Minutes of the Federal Open Market Committee

Meeting of November 15, 1995

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Wednesday, November 15, 1995, at 9:00 a.m.

PRESENT:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. Lindsey
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, Jordan, McTeer, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Broaddus, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Assistant General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Davis, Hunter, Lindsey, Mishkin, Promisel, Siegman, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Mr. Madigan, Associate Director, Division of
Monetary Affairs, Board of Governors
Mr. Simpson, Associate Director, Division of

Research and Statistics, Board of Governors

Mr. Reinhart,[1] Assistant Director, Division of Monetary Affairs, Board of Governors
Mr. Ramm,[1] Section Chief, Division of Research
and Statistics, Board of Governors

Ms. Low, Open Market Secretariat Assistant,
Division of Monetary Affairs, Board of
Governors

Messrs. Beebe, Goodfriend, Lang, Rolnick, and
Rosenblum, Senior Vice Presidents, Federal
Reserve Banks of San Francisco, Richmond,
Philadelphia, Minneapolis, and Dallas
respectively

Messrs. Gavin and Kopcke, Mses. Krieger and
Rosenbaum, Vice Presidents, Federal Reserve
Banks of St. Louis, Boston, New York, and
Atlanta respectively

Mr. Stevens, Consultant, Federal Reserve Bank of
Cleveland

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1. Did not attend portion of meeting covering the monetary policy discussion.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 26, 1995, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets and on System foreign currency transactions during the period September 26, 1995, through November 14, 1995. By unanimous vote, the Committee ratified these transactions.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period September 26, 1995, through November 14, 1995. By unanimous vote, the Committee ratified these transactions.

By unanimous vote, the Committee authorized the renewal for an additional one-year period of the System's reciprocal currency ("swap") arrangements with foreign central banks and the Bank for International Settlements that were due to mature on various dates in December 1995. The renewal encompassed all the System's swap arrangements except that with the Bank of Mexico, which is scheduled to mature on January 31, 1996, and will be considered at a later meeting. The amounts and maturity dates of the arrangements approved for renewal are shown in the table that follows:

Foreign bank	Amount of arrangement (millions of $ equivalent)	Term (months)	Maturity date
Austrian National Bank	$ 250.0	12 mos.	12/04/95
Bank of England	3,000.0	12 mos.	12/04/95
Bank of Japan	5,000.0	12 mos.	12/04/95
Bank of Norway	250.0	12 mos.	12/04/95
Bank of Sweden	300.0	12 mos.	12/04/95
Swiss National Bank	4,000.0	12 mos.	12/04/95
Bank for International Settlements --			
Swiss francs	600.0	12 mos.	12/04/95
Other authorized European currencies	1,250.0	12 mos.	12/04/95
National Bank of Belgium	1,000.0	12 mos.	12/18/95
Bank of Canada	2,000.0	12 mos.	12/28/95
National Bank of Denmark	250.0	12 mos.	12/28/95
Bank of France	2,000.0	12 mos.	12/28/95
German Federal Bank	6,000.0	12 mos.	12/28/95
Bank of Italy	3,000.0	12 mos.	12/28/95
Netherlands Bank	500.0	12 mos.	12/28/95

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information available at the time of the meeting was mixed, but on balance it suggested a more moderate rate of expansion of economic activity after a strong gain during the summer. Consumer spending had turned sluggish recently; but with order backlogs still large, business spending for durable equipment was continuing at a robust if somewhat less rapid rate, and the sizable rise in housing starts in the third quarter presaged higher residential construction outlays. Appreciable increases in employment and hours worked tended to confirm that the economy had continued to expand at a solid pace, although manufacturing activity had weakened a little. Consumer and producer prices had risen more slowly on average in recent months after having increased at elevated rates in the early part of the year, and growth in labor costs had slowed further.

Nonfarm payroll employment, though held down somewhat by the onset of a labor strike in the aircraft industry, increased in October at the average monthly pace of the third quarter; in addition, aggregate hours worked by private production workers rose appreciably further. Construction payrolls recorded another sizable advance. The rate of job growth in the services industry slowed a little further, reflecting a decline in employment in personnel supply services after two months of strong advances. Manufacturing employment declined again. The civilian unemployment rate edged down in October to 5.5 percent.

