

# FEDERAL RESERVE press release



For Use at 4:30 p.m.

October 9, 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 August 18, 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 August 18, 1992

The information reviewed at this meeting suggested that economic activity was continuing to expand, although at a subdued pace. Consumer spending had firmed recently; business purchases of capital equipment had risen further; and falling mortgage interest rates, which appeared to have triggered a wave of mortgage refinancings, likely were providing some impetus to housing demand. On the other hand, industrial production and employment had increased little on balance, and a sizable expansion in the labor force had raised the unemployment rate to a cyclical high. Recent data on wages and prices indicated that inflation was slowing.

A rebound in total nonfarm payroll employment in July more than offset a decline in June; however, about half the rise over June and July reflected temporary hiring associated with a federally sponsored summer jobs program that recently had been enacted. Apart from the jobs program, moderate gains in employment were recorded in service industries, while payrolls declined in both manufacturing and construction. The average workweek of production or nonsupervisory workers during the June-July period was at its lowest level of the year, and the civilian unemployment rate averaged 7-3/4 percent.

Industrial production, which had increased noticeably in earlier months, was about unchanged on balance over June and July, as a rise in July retraced a decline that had occurred in June. Much of the July advance stemmed from a higher level of output in mining and utilities, where special factors had held down production in earlier months. Factory output was unchanged in July after a small decline in June; production of computers and other information processing

equipment continued to increase at a rapid rate, but output of motor vehicles and parts fell in both months. Production schedules indicated that domestic assemblies of motor vehicles would increase in August. The utilization of total industrial capacity slipped on balance over June and July but remained a little above its December 1991 level.

Retail sales increased moderately in July after registering little growth in the second quarter. General merchandisers reported sharp gains following a period of sluggish sales since April, and sales rose considerably further at apparel outlets and furniture and appliance stores. Sales of motor vehicles dropped back in July from an elevated June pace. With mortgage rates falling, sales of new single-family homes increased in June after leveling off in May, and reports indicated that mortgage applications for home purchases were rising. Permits issued for the construction of new housing units advanced slightly in July, but starts of such units declined further.

Shipments of nondefense capital goods were up sharply in June, partly reflecting continued increases in shipments of office and computing equipment. Data on new orders pointed to a further substantial rise in business purchases of durable equipment in coming months. Nonresidential construction slackened again in June; weakness in industrial construction added to persisting contractions in outlays for commercial office buildings. Recent information on new contracts continued to suggest that nonresidential construction would decline more slowly over the months ahead.

Business inventories surged in June after declining a little in May. At the retail level, inventories increased by a substantial amount, with the accumulation spread about equally among durable and

nondurable goods. The jump in inventories lifted retailers' stocks-to-sales ratios to the upper end of the range of the past year. Wholesale trade inventories also expanded sharply in June, with runups reported for a wide range of goods; sales increased by more, however, and the inventory-to-sales ratio in wholesale trade fell slightly. By contrast, manufacturing stocks edged down in June, and the inventory-to-shipments ratio dropped to its lowest level since the middle of 1979.

The nominal U.S. merchandise trade deficit widened again in May. For April and May combined, the deficit was substantially larger than its average rate in the first quarter. The value of exports fell considerably over the two-month period, with reduced shipments of aircraft accounting for the bulk of the decline. The value of imports rose substantially, as imports of oil rebounded from first-quarter lows and imports of a wide range of other goods also increased. Economic activity in the major foreign industrial countries appeared to have slowed on balance in recent months. Canada, France, and Italy seemed to have experienced modest economic growth, but activity apparently had slowed or declined in Germany and Japan, and there was little indication that a recovery had begun in the United Kingdom.

