

Minutes of the Federal Open Market Committee

November 17, 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, November 17, 1998, at 9:00 a.m.

Present:

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

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. Bernard, Deputy Secretary
Ms. Fox, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist

Messrs. Cecchetti, Dewald, 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

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

Ms. Johnson, Director, Division of International Finance, Board of Governors

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

Messrs. Alexander and Hooper, Deputy Directors, Division of International Finance, Board of Governors

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

Mr. Whitesell, Assistant Director, Division of Monetary Affairs, Board of Governors

Ms. Garrett, Economist, Division of Monetary Affairs, Board of Governors

Mr. Kumasaka, Assistant Economist, Division of Monetary Affairs, Board of Governors

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

Mr. Moore, First Vice President, Federal Reserve Bank of San Francisco

Messrs. Beebe, Eisenbeis, Ms. Krieger, Messrs. Lang, and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Atlanta, New York, Philadelphia, and Dallas respectively

Messrs. Evans, Fuhrer, Hetzel, Miller, and Sellon, Vice Presidents, Federal Reserve Banks of Chicago, Boston, Richmond, Minneapolis, and Kansas City respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 29, 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 September 29, 1998, through November 16, 1998. By unanimous vote, the Committee ratified these transactions.

The Manager informed the Committee that he planned to initiate outright purchases in the secondary market of inflation-indexed Treasury securities. In the past, the System had been acquiring holdings of such securities in Treasury auctions in exchange for maturing nominal obligations. In the Manager's opinion, secondary market transactions would provide a helpful addition to the current range of assets that the System normally purchased, especially in a period of little or no increase in Treasury debt. Some members expressed concern that sizable purchases of indexed securities by the central bank might impair the liquidity of the market and limit the usefulness of these obligations as indicators of inflationary expectations. It was noted, however, that relatively limited System purchases of such securities were contemplated so that the market was not likely to be significantly affected. Moreover, the System's participation could contribute to a more active and liquid secondary market.

In further discussion of the wording of the operating paragraph of its directive, the Committee at this meeting focused on proposals by members to simplify and clarify the sentence relating to the symmetry or asymmetry of the directive as it applied to possible future policy changes. Time constraints did not permit the Committee to complete its deliberations, and it agreed to continue its discussion at a later meeting.

The Committee then turned to 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. Committee decisions to amend the Authorization for Domestic Open Market Operations and to renew certain swap line agreements also are summarized below.

The information reviewed at this meeting suggested some moderation in the expansion of economic activity from a brisk pace during the summer months. Although growth of economic activity in the third quarter apparently about matched the pace in the first half of the year, a large buildup of nonfarm inventories had accounted for a significant portion of the persisting strength of the expansion during the quarter. Growth in consumer spending had been well maintained during the summer months, and housing activity had remained at a high level. In other major sectors of the economy, business fixed investment had softened after having surged in the first half, and net exports had declined further, although at a reduced pace. Growth in employment had slowed appreciably on balance during the summer and early fall months, but tight conditions had persisted in most labor markets. Recent wage and price developments had been mixed.

Growth in nonfarm payroll employment slowed appreciably in September and October. The slowing partly reflected sizable job losses in manufacturing, which has been substantially affected since earlier in the year by increasing foreign competition stemming from the crisis in Asia. Outside of manufacturing, increases in employment in the service-producing industries moderated somewhat over the two months, although gains in finance, insurance, and real estate were relatively robust. The civilian unemployment rate remained near 4-1/2 percent during the two months.

Industrial output had declined slightly in recent months after having rebounded in August when production resumed at General Motors following settlement of the labor strike. Outside the motor vehicle sector, manufacturing output edged lower in recent months after having decelerated markedly earlier in the year. Weakness in the manufacturing and mining sectors was associated in large measure with the fallout from the turmoil in Asia, its repercussions on a number of U.S. trading partners, and the related softness in world oil markets. The downward trend in the utilization of capacity in manufacturing left the factory operating rate appreciably below its level of late last year.