Industrial production fell somewhat in October after having risen appreciably in the third quarter; most of the loss reflected the strike in the aircraft industry, but motor vehicle production and mining output also recorded substantial declines. In contrast, production of information processing equipment continued to rise at a rapid pace. Total utilization of industrial capacity contracted in October, with declines widespread across industries.

Total nominal retail sales, which had expanded relatively briskly over the second and third quarters, fell in October. As part of a pattern of widespread weakness in October, purchases at furniture and appliance stores were down appreciably after large gains in earlier months, and sales at general merchandise and apparel outlets reversed most of their sizable September increases. Housing demand and construction activity firmed in the third quarter: Sales of both new and existing homes posted solid advances, and single-family housing starts rose considerably, though multifamily starts remained sluggish.

Business investment in both equipment and structures expanded less rapidly in the third quarter. Stepped-up shipments of nondefense capital goods in August and September more than offset a sharp drop in shipments in July, but the quarterly average gain was significantly smaller than the increases recorded in the previous two quarters. Although orders for nondefense capital goods also rose more slowly in the third quarter, the still-sizable order backlogs pointed to substantial expansion of spending on business equipment in the near term. Nonresidential construction increased appreciably further in the third quarter, reflecting a surge in office and institutional building activity.

Available data suggested a reduction in business inventory accumulation in August and September. In manufacturing, the pace of stockbuilding slowed in the third quarter from the brisk rate of the first half of the year, leaving the factory stock-shipments ratio unchanged in the third quarter and a little above historic lows. In the wholesale sector, inventories were drawn down in August and September after sizable buildups in earlier months; with sales weak, the aggregate inventory-sales ratio for the sector edged up in the third quarter and was at the upper end of its range for recent years. Retail inventories expanded significantly in August (latest data available), but the stockbuilding was generally in line with sales and the ratio of inventories to sales remained near the middle of its range in recent years.

The nominal deficit on U.S. trade in goods and services narrowed markedly in August; for July and August-combined, the deficit was significantly smaller than its average rate in the second quarter. The value of exports declined over the two-month period, with increases in exports of computers and agricultural products more than offset by decreases in exports of aircraft, gold, and service receipts. Imports fell more than exports; with the notable exception of computers and semiconductors, declines were recorded in most major import categories. Available data indicated that economic expansion remained subdued in the major foreign industrial countries. Growth continued to slow in the European economies other than Italy, and the Japanese economy showed little evidence of a sustained recovery.

Consumer prices rose at a slightly faster rate in October; with a smaller increase in food prices offsetting higher energy prices, the index for items other than food and energy also picked up a little. For the four months ending in October, prices for nonfood, non-energy items advanced at a rate well below that of earlier in the year. Producer prices of finished goods edged down in October, reflecting a further decline in the prices of finished energy goods. Excluding food and energy, producer prices were unchanged in October and increased at a slower pace in the third quarter than in the first half of the year. Growth in total nominal hourly compensation of private industry workers slowed in the third quarter and, on a year-over-year basis, continued to trend down: the decrease in compensation growth over the past year spanned most major occupations and industries.

At its meeting on September 26, 1995, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated 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 or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with growth of M2 and M3 over the balance of the year at a pace near that experienced in recent months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate averaged close to 5-3/4 percent, apart from a temporary rise around the end of the third quarter. Other short-term market rates also changed little on balance; market participants continued to anticipate an easing of monetary policy at some point but apparently viewed the chances of near-term easing as small. Longer-term interest rates declined further over the intermeeting period, perhaps in response to a growing conviction that inflation pressures would remain subdued and that substantial reductions in fiscal deficits would be achieved over a period of years. The lower longer-term interest rates, coupled with continuing reports of strong corporate earnings, helped lift major indexes of equity prices to new record levels during the period. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined slightly over the intermeeting period.

Expansion of the broad monetary aggregates weakened in October. M2 was unchanged in October after having grown relatively rapidly in the third quarter and despite the persistence of low opportunity costs associated with holding M2 assets. For the year through October, M2 expanded at a rate in the upper half of the Committee's range for this aggregate in 1995. Growth of M3 apparently was held down somewhat by the reduced need for additional bank funding during a time of sluggish loan demand; for the year to date, M3 grew at a rate a little above its range. Total domestic nonfinancial debt had risen more slowly in recent months, reflecting reduced expansion of both private and federal borrowing. Nonetheless, for the year to date, this measure of debt remained around the midpoint of its monitoring range.

