

# FEDERAL RESERVE press release



For Use at 4:30 p.m.

May 22, 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 March 31, 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 March 31, 1992

Domestic policy directive

The information reviewed at this meeting suggested that domestic final demand, especially in the consumer sector, had strengthened somewhat in recent months. Production and employment had not picked up commensurately because businesses apparently were meeting much of their increased sales by drawing down inventories. Wage and price increases had continued to trend downward.

Total nonfarm payroll employment rebounded in February from a large drop in January. The February gain was concentrated in retail trade, but employment in services also rose moderately further and manufacturing payrolls, after five months of decline, were lifted somewhat by the return of auto workers from temporary layoffs. The average workweek increased substantially in manufacturing and in some service-producing industries. Although employment picked up in February, appreciable expansion of the labor force brought a rise in the civilian unemployment rate to 7.3 percent, and initial claims for unemployment insurance remained elevated.

Industrial production rose considerably in February but was little changed on balance over the first two months of the year. Part of the increase reflected an upturn in motor vehicle assemblies, with the remainder being spread across a broad range of other goods. Among final products, gains were posted in both business products, notably office and computing equipment, and consumer goods. By contrast, utility output again was held down by unseasonably warm winter weather, and the production of defense and space equipment continued

to ebb. Total industrial capacity utilization moved higher in February but remained well below its pre-recession high.

Retail sales registered large gains in January and February after edging down in the fourth quarter of 1991. The stronger sales were associated with sizable increases for most types of durable and nondurable goods. Single-family housing starts rose substantially further in January and February, reaching their highest level since the first quarter of 1990, and sales of both new and existing homes were up considerably on balance over the two months. With vacancy rates persisting at historically high levels, starts in the multifamily sector remained depressed.

Shipments of nondefense capital goods increased sharply in January and February, reflecting strength in office and computing equipment and in business purchases of motor vehicles; in addition, shipments of aircraft rebounded in January from a very low level in the fourth quarter. Recent data on orders pointed to further increases over coming months in outlays for business equipment other than aircraft. Nonresidential construction activity edged up in January but remained below its fourth-quarter average. Further declines were recorded in the construction of office buildings and hotels in January, and persisting weakness in commercial construction was signalled by continued decreases in appraised values of office properties in late 1991.

Business inventories registered steep declines in January after rising substantially in previous months. Stocks at wholesale and retail trade establishments reversed a sizable portion of the accumulation that occurred in the fourth quarter; even so, for many types of businesses in the trade sector, inventory-to-sales ratios remained at elevated levels. In manufacturing, inventories were

reduced further in January, with much of the drawdown occurring in defense aircraft and parts, food products, and petroleum. Inventory-to-shipments ratios in most manufacturing industries remained well below the cyclical peaks reached in early 1991.

The nominal U.S. merchandise trade deficit narrowed slightly in January and was essentially unchanged from its average rate in the fourth quarter. A decline in exports was concentrated in aircraft and automotive products. A slightly larger drop in the value of imports reflected weakness in both oil and consumer goods. The available data on fourth-quarter economic activity in the major foreign industrial countries indicated that real output declined in Canada, Germany, Japan, and the United Kingdom, while data for France pointed to little change. For the first quarter of this year, the limited data available showed some signs of recovery in continental Europe but suggested continued sluggishness in the other major industrial countries.

Producer prices of finished goods edged down on balance in January and February, as a reduction in energy prices more than offset an increase in food and other prices. Excluding the food and energy components, producer prices rose over the January-February period at about the 1991 pace. At the consumer level, food prices changed little over the two months while energy prices fell; prices of nonfood, non-energy items increased at about the same rate as last year but significantly below that of 1990. Average hourly earnings of production or nonsupervisory workers in February more than reversed a small decline in January. However, over the twelve-month period ending in February, this measure of worker earnings increased more slowly than in the twelve months ending in February 1991.

At its meeting on February 4-5, 1992, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions but that included a bias toward possible easing during the intermeeting period. Accordingly, the directive indicated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint might be acceptable or slightly lesser reserve restraint would be acceptable in the intermeeting period. The reserve conditions contemplated under this directive were expected to be consistent with growth of M2 and M3 at annual rates of around 3 percent and 1-1/2 percent respectively over the three-month period from December through March.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. Expected levels of adjustment plus seasonal borrowing were raised modestly immediately after the Committee meeting in anticipation of a slight rise in seasonal borrowing. In the event, adjustment plus seasonal borrowing remained quite low, averaging a little less than \$70 million over most of the intermeeting period; seasonal borrowing, newly subject to a market-based discount rate, increased relatively little and adjustment credit remained at depressed levels. The federal funds rate averaged around 4 percent over most of the intermeeting period, although late in the period the rate averaged a little lower.