Personal consumption expenditures rose considerably further during the third quarter, though at a much slower pace than that recorded earlier in the year. Retail sales were down slightly on balance during the quarter, reflecting a sharp drop in sales of motor vehicles associated with the work stoppage at General Motors. However, the settlement of that strike and the resumption of production led to an upturn in overall motor vehicle sales in August and a sizable advance in September. A large further gain in such sales contributed to a sharp rise in overall retail sales in October. Consumer confidence retreated further in October, but according to a major survey it turned up in early November, albeit to a level still somewhat below its peak earlier in the year.

Available indicators pointed to a pickup in business capital spending after a third quarter lull, owing to some extent to a recovery from the General Motors strike. Business investment

expenditures during the summer were held down in part by the strike-related decline in fleet sales of new motor vehicles. In addition, spending for other types of business equipment grew somewhat more slowly in the third quarter after having expanded at an extraordinary pace earlier in the year. Orders received by U.S. equipment makers continued to trend up through September. In contrast, nonresidential building activity apparently fell somewhat further in the third quarter. While the construction of lodging facilities surged and the construction of office space persisted at a high level, there was a decline in other commercial building, which includes retail stores and warehouses, industrial structures, and institutional buildings. The availability of financing for various types of construction appeared to lessen substantially in late summer, and financing costs rose for many borrowers.

In the residential sector, housing sales and starts remained quite strong, though below early summer highs. Housing activity showed signs of dropping off from peak levels during the latter part of the summer, but the decline in mortgage rates this fall produced an upturn in several indicators of demand for single-family housing, including a rebound in a survey index of homebuying conditions. Multifamily housing starts increased considerably in the third quarter, but since late summer the availability of financing for multifamily building projects has tended to diminish and interest costs to rise.

Business inventory accumulation was sizable in the third quarter, and stocks-sales ratios rose to uncomfortable levels in some industries that were being adversely affected by the nation's growing trade deficit. In manufacturing, however, stockbuilding slowed during the summer months and the stock-shipment ratio was unchanged at a level just above its average for the past year. At the wholesale level, a rapid increase during the third quarter lifted the inventory-sales ratio for this sector to its highest level since 1986; nearly half the rise was the result of a buildup of farm products that was related in part to an early harvest, but wholesalers of machinery, chemicals, and metals and minerals also apparently experienced undesired buildups of stocks. Retail inventories excluding motor vehicles accumulated at a slow pace during the summer, and the inventory-sales ratio for this category remained well within the narrow range of the past year.

The nominal deficit on U.S. trade in goods and services widened to some extent in July-August from its second-quarter average. The value of imports in the July-August period, though rising appreciably in August, was somewhat below the second-quarter average, with most of the decline involving automotive products and oil. The value of exports fell somewhat over the two months, largely reflecting declines in exports of automotive products and industrial supplies and reduced service transactions. Decreases in exports partly reflected weakness in foreign economies. In the third quarter, growth in economic activity slowed on average in the major industrial countries, other than Japan, from the average pace in the first half of the year and contracted for a fourth consecutive quarter in Japan. There were widespread indications in the industrial nations, particularly from surveys of business and consumer confidence, that some slowing was persisting into the fourth quarter. Elsewhere, the available evidence pointed to some improvement in economic trends in a number of Asian nations, but the economies of several sizable South American countries appeared to have weakened. Recent economic indicators for Mexico were mixed.

The performance of various measures of wages and prices was uneven in recent months. The most recently available employment cost index indicated that hourly compensation of private industry workers posted a sizable increase in the third quarter. However, gains in average hourly earnings moderated considerably in September and October. The increase in the

employment cost index over the past year was appreciably larger than in the previous year while the advance in average hourly earnings moderated somewhat.

