Minutes of the Federal Open Market Committee

Meeting of January 30-31, 1996

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, January 30, 1996, at 2:30 p.m. and continued on Wednesday, January 31, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Boehne
Mr. Jordan
Mr. Kelley
Mr. Lindsey
Mr. McTeer
Ms. Phillips
Mr. Stern
Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Ms. Minehan, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

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

Messrs. Lang, Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, 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

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

Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors

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

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

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

Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Richmond, and Chicago respectively

Mses. Krieger and Rosenbaum, Vice Presidents Federal Reserve Banks of New York and Atlanta respectively

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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, 1996, and ending December 31, 1996, 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 Ernest T. Patrikis, First Vice President of the Federal Reserve Bank of New York, as alternate;

Edward G. Boehne, President of the Federal Reserve Bank of Philadelphia, with J. Alfred Broaddus, Jr., President of the Federal Reserve Bank of Richmond, as alternate;

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

Robert D. McTeer, President of the Federal Reserve Bank of Dallas, with Jack Guynn, President of the Federal Reserve Bank of Atlanta, as alternate;

Gary H. Stern, President of the Federal Reserve Bank of Minneapolis, with Robert T. Parry, President of the Federal Reserve Bank of San Francisco, 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 meeting of the Committee after December 31, 1996, with the understanding that in the event of the discontinuance of 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*
Thomas C. Baxter, Jr.	*Deputy General Counsel*

Michael J. Prell	*Economist*
Edwin M. Truman	*Economist*
Richard W. Lang, David E. Lindsey, Frederic S. Mishkin, Larry J. Promisel, Arthur J. Rolnick, Harvey Rosenblum, Charles J. Siegman, Thomas D. Simpson, Mark S. Sniderman, and David J. Stockton	*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, 1996.

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 as Manager was satisfactory to the board of directors of the Federal Reserve Bank of New York.

By unanimous vote, the Authorization for Domestic Open Market Operations shown below was reaffirmed.

Authorization for Domestic Open Market Operations
Reaffirmed January 30, 1996

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:

> (a) To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account (including forward commitments) at the close of business on the day of a meeting of the Committee at which action is taken with respect to a domestic policy directive shall not be increased or decreased by more than $8.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;
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> (b) When appropriate, to buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of

trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers acceptances held at any one time shall not exceed $100 million;

(c) 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, and prime bankers acceptances of the types authorized for purchase under l(b) above, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 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; and provided further that in the event bankers acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes and directs the Federal Reserve Banks to lend U.S. Government securities held in the System Open Market Account to Government securities dealers and to banks participating in Government securities clearing arrangements conducted through a Federal Reserve Bank, under such instructions as the Committee may specify from time to time.

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 l(a) under agreements providing for the resale by such accounts of those securities within 15 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(c), 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.

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By unanimous vote, the Authorization for Foreign Currency Operations shown below was reaffirmed.

Authorization for Foreign Currency Operations
Reaffirmed January 30, 1996

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee

pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Austrian schillings
Belgian francs
Canadian dollars
Danish kroner
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Mexican pesos
Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	**Amount of arrangement (millions of dollars equivalent)**
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000

National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico	3,000
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	4,000
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1.A. above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies, or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in liquid form, and generally have no more than 12 months remaining to maturity. When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, his alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account ("Manager"), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to his responsibilities. At the request

of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

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By unanimous vote, the Foreign Currency Directive shown below was reaffirmed.

Foreign Currency Directive
Reaffirmed January 30, 1996

1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks and with the Bank for International Settlements.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the IMF Article IV.

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By unanimous vote, the Procedural Instructions with Respect to Foreign Currency Operations shown below were reaffirmed.

Procedural Instructions with Respect to Foreign Currency Operations
Reaffirmed January 30, 1996

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System and about any operations that are not of a routine character.

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Agreement to "Warehouse" Foreign Currencies

At its meeting on January 31-February 1, 1995, the Committee had approved an increase from $5 billion to $20 billion in the amount of eligible foreign currencies that the System was 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 enlargement of the warehousing agreement 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 had agreed that it would review each year the need to maintain this level of warehousing authority in light of the progress and requirements of the Program.