Many other market interest rates rose appreciably over the intermeeting period, as market participants interpreted incoming data as indicating that the economic recovery was regaining some momentum. The most pronounced increases occurred at intermediate maturities,

perhaps reflecting the improved cyclical outlook for business activity. Although yields on investment-grade corporate debt rose in tandem with rates on U.S. Treasury securities, yields on lesser-rated securities were unchanged to somewhat lower. Most broad indexes of stock prices declined somewhat over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies increased substantially over the period. The dollar declined initially on market expectations of additional monetary easing in the United States, but it subsequently appreciated in response to indications of a strengthening of the recovery. Late in the intermeeting period, a tightening of money market conditions in Germany, where monetary growth continued to be quite rapid and concerns over wage pressures were mounting, contributed to a retreat in the dollar. The yen weakened on balance in relation to the dollar and other major currencies in response to indications of further declines in economic growth and resultant expectations of another monetary easing action in Japan.

Growth of M2 and M3 accelerated sharply in February, but M2 apparently leveled off or even declined slightly in March and M3 contracted somewhat. Growth of M2 and M3 from December through March appeared to have been, respectively, somewhat above and close to the Committee's expectations. Much of the growth in both aggregates over recent months reflected a surge in transactions balances that, in turn, resulted to an important extent from narrow opportunity costs relative to market interest rates and from a bulge in demand deposits associated with mortgage refinancings and other financial market activity.

The staff projection prepared for this meeting pointed to a continuing recovery in economic activity. In the near term, growth in

consumer spending was expected to moderate after the first-quarter spurt, but residential construction was likely to record further substantial gains, and the pace of nonfarm inventory liquidation should slow. Over time, the cumulative effects of earlier declines in interest rates, the progress achieved in strengthening household and business balance sheets, and some diminution of credit supply restraints would provide continuing impetus to economic activity. Moreover, the retarding effects of depressed nonresidential construction activity were expected to lessen as the expansion progressed. The projection did not incorporate any major new fiscal initiatives at the federal level, and it anticipated that spending for goods and services at all levels of government would be restrained somewhat. The substantial, though diminishing, margin of slack in resource utilization was projected to be associated with appreciable further slowing in the underlying rate of inflation.

In the Committee's discussion, the members generally viewed the incoming information, including anecdotal reports from around the country, as providing substantial evidence of some quickening in the pace of overall economic activity. Final demands appeared to be strengthening in the context of improving business and consumer confidence. Nonetheless, key sectors of the economy, such as defense spending and commercial real estate, remained weak and a back-up in long-term interest rates, owing in part to lagging savings and strong demand for credit by the Treasury, threatened to limit gains in housing and business investment. With these cross-currents and sources of uncertainty raising at least some questions about the sustainability of the expansion, careful, ongoing evaluation was warranted. On balance, however, relatively moderate but sustained growth was seen as the most probable outcome. The members generally

regarded the prospects for some continuing slack in labor and product markets as consistent with their projections of a downtrend in the core rate of inflation.

With regard to financial developments bearing on the economic outlook, members stressed, as they had at earlier meetings, that considerable progress had been made in strengthening business and consumer balance sheets. While media attention continued to be focused on some large financial and nonfinancial firms that were experiencing difficulties, most businesses now appeared to be much more favorably positioned to weather adverse developments and to finance spending that would support an expanding economy. The improvement stemmed from ongoing efforts to streamline operations and enhance productivity and to reduce balance-sheet leverage and interest costs. For some business firms and many financial institutions, recent reports of a tendency for commercial real estate values to stabilize was a particularly favorable omen. Consumer balance sheets also were benefiting from lower interest rates that tended to lessen debt loads in relation to income and from the appreciated value of stock portfolios. On the negative side, the restructuring of business operations and balance sheets was still exerting considerable constraints on spending and lending activities, and it was unclear how much longer or to what extent those constraints would last. A number of members also expressed concern that the relatively slow growth of the broader monetary aggregates, were it to persist, might prove to be a harbinger of continued restraint in lending and of underlying weakness in the economy.

In their review of business conditions in different regions, members indicated that overall economic activity appeared to be rising in many parts of the nation while some signs of an emerging upturn



could be discerned in most other areas. Improving business conditions generally were associated with better retail sales since the start of the year and with the further recovery in housing demand. Indeed, the growing demands for consumer goods stemmed to an extent from the strengthening of housing markets. These developments were accompanied and bolstered by widespread indications of some improvement in business and consumer confidence, and some members commented that pent-up demands for many consumer durables might well materialize in the context of further gains in overall consumer confidence. However, most business executives were still very cautious despite increasing sales and a more favorable outlook for corporate profits, and consumer confidence remained well below earlier levels, apparently reflecting to a major extent the persistence of anxieties about job security and employment opportunities. Retail contacts and available statistical reports suggested that an important part of the spurt in retail sales in January and February was met out of inventories. Further growth in such sales would lead to efforts to rebuild inventories and induce related gains in production and incomes.

