FEDERAL RESERVE press release

For Use at 4:30 p.m. November 4, 1988

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 September 20, 1988.

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 September 20, 1988

Domestic Policy Directive.

The information reviewed at this meeting suggested that the expansion of economic activity might be moderating from the vigorous pace experienced earlier in the year. Information on output and spending in the third quarter was still fragmentary but recent statistics, including data on labor market activity, pointed on balance to some slowing in the rate of economic growth. Measures of price and wage inflation showed little change from recent trends, apart from the continuing upward impetus to food prices stemming from the drought.

Total nonfarm payroll employment rose more slowly in July and August, but gains in overall employment remained sizable. After four months of strong increases, manufacturing employment fell slightly although some industries with strong domestic and export sales recorded further increases. The civilian unemployment rate edged up in July and rose somewhat further to 5.6 percent in August, returning to its average level of the first half of the year.

Industrial production advanced somewhat further in August after a sharp increase in July. Production gains were recorded for most categories although they generally were smaller than those in July. Total industrial capacity utilization was little changed in August. Utilization rates remained at relatively high levels in primary processing industries but slipped in manufacturing as a whole after four months of increases.

Total retail sales were little changed on balance in July and August. Outlays for durable goods declined in both months, partly because of some slowing in unit sales of new automobiles. Sales of nondurable goods increased at a sluggish pace.

Recent information on business capital spending suggested some moderation from the very rapid growth in earlier months of the year. Real outlays for equipment continued to expand in July but at a pace well below that of the first half of the year as shipments of office and computing equipment fell. Nonresidential construction activity apparently edged higher in July despite further contraction in oil drilling and in spending on industrial and commercial structures other than office buildings. Inventory investment in the manufacturing and wholesale sectors in July evidently remained at about the moderate second-quarter pace. Housing starts rose in July, as multifamily construction rebounded from a reduced June level, but single-family starts remained close to the average pace of the first half of the year. Sales of new and existing homes retreated from their June pace, which had been the highest in more than a year.

The nominal U.S. merchandise trade deficit fell appreciably further in July from a considerably reduced second-quarter rate and was the lowest monthly deficit since March 1985. Virtually all of the improvement in July was due to a reduction in imports. The total value of exports was little changed from the June level as a sharp reduction in exports of automotive products about offset small increases in most other major categories. Economic activity in major foreign industrial countries slackened in the second quarter, but expansion appeared to have resumed in the current quarter.

Producer prices of finished goods, propelled by further substantial increases in refinery prices for gasoline, registered another large advance in August. At the level of crude materials, producer food prices were up sharply for the fourth straight month, reflecting the continuing effects of the drought. Consumer prices, available for July, advanced at about the second-quarter pace. Consumer food prices surged again; and energy prices rose further, mainly because of higher gasoline prices. Excluding food and energy items, consumer prices increased at about the average pace of the preceding twelve months.

In the foreign exchange markets, the trade-weighted value of the dollar changed little on balance over the period since the Committee meeting on August 16. Following that meeting, the dollar remained under upward pressure until late in the month when increases in European official lending rates arrested its climb. Following the softer U.S. employment report for August, the dollar moved lower in early September, but it subsequently firmed in response to the publication of the July merchandise trade figures.

At its meeting in mid-August, the Committee adopted a directive calling for no change in the degree of pressure on reserve positions. These reserve conditions were expected to be consistent with growth of M2 and M3 at annual rates of about 3-1/2 and 5-1/2 percent, respectively, over the period from June through September. The members agreed that somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets.

Reserve conditions remained essentially unchanged over the period since the August meeting. Adjustment plus seasonal borrowing averaged just below $600 million for the two reserve maintenance periods completed since the meeting, and federal funds primarily traded near the 8-1/8 percent level prevailing at the time of the meeting. In light of some indications of more moderate economic expansion, most other market interest rates declined 1/4 to 3/8 percentage point over the inter-meeting period. Broad indexes of stock prices were up 1 to 3 percent.

Growth of the broader monetary aggregates slowed again in August. The slower expansion of M2 was concentrated in its liquid deposit components and probably continued to reflect the rise since early spring of market interest rates and related opportunity costs of holding such deposits. Growth of M1 fell sharply in August, as total transaction deposits declined slightly. Reflecting a contraction in total reserves, growth of the monetary base slowed markedly in August.