Consumer energy prices rose appreciably in October, but they were still down sharply from a year earlier and on balance limited the increase of overall consumer prices over the past year. Core consumer prices moved up at a faster pace than overall consumer prices in recent months and over the past year, reflecting sizable increases in the prices of tobacco, used cars and trucks, and services. At the producer level, prices of finished goods edged up in recent months but were down on balance over the past year; excluding food and energy items, producer prices rose somewhat over the past year.

At its meeting on September 29, 1998, the Committee adopted a directive that called for implementing conditions in reserve markets that were consistent with a one-quarter percentage point decrease in the federal funds rate to an average of around 5-1/4 percent. The Committee also decided to adopt an asymmetric directive that was tilted toward ease to highlight its view that the risks to the economic expansion were mainly on the downside and to underscore its readiness to respond promptly to developments that threatened the sustainability of the expansion. The reserve conditions associated with this directive were expected to be consistent with some moderation in the growth of M2 and M3 over subsequent months.

Following the meeting, open market operations were directed initially toward implementing a slight easing in the degree of pressure on reserve positions. The federal funds rate, responding to quarter-end pressures and uncertainties created by shifting funding patterns in volatile financial markets, tended at first to average somewhat above the intended rate of 5-1/4 percent despite a relatively liberal provision of reserves by the System. Strains in financial markets continued to mount, with intermediaries and final investors much more cautious about risks and leverage and much more eager to hold very liquid assets. These developments in turn disrupted flows of funds in a number of financial markets. On October 15, the Committee discussed these developments and their implications for the domestic economy, and the members supported the Chairman's suggestion that, in keeping with the directive issued at the September 29 meeting, he instruct the Federal Reserve Bank of New York to reduce the intended federal funds rate by a further 25 basis points to around 5 percent. On the same day, the Board of Governors approved a reduction in the discount rate from 5 percent to 4-3/4 percent. These actions were taken in the light of growing indications of caution by lenders and unsettled conditions in financial markets more generally that were deemed likely to restrain aggregate demand in the future. Subsequently, trading in the federal funds market remained relatively volatile but the federal funds rate averaged close to its lower intended level. In financial markets more generally, strains gradually moderated after mid-October and sizable issuance of securities resumed in a number of key markets, but uncertainty remained high and relatively illiquid conditions persisted. In the stock market, share prices dropped in the weeks following the September meeting, but the market rallied strongly after mid-October and key market indexes posted sizable gains on balance over the intermeeting period.

In foreign exchange markets, the trade-weighted value of the dollar fell moderately over the period in relation to other major currencies. The largest decline occurred in relation to the Japanese yen and appeared to reflect efforts to reduce speculative exposure to that currency; changes in the value of the dollar against other major currencies were mixed, likely fostered by disparate interest rate and economic developments. The dollar also fell somewhat in terms

of a broad index of currencies of other countries that are important trading partners of the United States, including the developing nations of Latin America and Asia.

M2 and M3 posted very large increases in September and October. The gains appeared to be induced to an important extent by increased demand for safe and liquid assets in a period of substantial turmoil in financial markets that led to shifts of funds by households out of investments in equities and lower-rated corporate debt. The advance in M2 during October probably also was boosted by the decline in its opportunity cost resulting from the effects of the System's easing actions on market interest rates and the unusual softness in Treasury bill rates during much of the month. The even faster increase in M3 in October also reflected both inflows to institution- only money market mutual funds that were stimulated by declines in short-term market rates and bank efforts to fund heavy demand for loans arising in part from the deflection of demand for funding from securities markets. For the year through October, both aggregates rose at rates well above the Committee's ranges for the year. Expansion of total domestic nonfinancial debt moderated slightly in recent months after picking up earlier in the year.

