

FEDERAL RESERVE press release



For Use at 4:30 p.m.

July 5, 1991

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on May 14, 1991.

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

Attachment

RECORD OF POLICY ACTIONS OF THE
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on May 14, 1991

Domestic policy directive

The economic information reviewed at this meeting was mixed, but on balance it suggested that business activity might be in the process of stabilizing after declining in the fourth and first quarters. Retail sales were little changed in April and housing markets apparently strengthened in many areas; however, business fixed investment remained weak and some liquidation of inventories seemed to be continuing. Production held steady in April. Nonfarm payroll employment continued to decline but by much less than in previous months. Broad measures of prices and wages pointed to moderating inflation pressures, although a number of special factors tended to obscure underlying inflation trends.

Total nonfarm payroll employment fell further in April, but the reduction was substantially less than the declines in the latter part of 1990 and the early months of 1991. The job losses included much smaller decreases in manufacturing and construction; employment in wholesale and retail trade also continued to slide, and the loss more than offset a further gain at service establishments. The civilian unemployment rate declined somewhat in April to 6.6 percent.

After dropping sharply from October through March, industrial production was about unchanged in April. An upturn in the production of motor vehicles provided an important boost to industrial activity, and output of other consumer durable goods also edged up. These gains offset further declines in the production of consumer nondurable goods and business equipment. Industrial materials, while displaying a mixed

pattern, continued to decline as a group. Capacity utilization rates generally fell further in April, and operating rates for most industry groups were at their lowest point in the current recession.

Real business fixed investment fell sharply in the first quarter, with outlays for both equipment and structures decreasing substantially. The plunge in expenditures for equipment included large declines in spending for computers, motor vehicles, and many types of industrial equipment; in contrast, outlays for aircraft were markedly higher. Recent data on orders received by domestic manufacturers pointed to additional cutbacks in spending for most types of equipment. The sizable reduction in first-quarter expenditures for nonresidential structures followed an even larger decline in the fourth quarter. Forward-looking indicators of nonresidential construction suggested continuing weakness. Nonfarm business inventories fell substantially further in the first quarter, largely as a result of continuing liquidation of stocks of motor vehicles. In March, housing starts lost part of their sharp February gain. However, more recent anecdotal reports and surveys of homebuilders suggested that reduced mortgage rates were continuing to stimulate consumer interest in purchasing homes.

Retail sales, which had risen substantially in February after sizable declines in previous months, were now indicated to have increased somewhat further in March and to have changed little in April. The improvement in retail sales was led by the durable goods category. Unit sales of motor vehicles rose in March but subsequently

softened again in April. After rebounding earlier, consumer sentiment was reported to have declined slightly in April.

Producer and consumer prices changed little in March and April, partly because of some additional reduction in energy prices. Excluding their food and energy components, both producer and consumer prices were up considerably less in the latest two months than in previous months. Apparently reflecting an increase in the minimum wage, average hourly earnings rose at a faster rate in April than in earlier months of the year. In the first quarter, hourly compensation as measured by the employment cost index was boosted by special factors that included an increase in the wage bases for social security and medicare taxes.

The nominal U. S. merchandise trade deficit narrowed in February, and for January-February combined the deficit was considerably below its average rate in the fourth quarter. The improvement reflected a significant decline in the average price of oil imports, a lower volume of non-oil imports, and further expansion in the quantity of exports. In the first quarter, economic activity appeared to have continued to grow at a sluggish pace in the major foreign industrial nations as a group.

At its meeting on March 26, 1991, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that contained no presumption regarding the likely direction of possible intermeeting adjustments. Accordingly, the directive indicated that somewhat more or somewhat less pressure on reserve positions might be appropriate during the intermeeting period depending on progress toward price stability, trends in economic

activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The contemplated reserve conditions were expected to be consistent with some reduction in the growth of M2 and M3 from accelerated rates in previous months to annual rates of about 5-1/2 and 3-1/2 percent respectively over the three-month period from March through June.

For much of the period after the Committee meeting, open market operations were directed toward maintaining the existing degree of pressure on reserve positions. On April 30, in response to indications of continuing weakness in the economy and in the context of abating inflation pressures, the discount rate was reduced from 6 to 5-1/2 percent and part of this decline was allowed to show through to the federal funds rate. Adjustment plus seasonal borrowing averaged a bit above \$150 million over the intermeeting period, close to expected levels. During this period, two technical increases were made to assumed levels of borrowing to reflect a normal upswing in seasonal credit. Federal funds traded at an average rate just below 6 percent until late April; the rate was under downward pressure at times from market expectations of some further easing in monetary policy and from unanticipated reserve surpluses. After the announcement of the reduction in the discount rate on April 30, federal funds traded in a range around 5-3/4 percent.

