Minutes of the Federal Open Market Committee

September 29, 1998

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 Tuesday, September 29, 1998, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Ferguson
Mr. Gramlich
Mr. Hoenig
Mr. Jordan
Mr. Kelley
Mr. Meyer
Ms. Minehan
Mr. Poole
Ms. Rivlin

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

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

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

Messrs. Cecchetti, Dewald, Hakkio, Lindsey, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors[1]

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

Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Messrs. Alexander, Hooper, and Ms. Johnson, Associate Directors, Division of International Finance, Board of Governors

Mr. Reinhart, Deputy Associate Director, Division of Monetary Affairs, Board of

Governors

Mr. Struckmeyer, Assistant Director, Division of Research and Statistics, Board of Governors

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

Messrs. Spillenkothen and Parkinson,[2] Director, Division of Supervision and Regulation, and Associate Director, Division of Research and Statistics respectively, Board of Governors

Mr. Connolly, First Vice President, Federal Reserve Bank of Boston

Messrs. Eisenbeis, Goodfriend, Hunter, Kos, Lang, and Rolnick, Senior Vice Presidents, Federal Reserve Banks of Atlanta, Richmond, Chicago, New York, Philadelphia, and Minneapolis respectively

Messrs. Judd and Rosengren, Vice Presidents, Federal Reserve Banks of San Francisco and Boston respectively

Ms. Yucel, Research Officer, Federal Reserve Bank of Dallas

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 18, 1998, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market operations in foreign currencies for the System's account in the period since the previous meeting, and thus no vote was required of the Committee.

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 August 18, 1998, through September 28, 1998. By unanimous vote, the Committee ratified these transactions.

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 reviewed at this meeting suggested that economic activity was expanding at a moderate rate. Growth of private domestic final demand had slowed from its pace in the first half of the year, though it was still relatively robust, and reduced spending on U.S. exports and rising import competition were exerting appreciable restraint on overall activity, as was a slowing in inventory investment. Reflecting the moderation in growth from the first half of the year, total payroll employment was trending up at a somewhat slower pace. Despite the pressures on labor resources associated with still-tight labor markets, trends in wages and prices remained stable.

Growth in nonfarm payroll employment slowed somewhat over the July-August period. The deceleration reflected further job losses in the manufacturing sector, notably in the apparel and electronic components industries on which the crisis in Asia was having a sizable adverse effect. Outside of manufacturing, employment increases remained strong in the service-producing industries, and even though anecdotal reports continued to indicate shortages of skilled workers, further sizable job gains were recorded in construction. The civilian unemployment rate stayed at 4.5 percent in August.

Industrial output rebounded in August as production at General Motors resumed following the settlement of the labor strike. Outside the motor vehicle sector, however, output had changed little on balance over recent months in association with the erosion in net exports stemming from the turmoil in Asia and its repercussions on a number of other U.S. trading partners; production of consumer goods edged down on balance in July and August, and the growth of output of business equipment slowed. The rise in industrial production in August boosted the rate of utilization of manufacturing capacity, but the factory operating rate remained somewhat below the level of late last year.

Total retail sales were held down in July and August by a sharp contraction in spending for motor vehicles, but non-auto sales continued to rise at a brisk pace. The gains were widespread, with increases in spending on furniture and appliances, apparel, and miscellaneous nondurables especially strong. Purchases of services also were up appreciably further in July and August after a rapid second-quarter rise. Sales and construction of residential buildings remained quite strong on balance, reflecting very favorable homebuying conditions. Housing starts slipped in August but were still above the high level of the first half of the year. Sales of existing homes dropped back in August from the record high registered in July, while sales of new homes were slightly higher in July (latest data) than in the first half of the year.

Available indicators pointed to more moderate growth in business fixed investment after the surge in capital spending during the first half of the year. Shipments of nondefense capital goods declined in July and August, retracing much of June's large increase, while sales of medium and heavy trucks continued to increase at a rapid pace. Nonresidential construction weakened in July, extending a pattern of sluggish building activity; construction of industrial structures remained in a downtrend, and office building activity changed little on balance over June and July.