The staff forecast prepared for this meeting continued to point to considerable slowing in the expansion of economic activity to a pace appreciably below the estimated growth of the economy's potential, but the expansion was expected to pick up later to a rate more in line with that potential. Subdued 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, albeit diminishing, restraint on the demand for U.S. exports for some period ahead and to lead to further substitution of imports for domestic products. Domestic production also would be held back for a time 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 a bit by the tighter terms and conditions that were now imposed by many types of lenders and by the anticipated waning of positive wealth effects stemming from earlier increases in equity prices. Pressures on labor resources were likely to ease somewhat as the expansion of economic activity moderated, but inflation was projected to rise considerably over the year ahead in association with a partial reversal of the decline in energy prices this year.

In the Committee's discussion of current and prospective economic developments, members observed that indications of some moderation in the pace of the economic expansion were still quite limited, but they generally agreed that the economy appeared to be headed toward slower growth. Relatively tight profit margins and less ebullient growth in wealth were among the factors expected to be damping investment and consumption. In addition, even apart from the possibility of further financial contagion in Latin America, the weakness in foreign economies continued to be seen as a persistent source of restraint on demand in a number of domestic sectors, notably manufacturing, agriculture, and some extractive businesses. Although the financial markets had improved substantially in recent weeks, overall credit conditions were still relatively unsettled and a possible reintensification of difficulties in credit markets constituted an important downside risk to the expansion. The members recognized that not all the risks were in one direction, however. The economy had demonstrated remarkable resilience and strength over recent years, and in the view of some members the rapid growth of liquidity and bank credit suggested that financial conditions were not excessively tight. With regard to the outlook for inflation, members noted that while statistical and anecdotal information pointed to persistently tight labor markets in much of

the nation, price inflation remained subdued. Indeed, even though the recent evidence relating to prices was somewhat mixed, several broad measures of prices suggested that inflation might be on a declining trend.

In the course of the Committee's discussion, the members gave considerable attention to recent financial developments and their implications for the economic outlook. Financial markets clearly had calmed markedly since the System's easing actions in mid-October, though they were still atypically volatile. Risk spreads had narrowed substantially and other measures of financial market performance also suggested that risk aversion and the related desire for liquidity had diminished appreciably. Markets for new issues had reopened for many borrowers, and stock market prices had posted large gains. Nonetheless, strains and weaknesses in financial markets had not disappeared--many risk spreads were still at unusually high levels-- and the markets remained quite sensitive to unanticipated developments. Members also noted that the improvement in debt markets appeared to have come to a halt most recently and indeed that renewed strains had emerged in some short-term debt markets, though the latter probably were related in large measure to concerns about year-end pressures in the money markets. Indeed, efforts by lenders and borrowers to position for year-end financial statements were likely to contribute considerably to keeping market conditions unsettled over coming weeks. Lending activity at banks had increased sharply in recent months as many borrowers found other sources of funds less receptive or unavailable and turned to backup lines for credit, but banks also had tightened their credit terms and standards for most new loans and lines of credit. As a result, financing generally had become less available and more expensive for higher-risk business borrowers. In light of these developments, members believed that the continuing fragility of financial markets and the increased scrutiny of the credit quality of borrowers, though the latter was in some respects a welcome development, posed a considerable downside risk to the expansion. The very recent behavior of equity prices was difficult to explain satisfactorily, and potential movements in those prices posed risks on both sides of the most likely forecast: A future substantial increase would bolster wealth and spending, but a sharp decline also could not be ruled out--especially if, as seemed quite possible, added increases in prices were not supported by robust increases in profits.