Producer prices of finished goods increased modestly over June and July. Abstracting from the sometimes volatile food and energy components, prices of other finished goods rose at a significantly slower pace in the twelve months ended in July than in the preceding twelve months. At the consumer level, prices advanced only a little in July after a June increase that had been boosted somewhat by a temporary bulge in energy prices. Food prices, which were unchanged on balance over June and July, continued to hold down overall increases in consumer prices. Excluding food and energy

items, consumer price inflation over the year ended in July was markedly lower than in the preceding year. Measures of labor costs also evidenced smaller increases. Hourly compensation of private industry workers rose at a substantially slower pace in the second quarter and in the twelve months ended in June. The deceleration in overall compensation reflected slower growth in both its benefits and its wage and salary components. For production or nonsupervisory workers, average hourly earnings were unchanged in July, and the twelve-month change in this measure was substantially reduced.

At its meeting on June 30-July 1, 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 during the intermeeting period. The contemplated reserve conditions were expected to be consistent with a resumption of growth in M2 and M3 at annual rates of about 2 percent and 1/2 percent respectively over the three-month period from June through September.

The day after the meeting, the Board of Governors approved a reduction in the discount rate from 3-1/2 to 3 percent, and open market operations were directed at allowing the full amount of the reduction to be reflected in money market rates. These actions were taken in the context of a continuing downtrend in inflation and in light of incoming information that suggested flagging momentum in the economic recovery and persisting softness in credit and money. Later

in the intermeeting period, a technical increase was made to expected levels of adjustment plus seasonal borrowing to reflect rising demands for seasonal credit. Adjustment plus seasonal borrowing averaged close to expected levels during the two full reserve maintenance periods completed since the meeting. The federal funds rate, which had been around 3-3/4 percent prior to the monetary easing action, averaged 3-1/4 percent subsequently.

Other market interest rates declined considerably in early July, reflecting both the sluggishness portrayed by incoming economic data and the monetary policy easing. Commercial banks also lowered their prime rate from 6-1/2 percent to 6 percent. In subsequent weeks, with a steady flow of new information pointing to a hesitant recovery and more favorable trends in wages and prices, yields on intermediate- and long-term Treasury securities dropped further. Over the intermeeting period, yields on most private securities tended to decline by amounts comparable to those on Treasury instruments, but rates on fixed-rate home mortgages fell by somewhat less, apparently owing in large part to heightened mortgage investor concerns about prepayment risk stemming from a surge in refinancing activity. Broad indexes of stock prices changed little over the period.

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. Early in the period, the dollar fell in response to the more uncertain prospects for near-term growth in the United States and the concurrent easing of U.S. monetary policy. Later, the dollar fell further following an increase in the discount rate in Germany and the issuance of unfavorable U.S. trade data for May. Concerted central-bank intervention in foreign exchange markets

was undertaken to brake the decline of the dollar, and the latter tended to stabilize over the remainder of the intermeeting period.

M2 and M3 contracted somewhat further in July, despite a resumption of rapid growth in M1. Both broad monetary aggregates were substantially weaker in July than had been anticipated at the time of the June 30-July 1 meeting. The declines in these aggregates apparently reflected in part the continuing redirection of household holdings of time deposits toward bond and stock funds or the repayment of debt, and in part the reduced funding needs of depository institutions owing to the further rechanneling of credit demands outside the depository sector, a development that was encouraged by the declines in interest rates in long-term debt markets. To some extent, the persisting weakness in money also might have been associated with relatively slow expansion in income since the early months of the year. Through July, both M2 and M3 were appreciably below the lower ends of the Committee's ranges for their growth in 1992.

The staff projection prepared for this meeting pointed to a continuation of subdued economic expansion in the near term followed by a gradual pickup in growth through next year. The forecast took account of the further easing of reserve conditions in early July and the substantial rally that had taken place in the bond markets. Housing construction was expected to pick up in response to the declines in mortgage interest rates; and in the business sector, lower interest rates and improved profits and cash flows were projected to enhance access to sources of finance and to provide the basis for an acceleration in plant and equipment spending as the recovery gained momentum. The slow pace of hiring and the modest expansion of incomes currently were tending to restrain consumer spending, but continued progress by households in restructuring balance sheets and reducing

debt-servicing burdens, in conjunction with improving job prospects, were expected to foster growth in consumer spending more in line with the expansion of income. In addition, some stimulus to domestic production was projected to emerge over the forecast horizon from improving export demand as a result of the depreciation of the dollar in recent months and some anticipated strengthening of economic activity in the major foreign industrial countries. In the government sector, continuing cutbacks in defense spending were expected to damp federal expenditures, and budget problems at state and local levels of government to constrain spending and result in tax increases. A persisting though decreasing margin of slack in resource utilization was projected to be associated with further progress toward price stability.

