to a pickup in business spending for a broad range of industrial equipment over coming months. Nonresidential construction activity contracted less rapidly in the first quarter. While outlays for office buildings continued to plummet in response to the substantial overhang of unoccupied space, spending for other commercial buildings declined more slowly, and construction of industrial and public utility structures increased. Recent information on building permits and contracts suggested some further slowing of the decline in nonresidential construction.

Business inventories increased considerably in March after changing little in February. At the retail level, about half of the rise in March was in stocks at automobile dealers. For other retailers, the buildup of stocks reversed most of the drawdowns posted in the preceding two months. Inventory-to-sales ratios rose for most categories of retail stores but remained well below the elevated levels at the end of last year. Manufacturing inventories were essentially unchanged in March from the lower levels that prevailed in January and February. For many industries, stock-to-sales ratios in March were at their lowest levels in more than a decade. By contrast, stocks held by wholesalers increased again in March, and inventory-to-sales ratios were little changed from the relatively high level at the end of last year.

The nominal U.S. merchandise trade deficit declined in February, and its average for January-February was somewhat lower than the average rate in the fourth quarter. Exports for the two-month period were about unchanged from the strong fourth-quarter rate but were considerably higher than a year earlier. Imports in January and February were down from the fourth-quarter rate; most of the decline was associated with a fall in prices of oil imports. The available data on first-quarter economic activity in the major foreign industrial countries were mixed; signs of strengthening activity in Europe were offset by indications of continued weakness in Japan and Canada.

Producer prices of finished goods rose at a slightly faster pace in March and April, as energy prices partially retraced earlier declines. Excluding food and energy, producer prices increased over the March-April period at about the subdued average monthly rate seen over the twelve months ending in April. At the consumer level, prices jumped in March and rose more moderately in April. Prices of nonfood, non-energy consumer items increased a little more rapidly on balance in March and April than over the twelve-month period ending in April. Total hourly compensation for private industry workers advanced in the first quarter at a rate close to that recorded during the second half of 1991.

At its meeting on March 31, 1992, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward possible easing during the intermeeting period. Accordingly, the directive indicated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint might be acceptable or slightly lesser reserve restraint would be acceptable in the intermeeting period. The reserve conditions contemplated under this directive were expected to be consistent with growth of M2 and M3 over the period from March through June at annual rates of about 3-1/2 and 1-1/2 percent respectively.

Open market operations during the intermeeting period initially were directed toward maintaining the existing degree of pressure on reserve positions. Prior to mid-April, however, operations were adjusted to implement some easing in the degree of reserve pressure. This action was taken in light of the significant weakness in the broad monetary aggregates and of indications that the economic expansion was not as strong as its pace early in the year and that underlying inflation would continue to trend lower. The management of reserves was complicated to some extent during this period by the uncertainties associated with the mid-April tax date. A reduction in reserve requirements on transactions deposits from 12 percent to 10 percent implemented on April 2 had only minor effects on demands for excess reserves and on volatility in money markets. Expected levels of adjustment plus seasonal borrowing were raised in the intermeeting period in anticipation of a slight rise in seasonal borrowing. Over the three complete reserve maintenance periods during the intermeeting interval, adjustment plus seasonal borrowing averaged a little more than $100 million. The federal funds rate remained around 4 percent early in the intermeeting period but averaged a little below 3-3/4 percent in the weeks after the easing action.

Most other short-term interest rates fell more than the federal funds rate. Many market participants, interpreting incoming data as suggesting that the economic expansion would remain subdued and that the weakness in the broad monetary aggregates would persist, concluded that some further easing in policy was likely in the near term. Bond yields also fell, but generally by less than short-term rates, and they remained above the lows reached around the turn of the year. Changes in broad indexes of stock prices were mixed over the intermeeting period.

Questions about the prospects for the economic recovery in the United States and the related outlook for interest rates affected the value of the dollar in foreign exchange markets. On a trade-weighted basis in terms of the other G-10 currencies, the dollar remained within a fairly narrow range until late in the period, when growing market expectations of a near-term easing in U.S. monetary policy exerted downward pressure on its value.

