2-1-1995

Minutes of the Federal Open Market Committee

Federal Reserve System: Board of Governors

The Federal Reserve Board

Minutes of the Federal Open Market Committee
Meeting of January 31-February 1, 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., starting on Tuesday, January 31, 1995 at 1:30 p.m. and continuing on Wednesday, February 1, 1995 at 9:00 a.m.

PRESENT:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. LaWare
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. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

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

Mr. Fisher, Manager, System Open Market Account

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

Messrs. Hooper and Reinhart, Assistant Directors, Divisions of International Finance and Monetary Affairs, respectively, Board of Governors

Mr. Rosine,[1] Senior Economist, Division of Research and Statistics, Board of Governors

Mr. English,[1] Economist, Division of Monetary Affairs, Board of Governors

Mr. Freeman,[1] Section Chief, Division of International Finance, Board of Governors

Ms. O'Day,[1] Associate General Counsel, Legal Division, Board of Governors

Mr. Baer,[1] and Ms. Misback,[1] Managing Senior Counsels, Legal Division, Board of Governors

Mr. Ely,[1] Senior Attorney, Legal Division, Board of Governors

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

Messrs. Barron and Rasdall, First Vice Presidents, Federal Reserve Banks of San Francisco and Kansas City, respectively

Messrs. Beebe, Goodfriend, Lang, Rosenblum, Sniderman, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Richmond, Philadelphia, Dallas, Cleveland, and Atlanta, respectively

Messrs. McNees and Miller, Vice Presidents, Federal Reserve Banks of Boston and Minneapolis, respectively

Mr. Evans and Ms. Krieger, Assistant Vice Presidents, Federal Reserve Banks of Chicago and New York, respectively

---

1. Attended portions of the meeting.

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for the period commencing January 1, 1995, and ending December 31, 1995, had been received and that the named individuals had executed their oaths of office.

The elected members and alternate members were as follows:

William J. McDonough, President of the Federal Reserve Bank of New York, with James H. Oltman, First Vice President of the Federal Reserve Bank of New York, as alternate;

Cathy E. Minehan, President of the Federal Reserve Bank of Boston, with Edward G. Boehne, President of the Federal Reserve Bank of Philadelphia, as alternate;

Michael H. Moskow, President of the Federal Reserve Bank of Chicago, with Jerry L. Jordan, President of the Federal Reserve Bank of Cleveland, as alternate;

Thomas C. Melzer, President of the Federal Reserve Bank of St. Louis, with Robert D. McTeer, President of the Federal Reserve Bank of Dallas, as alternate;

Thomas M. Hoenig, President of the Federal Reserve Bank of Kansas City, with Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, as alternate.

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until the election of their successors at the first regularly scheduled meeting of the Committee after December 31, 1995, with the understanding that should they discontinue their official connection with the Board of Governors or with a Federal Reserve Bank, they would cease to have any official connection with the Federal Open Market Committee:

Alan Greenspan	Chairman
William J. McDonough	Vice Chairman
Donald L. Kohn	Secretary and Economist
Normand R. V. Bernard	Deputy Secretary
Joseph R. Coyne	Assistant Secretary
Gary P. Gillum	Assistant Secretary
J. Virgil Mattingly, Jr.	General Counsel
Ernest T. Patrikis	Deputy General Counsel
Michael J. Prell	Economist
Edwin M. Truman	Economist
Lynn E. Browne, Thomas E. Davis, William G. Dewald, David E. Lindsey, Frederic S. Mishkin, Larry J. Promisel, Charles J. Siegman, Lawrence Slifman, David J. Stockton, and Carl E. Vander Wilt	Associate Economists

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account until the adjournment of the first meeting of the Committee after December 31, 1995.

By unanimous vote, Peter R. Fisher was selected to serve at the pleasure of the Committee as Manager, System Open Market Account, on the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

> Secretary's note: Advice subsequently was received that the selection of Mr. Fisher was satisfactory to the board of directors of the Federal Reserve Bank of New York.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 20, 1994, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets since the December meeting. There were no market transactions for System Account during this period, 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

December 20, 1994, through January 31, 1995. 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 a strong further rise in economic activity during the closing months of 1994. Although consumer spending appeared to be less buoyant and housing demand had softened somewhat, growth in business investment, exports, and inventories remained brisk. Industrial production and payroll employment continued to record substantial gains. Broad indexes of prices for consumer goods and services had risen moderately on average over recent months despite shrinking margins of unemployed resources and further sizable increases in the prices of many materials.

