

FEDERAL RESERVE press release



For Use at 4:30 p.m.

July 6, 1990

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on May 15, 1990.

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 15, 1990

Domestic policy directive

The information reviewed at this meeting suggested that economic activity was continuing to expand at a moderate pace. The service-producing sector remained the mainstay for growth in income and employment; manufacturing was still sluggish and construction activity was slipping after the weather-related bulge earlier in the year. Some broad measures of prices reflected a partial unwinding of the earlier surge in prices of food and energy; however, underlying trends in consumer prices and labor costs suggested no weakening in inflationary pressures.

Total nonfarm payroll employment increased more slowly in March and April after sharp weather-related advances earlier in the year; job growth thus far in 1990 had averaged a little above that in the second half of last year in part because of the hiring of temporary workers for the census. In the private sector, nonfarm employment fell in both March and April, partly owing to an unwinding of an earlier surge in construction jobs during unseasonably mild winter weather. Job losses also were widespread in manufacturing; and, with the notable exception of health services, hiring in the services industries weakened considerably from the strong pace of 1989 and early 1990. In April, the civilian unemployment rate edged up to 5.4 percent.

Industrial production declined in April, reflecting a cutback in the manufacture of motor vehicles that was intended to bring inventories of new cars into better balance with sales. Industrial

activity had been buffeted by a variety of transitory influences in previous months, including strike activity in the aircraft industry, inventory adjustments in the motor vehicle industry, and unusual winter weather patterns that had affected the energy output of utilities; nevertheless, production in April was about unchanged from the levels of last December and a year earlier. Total industrial capacity utilization slipped in April after a small rise in March; operating rates in manufacturing had trended down over the twelve months ending in April as capacity increased while production remained about unchanged.

Real personal consumption expenditures edged lower in March, reversing a small net rise in the two previous months. Spending for goods was weak on balance over the three-month period, especially for food and apparel items; outlays for services continued to be robust, with notably strong gains for spending on medical care. Retail sales fell in April as a result of reduced purchases of motor vehicles, but upward revisions to data for the two previous months suggested a little more strength in consumption in the first quarter than had been indicated previously. Housing starts fell sharply in March after surging earlier in the year. The March decline likely reflected the effect of higher mortgage interest rates along with some payback for unusually strong housing construction activity in the two previous months of atypically mild winter weather.

Business capital spending strengthened in the first quarter of 1990 from a temporarily depressed fourth-quarter level. Outlays for nondefense capital goods rose sharply, partly as a result of a rebound in shipments of aircraft to domestic firms after a strike late in the

fourth quarter. Spending for information-processing equipment, notably computers, also increased while acquisitions of industrial equipment continued to languish. New orders for business equipment other than aircraft advanced at a slower pace in the first quarter. Favorable weather aided nonresidential construction activity in January and February; however, the pace of construction activity fell off in March, and construction permits and contracts continued to trend down. Manufacturing inventories were reduced considerably in February and March as factory shipments rebounded; declines were widespread among producers of durable goods, primary metals, fabricated metal products, nonelectrical machinery, and motor vehicles. For most industries, the inventory-to-shipments ratio was lower in March than at year-end. At the retail level, many types of establishments, including auto dealers, retail apparel, and general merchandise stores had trimmed their inventories substantially.

The nominal U.S. merchandise trade deficit narrowed in February as imports declined sharply and exports were little changed from January levels. For the January-February period, exports were moderately higher than in the fourth quarter, led by a rebound in shipments of aircraft. Over the same time period, the value of imports fell; a sizable decline in non-oil imports that was widespread across commodity categories outweighed higher imports of oil associated with the rebuilding of stocks depleted during the unusually cold weather in December. Indicators of economic activity in the major foreign industrial nations suggested a continuation of moderate growth in real economic activity in most major West European countries and Japan. Declines in industrial

production in the United Kingdom and Canada appeared to be signaling some slowing of economic growth in these countries.

Producer prices for finished goods dropped somewhat further in April, reflecting additional unwinding of the earlier surge in prices of food and energy. Producer prices for items other than food and energy had increased through April at a slower rate than in 1989. By contrast, consumer prices continued to rise in March at a faster pace than in 1989. Weather-related jumps in prices of food and energy accounted for much of the pickup in consumer price inflation in the first quarter, but prices for a wide range of other goods and services also increased more rapidly. Labor compensation, as measured by the employment cost index, rose at a faster rate over the twelve months ended in March than in the year-earlier period; wage increases remained fairly stable, but the cost of benefits jumped, only partly because of the January hike in social security taxes. Average hourly earnings increased a little more slowly in April, partly reflecting a sharp drop in employment in the relatively high-wage construction industry.