The staff forecast prepared for this meeting suggested that the growth of economic activity would slow from the strong third-quarter pace to a rate more in line with the increase in the economy's potential. The forecast assumed that the favorable interest-rate and wealth effects of the extended rally in the debt and equity markets would provide support for a moderate advance in final sales. Consumer spending was expected to expand at a rate generally in line with the growth of incomes; the favorable effects of higher prices on financial assets held by households would be offset to some extent by the difficulties of increasing numbers of households in servicing their growing debts. The greater affordability of housing stemming from the earlier decline in mortgage rates was projected to help sustain homebuilding activity at a relatively high level. In anticipation of reduced growth in sales and profits, business investment in new equipment and structures was projected to slow appreciably from the very rapid pace of the past few years. Strong export expansion would be associated with the improving outlook for the economies of major trading partners. Although substantial uncertainty still surrounded the fiscal outlook, the forecast continued to incorporate a considerable degree of fiscal restraint. In the staff's judgment, wage and price inflation likely would not deviate significantly from recent levels.

In the Committee's discussion, members commented that recent statistical and anecdotal information pointed on balance to an appreciable slowing in the economic expansion, which had displayed unexpected strength during the summer months. There was some mix of views among the members concerning how far the slowing might proceed, though they generally viewed moderate growth as the most likely course for the economy. A number of members believed that growth around potential was a probable outcome, with business activity sustained in part by the favorable developments this year in the bond and stock markets. Other members expressed concern about some signs of further ebbing in the strength of final demands, and they envisaged the possible need for a policy adjustment at some point to sustain continued moderate growth. With regard to inflation, members noted that despite generally high levels of resource use, including tight labor markets in many parts of the country, inflation had been more subdued than many had expected over the past several months. A number of members commented that they saw a basis in this development for mild optimism about the outlook for inflation, but others expressed concern that, in the context of current forecasts for economic activity and relatively high levels of resource use, progress toward lower inflation was unlikely over the projection period and indeed there was a risk of some modest deterioration in price performance.

In the course of the Committee's discussion, members reported on uneven business conditions in different parts of the country and among industries. On balance, modest to moderate growth appeared to characterize most regions, with overall levels of activity ranging from relatively robust in some regions to comparatively depressed in others. The mixed conditions were especially notable in manufacturing where numerous producers faced lagging demands while others, particularly in high-tech industries, found it difficult to satisfy strong demands for their products. More generally, the industrial sector of the economy had tended to stagnate for some time, including a slight decline in manufacturing activity reported for October, but recent improvement in orders for steel was cited as a favorable if not decisive omen in the outlook for industrial production. In other sectors of the economy, members observed that tourism displayed considerable strength in many areas, while cattle operations and energy production were adversely affected by high production costs or low prices.

In their review of developments in key demand sectors of the economy, members observed that consumer spending appeared to be on a firm growth trend, though weakness in overall sales of motor vehicles in recent months and a decline in total retail sales in October had introduced a cautionary note. It was suggested that the performance of retail sales during the holiday season would tend to set the tone for the longer-term trend in such sales, and in this respect available data and anecdotal reports covering the first part of November were somewhat promising. More generally, further growth in consumer spending, though probably at a somewhat slower pace than over the past year, appeared likely. Such growth would be supported by moderate expansion in incomes and by the favorable effects on household wealth and confidence of the substantial improvement in the value of financial assets this year and the ready availability of financing on relatively attractive terms. Consumer confidence currently seemed to be at a fairly high level, albeit not uniformly so across the country, and at least for the quarters immediately ahead, anticipated strength in homebuilding should induce spending for many household durables. On the negative side, some members emphasized that the growth in consumer debt was likely to exert an increasingly inhibiting effect on consumer spending. Moreover, the satisfaction of earlier pent-up demands might well limit sales of many consumer durables, notably motor vehicles, in coming quarters. In one view, the projected growth in personal incomes and the increases that had occurred this year in the value of household holdings of financial assets would provide relatively little stimulus to consumer spending because the distribution of such gains was heavily tilted toward consumers in higher income or older age groups.