Nonfarm payroll employment advanced considerably further in December after a sharp rise in November. Substantial job gains were recorded in December in service industries and in the retail trade sector. Hiring in manufacturing was brisk for a third straight month, with labor demand especially strong in motor vehicles, capital goods, and electronic equipment. Construction payrolls slipped after a large increase in November. The average workweek was unchanged in December, but factory overtime edged back up, matching the highest level reached in the history of this series. The civilian unemployment rate declined to 5.4 percent.

Industrial production registered another large advance in December. Manufacturing accounted for all of the gain; an upturn in mining production offset a decline in the output of utilities associated with unseasonably warm weather. In manufacturing, the output of motor vehicles and parts surged again and further solid gains were recorded in the production of other goods. The large advance in industrial output in December boosted rates of capacity utilization above already high levels.

Retail sales were reported to have changed little over November and December after substantial advances in September and October; the flattening of sales reflected sharply reduced increases in outlays for non-auto consumer goods. Consumer spending on services rose moderately on balance over November and December, with outlays for energy services held down by unusually mild weather. Although some indicators of housing demand had weakened, housing starts posted sizable gains on balance over November and December; single-family construction remained at a relatively high level despite the rise in mortgage rates in 1994, and multifamily construction continued its gradual recovery from the depressed levels of early 1993. The regional pattern of starts activity suggested that favorable weather accounted for little of the strength in December.

Business fixed investment was estimated to have grown at a very rapid pace in the fourth quarter, with a pickup indicated for business spending on both equipment and nonresidential structures. New orders for nondefense capital goods declined on balance over November and December, but the large backlog of unfilled orders, especially for computers, pointed to a continued strong expansion in spending on business equipment in coming months. Nonresidential construction activity was up considerably in November for a third straight month, with increases in construction widespread by type of structure. Recent data indicated that permits for nonresidential construction were continuing to trend higher and perhaps were running ahead of construction activity.

Business inventory investment remained brisk in November; in the aggregate, the buildup was in line with shipments and sales. In manufacturing, stocks increased more rapidly in November, but the ratio of stocks to shipments declined further and was at a historically low level. In wholesale trade, inventories rose less rapidly in November, but the inventory-to-sales ratio increased further, although it remained within its range of recent years. Inventory accumulation slowed a little at the retail level, and the inventory-to-sales ratio for this sector remained near the middle of its range of recent years.

The nominal deficit on U.S. trade in goods and services widened somewhat further in November, and for October and November combined the deficit was well above its average rate in the third quarter. The value of exports of goods and services increased more slowly in the October-November period than in the third quarter, largely reflecting reduced growth of exported industrial supplies. The rise in the value of imports of goods and services for the October-November period was led by increased imports of non-oil industrial supplies and automotive, capital, and consumer goods. Available data for the fourth quarter of 1994 indicated continued growth in economic activity, though perhaps at a somewhat slower pace, in the major foreign industrial countries.

Consumer price inflation slowed a little in December despite a jump in food prices that was only partly offset by a decline in energy prices. Excluding food and energy items, consumer prices edged up in December and rose significantly less in 1994 than in 1993. At the producer level, prices of finished goods also advanced more slowly in December, with a drop in energy prices balancing a surge in food prices. Prices of finished goods other than food and energy increased modestly in 1994 after being held down in 1993 by a sharp drop in the prices of tobacco products. In contrast to prices of finished goods, price inflation at earlier stages of production picked up in 1994. For intermediate goods other than food and energy items, prices rose at a faster rate in the second half of 1994, with the pickup most clearly evident in materials used in manufacturing. Prices of crude materials rose rapidly in the second half of 1994 and for the year as a whole. Increases in labor costs remained moderate. Average hourly earnings were little changed on balance over November and December, and for the year as a whole they advanced only slightly more than in 1993. More broadly, hourly compensation of private industry workers increased more slowly in the fourth quarter than in any of the previous three quarters of 1994, and the rise for the year was significantly less than in 1993.

At its meeting on December 20, 1994, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, 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, somewhat greater reserve restraint would be acceptable or slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with modest growth in the broader monetary aggregates over coming months.

Open market operations during the intermeeting period were directed toward maintaining the existing degree of pressure on reserve positions. With the need for seasonal credit diminishing over the period, adjustment plus seasonal borrowing trended lower but averaged a little above anticipated levels. Near year-end, the Trading Desk accommodated heavy demands for reserves through System RPs. The federal funds rate averaged close to 5-1/2 percent during the intermeeting period.