The Treasury and the Exchange Stabilization Fund had made no use of the warehousing facility over the past year. Nevertheless, consistent with Federal Reserve support for the program of assistance to Mexico, the members agreed that it was appropriate to postpone consideration of an adjustment in the overall size of the facility at least until the end of the disbursement phase of the Mexican program currently scheduled for August 1996. Accordingly, the Committee reaffirmed the warehousing authority by unanimous vote.

By unanimous vote, the Program for Security of FOMC Information was amended to conform it to the treatment of transcripts of FOMC meetings and the procedures that the Committee had been following for some time in regard to redactions of confidential information in transcripts and other documents that are released to the public after five years. In addition, the Committee agreed to amend the Program so that the automatic extension of Federal Reserve staff access to confidential material after six months could be suspended for certain particularly sensitive documents.

On January 23, 1996, the continuing rules, resolutions, and other instruments of the Committee had been distributed with the advice that, in accordance with procedures approved by the Committee, they were being called to the Committee's attention before the January 30-31 organization meeting to give members an opportunity to raise any questions they might have concerning them. Members were asked to indicate if they wished to have any of the instruments in question placed on the agenda for consideration at this meeting, and no requests for such consideration were received.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 19, 1995, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. He indicated that the swap line drawing by the Bank of Mexico had been repaid in full on January 29, 1996. The Committee ratified that transaction by unanimous vote.

The Manager also reported on recent developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency

obligations during the period December 19, 1995, through January 30, 1996. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 1996, 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.

Only a limited amount of new information was available for this meeting because of delays in government releases; that which was available, along with anecdotal commentary, suggested that the economy had been growing relatively slowly in recent months. Consumer spending had expanded modestly on balance, growth in business invest- ment in capital goods appeared to have slackened somewhat recently, and housing demand seemed to have leveled out. Slower growth in final sales was leading to inventory buildups in a few industries and these buildups, together with the disruptions from government shutdowns and severe weather, were having a restraining effect on economic activity. The demand for labor was still growing at a moderate pace, though, and the unemployment rate remained relatively low. The recent data on prices and wages had been mixed, but there was no firm evidence of a change in underlying inflation trends.

Nonfarm payroll employment continued to expand moderately in December; the gain was in line with the average monthly increase for 1995. Employment in manufacturing, boosted by the settlement of a strike at a major aircraft manufacturer, reversed the declines of October and November. Construction payrolls rose further in December, despite unfavorable weather in some parts of the country. Job growth remained solid in much of the services industry, although employment at personnel supply firms was little changed. The civilian unemploy- ment rate remained at 5.6 percent in December.

Industrial production edged up in December and for the fourth quarter as a whole advanced only slightly; industrial activity remained sluggish in January according to the limited statistical information that was available. In December, manufacturing output rose a bit in association with an increase in motor vehicle assemblies and aircraft production. Elsewhere in manufacturing, the growth of output of office and computing equipment slowed somewhat from the rapid pace of previous months, and the production of defense and space equipment and of nondurable consumer goods registered sizable declines. The output of utilities was boosted somewhat in December by the effect of colder-than-average temperatures on the demand for heating services. Utilization of total industrial capacity fell slightly but remained at a moderately elevated level.

Retail sales continued to grow at a relatively modest rate in December, and the fourth-quarter increase was considerably smaller than those of the previous two quarters. In the fourth quarter, lower spending at general merchandisers offset much of the sales gains registered at automotive dealerships, furniture and appliance stores, and building and supply outlets. Consumer surveys indicated some deterioration in consumer confidence in January. Recent indicators of housing demand and activity were mixed. Sales of new homes edged still lower in November (latest data available), and sales of existing homes declined by a larger amount in December than in November. However, housing starts rebounded in November from a sizable October decline, and conditions in mortgage markets remained quite favorable, led by a further decline in rates.