Business inventory accumulation eased further in July after having slowed sharply in the second quarter, and inventory-sales ratios remained moderate. Stockbuilding in manufacturing was at a somewhat lower rate in July than in the second quarter, and the stock-shipments ratio for the sector stayed a little above the low level that had prevailed over the past year. At the wholesale level, a further decline in inventories reflected additional reductions in motor vehicles; the inventory-shipments ratio remained in the upper part of its narrow range for the past year. In the retail sector, a sharp drop in stocks at automotive dealerships more than offset a rise in stocks of other goods. The aggregate inventory-sales ratio for the retail sector was at a relatively low level.

The nominal deficit on U.S. trade in goods and services narrowed slightly in July from its second-quarter average, with the value of imports falling more than the value of exports.

Much of the decline in imports and exports involved trade in automotive products with Canada and Mexico. Economic activity in the major foreign industrial countries other than Japan decelerated on average in the second quarter, with a deterioration in net exports partially offsetting continued strength in domestic final demand. In Japan, activity contracted for a third consecutive quarter; net exports made a large positive contribution as imports dropped sharply, but domestic demand, most notably business fixed investment, fell steeply.

Both the overall and the core CPI again rose moderately in August; a further increase in food prices was offset by a sizable decrease in energy prices. For the twelve months ended in August, core consumer prices rose slightly more than they had in the year-earlier period. At the producer level, prices of finished goods dropped appreciably in August, largely reflecting declines in the prices of finished foods and, notably, energy goods. Producer prices of finished goods other than food and energy moved slightly higher in the twelve months ended in August after having edged down in the year- earlier period. Producer prices at earlier stages of production were under strong downward pressure; prices of intermediate materials fell during the year ended in August by slightly more than they had risen in the year-earlier period, and prices of crude materials plunged further in the twelve months ended in August. Average hourly earnings of production or nonsupervisory workers continued to increase at a relatively moderate pace in the July-August period, and for the twelve months ended in August, they rose slightly more than in the year-earlier period.

At its meeting on August 18, 1998, the Committee adopted a directive that called for maintaining conditions in reserve markets that would be consistent with the federal funds rate continuing to average around 5-1/2 percent. However, in light of mounting financial strains abroad, their potential implications for the U.S. economy, and less accommodative conditions in domestic financial markets, the Committee concluded that the risks to the outlook were no longer tilted toward rising inflation but had become more balanced. Accordingly, the Committee adopted a directive that did not include a presumption about the likely direction of any adjustment to policy during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

Open market operations were directed throughout the intermeeting period toward maintaining the existing degree of pressure on reserve positions, and the federal funds rate remained close to its intended level of 5-1/2 percent. In an atmosphere of greatly increased volatility in financial asset values worldwide and a reduced appetite for risk among many investors, interest rates on U.S. Treasury securities, and to a much smaller extent on investment-grade corporate debt, fell appreciably during the intermeeting period; in contrast, yields on the bonds of lower-rated firms increased sharply, and a number of large banks tightened terms and standards for making business loans to sizable firms. Credit conditions also tightened in Europe, Asia, and Latin America. Share prices in U.S. and foreign equity markets remained volatile during the intermeeting period, and major U.S. equity price indexes declined considerably further on balance.

In foreign exchange markets, the trade-weighted value of the dollar depreciated substantially over the intermeeting period in relation to other major currencies. A spreading perception that the United States was more vulnerable than either Europe or Japan to an economic downturn in Latin America, increasing expectations of monetary easing in the United States, and shifts into yen associated with the end of the fiscal half-year in Japan and the unwinding of some investment positions financed in yen were factors that weighed on the dollar. By contrast, the dollar appreciated slightly in terms of an index of currencies that includes the developing countries of Latin America and Asia that are important trading partners of the United States.

Growth of M2 and M3 picked up considerably in August and apparently strengthened further in September. The acceleration was the result of unusually large inflows to money market funds that in part reflected households' preference for relatively safe, liquid placements for funds shifted out of equities and lower-rated corporate debt. For the year through September, both aggregates recorded growth rates well above the Committee's ranges for the year. Expansion of total domestic nonfinancial debt had moderated somewhat in recent months after picking up earlier in the year.