Sales of residential real estate and the construction of new homes, principally single-family dwellings, were displaying considerable strength across the country. In a number of areas the increases were appreciably greater than expected, though the gains appeared to be due at least in part to favorable weather conditions and thus might represent some borrowing from the future. Even so, and despite the inhibiting effects of recent increases in mortgage interest rates, the construction of single-family homes and its spillover effects in related industries were believed likely to make an important contribution to the overall expansion of economic activity over the next several quarters.

Construction of nonresidential structures continued to decline in many areas as work on existing buildings was completed and few new projects were started. Vacancy rates for office buildings remained high across the country, but there were indications in at least some major cities that prices and rental rates for commercial real estate might be stabilizing or even tending to firm. However, the better tone in those markets had not translated itself into new building activity. Indeed, commercial construction was likely to remain depressed for an extended period and to hold down the growth in overall business investment at a time when spending for business equipment might be trending appreciably higher.

The outlook for exports to a number of major foreign industrial countries was less encouraging than earlier, given financial and other difficulties that would tend to inhibit economic growth in those countries. On the favorable side, U. S. businesses had significantly enhanced their ability to compete in international markets over the course of recent years, partly through gains in productivity, and they were now in a better position both to sustain the nation's exports and to meet competition from foreign products in domestic markets. Moreover, the improved health of many Latin American economies was being reflected in higher export sales to such countries. Some parts of the country also were benefiting from large increases in the number of foreign visitors. Nevertheless, members suggested that the export sector was vulnerable to weakness from abroad, and reports from some business contacts tended to reinforce those concerns.

Turning to the outlook for fiscal policy, members noted that market concerns about possible legislation that would substantially increase an already massive federal deficit appeared to have subsided. Nonetheless, an important reason for the rise in intermediate- and

long-term interest rates since early January had been the apparently worsening outlook for federal deficit financing over the course of the next several years. Such deficits would tend to keep long-term interest rates fairly high, and in association with the nation's relatively low savings, they implied a financial constraint on the ability of the U. S. economy to generate robust increases in investment. Because the volume of savings available for investment was limited, interest rates had tended to react fairly strongly to indications of sizable gains in private spending.

The outlook for moderate economic growth and the associated, if diminishing, slack in labor and product markets were likely to prove consistent in the view of many members with further progress in reducing the core rate of inflation. Competitive price pressures remained strong in many local markets, and efforts to raise prices very often did not succeed. In this competitive environment, business firms seeking to maintain or increase profits were forced to concentrate on measures to curb costs rather than to raise prices. Labor markets were described as generally soft, and most wage settlements continued to have favorable implications for future costs and inflation. The outlook for energy costs, while always subject to unanticipated developments, nonetheless seemed favorable at this point.

In the Committee's discussion of policy, all of the members indicated that they were in favor of maintaining unchanged conditions in reserve markets for the period immediately ahead. A majority also indicated a preference for retaining the current bias in the directive toward possible easing during the intermeeting period, while the remaining members were in favor of moving to a symmetrical directive. A steady policy course, at least for now, was viewed as desirable in

the context of encouraging evidence of a strengthening economy and the outlook for continuing expansion at a pace that was deemed likely to be consistent with further progress toward price stability. The members acknowledged that the uncertainties in the economic outlook were considerable, but given the ongoing stimulus stemming from earlier easing actions, they agreed that for now an unchanged policy represented an appropriate balancing of the various risks to a satisfactory economic performance. In this connection, it was suggested that substantial further easing at this time might well fail to provide much added stimulus; indeed, it could prove to be counter-productive because of adverse repercussions in financial markets. Moreover, too much easing at this juncture could establish the basis for unduly rapid growth of money and credit when the economic expansion gathered momentum.

With regard to possible adjustments to the degree of reserve pressure during the intermeeting period, many of the members endorsed the view that it would be premature to move away from a directive that was biased toward ease to a symmetrical directive. While the members generally anticipated that economic and financial developments during the intermeeting period would not call for an adjustment to policy, many remained concerned about the vulnerability of the expansion to a variety of risks. In the circumstances, any policy adjustments in the weeks ahead were more likely to be in the direction of some easing than toward restraint. A number of these members also commented that even though the risks of a deviation from the projected path of the economy now seemed to be in better balance than earlier, the consequences of a substantial shortfall from expectations would be much more severe than the effects of a comparable overshoot. Other members did not rule out the possible need for an easing move in the period

ahead, but they believed that the more balanced risks that were now perceived to surround the economic outlook warranted a symmetric directive. Some observed that such a directive did not preclude an easing action that might be triggered by economic or financial developments, including the behavior of the monetary aggregates, in the weeks ahead. Moreover, in the view of some of these members, a directive that remained tilted toward ease under prevailing circumstances could be misread by domestic and international observers as evidence of greater concern about the economic outlook than many members currently felt, or as an indication of a bias on the part of the Committee toward bolstering the real economy rather than securing further progress toward price stability.