The staff projection prepared for this meeting incorporated somewhat slower growth of economic activity in the current quarter than had been projected earlier, largely reflecting the recent softening in the data on employment. The rate of expansion through the end of 1989 was expected to remain on balance below the pace in recent quarters, with the drought likely to contribute to an uneven quarterly pattern of growth. To the extent that monetary policy did not accommodate any tendency for growth in final demand to be sustained at a pace that threatened more inflation, pressures would be generated in financial markets that would restrain domestic spending. The staff continued to project relatively limited growth of consumer spending, considerably reduced expansion of business fixed investment, and sluggish housing activity. The foreign sector was still expected to make a major contribution to domestic economic growth, even though progress in reducing the trade deficit was thought likely to be slower than in recent quarters. The staff also anticipated some continuing cost pressures over the next several quarters, reflecting the effects of rising import prices and especially of reduced margins of unutilized labor and other production resources.

In the Committee's discussion of the economic situation and outlook, members noted that the recent indications of some moderation in the rate of economic growth tended to reinforce their expectations of a reduced rate of economic expansion through next year. The members welcomed the signs of somewhat slower economic growth, given the risks of higher inflation. A number were concerned that the apparent slowing might prove to be only a temporary pause in a generally strong expansion or to be inadequate to avert an intensification of inflationary pressures without further monetary restraint. Others, while noting the still tentative nature of the incoming data, interpreted recent developments in financial markets as well as the real economy as suggesting a greater likelihood that policy had tightened sufficiently to put the economy on a desirable course toward moderate growth that would prove compatible over time with the achievement of the Committee's anti-inflationary objectives.

In the Committee's discussion of factors bearing on the economic outlook, a number of members emphasized that, on the whole, indicators of economic activity continued to suggest appreciable momentum in the expansion. Recent growth of payroll employment, while below the average pace of the first half of the year, was still substantial. Capital spending exhibited few signs of weakening following a period of rapid expansion, and sizable profits augured for continuing growth. Likewise, new orders, notably for exports, were holding up well, and some greater inventory investment was seen as a reasonable prospect, given current low inventory-to-sales ratios. A number of members also referred to continuing evidence of a high level of business activity in many parts of the country. Indeed, in some areas and industries, growth was being constrained by a limited availability of labor and other production resources. At the same time, members noted that economic performance remained uneven across the country, depending on the mix of local industries, and a few signs of moderation could be observed even in areas that were characterized by strong local economies. Retail sales were lackluster in a number of areas, and the drought was having a mixed impact on agriculture. The drought's adverse effects in some parts of the country contrasted with income gains in other areas where producers experiencing more normal crop yields were benefitting from higher prices. On balance, local conditions appeared consistent with expectations of somewhat slower growth in domestic demand.

Members continued to anticipate further improvement in the nation's trade balance over the next several quarters. That view was bolstered by local reports of strength in export demands for a wide variety of products and indications of gains in domestic market shares by firms in the United States. The prospective improvement in net exports was not likely to be as strong as in recent quarters, however, reflecting the lagged effects of the rise in the exchange value of the dollar over the course of recent months.

With regard to the outlook for inflation, members generally emphasized that the risks remained on the side of an intensification of inflationary demand pressures. Some favorable developments that had tended to dampen inflation, such as declining oil prices and a rising dollar, might well be reversed. More fundamentally, given current utilization rates of labor and other production resources, the economy was probably near the point where expansion at a rate somewhat above the economy's trend growth potential could result in greater pressures on wages and prices. Other members saw less risk of more inflation, particularly in the context of what they viewed as the moderating growth of the economy and the appreciable tightening of monetary policy over the past several months. Consistent with this view, some noted that inflationary expectations appeared to have eased as evidenced, for example, by the performance of long-term debt markets and the behavior of the dollar in foreign exchange markets. Moreover, industrial commodity prices had been relatively stable for an extended period. Reports from contacts around the nation did not suggest much change recently in local price and wage developments. Capacity constraints and labor shortages in some industries and areas continued to be a source of inflationary pressures, but there were few reports of outsized increases in prices or wages. Indeed, some members noted that prices had tended to level out or to rise more slowly in a number of industries and indications of faster increases in wages were limited.