Most other market interest rates declined slightly on balance over the period after the December 20 meeting. Very short term interest rates fell after the first of the year, reflecting the disappearance of year-end premiums. More broadly, favorable news on inflation and indications of some unexpected slowing in the growth of final demands apparently led market participants to conclude that further tightening of monetary policy, though still expected to be substantial, would be less than previously thought and would be spread over a longer period. Yields on tax-exempt instruments declined considerably as concerns about the implications of Orange County's problems for the financial condition of other municipal governments abated. Strong earning reports for the fourth quarter boosted major indexes of equity prices.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies declined somewhat over the intermeeting period. The dollar fell substantially against the mark, which was buoyed by safe-haven inflows from weaker European currencies, but dropped less against the yen. One factor that weighed against the dollar was uncertainty about the consequences for the U.S. economy of the sharp depreciation of the Mexican peso and the related economic and financial problems in Mexico and other developing economies; market participants expressed some concern that the crisis might constrain U.S. monetary policy in the event of further domestic inflation pressures and that the counterpart to the large prospective reduction in the Mexican current account deficit would lie importantly in the already substantial U.S. deficit.

Growth of M2 and M3 strengthened in December, and data for the first half of January suggested a further acceleration in that month. Much of the pickup in M2 in December was due to rapid expansion in overnight repurchase agreements and overnight Eurodollars, which outweighed a further contraction of liquid accounts associated in part with depositor efforts to obtain higher returns by shifting funds into market instruments. The faster growth of M3 reflected, in addition to the acceleration of its M2 component, bank use of large CDs and nondeposit sources of funds to finance relatively robust demands for credit. From the fourth quarter of 1993 to the fourth quarter of 1994, M2 grew at the lower end of the Committee's range for 1994 and M3 in the lower half of its range. Total domestic nonfinancial debt had continued to expand at a moderate rate in recent months, and for 1994 it was in the lower half of its monitoring range.

The staff forecast prepared for this meeting suggested that growth of economic activity would slow substantially over the next several quarters and for some period thereafter would average less than the rate of increase in the economy's potential output. Consumer spending was projected to be well sustained for a time but to be restrained later by smaller gains in real incomes, the satisfaction of pent-up demands, and the lagged effects of higher interest rates on the demand for durable goods. Business outlays for new equipment were expected to decelerate substantially in response to higher financing costs and slower growth of sales and profits. Homebuilding was anticipated to soften a little in response to slower growth in jobs and income as well as to the increase that had occurred in mortgage rates. Recent developments in Mexico were expected to cut into exports in the near term, but the sustained economic growth elsewhere would keep export demand on an uptrend. Although there was considerable uncertainty regarding the fiscal outlook, in light of the Congressional intent to cut the federal deficit the forecast incorporated a somewhat greater degree of fiscal restraint than had been built into recent forecasts. In the staff's judgment, the economy currently was operating beyond its long-run, noninflationary capacity, and there remained a substantial risk that inflation could ratchet higher absent further monetary policy actions.

In the Committee's discussion of current and prospective economic developments, the members agreed that growth in economic activity could be expected to moderate considerably over the course of 1995, although inflation was likely to be higher than in 1994. They acknowledged that their current projections were subject to substantial risks. The expansion continued to display appreciable momentum and signs of slower growth were still quite limited and tentative. Even so, the members remained persuaded that the lagged effects of the policy tightening implemented over the course of 1994 would become increasingly evident in interest-sensitive sectors of the economy as the year progressed. The projected moderation in the growth of final demands, which probably would be concentrated at least initially in the housing and consumer durables sectors, would undoubtedly reinforce an expected cutback in inventory investment from its unsustainable pace in recent quarters. A key uncertainty in the outlook was whether the slowing in overall economic growth would be sufficient to relieve the current pressures on labor and other producer resources, which many members saw as portending higher inflation, or, indeed, whether such pressures would intensify further. Opinions differed to some degree with regard to both the likely extent of the prospective slowing in economic growth and the outlook for inflation. However, most of the members concluded that some rise in inflation appeared probable over coming quarters, and they were concerned that this upturn would not be reversed and could be extended in the absence of further monetary restraint.