M2 and M3 contracted in March and April. The performance of these aggregates was considerably weaker than the Committee's expectations at the time of the March meeting. Expansion in transactions balances, which had accounted for much of the growth in the broader aggregates over previous months, slowed markedly. Some of the slowdown perhaps reflected a reduced need for liquid balances to make personal tax payments, which were unusually weak in April. In addition, some retail time deposit funds evidently were shifted into the capital markets in response to the low offering rates on these deposits relative to market rates. Through April, expansion of M2 was slightly above and that of M3 was slightly below the lower ends of the ranges established by the Committee for the year.

The staff projection prepared for this meeting pointed to a continuing recovery in economic activity. In the near term, expansion in consumer spending was expected to be considerably below the rapid first-quarter pace, and growth in spending on residential construction was likely to moderate in response to the earlier backup in mortgage interest rates. On the other hand, stronger orders for nondefense capital goods portended some pickup in business fixed investment despite the continuing drag exerted by the persisting, though abating, weakness in nonresidential construction; in addition, inventory liquidation was likely to slow from the first-quarter pace. Over time, some easing of restraints on credit supplies and the progress achieved in restructuring business and household balance sheets would help set the stage for sustained, moderate growth in spending. The projection did not incorporate any major new fiscal initiatives at the federal level. The considerable margin of slack in resource utilization, though decreasing, was projected to be associated with appreciable further slowing in the underlying rate of inflation.

In the Committee's discussion, members referred to the indications that the rate of economic growth had slowed since earlier in the year, but they interpreted the recent statistical and anecdotal information as consistent on balance with a continuing and relatively broad-based expansion in overall business activity. Although some sectors of the economy remained troubled, reports from many parts of the country suggested that economic activity was expanding and that business executives were becoming more confident that a sustained recovery was under way. Several members noted, however, that in the absence of strong momentum in any sector of the economy, the advance was proceeding at a pace that was well below the typical rate of growth in the early phases of past cyclical upswings. In such circumstances, a faltering in the recovery, such as had occurred in 1991, could not be ruled out, especially given the financial difficulties still being experienced by many business firms, consumers, and lending institutions that in turn appeared to be reflected in the continued weakness in broad measures of money and credit. A differing view gave more weight to the recently abnormal behavior of the velocities of broad money and debt and the possibility that, once the recovery was more firmly established, some sectors of the economy and thus the economy more generally might generate more strength than was currently projected. With regard to the outlook for inflation, the recent performance of some key indicators of labor compensation and prices was somewhat disappointing. However, members continued to view further progress as likely, given the persisting though diminishing slack that was projected in labor and other production resources.

Many of the members commented that the various financial constraints on the expansion were diminishing and that a sounder financial foundation to support sustained economic recovery was being established. Considerable restructuring of balance sheets by both business firms and households had been accomplished; these developments together with lower interest rates had reduced interest burdens and had increased the capacity to borrow and spend. In the financial sector, banking institutions were continuing to work down problem credits in their loan portfolios and, in the context of growing profits associated with relatively wide interest margins on loans, were rebuilding their capital positions. The access of lending institutions to the capital markets had improved, and there were increasing indications, not yet reflected in the loan data, that banks were seeking lending opportunities more actively in many parts of the country and that loan demand from small and medium-sized businesses was tending to revive. Thus, while banking institutions remained cautious lenders and their loan rates were on the high side in relation to market rates, members saw some signs that a more accommodating climate was emerging in loan markets.

In their reports on business conditions in various parts of the country, members noted that at least modest growth seemed to be occurring in most regions, while with some exceptions activity in other areas appeared to be stabilizing after declining earlier. Business confidence seemed to be improving, indeed appreciably so in some areas, and was described as more optimistic even in sections of the country that did not appear to be participating thus far in the economic recovery. Nonetheless, business concerns about the sustainability of the expansion were being reflected in cautious hiring and investment decisions. On balance, current business attitudes pointed to continuing economic expansion, though many business executives did not anticipate a robust recovery and the overall state of confidence appeared to be somewhat fragile.