Most short-term interest rates declined somewhat more than the federal funds rate over the intermeeting period, apparently reflecting reactions to indications of continued weakness in the economy as well as the easing in reserve conditions. Banks reduced their prime rate from

9 to 8-1/2 percent in early May after the easing of monetary policy. In long-term debt markets, yields on Treasury bonds were little changed on balance over the period as market participants appeared to focus increasingly on the prospects for very large Treasury financing needs. In private-sector bond markets, rates edged lower and risk premia fell further after declining sharply in February and March. Major stock price indexes retreated from record levels reached during April but still rose on balance over the period. Prices of bank debt and equities outpaced the broader indexes, in part because bank earnings for the first quarter were not as poor as many investors had feared.

In foreign exchange markets, the dollar tended to weaken in reaction to the easing of U. S. monetary policy in late April and the release of data that failed to confirm market expectations of a quick recovery in U. S. economic activity after the end of the Persian Gulf war. However, some decline in short-term interest rates abroad and reactions to political developments in Germany and the Soviet Union limited the downward pressure on the dollar. On balance, the dollar was little changed over the period in terms of the other G-10 currencies, and at the time of this meeting it was at a level well above its lows of mid-February.

After accelerating to a relatively rapid pace in February and March, growth of M2 slowed appreciably in April. The slowing was somewhat greater than had been anticipated and appeared to be related in part to a relatively small buildup in household deposit balances associated with a falloff in income tax payments. The expansion of M3, which already had moderated in March, stalled in April. Apart from the

effect of reduced M2 growth, M3 was influenced by a runoff of large time deposits associated with contracting credit at depository institutions. For the year through April, M2 expanded at a rate close to the midpoint of the Committee's annual range; M3 grew at a pace in the upper half of the Committee's range, as the elimination of reserve requirements on nontransaction accounts induced some foreign banks to shift funding into the U. S. CD market.

The staff projection prepared for this meeting suggested that a recovery in economic activity was imminent and would be fully under way by the summer months; the expansion was projected to continue through 1992. In the context of moderate growth in consumer spending, the recovery would be stimulated by an upturn in homebuilding and a swing in coming months from decumulation to accumulation of inventories. Capital expenditures were expected to strengthen over time as sales trends improved. On balance, however, the projection pointed to a recovery that was less robust than most of those experienced in previous postwar cycles. Among the factors that would tend to inhibit the recovery were the effect of unoccupied nonresidential structures on construction activity, the absence of further significant impetus from net exports, and the prospect of some continued constraint on the availability of credit. Federal fiscal policy was expected to remain moderately restrictive, and efforts by states and localities to cope with budgetary imbalances also promised to exert some restraint on domestic demand. Against the background of some persisting slack in labor and product markets, the staff anticipated that the underlying rate of inflation would trend down in coming quarters.

In the Committee's discussion of the economic situation and outlook, members commented that current business indicators continued to provide mixed signals of the prospects for the economy but that a variety of developments appeared to have laid the groundwork for a recovery. Indeed, in the view of a number of members, the economy might well be close to its recession trough. Consumer spending, while disappointing to many business firms, appeared to have been better maintained in recent months than earlier reports had suggested, and demand for housing clearly had picked up across the nation. Overall spending had exceeded production by a considerable margin since the fall of 1990, and at some point the liquidation of inventories would end and a pickup in production would be needed to satisfy ongoing demand. On the financial side, the stock market remained strong; households and business firms were making progress in rebuilding their balance sheets; and the overall condition of the banking system appeared to be improving despite the continuing difficulties of a number of individual institutions. Negative factors included indications of relatively depressed business sentiment; business capital spending remained weak and members were concerned that additional retrenchment in business expenditures could develop, possibly induced by further disappointment over the level of consumer spending, that would deepen and prolong the recession. Consumer confidence had receded after its surge at the end of the Persian Gulf war. Consumer and business attitudes were seen as a critical factor bearing on the prospective performance of the economy.

Despite the uncertainties, the members generally viewed a business recovery in the months ahead as a reasonable expectation. At

the same time, however, while acknowledging the unpredictability of the economy's momentum once the recovery got under way, many questioned the potential strength of the anticipated expansion. Their assessment of current conditions did not point to major sources of stimulus to the economy, aside perhaps from residential housing. Some members also observed that the rebuilding of balance sheets, to the extent that it continued, might temper the initial strength of the recovery though it would have obviously favorable implications for the sustainability of the recovery over time. With regard to inflation trends, members commented that on the whole recent price and wage developments were encouraging and provided a firmer basis than earlier for projections of appreciable progress in reducing the core rate of inflation over the next several quarters.