The sparse statistical data available on business fixed investment, along with anecdotal information, suggested a moderation recently in the expansion of business spending on capital goods, including some slowing of investment in computers. Investment in

transportation equipment, however, apparently had held up well in the fourth quarter. Incoming data on construction contracts pointed to some slowing in the growth of nonresidential building activity from a relatively brisk pace during most of 1995.

The information available on business inventories suggested that inventory imbalances might have emerged in a few sectors in association with weaker-than-expected sales. Motor vehicle inventories were at elevated levels compared with sales in late 1995, and manufacturers responded by offering incentive packages on new cars and trucks and by adjusting downward their January production schedules. Data on manufacturing and retail trade inventories for November had been delayed, but published information on inventories held by wholesale distributors indicated a decline in that month, reversing part of October's sizable run-up. Much of the decline occurred in nondurable goods, although machinery distributors also reported a sizable liquidation. The inventory-sales ratio for the wholesale trade sector edged down in November but remained near the high end of its range in recent years.

The nominal deficit on U.S. trade in goods and services narrowed in October from its average rate in the third quarter. The value of imports declined by more than the value of exports. Much of the contraction in imports reflected reductions in oil and automotive products that more than offset another strong rise in computer goods. For exports, an advance in machinery exports to record levels was outweighed by a reduction in shipments of agricultural and automotive products. Available data on economic activity in the major foreign industrial countries suggested that the pace of expansion in Europe had slowed further on average while growth in Japan had picked up a little.

Recent data suggested little change in underlying inflation trends. Consumer prices increased slightly in December after being unchanged in November; food prices were quiescent over the two-month period while energy prices rose on balance, with a December rebound more than offsetting a sizable November drop. Excluding food and energy items, consumer prices were up modestly over the November- December period and for all of 1995 advanced slightly more than in 1994. Producer prices of finished goods were up considerably in November and December after having risen slowly in earlier months; in large part, the price increases late in the year reflected sharp upward movements in both finished foods and finished energy prices. For 1995, producer prices of finished goods other than food and energy rose at a subdued pace, though somewhat more than in 1994. Commodity prices had been mixed recently after trending down earlier. Average hourly earnings of production and nonsupervisory workers increased somewhat in December after having been unchanged in November. Increases in average hourly earnings had been trending up over the past several years.

At its meeting on December 19, 1995, the Committee adopted a directive that called for some slight easing in the degree of pressure on reserve positions, which was expected to result in a decline in the federal funds rate from around 5-3/4 percent to around 5-1/2 percent. The directive did not include a presumption about the likely direction of any adjustments to policy 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, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

After the meeting, open market operations were directed initially toward implementing the slight easing in the degree of reserve pressure that had been adopted by the Committee and thereafter toward maintaining this new reserve posture. Operations were complicated by large swings in reserve demands associated with year- end pressures and the adverse effects of unusually severe winter weather on check clearings. Although the federal funds rate

exhibited somewhat greater volatility than normal over the period, it nonetheless averaged close to the expected level of 5-1/2 percent. The occasional periods of firmness in reserve market conditions contributed to higher adjustment plus seasonal borrowing, on average, over the period.

Most market interest rates had declined somewhat further over the period after the December 19 meeting. Rates moved lower immediately after the policy easing action, and most fell still more on balance over the remainder of the intermeeting interval in response to incoming information about the economy and the prospects for fiscal policy, at least in the near term. Both were seen as suggesting slower economic expansion for a time and an increased likelihood of additional easing of monetary policy in coming months. With bond yields down on balance, and occasionally approaching two-year lows, major indexes of equity prices advanced sharply further.

The trade-weighted value of the dollar in terms of the other G-10 currencies continued to rise over the intermeeting period despite the decline in U.S. interest rates. The dollar's upward movement against the German mark and other European currencies was associated with increasing indications of further weakening of economic expansion in key European countries and greater declines in interest rates in those countries than in the United States. The dollar's appreciation relative to the Japanese yen appeared to be related in part to a narrowing of Japan's trade and current account surpluses. The dollar was unchanged on balance against the Canadian dollar, while the Mexican peso rose considerably in relation to the dollar.