The staff forecast prepared for this meeting incorporated a considerably weaker assessment of underlying aggregate demand, owing to downward revisions to growth abroad and to the less accommodative conditions that were evolving in U.S. financial markets. The staff projected that the expansion of economic activity would slow for a time to a pace appreciably below the estimated growth of the economy's potential and then would pick up to a rate more in line with that potential. Damped expansion of foreign economic activity and the lagged effects of the earlier rise in the foreign exchange value of the dollar were expected to place considerable restraint on the demand for U.S. exports for a period ahead and to lead to further substitution of imports for domestic products. Domestic production also would be held back for a while by the efforts of firms to bring inventories into better balance with the anticipated moderation in the trajectory of final sales. In addition, private final demand would be restrained by tighter lending terms and conditions as well as the drop that had occurred in equity prices. Pressures on labor resources were likely to ease somewhat as the expansion of economic activity slowed, but inflation was projected to pick up gradually in association with a partial reversal of the decline in energy prices this year.

In the Committee's discussion of current and prospective economic conditions, members focused on developments that pointed to the potential for a significant weakening in the growth of spending. They recognized that there were at present few statistical indications that the economy was on a significantly slower growth track. Indeed, the available data suggested that consumer expenditures and business investment retained considerable strength. At the same time, however, investors' perceptions of risks and their aversion to taking on more risk had increased markedly in financial markets around the world. That change in sentiment was exacerbating financial and economic problems in a number of important trading partners of the United States. In addition, it was generating lower equity prices and tightening credit availability in U.S. financial markets. As a consequence, the downside risks to the domestic expansion appeared to have risen substantially in recent weeks. Though labor markets were expected to remain relatively tight for some time, the members saw little prospect that inflation would gather significant momentum in coming quarters. Declining commodity and other import prices would be restraining prices and inflation expectations for a while. Overall consumer prices might rise a little more rapidly next year as the effects of a number of favorable factors, such as falling energy prices, diminished or reversed, but underlying inflation was expected to stay quite subdued as inflation expectations remained damped and pressures in labor markets became less pronounced.

The intensification and further spread of turmoil in international financial markets, notably since the outbreak of a financial crisis in Russia in mid-August, had spilled over into U.S. financial markets. Strong demands for safety and liquidity had driven down yields on U.S.

Treasury securities, but spreads of private rates over Treasury rates had gapped higher. Increases in risk spreads were especially large for lower-grade borrowers and on bonds below investment grade, whose rates had increased considerably since mid-August. In addition, many banks had tightened their credit standards and terms. Prices in U.S. equity markets, which had weakened appreciably before the crisis in Russia, had declined substantially further. These market developments strongly suggested, and anecdotal reports tended to confirm, the emergence of widespread perceptions of greater risks in a broad range of financial investment activities and of considerably greater reluctance to put capital at risk. The members did not believe that the tightness in credit markets and strong demand for safety and liquidity were likely to lead to a "credit crunch," though some members expressed the view that such an outcome could not be ruled out. At a time when business balance sheets already indicated a significant softening of cash flows owing to weaker profits, many business firms were experiencing increased difficulty and costs in their efforts to raise funds in debt or equity markets or to borrow from lending institutions; if these conditions were to persist, the sustainability of the current strength in business capital expenditures would come into question. The decline in stock market prices also appeared likely to damp the growth of consumer spending over time, with added implications for business capital expenditures.

Despite the emergence of decidedly less hospitable financial conditions, there were few indications in the data available to the Committee of any weakening as yet in consumer and business spending. Consumer expenditures, though temporarily held back by shortages of new motor vehicles stemming from the work stoppage at General Motors, had remained on a solid uptrend, with overall growth in recent months apparently slipping only a little from a remarkably rapid pace in the first half of the year. Strong growth in jobs and incomes along with substantial further increases in stock market prices through mid-July had fostered a high level of consumer confidence and spending. Members commented that the more recent weakness in the stock market and the related decline in household net worth had removed an important support for the growth of consumer spending, but they noted that recent surveys indicated only a slight deterioration in consumer sentiment and that the stimulus from earlier stock market gains probably would dissipate only gradually. Looking further ahead, consumer spending could be expected to expand at a pace that was more in line with the growth of household incomes than it had been in recent years.