Foreign economic and financial developments were another important source of downside risk and uncertainty. The economic and financial turmoil in Asia had spread to numerous other nations around the world and to an extent to the United States. While economic weakness in many U.S. trading partners likely would continue to have adverse effects on net U.S. exports, the potential extent of such weakness was subject to considerable uncertainty as were the associated repercussions on financial markets. As they had at previous meetings, members referred to numerous anecdotal reports of heightened competition from foreign producers that was curbing the sales of many domestic manufacturers, notably in the steel industry, and in some other industries and agriculture. Moreover, the low level of world oil prices, which appeared to be importantly associated with diminished demand from Asian countries, was retarding production and reducing revenues in the U.S. energy and related industries. On the positive side, members commented that economic and financial conditions appeared to have stabilized or improved a bit in a number of Asian nations, though the recession in Japan showed little evidence of coming to an end, and the outlook for Brazil seemed a little more promising. However, economic and financial conditions in Brazil and a number of other countries remained very fragile. The recent depreciation of the dollar, while perhaps putting some upward pressure on prices, would damp the deterioration in net U.S.

exports.

In their review of recent and prospective developments across the nation and in key sectors of the economy, members referred to scattered indications of some slowing in private domestic final demands. In the important consumer sector, however, evidence of weakening growth in expenditures was quite limited. The most recent anecdotal reports pointed to solid growth in most though not all regions of the country, and retail sales posted a strong advance in October. Moreover, consumer sentiment remained at a high level, albeit below its peak earlier in the year according to a recent survey. Members commented, however, that the more moderate growth in employment and incomes experienced recently likely would persist and should result in reduced gains in consumer expenditures next year, but they also noted that the extent of the deceleration was subject to considerable uncertainty. Some members referred to reports from contacts in the retailing industry who expressed some concern about the potential for weaker retail sales after the holiday season. A significant factor bearing on consumer spending would be the performance of the stock market. The impetus from the wealth effects of rapidly rising share prices would wane if such prices were to stabilize near current levels.

With regard to business fixed investment, anecdotal evidence was accumulating that many business firms, notably in manufacturing, were scaling back their planned capital outlays for the year ahead. Factors contributing to the prospective deceleration in business capital expenditures included a weaker trend in profits over the past several quarters, a related deterioration in business cash flows, and a large buildup in capacity over the course of recent years. Members also referred to indications of curtailed availability and more costly financing for some businesses, notably for relatively speculative construction projects. A number of members observed that the latter was a healthy development in that it would tend to hold down overbuilding in some areas. Overall, capital expenditures would undoubtedly recover from their slight decline during the summer months, but the outlook was for growth next year at a pace well below that experienced for an extended period before mid-1998. Housing construction was expected to remain at a high level, buttressed by attractive terms on new home mortgages, but housing activity appeared to have peaked or declined slightly in some regions.

The rapid buildup in inventories during the third quarter was not likely to continue, but the timing and extent of the expected moderation were largely unpredictable. It was noted in this regard that while inventories appeared to have risen to uncomfortable levels in some industries, there was no evidence of a general inventory overhang. Looking ahead, the projected slowing in the growth of final sales, including the effects of weak export markets, likely would reinforce business efforts to bring the growth of their inventories into better alignment with that of their sales, and such a development should contribute to the projected slowing in overall economic activity in coming quarters. It was unclear at this point to what extent year 2000 concerns might stimulate extra inventory investment prior to the end of 1999.

In their review of developments bearing on the outlook for inflation, members commented that labor markets remained exceptionally tight, though there was little evidence that they had tightened further in recent weeks. Employers were continuing to resist pressures to grant unusually large wage increases, and the persistence of vigorous competition, including that from Asian imports, was preventing most business firms from passing cost increases through to prices. Indeed, the declining trend in profits in recent quarters suggested that many firms

were absorbing some of their rising labor costs to the extent that the latter were not offset by improvements in productivity. Looking ahead, slower growth in economic activity would tend to hold down pressures on wages and prices during 1999 and imports from Asian and other depressed economies would continue to generate intense competition in many markets; but labor markets remained tight, energy and commodity prices could well turn up after substantial declines, and the recent depreciation of the dollar would lessen pressures from foreign competition. A number of members expected that, on balance, inflation might be less favorable next year, though any deterioration in underlying trends should be relatively limited; others anticipated little change in and possibly some further ebbing of price inflation, extending the subdued behavior of a number of comprehensive measures of prices.