Turning to individual sectors of the economy, members observed that the strong growth in consumer spending in the early months of the year, apparently outpacing the expansion in income, seemed to have slowed more recently. Nonetheless, improving consumer sentiment against the background of reduced debt burdens and strengthening employment opportunities pointed to further gains in consumer spending. Over time, such spending was likely to be associated more closely with developments in labor markets and the related growth in disposable incomes, though the demand for consumer durables also would respond to changing conditions in the housing markets. In those markets, anecdotal reports from around the country tended to confirm recent data indicating some slowing of activity from the pace at the start of the year, but conditions varied substantially across the nation. Housing activity had tended to display considerable sensitivity to changes in mortgage rates, and the recent declines in the latter along with gains in consumer confidence were seen as likely to encourage some pickup in housing demand and residential construction. Nonresidential construction, especially that of office buildings and hotels, was expected to remain weak for an extended period in many areas as excess capacity was absorbed. On the positive side, rates of occupancy and prices of existing buildings appeared to be approaching bottom or stabilizing in many areas, thereby facilitating sales of repossessed property on the books of financial institutions. Other nonresidential construction activity was mixed; oil and gas drilling was still quite weak, but the construction of manufacturing and wholesale space was displaying some strength in various parts of the country. Gains in final demand, if sustained, were expected to foster appreciable further increases in the production of business equipment.

Government purchases of goods and services continued to be constrained by budgetary problems, including the severe financial difficulties of many state and local governments, and with defense spending projected to decline substantially, the government sector appeared likely to remain a negative influence on economic activity over the next several quarters. With regard to the outlook for exports, members referred to reports of relatively strong sales abroad by firms in some parts of the country. More generally, prospective growth in exports to some key industrial nations could be relatively sluggish if recent economic trends in those nations were to persist, though exports to a number of developing countries appeared to be rising fairly briskly. At the same time, the recovery in the domestic economy was likely to foster relatively rapid growth in imports. On the whole, net exports were expected to make little or no contribution to the expansion in domestic economic activity.

Despite the somewhat disappointing inflation news in recent months, the members generally viewed a slow downtrend in the rate of inflation as a plausible outcome for the year ahead. Reports from various parts of the country emphasized the highly competitive markets for many producer goods and the inability of many sellers to increase profit margins or to pass on rising costs through higher prices. Commodity prices had tended to fluctuate in a narrow range and appeared consistent with progress toward price stability. Consumer resistance to rising prices was described as strong. In the context of the relatively limited pressures on production resources associated with the members' outlook for economic activity and an appropriate monetary policy, the slow process of reducing inflation was believed likely to continue for some time.

In the Committee's discussion of policy for the intermeeting period ahead, all of the members endorsed a proposal to maintain an unchanged degree of pressure in reserve markets. The members agreed that policy seemed to be appropriately positioned at this point to accommodate sustained economic expansion while also encouraging progress toward price stability.

In the course of the Committee's discussion, members devoted considerable attention to the behavior of the monetary aggregates. They expressed varying degrees of concern about the slow growth of M2 and M3 in 1992, including declines in March and April. Some emphasized that the lagging growth of those aggregates this year was occurring after relatively limited expansion over the previous year or so. Although the growth rates and velocities of the broader aggregates were subject to considerable short-run variations and had to be evaluated in the context of surrounding economic and financial circumtances, average growth over longer periods of time had been quite subdued. Plausible explanations, relating importantly to temporary factors such as the unexpectedly weak build-up of balances associated with the April tax date, permitted at least some discounting of the recent weakness of the broader aggregates, and growth of both M2 and M3 according to a staff analysis was likely to resume at a modest pace over the balance of the second quarter. However, in the opinion of a number of members, continuing weakness in these aggregates could be indicative of an increase in the downside risks to the expansion and would thus be a matter of growing concern.