In the Committee's discussion of current and prospective economic developments, members referred to statistical and anecdotal indications that the rate of economic expansion had slowed to a relatively subdued pace since the early months of the year. A number of factors seemed to be restraining the expansion, including efforts by business firms and households to restructure balance sheets, some apparent deterioration in business and consumer sentiment, and sluggish economic growth abroad. Nonetheless, the low levels of real and nominal interest rates in short-term debt markets, recent decreases in intermediate- and long-term interest rates and in the foreign exchange value of the dollar, and the fairly ample liquidity suggested by some measures all were consistent with expectations of some strengthening in business activity in coming quarters. Still, in the view of a number of members, the economic expansion was likely to be on a slightly lower track over the next several quarters than they previously had anticipated. At the same time, many commented that



they were encouraged by the accumulating signs of diminishing price and wage inflation, and some observed that faster and more convincing progress was being made toward achieving price stability than they had anticipated earlier.

The members recognized that the outlook for the economy was subject to major uncertainties. A number commented that they could not identify any sector of the economy that seemed primed to provide the impetus needed for a vigorous expansion, but they also acknowledged the difficulty of anticipating the pattern and trajectory of an expansion. With regard to domestic economic developments, the ongoing restructuring activities by financial and nonfinancial firms and by households were continuing to exert a restraining effect on economic activity by diverting cash flows from business investment and consumer expenditures. Considerable progress appeared to have been made toward redressing earlier over-expansion and credit excesses. Over time cash flows would be redirected toward more normal patterns of spending for goods and services, with stimulative implications for the economy. However, the timing and extent of such a development could not be predicted with any degree of confidence, and in any case the positive effects probably would be felt only gradually and there could be substantial restraint on economic activity for a longer period than was anticipated earlier. On the more positive side, banking institutions had made a good deal of progress in improving their capital positions and strengthening their portfolios, and many of these institutions now were reported to be seeking lending opportunities more actively, though the demand for loans remained unusually depressed.

Turning to developments in key sectors of the economy, members noted that, for now, consumers continued to be affected by a

high degree of caution that appeared to stem especially from concerns about job security and job opportunities in an environment of continuing business consolidations, cutbacks by state and local governments, and reductions in defense spending. Against the background of quite limited growth in overall demand which could be met largely through improvements in productivity and lengthening workweeks, business firms were continuing to hold back in their hiring of new workers. Ongoing efforts by many consumers to reduce their debt burdens and lower interest income from declining rates on deposits and market instruments were contributing to the softness in consumer spending. Against this background, some members indicated that they would not rule out a further rise in the personal saving rate.

Overall spending by business firms on fixed investment and inventories was believed likely to remain relatively moderate, at least in the quarters immediately ahead, in light of the negative business sentiment associated in turn with lagging consumer and government expenditures. While spending for equipment was growing at a fairly brisk pace, spurred by efforts to modernize production facilities for competitive reasons, business construction continued to be deterred by an over-supply of space in commercial structures, especially office buildings, in numerous areas around the country. Cautious inventory investment reflected lackluster demand as well as continuing efforts to manage inventories more tightly in relation to sales.

The outlook for housing activity appeared to have improved somewhat after the recent declines in mortgage rates, though the available data and anecdotal reports on housing market developments were mixed. While mortgage refinancing activity had turned sharply

upward across the nation, mortgage loan demand for home purchases was still lagging in many areas.