At its meeting on March 27, 1990, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include any presumption regarding the likely direction of any intermeeting adjustments in policy. The Committee agreed that some firming or some easing in reserve conditions would be appropriate during the intermeeting period depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. With unchanged reserve

conditions, M2 and M3 were expected to grow at annual rates of about 6 and 4 percent respectively over the period from March through June.

Open market operations in the intermeeting interval since the March 27 meeting had been directed at keeping reserve conditions essentially unchanged. Adjustment plus seasonal borrowing levels moved up to about \$300 million by the end of the intermeeting period from the \$150 million range prevailing initially, reflecting a normal rise in seasonal borrowing. The federal funds rate remained in the vicinity of 8-1/4 percent over the period, although funds had tended to trade a little below this level since late April as shortfalls in federal tax receipts tended to keep nonborrowed reserves at higher-than-expected levels. Responding to shifting sentiment regarding the strength of the economy, inflation prospects, and the likelihood of a near-term tightening of monetary policy, other market interest rates initially rose in the intermeeting period and then fell sharply. Short-term rates declined a little on balance over the period while rates in long-term debt markets were somewhat higher.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined considerably over the intermeeting period. Much of the decline occurred following the release in early May of weaker-than-expected U.S. employment data for April and the related drop in U.S. interest rates. Foreign interest rates showed mixed movements over the intermeeting period; the Japanese stock market rebounded substantially from its low in early April. The dollar was weak against the German mark, which strengthened against most currencies as developments appeared to relieve some concerns about the

outlook for inflation in Germany. Very late in the intermeeting period the dollar weakened against the yen as well.

Growth of M2 slowed further in April; the expansion of this aggregate was damped by the sizable opportunity costs of holding retail deposits as interest rates offered on these accounts continued to lag behind earlier increases in market rates. At thrift institutions, conservative rate-setting reflected the ongoing contraction of their funding needs during a period of asset reduction. Banks also held down their deposit rates, as inflows of retail deposits were proving sufficient to fund credit expansion. The apparently steeper contraction of thrift assets, along with slow credit expansion at banks, held down overall needs for funds at depository institutions and resulted in relatively weak M3 growth in April. Expansion of M2 and M3 through April was a little above the midpoint and around the lower end, respectively, of the ranges established by the Committee for 1990.

The staff projection prepared for this meeting suggested that the economy was likely to expand at a moderate pace over the balance of the year. Consumer demand, especially for services, was expected to be a major source of support for continued growth of the economy. Business capital spending was projected to increase further in 1990, but the extent of the rise could be limited somewhat by low profit margins associated with relatively slow growth in final demands and lower levels of capacity utilization. Nonresidential construction activity was expected to be held down by the overbuilt condition of many commercial real estate markets around the country along with greater caution on the part of lenders. Homebuilding was projected to be damped by the

somewhat higher mortgage rates now in place. Net exports of goods and services were expected to increase only modestly in real terms over the rest of the year. The projection assumed moderate restraint on expenditures at all levels of government. Price inflation was expected to ease substantially in the months ahead, following the bulge earlier in the year, but little improvement was anticipated in the underlying trend of inflation over the next several quarters and reductions in price pressures might ultimately involve some additional pressures in financial markets.

In the Committee's discussion of the economic situation and outlook, members generally agreed that the current information on business conditions pointed on balance to relatively moderate but sustained economic expansion. Final demands appeared to be expanding further, though not rapidly, and available information suggested that business inventories were quite lean. Fiscal policy was an important source of uncertainty in the outlook, though there was some basis for optimism in light of the discussions on deficit reductions that were just getting under way between the Administration and the Congress. Credit conditions constituted another major area of uncertainty; there were reports of tighter lending constraints, but the evidence was fragmentary and difficult to assess and on balance seemed to indicate that the effect on the overall economy remained quite limited. Under circumstances in which the economy seemed likely to retain appreciable forward momentum, many members were concerned about the outlook for inflation, given currently high levels of resource utilization and information on cost and price developments earlier in the year. Recent

data suggested some relief from the bulge in prices in the first quarter; whether underlying inflationary pressures had intensified was debatable, but the members generally agreed that the prospects for significant reductions in inflation pressures during the quarters immediately ahead were not promising.