Further sizable growth in business fixed investment, but at a pace well below that experienced in recent years, was expected to provide appreciable impetus to the expansion over the next several quarters. Favorable factors in the outlook for business capital spending included a desire to upgrade technological capabilities for competitive reasons, strong business earnings and cash flows, and an ample availability of financing on relatively liberal terms. Declining office vacancy rates in a number of areas would help to support office construction, and several members also commented on the strength in commercial and other nonresidential building activity in various parts of the country.

Ongoing efforts by many business firms to bring inventories into better alignment with sales had resulted in declining inventory investment since earlier in the year. Some further inventory adjustments, notably in stocks of motor vehicles, were expected over coming months, though not at a pace that would have a marked retarding effect on economic activity. Over much of 1996, inventory investment was projected to be a more neutral factor in the economy, with accumulation proceeding at a pace in line with growth in final sales, but the risks of unexpected developments in this sector of the economy were always substantial.

The outlook for fiscal policy remained obscured by the uncertain outcome of the current debate between the Congress and the Administration. While substantial fiscal restraint aimed at eventually balancing the budget appeared to be the likely result, the timing of the implementation of various tax and expenditure initiatives and the resulting extent of the fiscal restraint over the forecast period could not be anticipated with any degree of precision. For the nearer term, the ongoing shutdown of much of the federal government presented a downside risk to the expansion whose effects would depend on the presently uncertain duration of the shutdown and the potential unsettlement in financial markets that might develop at some point. The members generally believed, however, that in light of the underlying strength of the economy, the retarding effects of likely federal budget developments would not be sufficient in themselves to arrest the expansion over the forecast period, at least if the federal government shutdown were of relatively short duration and a federal debt default were averted.

The nation's foreign trade deficit had worsened substantially during the past several years, but current forecasts did not point to further deterioration over the projection period. An anticipated firming in the economies of major U.S. trading partners was expected to bolster exports. Several members questioned, however, the extent to which forecasts of strengthening economic activity were likely to materialize in a number of these countries, and they suggested that the foreign sector might well remain a somewhat constraining factor in the performance of the domestic economy.

Members welcomed the generally favorable price and cost developments of recent months and the related indications that currently high levels of resource use did not appear to be associated with rising inflationary pressures. Many emphasized the persistence of subdued increases in labor costs, and a number provided supporting anecdotal indications of relatively small advances in labor compensation in many parts of the country despite tight labor markets. The anecdotal reports also continued to suggest that strong competition was holding down price inflation and that producers were benefiting from soft prices of industrial materials. While a number of members believed that these developments might augur a modest decline in inflation over the year ahead, given current forecasts of moderate economic expansion, many viewed as more likely the prospect of little or no progress toward price stability over coming quarters and some expressed concern about the potential for an upward drift in the rate of inflation. An underlying factor in the relatively favorable climate for inflation was the continued limited rise in the costs of worker benefits. In the view of some members, however, benefit costs were likely to be less well contained as time went on and further major gains in curbing such costs became more difficult to achieve. Moreover, worker willingness to accept relatively limited increases in wages and other compensation might well begin to erode as concerns about job security tended to diminish after an extended period of relatively low unemployment. On balance, recent experience had raised questions about the relationship between levels of resource use and inflation that warranted careful monitoring.

In the Committee's discussion of policy for the intermeeting period ahead, all but one member favored or could accept an unchanged policy stance. This policy position took account of current indications of a generally acceptable rate of economic growth and the absence of any clear signs regarding the future strength of the expansion in relation to the economy's potential or the future course of inflation. Several commented that current monetary policy might be viewed as somewhat restrictive, though the degree of restraint was difficult to calibrate and it did not appear as yet to be inhibiting declines in intermediate- and long-term interest rates, increases in stock prices, or the availability of financing from lending institutions.