In keeping with the practice at meetings when the Committee establishes its long-run ranges for growth of the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared individual projections of economic activity, the rate of unemployment, and inflation for the year 1995. Measured from the fourth quarter of 1994 to the fourth quarter of 1995, their forecasts of the growth in real GDP had a central tendency of 2 to 3 percent, compared with a growth rate of 4 percent estimated for 1994. Most of the members also anticipated that economic expansion in line with their forecasts would be associated with little change in the unemployment rate and their projections of the rate in the fourth quarter of 1995 were centered in a narrow range around 5-1/2 percent. The high levels of resource utilization implied by these projections were viewed by most members as likely to foster somewhat greater pressure on wages and prices. Accordingly, projections of the rate of inflation, as indexed by the consumer price index, had a central tendency of 3 to 3-1/2 percent for the period from the fourth quarter of 1994 to the fourth quarter of 1995, compared with rates of about 2-3/4 percent in both 1993 and 1994.

In their review of regional economic developments, members referred to widespread evidence of further growth in business activity, but a number also mentioned scattered signs of some softening in a few areas or industries. Several emphasized, however, that the anecdotal evidence did not currently point to any significant moderation in the overall growth of the economy. With regard to financial conditions, members commented that they saw little indication that policy tightening actions over the past year were constraining the availability of credit to any observable degree. Despite higher interest rates, financial conditions remained broadly supportive of further economic expansion. The performance of stock market prices and the relatively narrow quality spreads in debt markets attested to a considerable degree of confidence among investors. Members also took note of the accommodative lending policies of banking institutions. Those policies had encouraged rapid growth in consumer and business loans and evidently were contributing to the ongoing strength of the economic expansion. Some members expressed concern that a number of banks might have eased their lending standards unduly and thus assumed unwarranted risks in their loan portfolios.

In their assessment of developments in key sectors of the economy, members referred to the sluggish behavior of non-auto retail sales in November and December, but they also noted that the available information on consumer spending during the first few weeks of this year was inconclusive with regard to the possible emergence of a slowing trend. Anecdotal commentary on retail sales was mixed, and evidence of some decline in January sales of motor vehicles needed to be evaluated with caution because of the introduction of a new reporting method. Consumer confidence was at a high level, but some members observed that consumer indebtedness had grown rapidly and was likely to exert a retarding effect on consumer spending at some point. In this regard, however, it was pointed out that rising consumer incomes had kept debt service burdens from increasing significantly thus far. On balance, the members believed that the growth in consumer spending probably would slow over the forecast horizon though such spending might be relatively well maintained for some period, given the ongoing expansion in jobs and incomes and the ready availability of financing to many consumers. In any event, the outlook for this sector of the economy, which was critical to any significant moderation in overall economic growth, was uncertain with regard to both the timing and the extent of possible slowing.

Housing construction was cited as potentially the most important demand sector of the economy that was likely to contribute to more moderate economic growth over the year ahead. As evidenced by nationwide data through the end of 1994, single-family housing starts had held up unexpectedly well despite sizable increases in home mortgage rates, but anecdotal reports from around the country had pointed to weakening demand for new homes for several months and continued to do so. Against the background of current mortgage rate levels and the rise that had occurred in home mortgage indebtedness, the members continued to anticipate softening demand for housing, at least in the single-family sector. The mild uptrend in the much smaller multifamily sector was likely to continue for some period, given low rental vacancy rates in a number of areas, and further improvement in nonresidential construction was likely to offset to some extent the overall slowing in housing construction.

In the capital goods sector, real business-fixed investment had strengthened further in the fourth quarter, and the members believed, on the basis of rising order backlogs and the strength of permits for new business construction, that considerable momentum had carried into this year. While the growth in spending for business equipment undoubtedly would moderate from its extraordinary pace over an extended period, large business profits and the still relatively low user cost of capital would tend to support appreciable further growth in such investment in the context of elevated levels of capacity utilization and ongoing efforts, induced by strong market competition, to increase productivity. Moreover, nonresidential construction was now trending higher, with particular strength evident in industrial and commercial construction.

The pace of inventory accumulation in recent quarters was viewed as unsustainable and a decline in inventory investment was seen as likely over the forecast horizon, though the precise timing and extent were impossible to predict. While slower growth in final demand might in most circumstances stimulate a relatively sharp adjustment in inventory investment, members cited factors that could mute the size of that adjustment and its effects on overall GDP. These included relatively low inventory/sales ratios across much of the economy and little anecdotal or other evidence of unintended inventory accumulation. Moreover, because an unusually large share of the inventory buildup in recent quarters appeared to involve imports, a cutback in such investment should tend to have a smaller-than-usual impact on domestic production. There was no current evidence that inventory investment was slowing, and indeed recent data on business loans at banks might suggest some acceleration in inventory accumulation since the beginning of the year. Nonetheless, as more moderate growth in final demand began to emerge, concerns about the availability of materials used in the production process or stocks needed to meet market demand should diminish, and business firms could be expected to trim their demand for inventories, perhaps aggressively for a time. Indeed, this sector of the economy might well account for much of the slowing in the expansion for some period of time during the year ahead.