In the course of the discussion, members expressed varying degrees of concern about the behavior of the monetary aggregates. According to the most recently available data for March, M2 apparently leveled off or declined slightly and M3 contracted somewhat. Moreover, the weekly pattern toward the end of March suggested the possibility of sluggish growth on average in April. While this development needed to be assessed in the context of emerging information on the economy and financial markets, it was suggested that a persisting shortfall in the growth of M2 and M3 could signal that monetary policy was not positioned to support a satisfactory expansion. For the year through March, growth of M2 had fallen somewhat short of the midpoint of the Committee's range for 1992, and in the view of some members growth near the midpoint or somewhat higher in the range might be more consistent with a desirable economic performance for the year. On the other hand, expansion of narrow money and reserves had been quite robust for some time. In the view of at least one member, the possibility could not be ruled out that

this rapid growth could be signalling an overly accommodative monetary policy which, if continued, could boost inflation pressures at some point. Conclusions could not be drawn on the basis of short-term movements in the narrow or broad monetary aggregates, and in any event the implications for the economy of specific monetary growth rates were clouded by a variety of developments that the members had discussed at length at the February meeting. Nonetheless, against the background of relatively sluggish growth in the broader aggregates for an extended period, many members agreed that the ongoing performance of those aggregates should be monitored closely. Indeed, some observed that concerns about the behavior of the broader aggregates, rather than the currently available information on economic activity, persuaded them that a directive that was tilted toward ease was preferable to a symmetrical directive at this time.

At this meeting, the Committee reviewed its practices with regard to the maturity composition of its portfolio of Treasury obligations. The overall approach in recent years had been to meet the long-term need for growth in the System's portfolio through purchases in all maturity sectors of the market for Treasury obligations, with a major emphasis on ensuring substantial liquidity in the System's portfolio. With regard to the Treasury's quarterly financings, the Manager had followed the practice over the past several years of exchanging the bulk of the maturing securities held in the System account into the shortest issue offered by the Treasury, while placing relatively small amounts in the longer-term Treasury offerings. This approach had replaced the earlier practice of rolling over maturing System holdings into the refinancing issues in roughly proportionate amounts to the size of those issues being offered to the public. The System's participation in Treasury financings had

contributed importantly to the reduction in the average maturity of the System portfolio in recent years; however, given Treasury techniques with regard to accommodating System rollovers, the System's actions did not have any effect on the amounts or the maturity composition of the securities being acquired by the public. The members generally agreed that current practices for managing the composition of the System's portfolio remained appropriate. Rollovers in Treasury financings would continue to be tilted toward the shorter-maturity offerings, and net additions to System holdings would be made in all maturity areas, taking account of the progress already made in enhancing the liquidity of the System's portfolio.

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 their preference for or acceptance of a directive that included some bias toward 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 of M2 and M3 at annual rates of around 3-1/2 percent and 1-1/2 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 suggests a strengthening in domestic final spending, although industrial production and overall employment do not appear to have picked up correspondingly. Retail sales

registered large gains in January and February, with data on inventories, which are available through January, showing some offsetting decline in that month. Single-family housing starts increased substantially further in January and February. Recent data on orders and shipments of nondefense capital goods indicate an increase in outlays for business equipment, but non-residential construction has remained in a steep decline. The nominal U.S. merchandise trade deficit narrowed slightly in January and was essentially unchanged from its average rate in the fourth quarter. Industrial production rose considerably in February, partly reflecting an upturn in motor vehicle assemblies, but was little changed on balance over the first two months of the year. Total nonfarm payroll employment rebounded in February from a large decline in January. With the labor force growing appreciably in recent months, the civilian unemployment rate has risen to 7.3 percent. Wage and price increases have continued to trend downward.

Most interest rates have risen appreciably since the Committee meeting on February 4-5. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies increased substantially over the intermeeting period.

Growth of M2 and M3 accelerated in February, but M2 appears to have leveled off and M3 to have declined in March. Much of the growth in the broader aggregates over recent months has been accounted for by a surge in transactions balances.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at its meeting in February established ranges for growth of M2 and M3 of 2-1/2 to 6-1/2 percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1991 to the fourth quarter of 1992. The monitoring range for growth of total domestic nonfinancial debt was set at 4-1/2 to 8-1/2 percent for the year. With regard to M3, the Committee anticipated that the ongoing restructuring of depository institutions would continue to depress the growth of this aggregate relative to spending and total credit. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.



In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint 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 March through June at annual rates of about 3-1/2 and 1-1/2 percent, respectively.

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

Votes against this action: None.