In the Committee's discussion of policy for the intermeeting period ahead, nearly all the members indicated that they could accept a proposal to reduce the federal funds rate by a further 25 basis points to an average of 4-3/4 percent. This policy decision was viewed as a close call by several members. While the growth of the economy was expected to slow appreciably over the year ahead, the expansion currently displayed only modest signs of moderating from what seemed to be an unsustainable pace. Moreover, many members saw some risk that an easing move at this point might trigger a strong further advance in stock market prices that would not be justified on the basis of likely future earnings and could therefore lead to a relatively sharp and disruptive market adjustment later. The members were more concerned, however, about the risks stemming from the still sensitive state of financial markets, and in that regard many believed that a prompt policy easing would help to ensure against a resurgence of severe financial strains. A further easing move would complete the policy adjustment to the changed economic and financial climate that had emerged since midsummer and would provide some insurance against any unexpectedly severe weakening of the expansion. Most members saw little risk that a modest easing would ignite inflationary pressures in the economy, given the subdued behavior of inflation and their outlook for economic activity. Moreover, the easing could readily be reversed if unexpected circumstances should call for such an action. In this view, the risks of inaction were greater in terms of the potential financial consequences and also could materialize much sooner than the risks of stimulating greater inflation through the slight easing that was contemplated.

Some members indicated that in light of continued robust economic growth, tight labor markets, and improving financial conditions they had a preference for awaiting further developments that might provide a stronger basis for an easing action. Some of these members expressed concern that easier reserve conditions would accommodate a step-up in monetary growth that was already quite rapid, with potentially inflationary consequences later. Nonetheless, all but one of these members could endorse the decision to ease, given the evident downside risks in the international situation, financial market uncertainty, the likelihood that inflation would still be quite low, and the possibility of reversing the action reasonably promptly should circumstances warrant.

Given its decision to ease policy, the Committee favored a change to symmetry from the asymmetry toward ease in its recent directives. A symmetrical directive was now felt to be appropriate in light of the Committee's expectation that further easing was not likely to be needed over the months ahead unless ongoing developments pointed to a more substantial decline in the growth of economic activity or further ebbing of inflation than was currently anticipated. The members recognized that the possible emergence of severe year-end pressures in the money market might require some temporary easing in reserve conditions,

but such a development did not seem to have a high probability and could in any event be readily and properly accommodated regardless of the bias in the directive.

At the conclusion of the Committee's discussion, all except one member 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 4-3/4 percent. These members also accepted a proposal to remove the bias toward easing that had been adopted at the previous meeting. 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 or a slightly lower federal funds rate would be acceptable during the intermeeting period. A staff analysis prepared for this meeting suggested that the reserve conditions contemplated by the Committee were likely to be consistent with some moderation in the growth of M2 and M3 over the months ahead.

The 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 some moderation in the expansion of economic activity from a brisk pace during the summer months. Growth in nonfarm payroll employment slowed appreciably in September and October; the civilian unemployment rate remained near 4-1/2 percent. Industrial production has declined slightly in recent months. Business inventory accumulation was sizable in the third quarter, and stock-sales ratios rose to uncomfortable levels in some sectors strongly affected by the nation's trade deficit. The nominal deficit on U.S. trade in goods and services widened somewhat in July-August from its second-quarter average. Total retail sales rose sharply in October after increasing only moderately in August and September. Residential sales and building starts have remained quite strong, but below recent peaks. Available indicators point to a pickup in business capital spending after a lull in the third quarter, owing in part to a recovery from the summer strike in the motor vehicle industry. Trends in various measures of wages and prices have been mixed in recent months.

Most market interest rates have risen on balance since the meeting on September 29, though yields on the bonds of lower-rated firms have declined. The Board of Governors approved a reduction in the discount rate from 5 to 4-3/4 percent on October 15. Share prices in U.S. and global equity markets have remained volatile but have posted sizable gains on balance over the intermeeting period. In foreign exchange markets, the trade-weighted value of the dollar declined moderately over the period in relation to other major currencies; it also fell somewhat in terms of an index of the currencies of other countries that are important trading partners of the United States.