With regard to developments in specific sectors of the economy, members expected growth in consumer spending, notably for services, to continue to provide the principal momentum for the expansion. Exports also might expand, given the outlook for continuing growth in other industrial countries, the prospects for increasing, if still limited, demands from Eastern Europe, and more generally the lagged effects of the sizable decline in the exchange value of the dollar from its 1989 high. The outlook for business investment expenditures was less clear; recent indicators such as new orders for capital equipment and surveys of business investment plans suggested continuing expansion--and possibly some quickening over the near term--in spending for plant and equipment. However, the outlook for office and other commercial building activity appeared less favorable in light of the overbuilding in many areas and indications of tighter constraints on the availability of credit to builders. The prospects for housing construction also were adversely affected by these factors as well as the effects of higher mortgage rates. Members commented that outside the commercial building and real estate sectors and apart from lending to finance equity retirements, there was little evidence of more than a mild, if any, curtailment of credit to business firms in most parts of the country. To a considerable extent, the retrenchment in business lending appeared

to reflect desirable reassessments of credit risks or reduced demand for financing. Nonetheless, the possibility that lenders might restrict credit further and to a wider range of borrowers remained a potential constraint on aggregate economic activity. Currently low levels of business inventories could be viewed as an element of strength in the outlook, but limited inventories also implied that, if aggregate demands were to strengthen materially, production could accelerate considerably and add to pressures on productive resources, especially given high levels of resource utilization in the United States and apparently in many other industrial nations.

With regard to the outlook for prices and wages, the most recently available data on economic activity and prices had tended to ease concerns that inflationary pressures might be intensifying. Producer prices for finished goods had edged lower in recent months, and other key measures of inflation were expected to show reduced increases over the months ahead as sharp earlier advances in food and energy prices continued to unwind. Nonetheless, there was some risk that the core rate of inflation, excluding swings in food and energy prices, might edge higher at current levels of resource utilization. In this regard, some members commented that increases in labor compensation costs had tended to accelerate in recent quarters and that conditions in labor markets continued tight in many parts of the country. Prices of many services, notably for health care, were still increasing very rapidly. Commodity prices had been under sporadic upward pressure and remained substantially above earlier levels. The decline in the value of the dollar to its lowest level since late 1988 on a weighted-average

basis, if sustained, could reverse the favorable effects of earlier dollar appreciation. Other members acknowledged the potential for a persisting high rate of inflation, but they continued to anticipate some progress toward a lower core rate of inflation over time if their expectations of relatively moderate growth in economic activity were realized. In support of this view, it was noted that competition remained strong in many markets for goods, including competition from imports, and ongoing additions to capacity in some key industries experiencing strong demand would help to hold down inflationary cost pressures. In addition, the expansion of M2 at a relatively subdued pace over an extended period suggested that monetary conditions were consistent with progress toward reducing inflation.

Turning to the conduct of monetary policy in the intermeeting period ahead, nearly all of the members supported a proposal to maintain unchanged conditions of reserve availability at least initially following today's meeting. The members generally agreed that unchanged reserve conditions could reasonably be expected to be associated with continued moderate expansion in business activity. At the same time, they remained concerned about the lack of progress against inflation, and some commented that the need to contain and ultimately to reduce inflation might well require a firming of policy at some point. Price stability, it was emphasized, was a vital objective of monetary policy and was essential to the achievement of overall objectives for the economy. However, recent data on the economy and prices provided some comfort that inflation pressures were not building, and there were some downside risks to the economic outlook stemming from conditions in

financial markets. Growth of the monetary aggregates had slowed appreciably and, while there was considerable uncertainty, credit conditions also could be tightening with potential effects on spending. Partly in light of these developments, some members stressed that it was too soon to conclude that current monetary policy would not have desired anti-inflationary effects. Under these circumstances, all but one member favored the retention of unchanged reserve conditions, pending additional information that might tilt the risks toward greater price pressures or a weaker economy.