Growth in business investment spending, while apparently moderating from an extraordinary pace during the first half of the year, likewise seemed to have been little affected to date by the tightening in credit conditions and the increased aversion to risktaking. Data on shipments of capital equipment continued to display a clear uptrend and members reported very strong construction activity in many parts of the country. Declining relative prices and rapid technological advances were likely to generate appreciable further growth in spending for computer and office equipment over the projection horizon. Moreover, new orders for capital equipment did not suggest any general weakening, though such orders had declined dramatically in the steel industry under the weight of intense foreign competition. Even so, the members anticipated that the pronounced increase in investor and lender perceptions of risk would result in considerable moderation in the growth of overall business investment, especially in light of concurrent expectations of reduced gains in sales and profits and evidence of some diminution in both internal and external sources of financing. Reports from nearly every Federal Reserve District suggested that executives had become considerably more concerned about business prospects. In a number of cases they already had seen a substantial downturn in their exports or a surge in competing imports at prices they found difficult to match. In other cases they were anticipating such developments or were reacting to the general sense of unease and uncertainty evident in financial markets. Forthcoming data on capital spending including new orders and contracts were likely to point to a weaker uptrend in business fixed investment. How much weaker was a major uncertainty in the economic outlook and a key to determining the extent to which financial market turmoil was likely to affect the real economy.

Very favorable underlying factors, including a strong job market and declining mortgage rates, had helped to sustain homebuilding activity at an elevated level. The large further advance in stock market prices earlier in the year also appeared to have been a positive factor in the strong performance of the housing market. While anecdotal reports suggested that softening was confined to only a few areas, the delayed effects of the drop in stock market prices and forecasts of slower employment and income growth suggested some moderation in housing activity at some point. Even so, the continued affordability of new homes for many households was likely to sustain housing demand at a relatively high albeit diminished level, and homebuilding activity would be bolstered for a time as backlogs created by shortages of skilled construction workers in many areas were worked off.

Net exports, while subject to a great deal of uncertainty, were seen as likely to continue to restrain demand and production to a substantial extent over coming quarters. Members cited examples from across the country of business firms, notably in the manufacturing sector but also in energy, agriculture, forest products, and some other industries, that already were being adversely affected by weaker export markets and increased competition from lower-priced imports. Moreover, the intensification of turmoil in international financial markets since the Russian devaluation and debt moratorium had led to tighter financial conditions in key U.S. trading partners--especially in the Americas--a development that was likely to weaken growth in those markets and demand for U.S. products. Of potentially greater importance for the domestic economic outlook, however, was the spread of international financial unsettlement to U.S. financial markets and the attendant deterioration in business and investor confidence. It was clear that the contagious effects of international economic and financial turmoil had markedly increased the downside threat to the domestic expansion.

In their comments about the outlook for inflation, members referred to the persistence of very tight labor markets across the nation and to indications of escalating increases in labor compensation in a number of areas. At the same time, price inflation generally had remained subdued, with little evidence of acceleration. As had been true for an extended period, competitive pressures were widely reported to be preventing employers from passing through rising labor costs to consumer prices. Looking ahead, members cited a variety of factors bearing on the prospects for inflation that on the whole suggested that the risks of an inflationary uptrend had receded. Favorable factors in the outlook for prices included the lingering effects of the dollar's earlier appreciation, ample industrial capacity, generally declining commodity and other import prices, and an apparently more rapid trend of productivity gains. Over time, some slowing in economic growth and less intense pressures on labor resources would hold down increases in labor costs. Developments that might tend to offset these positive factors, at least in part, included a possible turnaround in energy prices after sizable declines over the past year and an upturn in the costs of worker benefits, notably for medical expenses. A few members also observed that the rapid growth of key monetary aggregates, including M2, over a period of several quarters was a worrisome element in the outlook for inflation, though the most recent surge in M2 probably was induced in large measure by a flight to quality and liquidity.