Fiscal policy was under active debate in the Congress, and the members viewed the outcome of that debate as very uncertain. The emergence of a moderately restrictive fiscal policy might be a reasonable assumption to incorporate in current forecasts, albeit an assumption that clearly was subject to a wide range of error. In any event, any progress toward cutting future budget deficits was likely to have a favorable effect on domestic financial markets and perhaps also on the dollar in foreign exchange markets.

Developments in Mexico and their possible repercussions in other developing nations had negative implications for U.S. exports, at least over the short run. Indeed, some members cited anecdotal evidence that reduced trade with Mexico had already emerged since late 1994. Moreover, the effects of the earthquake in Kobe, Japan, seemed to be disrupting trade with that nation in agricultural and other bulk goods and was likely to continue doing so over the near term. Looking beyond the months immediately ahead, the relatively robust growth projected for many industrial countries together with the lower value of the dollar should boost the nation's overall external trade balance, though probably not to the extent of providing substantial stimulus to the economy. One member observed that a number of countries throughout the world faced the potential for important changes in political conditions that could have adverse effects on their growth and trading relationships, with possible repercussions on U.S. exports.

Members commented that the strong growth in economic activity and high levels of resource utilization had fostered relatively rapid increases in the prices of many raw materials and semi-finished goods used in the production process, but contrary to numerous forecasts these developments had not led thus far to a broad pickup in inflation as measured by the prices of final goods and services. This favorable development might be explained in part by lags in the inflation transmission process and perhaps to some degree by various structural changes and productivity improvements in recent years that may have raised both the level and the rate of increase of the economy's potential for sustained activity. Many members observed, however, that it would not be prudent from a monetary policy standpoint to assume that continued rapid economic growth and further pressures on producer resources would not lead to rising inflation over the quarters ahead. While competitive pressures still generally limited the extent to which business firms could pass through rising costs of raw materials and other producer inputs to the prices of final goods, the members referred to increasingly numerous examples of successful efforts to raise such prices and to apparently growing business expectations that it would be possible to implement such increases over the months ahead. On balance, the members generally were persuaded that the economy had attained levels of labor and capital utilization that implied a strong risk of rising inflation over coming quarters.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee at this meeting reviewed the ranges for growth of the monetary and debt aggregates in 1995 that it had established on a tentative basis at its meeting in July 1994. The tentative ranges included expansion of 1 to 5 percent for M2 and 0 to 4 percent for M3, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The monitoring range for growth of total domestic nonfinancial debt had been set provisionally at 3 to 7 percent for 1995. The ranges for M2 and M3 were unchanged from those that the Committee had used in 1994, while the range for debt was one percentage point lower.

All the members endorsed a proposal to adopt the ranges that the Committee had set on a tentative basis in July 1994. While some acceleration in the growth of the broad monetary aggregates from the pace in 1994 could be anticipated over the year ahead according to a staff analysis, monetary expansion within the ranges in question appeared to be consistent with the moderation in the expansion of nominal GDP that the members were projecting for 1995 and that they viewed as desirable to head off increasing inflation. Moreover, the ranges for the broad monetary aggregates had been reduced over the past decade to levels that, notably in the case of M2, should now be consistent over long periods with the Committee's objectives for stable prices and maximum sustainable economic growth. This outcome would depend on the restoration over time of the historical velocity patterns linking the monetary aggregates to broad measures of economic performance, including a level velocity trend for M2. It was noted in this regard that until recent years the growth of M3 had tended to exceed that of M2--a pattern that seemed to be re-emerging--and therefore a somewhat higher range might be set for M3 than for M2. However, the members did not believe that a persuasive argument could be made at this juncture for raising the M3 range, though they did not want to rule out the option of doing so later, possibly when the ranges were reviewed at midyear. Indeed, to make the change at this point might convey a misleading message regarding the Committee's policy intentions or its confidence in prospective monetary growth relationships.