In the course of this discussion, members referred to a staff analysis which concluded that, on the assumption of an unchanged degree of reserve pressure, growth of both M2 and M3 was likely to accelerate somewhat from the recent pace, with the cumulative expansion of M3 moving that aggregate more comfortably within the Committee's range for the year. Several members observed that while the slower growth of M2 and M3 might be explained at least in part by temporary developments, notably the sluggish adjustment of deposit interest rates to earlier increases in short-term market rates and perhaps the effects of large swings in deposit balances associated with April tax payments, a failure of such growth to pick up could be a matter of increasing concern; in particular, persisting sluggishness in monetary growth might reflect a combination of underlying weakness in the demand for loans in a softening economy and growing constraints on the availability of credit to potential borrowers. However, given the volatility of monetary growth rates, members believed it was premature to reach a firm conclusion on this issue. Moreover, despite its slowing in recent

months, growth of M2 for the year to date was close to the midpoint of the Committee's range, reflecting relatively robust expansion in late 1989 and early 1990.

With respect to possible adjustments in the degree of reserve pressure during the period before the next Committee meeting in early July, a majority of the members expressed a preference for a directive that did not bias prospective operations toward tightening or easing but made an intermeeting adjustment, if any, equally likely in either direction, depending on economic and financial developments and the behavior of the monetary aggregates. Other members preferred a directive that was tilted toward possible tightening, given their desire to respond promptly to any indications of greater inflationary pressures and their judgment that in the current inflationary environment the next policy move was likely to be in the tightening direction. Some of these members commented that such a bias in the directive would tend, as it became known, to enhance the credibility of the System's anti-inflationary policy and help to make that policy more effective over time. However, given the risks to the economy and the uncertainties in the outlook, these members also could accept a symmetric directive with regard to intermeeting adjustments.

At the conclusion of the Committee's discussion, all except one member indicated that they preferred or could accept a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include any presumption about the likely direction of adjustments in policy, if any, during the intermeeting period. With regard to the factors that were important in considering

the need for any intermeeting changes in reserve conditions, the Committee continued to give primary weight to those bearing on the inflation outlook. Accordingly, slightly more or slightly less pressure on reserve positions would be appropriate during the period ahead depending on progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The maintenance of steady reserve conditions was expected to be consistent with somewhat slower monetary expansion in the current quarter than the members had anticipated at the time of the March meeting, including growth of M2 and M3 at annual rates of about 4 and 3 percent respectively over the three-month period ending in June. The intermeeting range for the federal funds rate, which provides one mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, was 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 economic activity is continuing to expand moderately. Total nonfarm payroll employment increased more slowly in March and April after sharp advances earlier in the year; its average growth thus far this year has been above that in the second half of 1989, in part because of the hiring of temporary workers for the census. In April, the civilian unemployment rate moved up to 5.4 percent. Industrial production declined in April, reflecting what appears to be a temporary cutback in the manufacture of motor vehicles. Consumer spending has been sluggish on balance in recent months; outlays for goods have been weak while expenditures for services have remained strong. Business spending for equipment has been rising, but construction activity, both residential and nonresidential, appears to have weakened after a

temporary boost early in the year. The nominal U.S. merchandise trade deficit narrowed somewhat in January and February from its average rate in the fourth quarter. Consumer prices continued to rise at a faster pace in March than in 1989; producer prices were down somewhat further in April, reflecting additional unwinding of the earlier surge in prices of food and energy. The latest data on employment costs suggest some deterioration in underlying trends.

Short-term interest rates have declined a little on balance since the Committee meeting on March 27, while rates in long-term debt markets have risen slightly over the period. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined considerably over the intermeeting period.

Growth of M2 slowed in April and that of M3 remained relatively weak. Through April, expansion of M2 and M3 was a little above the midpoint and around the lower end, respectively, of the ranges established by the Committee for 1990.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 3 to 7 percent and 2-1/2 to 6-1/2 percent respectively, measured from the fourth quarter of 1989 to the fourth quarter of 1990. The monitoring range for growth of total domestic nonfinancial debt was set at 5 to 9 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from March through June at annual

rates of about 4 and 3 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, Boehne, Boykin, Johnson, Kelley, LaWare, Ms. Seger, and Mr. Stern.
Vote against this action: Mr. Hoskins.

Mr. Hoskins dissented because he preferred a tightening of reserve conditions to help assure that progress would be made toward a reduced rate of inflation and the Committee's ultimate objective of price stability. Although price pressures appeared to be receding from the pace of early in the year, inflation remained too high. He recognized that M2 growth had slowed and there were potential financial developments that might have adverse consequences for the expansion, but he believed that growth of M2 in the bottom half of the 1990 target range would be desirable in order to achieve a gradual reduction in inflation in 1991 and thereafter. Moreover, a timely move toward greater monetary restraint would enhance the credibility and effectiveness of monetary policy in countering the persisting strength of inflationary pressures.