Reports from around the country indicated that business conditions were still uneven. Economic activity appeared to have weakened somewhat further in some regions over the course of recent months but had changed little or shown modest gains in other parts of the nation. Relatively weak economic conditions had limited the tax revenues of numerous state and local governments, including many major cities, and the imposition or the prospect of higher taxes along with efforts to cut services were having an unsettling influence on business and consumer confidence in many areas. More generally, fiscal developments, including trends in federal spending, were expected to have a retarding effect on the nation's economy over the balance of the year and in 1992.

Many of the members observed that the consumer sector might well remain relatively sluggish in the months ahead as consumer

expenditures continued to be restrained by lagging growth in disposable incomes and by concerns about employment prospects, debt burdens, and the health of a number of financial institutions. With regard to the prospects for business capital spending, members continued to anticipate that significant strengthening would lag an improvement in consumer spending. In this connection, some commented that unless tangible evidence of stronger consumer spending began to emerge fairly soon, already gloomy business attitudes would be shaken further and could lead to an additional cutback in business capital expenditures. For now, the weakness in investment spending appeared to reflect in large measure a stretching out of major capital projects rather than widespread cancellations. The large issuance of new equity and long-term debt by business firms was being used at this point mainly to shore up balance sheets rather than to finance capital expenditures, but these activities implied that business firms would be in an improved position to finance more investment spending later in response to a pickup in the demand for their products and an ongoing need to modernize production facilities for competitive reasons. In any event, commercial construction activity was likely to remain depressed for an extended period until a severe overcapacity in office space and other facilities in many parts of the country could be worked down.

Several members commented that a turnaround in inventory investment could play a significant role, as it had historically, in helping to generate a business recovery. The members recognized that a good deal of uncertainty typically surrounded the outlook for inventories, and it seemed especially difficult to anticipate inventory

behavior in the context of still evolving business policies aimed at much tighter inventory controls. Nonetheless, the general liquidation of inventories was not likely to persist and its termination would at the minimum remove a major retarding influence on economic activity, should appreciable rebuilding of inventories fail to materialize in the near term. Indeed, the reduction in auto dealer inventories since late 1990 already had caused production schedules in the motor vehicles industry to be raised substantially for the second quarter despite still lagging sales. A question obviously remained regarding the prospective strength of the buildup in business inventories once there were relatively firm indications of a recovery in final demand from recession levels. In one view, a pickup in inventory investment was likely to be a key source of expansion in the economy. A differing view suggested a relatively limited role for inventories in buttressing an expansion in light of the now widespread business practice of tighter inventory management.

Housing construction also was cited as a sector of the economy that might make a significant contribution to a rebound in economic activity. Reports from around the country already indicated a marked revival in buyer interest, abetted by reduced mortgage rates and lower home prices in many areas. Those developments had greatly enhanced the affordability of houses. The availability of financing to many home builders remained subject to some uncertainty, but while lending institutions would probably apply stricter credit standards than in earlier years, the improving financial condition of these lenders should induce them in the context of strengthening housing markets generally to

provide the financing that would be needed to translate increased home sales into more home construction.

With regard to the outlook for inflation, members indicated that they were encouraged by recent price and wage developments. Some observed that greater progress had been made in recent months than they had anticipated earlier, and many commented that more progress in reducing the core rate of inflation was a likely prospect over the next several quarters. In this connection, members reported that competitive pressures remained strong and that many business firms found it difficult to sustain price increases. Moreover, the prices paid by business firms for raw materials had tended to hold in a narrow range, and many business contacts indicated that they did not anticipate much change in such prices during the months ahead. More generally, the members continued to express confidence that the ongoing effects of earlier monetary policy actions and reduced monetary growth over an extended period together with the slack that had emerged in labor and product markets would result over time in a lasting downward adjustment in the core rate of inflation. In addition, the appreciation of the dollar in foreign exchange markets would tend with some lag to exert a favorable restraining effect on prices. A number of members cautioned, however, that a significant reduction in the core rate of inflation was not yet assured, and some observed that the failure of long-term bond yields to adjust more fully to recessionary economic conditions and to the substantial cumulative decline in short-term interest rates over the course of recent quarters might well be indicative of continued and still considerable inflationary expectations on the part of the public.

In the Committee's discussion of a desirable policy for the intermeeting period ahead, all of the members indicated their support of a proposal to maintain an unchanged degree of pressure on reserve positions. Most also preferred to retain the current instruction in the directive that did not bias possible intermeeting adjustments toward ease or toward restraint. Monetary policy appeared to be properly positioned at this point to help implement the Committee's objectives in that it reflected an appropriate balancing of the risks of an overly stimulative policy that would threaten progress against inflation versus the risks of a deepening recession or an overly delayed recovery. A number of members commented that some further deterioration in economic activity could not be ruled out, and some emphasized that the costs of a substantial shortfall in economic activity from current projections would be much greater than those of a markedly faster expansion than the members currently expected, since present levels of slack in labor and other resource use would tend to limit the price consequences of a period of robust economic growth. However, the System's earlier easing actions, including the most recent reduction in the discount rate in late April and some associated easing in reserve conditions, had provided a good deal of insurance against cumulative further weakening in business activity. Moreover, the System's commitment to the goal of reducing inflation argued for a cautious approach to any further easing at a time when the economy might be close to its recession trough. Steady progress against inflation would foster lower interest rates in long-term debt markets and would thus provide an added degree of stimulus to the economy; conversely, a resurgence in inflation would