The Committee also considered the potential advantages and disadvantages of setting specific targets for bringing inflation down and achieving price stability over time. Such targets might provide an alternative or supplemental approach to the monetary growth ranges, which had been found to be unreliable guides for monetary policy over the past several years. The members discussed a number of aspects of inflation targeting. On the one hand, such targeting would help to anchor the conduct of monetary policy and progress in meeting these objectives could enhance the credibility of the Federal Reserve and perhaps reduce the overall cost of attaining price stability. On the other hand, close adherence to preset inflation targets could unduly constrain the Federal Reserve in its efforts to counteract the effects of cyclical shortfalls in the performance of the economy. The members agreed that the discussion had been helpful in outlining the issues and that the subject should be revisited. It was noted in this connection that the Committee might be asked to comment during the months ahead on specific Congressional proposals for inflation targeting.

At the conclusion of its discussion, all the members voted to approve without change the tentative ranges for 1995 that the Committee had established in July of last year. In keeping with its usual procedures under the Humphrey-Hawkins Act, the Committee would review its ranges at midyear, or sooner if interim conditions warranted, in light of the growth and velocity behavior of the aggregates and ongoing economic and financial developments. Accordingly, the following longer-run policy statement for 1995 was approved for inclusion in the domestic policy directive.

> 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 this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee anticipated that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was lowered to 3 to 7 percent for the year. 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.

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

Votes against this action: None.

In the Committee's discussion of policy for the intermeeting period ahead, all the members indicated that they could support some firming in reserve conditions, though a few preferred to delay such an action pending the receipt within the next few weeks of significant new information that could help the Committee to evaluate whether and to what extent the economic expansion might be slowing. Most of the members were convinced, however, that current monetary policy should be adjusted promptly to a more clearly restrictive stance. In their view, prompt action was needed to counter inflationary pressures and inflationary expectations in an economy that already seemed to be operating at, and perhaps beyond, sustainable capacity levels and to be continuing to expand at a pace above its long-run potential. In these circumstances, a delay in tightening policy would incur an unacceptable risk of allowing further inflationary momentum to develop in the economy and would require more tightening over time than might otherwise be needed to achieve the Committee's objectives. Part of the risk involved a potential further decline in the dollar at a time when there already was considerable concern about rising pressures on prices. Some tightening of policy at this meeting was generally anticipated in markets, and a failure to take action now was likely in the view of a number of members to raise questions about the credibility of the System's anti-inflation resolve and to generate some unsettlement in financial markets, notably in the foreign exchange market where the dollar already appeared to be vulnerable to further weakness. In terms of balancing the policy risks that were involved, a prompt move would provide some insurance against what these members viewed as the principal risk in current circumstances--that of rising inflation. The risks of excessive tightening, while not completely absent, were believed to be limited in light of the apparent strength and momentum of the expansion, which many forecasters had underestimated over the past year. One member expressed the view that while monetary growth had been damped, continuing restraint on the growth of the narrow monetary aggregates was desirable to offset a previous build-up in liquidity and help assure that inflationary pressures would be contained.

Members who saw an advantage in postponing a decision to tighten policy commented that, in light of some scattered signs of a moderating expansion, it would be helpful to wait for certain key statistics that would become available within the next few weeks to judge the extent of any moderation. Data on retail sales in January might provide particular insights as to whether the softening in such sales in November and December was persisting. The favorable news on inflation in the fourth quarter had lessened concerns about an immediate inflation threat, and if the incoming information confirmed the need for further tightening, the short delay in implementing it would have only a minimal cost. In addition, an increase in monetary restraint would be likely to exacerbate the problems of Mexico and perhaps to some extent those of Canada and would have potentially adverse implications for U.S. trade with both of these key trading partners. Because the probability that incoming information would counsel against any further policy tightening was certainly less than 50 percent so that only a matter of timing was likely to be involved, these members indicated that they would join with the other members in voting to tighten policy at this meeting.

Concerning the possible need to adjust policy during the intermeeting period, the members were unanimously in favor of adopting a symmetric directive. Given a decision to implement some tightening in monetary policy at this meeting, they did not believe that there should be a presumption toward possible further tightening in this period. A number of members observed that further monetary restraint might not be needed if, in line with their expectations, the incoming evidence on the performance of the economy suggested that the expansion was moderating sufficiently for the economy to return to a growth path consistent with containing inflation pressures. In any event, the Committee's most difficult decision over the next several quarters was likely to be that of determining when further tightening was no longer desirable.

Prior to the end of the meeting, the members were apprised of a disposition on the part of the Board of Governors to approve an increase of 1/2 percentage point in the discount rate that was pending at several Federal Reserve Banks. In the event that such an increase was approved by the Board, the members agreed that open market operations should be conducted so as to allow that increase to be reflected fully in reserve markets.