In their discussion of policy for the intermeeting period ahead, all the members endorsed a proposal calling for a slight easing in reserve markets to produce a decline of 1/4 percentage point in the federal funds rate to an average of about 5-1/4 percent. In their view, such an action was desirable to cushion the likely adverse consequences on future domestic economic activity of the global financial turmoil that had weakened foreign economies and of the tighter conditions in financial markets in the United States that had resulted in part from that turmoil. At a time of abnormally high volatility and very substantial uncertainty, it was impossible to predict how financial conditions in the United States would evolve. In the view of many members, equity prices and risk spreads in U.S. financial markets previously had embodied an overly optimistic assessment of business prospects and they saw some correction in these markets as a positive development. Moreover, they expected markets to become much more settled once the initial adjustments to new risk assessments had been made. On balance, however, credit conditions were likely to remain tighter and equity prices lower than earlier, and in the context of continued damped inflation, monetary policy had the room to adjust to these new circumstances. In any event, an easing policy action at this point could provide added insurance against the risk of a further worsening in financial conditions and a related curtailment in the availability of credit to many borrowers.

The members agreed that the decrease in the federal funds rate should be limited to 25 basis points. Several emphasized in this regard that although the risk of rising inflation might have receded, it was still present, especially in light of the persistence to date of very tight labor markets and relatively robust economic growth. In these circumstances, while an easing move was warranted to provide some insurance against undesirably tight domestic financial conditions, many members saw the need for a cautious policy action. A more sizable policy move at this point might convey an exaggerated impression of the Committee's current thinking regarding the extent of downside risks in the economy.

The members were divided over whether to retain the current symmetrical directive or to adopt an asymmetrical directive that would be tilted toward ease. A small majority favored moving to asymmetry on the grounds that it seemed more consistent with the increased downside risks to the economy that they believed would exist even after the contemplated policy action and that it would underscore the Committee's readiness to respond promptly to conditions that might threaten the sustainability of the expansion. Other members expressed a preference for a symmetric directive but indicated that they could accept a directive that was tilted toward ease. In their opinion, the uncertainties relating to the direction of the next policy move were sufficiently great on both sides to justify a neutral directive. Some commented that unanticipated developments were likely in any event to provide the principal basis for future policy actions. They suggested that the Committee would undoubtedly confer by telephone should such developments materialize during the intermeeting period, and the symmetry or asymmetry of the directive would have little bearing on whatever policy decision might be reached.

At the conclusion of the Committee's discussion, all the members supported a directive that called for conditions in reserve markets that would be consistent with a slight decrease in the federal funds rate to an average of about 5-1/4 percent. All the members also indicated that they could accept a change in the directive to include a bias toward easing. 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 a slightly higher federal funds rate might be acceptable or a somewhat lower federal funds rate would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with some moderation in the growth of M2 and M3 over the months ahead.

Federal Reserve Bank of New York was authorized and directed, until instructed otherwise by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

> The information reviewed at this meeting suggests that the economy has been growing at a moderate rate, paced by brisk, albeit slowing, increases in spending by businesses and households, while expansion in overall economic activity has continued to be restrained by developments abroad. Nonfarm payroll employment grew somewhat more slowly over July and August, mostly reflecting job losses in the manufacturing sector; the civilian unemployment rate was unchanged at 4.5 percent in August. Industrial production has changed little on balance over recent months. Total retail sales over July and August were held down by a sharp contraction in spending for motor vehicles. Residential sales and construction have remained quite strong in recent months. Available indicators point to continued growth in business capital spending, but at a more moderate pace than in the first half of the year. Business inventory accumulation slowed further in July. The nominal deficit on U.S. trade in goods and services narrowed slightly in July from its second-quarter average. Trends in wages and prices have remained stable in recent months.
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> Most interest rates have fallen appreciably since the meeting on August 18, though yields on the bonds of lower-rated firms have increased and a number of large banks have tightened terms and standards for making business loans. Broadly similar developments have occurred in major foreign markets. Share prices in U.S. and global equity markets have remained volatile and major indexes have declined considerably further on balance over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar declined substantially over the intermeeting period in relation to other major currencies; it was up slightly in terms of an index of the currencies of the developing countries of Latin America and Asia that are important trading partners of the United States.
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> Growth of M2 and M3 strengthened considerably in August and appeared to have picked up further in September, partly reflecting shifts of funds by households out of investments in equities and lower-rated corporate debt. For the year through September, both aggregates rose at rates well above the Committee's ranges for the year. Expansion of total domestic nonfinancial debt has moderated somewhat in recent months after a pickup earlier in the year.
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> 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 reaffirmed at its meeting on June 30-July 1 the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1997 to the fourth quarter of 1998. The range for growth of total domestic