Other members tended to discount to an extent the sluggish behavior of the broader aggregates. In this view, a variety of developments that were reflected in the channeling of credit away from depository institutions seemed to have altered previous relationships between M2 and M3 and measures of spending and income. To an important degree, current spending was being financed internally or, especially in the case of business firms, by raising funds in the capital markets. Moreover, against the background of weak loan demand and relatively low deposit offering rates and an unusually steep yield curve, many depositors were shifting funds from M2 into higher yielding, longer-term market assets. In these circumstances, satisfactory economic expansion would tend to be consistent with weaker growth and a higher velocity of M2 than would be suggested by historical relationships. Some members viewed the strength of M1 and reserves as indicative of a quite accommodative monetary policy in recent quarters, and they felt that continued rapid expansion in these measures could raise questions about the consistency of current monetary policy with progress toward price stability.

The members expressed differing preferences with regard to possible adjustments to the degree of reserve pressure during the intermeeting period, but all indicated that they could accept a symmetric directive. Some preferred such a directive because it would tend to underscore their view that the risks to the expansion and the possible need to adjust policy were now fairly evenly balanced in either direction. In light of the information on the economy reviewed at this meeting, they felt that current monetary policy was likely to remain properly positioned to accommodate the Committee's objectives for some time and that any adjustment to policy should be approached with considerable caution. In the context of persisting concerns about inflation, an easing in reserve conditions and lower short-term interest rates might well fail at this time to induce lower interest rates in long-term debt markets, though circumstances might change. In any event, the Committee should keep its options open and changing circumstances might warrant a Committee consultation during the weeks ahead.

A number of members expressed a preference for continuing to bias the directive toward possible easing during the intermeeting period. In this view, the risks to the expansion appeared to be tilted at least marginally to the downside, and while a steady policy course might well prove to be appropriate until the next meeting, these members believed it would be desirable for policy to be adjusted fairly promptly should the incoming evidence suggest a faltering expansion, especially if money growth were still lagging. Other members preferred a bias toward possible firming during the intermeeting period. They believed that a relatively stimulative monetary policy was in place and that the next move in policy might well need to be to the tightening side if, in the context of a strengthening economy, the Committee was to continue to pursue its long-run objectives of sustainable economic growth and progress toward price stability.

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. The members also noted that they preferred or could accept a directive that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with growth of M2 and M3 at annual rates of around 2-1/2 percent and 1-1/2 percent respectively over the two-month period from April through June.

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 on balance that economic activity is expanding at a moderate pace. Total nonfarm payroll employment increased somewhat in April, and the civilian unemployment rate edged down to 7.2 percent. Industrial production rose appreciably further in April partly reflecting some further recovery in motor vehicle assemblies. A rebound in retail sales in April about offset the decline in March. Single-family housing starts fell considerably for a second month in April. Recent data on orders and shipments of nondefense capital goods indicate appreciable increases in outlays for business equipment, and building contracts point to some slowing of the decline in nonresidential construction. The nominal U.S. merchandise trade deficit in January-February was somewhat below its average rate in the fourth quarter. Incoming data on prices and labor costs suggest little change from recent trends.
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> Most interest rates have fallen since the Committee meeting on March 31. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined on balance over the intermeeting period.
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> M2 and M3 contracted in March and April; and expansion in transactions balances, which had accounted for much of the growth in the broader aggregates over previous months, slowed markedly. Through April, expansion of M2 was slightly above and that of M3 was slightly below the lower ends of the ranges established by the Committee for the year.
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> 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 February established ranges for growth of M2 and M3 of 2-1/2 to 6-1/2 percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1991 to the fourth quarter of 1992. The monitoring range for growth of total domestic nonfinancial debt was set at 4-1/2 to 8-1/2 percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of 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. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint 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 April through June at annual rates of about 2-1/2 and 1-1/2 percent, respectively.

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

2. Authorization for Domestic Open Market Operations

The Committee approved a temporary increase of $2 billion, to a level of $10 billion, in the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities. The increase amended paragraph 1(a) of the Authorization for Domestic Open Market Operations and was effective for the intermeeting period ending with the close of business on July 1, 1992.

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

The Manager for Domestic Operations advised the Committee that the current leeway of $8 billion for changes in System Account holdings might not suffice to meet the potentially large need to add reserves over the intermeeting period to accommodate a seasonal bulge in currency in circulation, an increase in required reserves, and other factors that might call for substantial reserve additions.