At the conclusion of the Committee's discussion, all the members indicated that they could support a directive that called for increasing somewhat the degree of pressure on reserve positions. In the implementation of this policy, account would be taken of a possible increase of 1/2 percentage in the discount rate that was under consideration by the Board of Governors. The members also agreed that the directive should not include any presumption about possible 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 somewhat greater or somewhat lesser reserve restraint would be acceptable during the intermeeting period. According to a staff analysis, the reserve conditions contemplated at this meeting would be consistent with moderate growth in M2 and M3 over coming months.

At the conclusion of the meeting, 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 a strong further rise in economic activity during the closing months of 1994. Nonfarm payroll employment was up considerably further in December after a sharp increase in November, and the civilian unemployment rate declined to 5.4 percent. Industrial production registered another large advance in December and capacity utilization continued to move up from already high levels. Current estimates indicate little change in retail sales over November and December, while housing starts posted sizable gains on balance over the two months. Orders for nondefense capital goods point to a continued strong expansion in spending on business equipment; permits for nonresidential construction have been trending appreciably higher. The nominal deficit on U.S. trade in goods and services widened somewhat in October-November from its average rate in the third quarter. Prices of many materials have continued to move up rapidly, but broad indexes of prices for consumer goods and services have increased moderately on average over recent months.
>
> Most market interest rates have declined slightly on balance since the Committee meeting on December 20, 1994. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has declined somewhat over the intermeeting period. The Mexican peso has depreciated sharply against the dollar.
>
> Growth of M2 and M3 strengthened in December and January. From the fourth quarter of 1993 to the fourth quarter of 1994, M2 grew at a rate at the bottom of the Committee's range for 1994 and M3 at a rate in the lower half of its range for the year. Total domestic nonfinancial debt has continued to expand at a moderate rate in recent months, and for the year 1994 it grew at a rate in the lower half 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 this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee anticipated that money growth within these ranges would be consistent with its broad policy objectives. The monitoring range for growth of total domestic nonfinancial debt was lowered to 3 to 7 percent for the year. 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 increase somewhat the existing degree of pressure on reserve positions, taking account of a possible increase in the discount rate. 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, somewhat greater reserve restraint or somewhat 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, LaWare, Lindsey, Melzer, Ms. Minehan, Mr. Moskow, Mses. Phillips and Yellen.

Votes against this action: None.

Temporary Increase in Reciprocal Currency Agreement with the Bank of Mexico and Increase in Agreement to "Warehouse" Foreign Currencies

On December 30, 1994, the Committee approved a temporary increase from $3 billion to $4-1/2 billion in the System's reciprocal currency (swap) agreement with the Bank of Mexico and it also approved the activation of that agreement. The Committee approved a further temporary increase of $1-1/2 billion and activation of that amount at this meeting, thereby raising the swap arrangement with the Bank of Mexico to a level of $6 billion, consisting of the regular $3 billion line and a special $3 billion line. The special $3 billion line may be drawn on until January 31, 1996. Drawings would be for three-month periods and could be renewed a maximum of three times. Once a drawing on the special line is repaid, the size of the line will be reduced pari passu. All drawings on the special line will have to be repaid no later than January 31, 1997. The terms and conditions for use of the permanent $3 billion swap facility with the Bank of Mexico remain unchanged and drawings, once repaid, will require Committee action prior to subsequent use. The Treasury has undertaken to assure the repayment of any swap drawing by the Bank of Mexico on the $6 billion in lines that is outstanding more than 12 months.

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

Votes against this action: Messrs. Lindsey and Melzer.

The Committee also approved at this meeting an increase from $5 billion to $20 billion in the amount of eligible foreign currencies that the System is prepared to "warehouse" for the Treasury and the Exchange Stabilization Fund (ESF). The purpose of the warehousing facility, which has been in place for many years, is to supplement the U.S. dollar resources of the Treasury and the ESF for financing purchases of foreign currencies and related international operations. The size of the warehousing facility had ranged up to $15 billion in past years, but it was reduced to $5 billion in February 1992. The expansion of the warehousing agreement at this meeting was intended to facilitate U.S. participation in the Multilateral Program to Restore Financial Stability in Mexico, announced by President Clinton on January 31, 1995, by warehousing up to $20 billion in German marks and Japanese yen held by the Treasury through the ESF. The Committee will review each year the need to maintain this level of warehousing authority in light of the progress and needs of the Program.