M2 and M3 have posted very large gains in recent months, reflecting the effects of recent System easing actions on market interest rates and shifts of funds by households out of investments in equities and lower-rated corporate debt. For the year through October, both aggregates rose at rates well above the Committee's ranges for the year. Expansion of total domestic nonfinancial debt has moderated

slightly in recent months after a pickup earlier in the year.

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.

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 4-3/4 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 or a slightly lower federal funds rate would be acceptable in the inter-meeting 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, Kelley, Meyer, Ms. Minehan, Mr. Poole, and Ms. Rivlin.

Votes against this action: Mr. Jordan.

Mr. Jordan dissented because he believed that the two recent reductions in the Federal funds rate were sufficient responses to the stresses in financial markets that had emerged suddenly in late August. An additional rate reduction risked fueling an unsustainably strong growth rate of domestic demand. He expressed concern that the excessively rapid rates of growth of the monetary and credit aggregates were inconsistent with continued low inflation. Moreover, any further monetary expansion in response to economic weakness abroad could ultimately have a disrupting influence on domestic prosperity if policy were forced to reverse course at a later date to defend the purchasing power of the dollar.

Renewal of Reciprocal Currency Arrangements with the Banks of Canada and Mexico

The Committee voted unanimously to re-authorize Federal Reserve participation in the North American Framework Agreement, established in 1994, and the associated bilateral reciprocal currency ("swap") arrangements with the Bank of Canada and the Bank of Mexico. These arrangements, which predated the North American Framework Agreement, were linked into a trilateral facility in connection with the establishment of the North American Financial Group in 1994 to facilitate consultation and cooperation among the three countries in the area of macroeconomic policy as an outgrowth of the increasing integration of those economies expected to result from the North American Free Trade Agreement.

Owing to the formation of the European Central Bank and in light of 15 years of disuse, the

bilateral swap arrangements of the Federal Reserve with the Austrian National Bank, the National Bank of Belgium, the Bank of France, the German Federal Bank, the Bank of Italy and the Netherlands Bank were jointly deemed no longer to be necessary in view of the well established present-day arrangements for international monetary cooperation. Accordingly, it was agreed by all the bilateral parties to allow them to lapse. Similarly, it was jointly agreed to allow the bilateral swap arrangements between the Federal Reserve and the National Bank of Denmark, the Bank of England, the Bank of Japan, the Bank of Norway, the Bank of Sweden, the Swiss National Bank, and the Bank for International Settlements to lapse in light of their disuse and present day arrangements for international monetary cooperation.

Authorization for Domestic Open Market Operations

On the recommendation of the Manager, the Committee voted unanimously to amend the authorization for domestic open market operations to extend the maximum maturity of System repurchase agreements from 15 calendar days to 60 calendar days. The purpose of the expanded authority was to enhance the flexibility of the Manager in meeting reserve supplying objectives during periods of pronounced seasonal needs, notably those associated with the year-end. Subject to the Committee's approval, the Manager would initiate the System's use of extended-term repurchase agreements ahead of the coming year-end, and he anticipated that such use could prove to be especially advantageous in late 1999 to the extent that year 2000 concerns generated accentuated seasonal demand for currency. In addition, the availability of the extended funding could help to allay concerns in the federal funds market about the cost of financing during periods of peak seasonal pressures, with favorable effects on the market's functioning.

Accordingly, effective November 17, 1998, paragraphs 1(b) and 3 of the authorization for domestic open market operations were amended to read as follows:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

- (b) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 60 calendar days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual dealers; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of

those securities within 60 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph l(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 22, 1998.

The meeting adjourned at 1:25 p.m.

Normand Bernard
Deputy Secretary

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