Members expressed somewhat differing views regarding the stance of monetary policy that was likely to prove consistent with the Committee's objectives over time. In the view of some, private spending was not likely to have sufficient momentum to overcome the effects of increased fiscal restraint if the current stance of monetary policy were maintained. In the circumstances, an easing at some point would be needed to foster sustained economic growth at an acceptable pace and would be consistent with progress toward the System's price stability objective. For most of these members, however, the stronger-than-expected performance of the economy in the third quarter had reduced the urgency of such a policy move and had created enough uncertainties to justify a careful appraisal of unfolding developments before a decision was made to ease policy. In the view of one member, the probability of a shortfall from an acceptable rate of economic expansion was sufficiently high to require an immediate easing of policy. Other members believed that an unchanged policy was desirable under current conditions and that the direction and timing of the next policy move was more open to question. Not only were recent data giving an uncertain picture of the underlying strength of aggregate demand, but current forecasts generally did not point to progress toward the System's long-run goal of price stability. In this view, therefore, the current stance of monetary policy, even if slightly restrictive, was likely to be consistent with satisfactory economic growth over time and it would provide better assurance of consolidating gains against inflation and fostering some further moderation in price increases over coming years. With regard to potential fiscal policy developments, although an especially broad range of outcomes seemed possible, the members agreed that the Committee could not freeze its policy options while it awaited the outcome of a prolonged federal budget debate nor could it commit itself to a specific response to a particular fiscal policy agreement. Fiscal policy and any associated market reactions would be among the many factors that would have to be taken into account in the formulation of monetary policy.

In the Committee's discussion of possible intermeeting adjustments to monetary policy, a majority of the members expressed a preference for retaining a symmetric directive. In their view, the potential need to adjust policy during the relatively short intermeeting period was remote and some of these members also believed that the direction of the next adjustment to policy was uncertain. A few also noted that the adoption of a biased intermeeting instruction at this point might send an unintended message regarding the prevailing view within the Committee concerning the risks to the expansion. The remaining members said that they preferred a directive that was tilted toward an easing policy action. Such an instruction in the directive would be consistent with what they viewed as the most likely policy course over coming months. They agreed, however, that the current uncertainties surrounding the economic outlook were not likely to be resolved during the weeks immediately ahead and since no policy action was likely to be required in this period, they could accept a symmetric directive.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could vote for a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy 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, the Committee decided that slightly greater 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 moderate growth in M2 and M3 over coming months.

The information reviewed at this meeting suggests a moderation in the expansion of economic activity after a strong gain in the third quarter. Nonfarm payroll employment increased further in October and the civilian unemployment rate edged down to 5.5 percent. Industrial production fell somewhat in October after a moderate rise in the third quarter. Total nominal retail sales were little changed on balance over September and October. Single-family housing starts were up considerably in the third quarter. Orders for nondefense capital goods point to substantial expansion of spending on business equipment in the near term; nonresidential construction has risen appreciably further. The nominal deficit on U.S. trade in goods and services narrowed over July and August from its average rate in the second quarter. After increasing at elevated rates in the early part of the year, consumer and producer prices have risen more slowly on average in recent months.

Short-term market interest rates have changed little on balance since the Committee meeting on September 26 while long-term rates have fallen somewhat. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined slightly over the intermeeting period.

In October, M2 was unchanged and M3 growth moderated. For the year through October, M2 expanded at a rate in the upper half of its range for 1995 and M3 grew at a rate a little above its range. Growth in total domestic nonfinancial debt has slowed somewhat in recent months but for the year to date remains around the midpoint of its monitoring range.

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 July reaffirmed the range it had established on January 31-February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. 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 or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan McDonough, Blinder, Hoenig, Kelley, Melzer, Ms. Minehan, Mr. Moskow, Mses. Phillips and Yellen.

Vote against this action: Mr. Lindsey.

Mr. Lindsey dissented because he believed that monetary policy should be eased. The evidence suggested to him that in the absence of an easing move the underlying rate of nominal GDP growth was likely to be lower than needed to maintain real GDP at or near its potential. The intermediate forecast was subject to a number of significant risks: household balance sheets seemed unlikely to sustain the current rate of durables expenditure for any extended period; government expenditures were certain to be cut substantially; and with fiscal contractions underway in Europe and Canada and severe financial stresses present in Japan and Mexico, he did not see much likelihood of a substantial expansion of exports. In keeping with his views, the financial markets were signalling the likelihood that a weaker pace of nominal GDP growth would materialize. The yield curve was virtually flat, with government securities up through relatively long maturities trading at yields below the current average federal funds rate. Thus, markets would be unlikely to find some easing inappropriate and over the intermediate horizon would view the current level of short-term rates as unsustainable.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 19, 1995.

The meeting adjourned at 1:35 p.m.

Donald L. Kohn
Secretary

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