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

Members who voted to approve these proposals were persuaded that the nature and severity of Mexico's financial problems could not be contained without making available substantial financial assistance to the Government of Mexico. The financial support provided by the United States would be accompanied by similar assistance from the IMF and would be conditioned on Mexico's commitment to implement major changes in its economic policies, including monetary policy. It was emphasized during the Committee's discussion that the United States had a strong interest in encouraging the restoration of stability in Mexico for numerous reasons, including the growth of trade between the two nations and the resulting creation of jobs in both countries. Moreover, Mexico's financial problems appeared to be spreading to a number of other nations and adversely affecting the dollar in the foreign exchange markets. The participation of the Federal Reserve in this effort was strongly endorsed by the Administration and the overall program had the support of the bipartisan leadership in the Congress. Apart from temporary financial resources, the Federal Reserve was in a position to supply expertise and experience that were not readily available elsewhere. On the negative side, the members acknowledged that there could be no assurances that the rescue program would succeed, but its scale, its multinational character, and the apparent willingness of Mexican officials to pursue the difficult policies needed to assure success were grounds for optimism.

Messrs. Lindsey and Melzer dissented with respect to increases in both the swap line and the warehousing arrangement with the Exchange Stabilization Fund. They did not believe that the Committee had been provided sufficient information to assess whether developments in Mexico threatened U.S. financial stability, a possible justification for increased central bank lending on a short-term basis, Furthermore, they considered it inappropriate for the Federal Reserve to participate, directly or indirectly, in intermediate to long-term financing to facilitate debt restructuring. They were concerned that such participation in a fiscal policy matter might compromise, or appear to compromise, the independence of the monetary policy process. Mr. Lindsey added that the latter risks were significantly enhanced given the absence of Congressional authorization or more general public support for these measures.

Disclosure Policy.

At this meeting, the Committee decided to retain the procedures that it had followed over the past year for providing greater information to the public about its policy actions and discussions. It was the judgment of the members that these procedures strike an appropriate balance between making the Committee's decisions and deliberations accessible to the public as soon and as fully as feasible, while safeguarding the Committee's flexibility in policymaking and preserving an unfettered deliberative process. The procedures in question involve the prompt announcement of the Committee's decisions and the release of minutes and transcripts of FOMC meetings.

The Committee will continue its practice of announcing each change in the stance of monetary policy in a press release on the day the decision is made. This practice removes any uncertainty about the Committee's intentions in regard to reserve conditions and enables all financial market participants and others to receive the information at the same time. When no change is made at a meeting, the Committee normally will announce only the time when the meeting ended and that there are no further announcements. However, in some infrequent circumstances, the Committee may decide to issue a statement even when no change in policy is made.

The full substance of the Committee's deliberations relating to each policy decision will continue to be reported, as is the current practice, in comprehensive minutes of the meeting that are released two or three days following the next regularly scheduled meeting. For historians and other students of monetary policymaking, those minutes will be supplemented by lightly edited transcripts of the discussion at each Committee meeting. For recent and future meetings, transcripts for an entire year will be released with a five-year lag; earlier transcripts dating back to March 1976 will continue to be released on an ongoing basis as the light editing process is completed. Continuing the practice followed since the beginning of 1994, transcripts prepared by the Committee's Secretariat will be circulated to each participant to verify his or her comments, and only changes that clarify meaning, such as the correction of grammar or transcription errors, will be permitted. A limited amount of material will be withheld from the publicly released version of these documents, primarily to protect the confidentiality of foreign and domestic sources of information that likely would be lost if the information they provide were to be made public. As required by law, a complete, unredacted version of the transcript of each meeting will be turned over to the National Archives after 30 years have elapsed.

For the purpose of preparing the minutes and transcripts, the discussions of monetary policy at Committee meetings will continue to be recorded. The tape recorder may be turned off at the Chairman's discretion when the Committee deals with issues unrelated to monetary policy, such as organizational and personnel matters. The transcripts will indicate that the tape recorder has been turned off and the minutes will provide a summary description of the matters that were discussed, As permitted by the National Records Act, the recordings and unedited transcripts will be discarded after all the participants at the meeting have reviewed and corrected, as necessary, the transcripts prepared by the Secretariat.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 28, 1995.

The meeting adjourned at 3:20 p.m.

Donald L. Kohn
Secretary

Return to top

FOMC

Home | Monetary policy
Accessibility | Contact Us

Last update: May 4, 2007