Growth of M2 and M3 strengthened in December and January. The pickup in M2 growth partly reflected the effect of recent declines in short-term interest rates; those declines had made money market instruments less attractive relative to household savings accounts in M2, whose offering rates tend to be adjusted downward with a considerable lag. In addition, the flattening of the term structure of interest rates had lessened the comparative attractiveness of bond mutual funds, which had continued to experience only light inflows. Faster growth of M3 in December and January was associated with both the pickup in M2 expansion and the issuance of additional large time deposits to help finance a noticeable step-up in bank loan demand in January. The expansion of M2 from the fourth quarter of 1994 to the fourth quarter of 1995 was in the upper half of the Committee's annual range, and M3 grew at the upper end of its range. Growth of total domestic nonfinancial debt had been moderate in recent months, and for the year was near the midpoint of this aggregate's monitoring range.

The staff forecast prepared for this meeting suggested that economic activity would expand at a relatively slow pace over the near term. This forecast was not materially different from that prepared for the December meeting, except for a slightly weaker outlook for the current quarter that was related in part to an inventory correction and the effects of unusually severe winter weather on spending and output. Over the remainder of the two-year forecast horizon, the economy was expected to grow generally along its estimated potential. Consumer spending was anticipated to keep pace with the growth of disposable income; concerns about job security remained and consumer debt burdens had risen further, but the still-ample availability of credit and the substantial rise in the value of household equity holdings would support further increases in consumption. The further decline in mortgage rates recently from already-favorable levels would help to sustain homebuilding activity at a relatively high level. With sales and profits projected to grow more slowly, and with utilization of existing capacity having eased considerably, business investment in new equipment and structures was expected to expand at a more moderate rate. In light of the recent strengthening of the dollar, the external sector was expected to exert a small restraining influence on real activity over the projection period as a whole. Much uncertainty still surrounded the fiscal outlook, but the recent impasse in the budget negotiations between the Administration and the

Congress suggested a lower degree of fiscal restraint over coming years than had been assumed in the previous forecast. Given the projected outlook, rates of utilization of labor and capital resources and of inflation were not expected to change materially.

In the Committee's discussion of current and prospective economic activity, members noted a number of temporary factors that were retarding the expansion. The weakness in business activity this winter was to some extent the result of the partial shutdown of the federal government and the severe storms in a number of regions; both clearly were transitory influences on the economy. Growth of economic activity also was being constrained by production cutbacks stemming from efforts to bring stocks into better alignment with disappointing sales in a number of industries. Even so, in the absence of major overhangs in inventories of business equipment and consumer durables, and given favorable conditions in financial markets, members believed that a resumption of moderate, sustainable growth after a relatively brief period of weakness was the most likely outlook for the economy. At the same time, many observed that the risks to such an outcome did not seem balanced. A number of concerns, including the extent of the damping effects of high debt loads and employment uncertainty on consumption and questions about the sources of further export growth, suggested the possibility of sluggish expansion, while possible developments on the upside were more difficult to identify. With resource use unlikely to vary appreciably, the members generally expected no significant change in the underlying inflation picture over the year ahead. The recent performance of inflation had some encouraging aspects, and the odds on greater price pressures seemed relatively small at this time.

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 1996. Measured on the basis of chain-weighted indexes, the forecasts of the growth in real GDP had a central tendency of 2 to 2-1/4 percent and a full range of 1-1/2 to 2-1/2 percent for the period from the fourth quarter of 1995 to the fourth quarter of 1996. The members and nonmember presidents generally anticipated that economic expansion in line with their forecasts would be associated with employment growth close to that of the labor force. Accordingly, their forecasts of the civilian rate of unemployment in the fourth quarter of 1996 were near the current level, with a central tendency of 5-1/2 to 5-3/4 percent and a full range of 5-1/2 to 6 percent. Projections of the rate of inflation, as reflected in the consumer price index, had a central tendency of 2-3/4 to 3 percent; that central tendency was on the high side of the outcome for 1995-- when the rise in the index was held down by damped increases in food prices and declines in energy prices--but a few of the forecasts anticipated a slightly lower rate of inflation.