Given serious budgetary problems at all levels of government, the public sector of the economy was not viewed as likely to provide stimulus to the expansion over the next several quarters. At the federal level, continuing declines in defense spending were expected to be offset only in part by fairly slow growth in other expenditures for goods and services, and some of the most depressed areas of the country were strongly affected by trends in the defense industry. At the state and local government levels, the well-publicized budget problems of California were shared to one degree or another by many other parts of the country; spending curbs seemed likely to hold down any impetus to demand from this sector of the economy, while increases in state and local taxes would tend to restrain business and household demand.

The outlook for the nation's foreign trade balance was difficult to evaluate. The decline in the foreign exchange value of the dollar had favorable implications for net exports over time, but the outlook for relatively restrained expansion in key industrial countries pointed to limited growth in the demand for U.S. exports. At the same time, even moderate economic growth in the U.S. economy could be expected to foster some further increases in imports over coming quarters despite the lower dollar.

With regard to the outlook for inflation, many of the members commented on what they viewed as increasingly persuasive evidence of slower rates of increase in wages and prices. Against the background of relatively restrained growth in economic activity and the related outlook for limited pressures on labor and other productive resources, a number of members indicated that they had

lowered their inflation forecasts for the next several quarters. There were widespread reports of strong competitive pressures in most industries and of successful efforts to hold down costs through improvements in productivity. On the negative side, the considerable depreciation of the dollar in recent months and lingering concerns about future price pressures, apparently associated especially with worries about the outlook for the federal budget, could tend to impair progress toward price stability. On balance, however, members saw the prospects for significantly less inflation over the projection horizon as quite promising.

Turning to policy for the intermeeting period, a majority of the members indicated that they favored an unchanged policy, while some expressed a preference for further easing either at this meeting or in the near future. The members who supported a steady policy course recognized that in a period characterized by relatively sluggish economic expansion and a wide variety of risks to the economy, conditions might emerge that would warrant consideration of some further easing. For the time being, however, they preferred a wait-and-see approach in view of the recent easing of reserve conditions and the considerable declines in longer-term interest rates and in the foreign exchange value of the dollar. The Committee should continue to evaluate a variety of indicators for signs that the expansion might be falling short of an acceptable growth path.

Some members commented that an easing of monetary policy under current conditions would incur too great a risk of adversely affecting domestic bond markets. One aspect of that risk was the possibility of a destabilizing decline of the dollar in foreign exchange markets; the potential for such a decline had prompted the recent exchange market intervention in support of the dollar by the

United States and several other nations. Any further easing in this view should be implemented only under conditions or circumstances where the System's commitment to its price stability objective was not likely to be brought into question. An unchanged policy also would give the Committee more room to respond vigorously, if necessary, to a weaker-than-expected economy or to disruptive conditions in financial markets, should they develop at some point.

Members who leaned toward some near-term easing of reserve conditions commented that such a policy move was not likely to foster inflationary pressures under current or prospective economic conditions, given the appreciable margin of unused resources in the economy. At the same time, an easier monetary policy would accelerate balance-sheet restructuring activities and tend to compensate for the adverse effects of such activities on spending. A greater degree of monetary policy easing than had been needed in the past seemed to be required to overcome the depressing effects of the restructuring activities and to cushion an already sluggish expansion against the possibility of some further loss in momentum.

One factor weighing in favor of careful consideration of a more accommodative posture in reserve markets was the behavior of the broad monetary aggregates. The staff analysis prepared for this meeting suggested that some pickup in the growth of M2 and M3, though to a still quite sluggish pace, was likely over the months ahead on the assumption of unchanged conditions in reserve markets. Members observed that the indications of some renewed M2 growth since late July tended to support that conclusion; some also drew encouragement from the sharp upturn in the growth of reserves and M1 in July. The members noted that growth of the broader aggregates in line with current expectations implied expansion for the year at rates somewhat

below the lower ends of the Committee's ranges. Such a development would be consistent with the Committee's policy objectives if, as expected, unusual strength in the velocity of M2 and M3 were to persist over the balance of the year. In the circumstances, monetary growth and indicators of velocity behavior would need to be monitored carefully over coming months.