> nonfinancial debt was maintained at 3 to 7 percent for the year. For 1999, the Committee agreed on a tentative basis to set the same ranges for growth of the monetary aggregates and debt, measured from the fourth quarter of 1998 to the fourth quarter of 1999. 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.
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> In the implementation of policy for the immediate future, the Committee seeks conditions in reserve markets consistent with decreasing the federal funds rate to an average of around 5-1/4 percent. 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, a slightly higher federal funds rate might or a somewhat lower federal funds rate would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with some moderation in the growth in M2 and M3 over coming months.

Votes for this action: Messrs. Greenspan, McDonough, Ferguson, Gramlich, Hoenig, Jordan, Kelley, Meyer, Ms. Minehan, Mr. Poole, and Ms. Rivlin.

Votes against this action: None.

Release of Information about FOMC Meetings
At this meeting, the Committee reviewed its current practices relating to its policy announcements, meeting minutes, and directive wording. This discussion was part of an ongoing appraisal of the Committee's disclosure policies. The Committee took no action at this meeting but agreed that further review of some of these issues would be appropriate.

Financial Problems of a Large Hedge Fund
The Committee discussed the limited role of the Federal Reserve Bank of New York in facilitating a private-sector resolution of the severe financial problems encountered in the portfolio managed by Long-Term Capital Management L.P. The size and nature of the positions of this fund were such that their sudden liquidation in already unsettled financial markets could well have induced further financial dislocations around the world that could have impaired the economies of many nations, including that of the United States. Against this background, the Federal Reserve Bank of New York had brought together key interested parties with the aim of increasing the probability of an orderly private-sector solution to the hedge fund's difficulties.

Conference Call
In a telephone conference held on October 15, 1998, the Committee members discussed recent economic and financial developments and their implications for monetary policy. Risk aversion in financial markets had increased further since the Committee's meeting in September, raising volatility and risk spreads even more, eroding market liquidity, and constraining borrowing and lending in a number of sectors of the financial markets. Although indications of any softening in the pace of the economic expansion across the country remained sparse, the widespread signs of deteriorating business confidence and evidence of less accommodative domestic financial conditions suggested that the downside risks to the expansion had continued to mount.

Against this background, a consensus emerged in favor of a 1/4 percentage point reduction in the federal funds rate that would accompany a reduction in the discount rate that the Board of Governors was expected to approve at a meeting following this telephone conference. Some members were concerned that a policy move so soon after the late September action might be misread as indicative of a degree of concern about prospective developments in financial markets or the economic outlook that did not represent the Committee's thinking. However, the members generally concluded that the risk of adverse market reactions was worth taking and that the easing actions under consideration were more likely to help settle volatile financial markets and cushion the effects of more restrictive financial conditions on the ongoing expansion. At the conclusion of this discussion, the Chairman indicated that he would instruct the Federal Reserve Bank of New York to lower the intended federal funds rate by 25 basis points, consistent with the Committee's directive issued at the meeting on September 29, 1998.

It was agreed that the next meeting of the Committee would be held on Tuesday, November 17, 1998.

The meeting on September 29 adjourned at 2:40 p.m.

Donald L. Kohn
Secretary

Footnotes

1 Attended portion of the meeting relating to the Committee's disclosure policies.

2 Attended portion of meeting relating to developments stemming from the financial difficulties of a large hedge fund.