At its meeting in late June the Committee reviewed the basic policy objectives that it had set for growth of the monetary and debt aggregates in 1988 and it established tentative objectives for expansion of those aggregates in 1989. For the period from the fourth quarter of 1987 to the fourth quarter of 1988, the Committee reaffirmed the ranges of 4 to 8 percent set in February for growth of both M2 and M3. The monitoring range for expansion of total domestic nonfinancial debt in 1988 was left unchanged from its February specification of 7 to 11 percent. On a cumulative basis through August, M2 had grown at an annual rate slightly above, and M3 at a rate more noticeably above, the midpoints of their annual ranges. Expansion of total domestic nonfinancial debt appeared to have moderated to a pace marginally below the midpoint of its range. For 1989 the Committee agreed on tentative reductions to ranges of 3 to 7 percent for M2 and 3-1/2 to 7-1/2 percent for M3. The monitoring range for growth of total domestic nonfinancial debt was lowered to 6-1/2 to 10-1/2 percent for 1989. It was understood that all the ranges for next year were provisional and that they would be reviewed in February 1989 in the light of intervening developments. With respect to M1, the Committee reaffirmed in June its earlier decision not to set a specific target for growth in 1988 and it also decided not to establish a tentative range for 1989.

In the Committee's discussion of policy implementation for the weeks immediately ahead, all of the members agreed on a proposal calling for an unchanged policy stance pending an evaluation of further economic developments. Those who perceived the risks in the economic outlook as still decidedly on the side of continued strong demand and greater inflationary pressures saw enough uncertainties in the current economic situation to warrant a pause in the policy firming process. Others were less persuaded that inflationary pressures would intensify, especially given the degree of policy restraint that already had been implemented over the past several months. It was noted that additional firming at this time could have undesirable repercussions on the dollar in foreign exchange markets and on the financial condition of many already troubled depository institutions. Some members expressed concern that a marked weakening in the economy, which would become a greater risk if policy were tightened further, would disrupt the urgent task of reducing the federal budget deficit.

In their consideration of a desirable policy for the near term, the members took account of a staff analysis which suggested that monetary expansion was likely to remain relatively damped in coming months. This outlook assumed a continuing lagged adjustment of offering rates on retail deposits to earlier increases in market interest rates.

With regard to possible adjustments in the degree of reserve pressure during the intermeeting period, all of the members indicated that the balance of risks in the economy were such that they favored or could accept a directive that would more readily accommodate a move toward firming than an adjustment toward easing in the weeks ahead.

Some commented that near-term developments were not likely to call for a policy change in this period, while others saw a greater likelihood that intermeeting developments would point to the desirability of some firming. The potential need for some easing was viewed as remote.

At the conclusion of the Committee's discussion, all of the members approved a directive that called for maintaining the current degree of pressure on reserve positions. The members decided that somewhat greater reserve restraint would be acceptable, or slightly lesser reserve restraint might be acceptable, over the intermeeting period depending on indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated by the Committee were expected to be consistent with growth of M2 and M3 at annual rates of around 3 percent and 5 percent, respectively, over the four-month period from August to December. 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 meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that the expansion in economic activity may be moderating from the vigorous pace earlier in the year. Total nonfarm payroll employment grew more slowly in July and August, though the increases in the two months were still sizable. The civilian unemployment rate rose to 5.6 percent in August. Industrial production advanced slightly further in August after a sharp increase in July. Retail sales were flat in July and August. Recent indicators of business capital spending suggest some moderation from the especially rapid growth

in earlier months of the year. Preliminary data for the nominal U.S. merchandise trade deficit in July showed some further reduction from the improved second-quarter rate. The latest information on prices suggests little if any change from recent trends.

Most interest rates have declined somewhat since the Committee meeting on August 16. Over the intermeeting period, the trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies was about unchanged on balance.

Expansion of M2 and M3 moderated further in August. For the year through August, M2 has grown at a rate slightly above, and M3 at a rate more noticeably above, the midpoints of the ranges established by the Committee for 1988. M1 was unchanged in August after registering relatively strong growth in June and July. Expansion of total domestic nonfinancial debt for the year thus far appears to be at a pace somewhat below that in 1987.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability over time, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in late June reaffirmed the ranges it had established in February for growth of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth of total domestic nonfinancial debt was also maintained at 7 to 11 percent for the year.

For 1989, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1988 to the fourth quarter of 1989, of 3 to 7 percent for M2 and 3-1/2 to 7-1/2 percent for M3. The Committee set the associated monitoring range for growth of total domestic nonfinancial debt at 6-1/2 to 10-1/2 percent. It was understood that all these ranges were provisional and that they would be reviewed in early 1989 in the light of intervening developments.

With respect to M1, the Committee reaffirmed its decision in February not to establish a specific target for 1988 and also decided not to set a tentative range for 1989. The behavior of this aggregate will continue to be evaluated in the light of movements in its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from August through December at annual rates of about 3 and 5 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Black, Forrestal, Heller, Hoskins, Johnson, Kelley, LaWare, Parry, and Ms. Seger.