probably induce a backup in long-term interest rates, including mortgage rates, with adverse implications for housing markets and the economy. Against this background, the members concluded that a desirable policy was to take no action at this time but to monitor carefully the ongoing effects of the System's earlier easing moves.

In the course of the Committee's discussion, a number of members underscored the desirability of achieving monetary growth within the Committee's ranges for the year. According to a staff analysis prepared for this meeting, both M2 and M3 were likely to strengthen over the balance of the current quarter after showing little or no growth in April. For the quarter as a whole, expansion of both monetary aggregates was expected to be below the rates projected at the time of the March meeting, but their cumulative growth through midyear would still be in the middle portions of their respective annual ranges. The members recognized that the economy was subject to events beyond the Committee's control, but an appropriate rate of monetary expansion at this stage would support the view that policy was positioned to help prevent substantial further weakening in business activity on the one hand while guarding against disappointing inflation results later on the other. Subnormal monetary growth might be an indication that monetary policy was still too tight, perhaps because of the reluctance of depository institutions and other lenders to extend credit. In that regard, it might be especially useful in this period to scrutinize the asset side of bank balance sheets, notably the behavior of various categories of loans, and other data on debt trends in relation to typical cyclical behavior for possible clues regarding both the strength

of credit demands and business activity and changes in lending practices and conditions.

Turning to possible adjustments to the degree of reserve pressure during the intermeeting period, all of the members supported or could accept a symmetrical directive in light of their current assessments of the prospects for the economy and the behavior of the monetary aggregates. Some members emphasized that the marked uncertainties in the current economic situation underscored the need for a great deal of vigilance in appraising ongoing economic developments. Some indicated a slight preference for a directive that was tilted toward possible easing. These members believed that the risks in the economy remained at least marginally tilted toward a weaker than projected economic performance and that any policy adjustments in the intermeeting period were likely to be in the direction of some easing. Should the incoming data suggest a substantial shortfall from expectations, monetary policy in this view should be adjusted promptly toward ease. In the view of a majority of the members, however, a symmetrical directive was warranted because the risks to the economy were reasonably well balanced at this point. While incoming data on business activity might remain relatively weak over the near term, a change in policy probably would not be called for so long as such data did not suggest a further cumulative decline in economic activity but tended to confirm already available anecdotal information and current Committee expectations.

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 intermeeting adjustments in policy. Accordingly, the Committee decided that somewhat greater reserve restraint or somewhat lesser reserve restraint might be acceptable during the period ahead depending on progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets. The reserve conditions contemplated at this meeting were expected to be consistent with growth of M2 and M3 at annual rates of around 4 and 2 percent respectively over the three-month period from March 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 provides mixed signals regarding the course of economic activity, which had weakened appreciably further earlier in the year. Following sharp decreases in previous months, total nonfarm payroll employment fell somewhat further in April; the civilian unemployment rate edged down to 6.6 percent. Industrial output changed little in April after declining markedly in earlier months. Retail sales were about unchanged in April and are now indicated to have risen somewhat in March. Advance indicators continue to point to weakness in business fixed investment in coming months. Housing starts were down in March, partly offsetting a sizable advance in February, but sales of new and existing homes continued to rise. The nominal U.S. merchandise trade deficit declined in February and its January-February rate was considerably below the average rate in the fourth quarter. Producer and consumer prices were little changed over March and April, partly reflecting further reductions in energy prices.

Short-term interest rates have declined since the Committee meeting on March 26, while bond yields have changed little. The Board of Governors approved a reduction in the discount rate from 6 to 5-1/2 percent on April 30. The trade-weighted value of the dollar in

terms of the other G-10 currencies showed little change on balance over the intermeeting period.

Growth of M2 and M3 weakened in April; for the year thus far, expansion of M2 has been at the midpoint of the Committee's range, while growth of M3 has been in the upper half of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote a resumption of sustainable growth in output, 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 2-1/2 to 6-1/2 percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1990 to the fourth quarter of 1991. The monitoring range for growth of total domestic nonfinancial debt 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 thrift depository institutions would continue to depress its growth relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Depending upon progress toward price stability, trends in economic activity, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint or somewhat 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 March through June at annual rates of about 4 and 2 percent, respectively.

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

Votes against this action: None.