In the Committee's discussion of possible intermeeting adjustments to the degree of reserve pressure, a majority of the members indicated their preference or acceptance of a directive that was biased towards possible easing during the weeks ahead. Members who preferred some easing over the near term indicated that they could support a directive that gave particular weight to developments that might call for an easing move. Some others noted that while they might have preferred a symmetric directive in current circumstances, the proposed bias in the directive was acceptable because an easing of reserve conditions was more likely than a tightening in the intermeeting period. Moreover, a return to a symmetric directive might well be misread as a change in policy that the Committee did not intend at this point. Two members expressed a strong preference for a symmetric directive because they were persuaded that monetary policy should not be eased except in response to compelling new evidence that current policy was impeding an expansion of the economy in line with its long-run potential. They noted that a symmetric directive would not rule out a policy change, in either direction, during the intermeeting period if such a change appeared to be warranted by the incoming economic or financial information.

At the conclusion of the Committee's discussion, all but two of the members indicated that they favored or could accept 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, 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 during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with growth in M2 and M3 at annual rates of about 2 percent and 1/2 percent respectively over the six-month period from June 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 suggests that economic activity is continuing to expand at a subdued pace. Total nonfarm payroll employment rebounded in July after declining in June, and the civilian unemployment rate edged down to 7.7 percent. Manufacturing output was unchanged in July, but overall industrial production was boosted by a higher level of mining and utility output. Retail sales increased moderately in July. Permits issued for the construction of new housing units rose slightly in July, but housing starts fell. Recent data on orders and shipments of nondefense capital goods indicate further increases in outlays for business equipment, while nonresidential construction has remained soft. The nominal U.S. merchandise trade deficit in April-May was substantially above its average rate in the first quarter. Incoming data on wages and prices suggest that inflation is slowing.

Interest rates have declined considerably since the Committee meeting on June 30-July 1. The Board of Governors approved a reduction in the discount rate from 3-1/2 to 3 percent on July 2. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined further over the first several weeks of the intermeeting period, but it has stabilized more recently.

M2 and M3 contracted somewhat further in July. Through July, both aggregates were appreciably below the lower ends of the ranges established by the Committee for the year.

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 on June 30-July 1 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 1991 to the fourth quarter of 1992. The Committee anticipated that developments contributing to unusual velocity increases could persist in the second half of the year. The monitoring range for growth of total domestic non-financial debt also was maintained at 4-1/2 to 8-1/2 percent for the year. For 1993, the Committee on a tentative basis set the same ranges as in 1992 for growth of the monetary aggregates and debt measured from the fourth quarter of 1992 to the fourth quarter of 1993. 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 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 June through December at annual rates of about 2 and 1/2 percent, respectively.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Hoenig, Jordan, Kelley, Lindsey, Mullins, Ms. Phillips, and Mr. Syron.

Votes against this action: Messrs. LaWare and Melzer.

Messrs. LaWare and Melzer dissented because they did not favor a directive that was biased toward possible easing during the intermeeting period. In their view, monetary policy already was appropriately stimulative, as evidenced in part by the low level of



short-term interest rates and by the rapid growth in reserves since early this year, and was consistent with the promotion of economic growth in line with the economy's long-run potential. Business and consumer confidence were in fact at low levels, but they reflected a variety of problems facing the economy that were unrelated to the stance of monetary policy. Accordingly, what was needed at this point was a more patient monetary policy--one that was less predisposed to react to near-term weakness in economic data and that allowed more time for the effects of earlier easing actions to be reflected in the economy. Indeed, an easing move in present circumstances might well stimulate inflationary concerns by reducing confidence in the System's willingness to pursue an anti-inflationary policy and thus could have adverse repercussions on domestic bond markets and further damaging effects on the dollar in foreign exchange markets.