In their review of developments across the nation, the Federal Reserve Bank presidents reported modest growth in most major areas of the country. Many referred, however, to an admixture of strengths and weaknesses in their local economies, and a majority observed that on balance growth in regional business activity appeared to have slowed in the last few months. In keeping with the data available for the nation as a whole, the slowing seemed to be concentrated in manufacturing and especially at firms producing motor vehicles and parts. Some presidents referred to relatively negative, or at least cautious, sentiment among many of their business contacts.

Much of the recent softening in economic activity appeared to arise from production cutbacks in various sectors of the economy where involuntary accumulation of inventories seemed to have occurred as a result of weaker sales trends in the past few months. The members expected this inventory adjustment process to have a relatively pronounced effect on production and overall business activity in the current quarter and perhaps to some extent

in the second. While a greater-than-expected inventory adjustment with spreading effects through the economy could not be ruled out, the underlying strength of demand was likely to be sufficient to restore and sustain moderate growth in overall economic activity as the current inventory and production adjustments subsided.

With regard to consumer spending, members referred to overall indications of lackluster retail sales during the holiday season and into January. The anecdotal commentary on retail sales attributed some of the recent weakness in a number of areas to the clearly temporary effects of unusually severe winter weather and the partial shutdown of the federal government. The members anticipated that moderate growth in retail sales would resume, though some felt that the consumer sector might remain vulnerable on the downside. The consumer spending outlook was complicated by a number of crosscurrents. Negative factors cited by the members included ongoing concerns about job security that were being sustained by a continuing stream of workforce reduction announcements by major business concerns, increased consumer debt burdens that were showing up in rising delinquency rates on some types of loans, and the apparent satisfaction of much of the earlier pent-up demand for consumer durables. On the positive side, reduced interest rates, still readily available credit, and the accumulation of financial wealth from the sharp rise in stock and bond prices were seen as likely to support continuing gains in consumer spending.

Further increases in business fixed investment were viewed as a likely prospect for the year ahead, though the growth of such investment probably would be well below the strong pace experienced earlier in the current cyclical expansion. Anecdotal reports indicated continuing strength in nonresidential construction in some parts of the country, but declining rates of capacity utilization augured reduced growth going forward. The expansion of investment in producers' durable equipment also was expected to slow, but from a pace that had seemed unsustainable. While appreciable further growth could be expected in expenditures for high-tech equipment as business firms continued to focus on improving the efficiency of their operations in a highly competitive environment, spending for other types of equipment was likely to be sluggish. Members noted in particular the prospects for weaker business spending for motor vehicles, especially for heavy trucks. However, the fundamental determinants of investment in business equipment, including the reduced cost of financing such investment, remained positive and this sector of the economy should continue to provide considerable impetus to the expansion.

The members also viewed the considerable decline that had occurred in mortgage interest rates and the ample availability of housing finance as key factors in their forecasts of sustained residential construction at relatively high levels. Adverse weather conditions appeared to have retarded home building activity in a number of areas in recent weeks, but several members commented that underlying trends in housing demand were favorable and that residential construction had remained relatively strong in several parts of the country.

The outlook for fiscal policy was uncertain, especially with regard to whether longer-term spending and taxation measures would be enacted to implement the goal of a balanced federal budget by the year 2002. For the year immediately ahead, however, the members continued to anticipate considerable restraint in federal spending, partly as a byproduct of the current budget debate between the Congress and the Administration. With regard to the external sector of the economy, prospects for economic growth in major trading partners--led by developments in Europe--appeared to have weakened, and the recent appreciation of the dollar in the foreign exchange markets also might tend to damp net exports. Consequently, several members saw downside risks in the foreign trade sector over the year ahead.

The members anticipated that inflation would remain contained in 1996, but they did not expect significant progress toward more stable prices. They referred to crosscurrents bearing on the outlook for wages and prices in the year ahead. Factors pointing to potentially higher

inflation included increased pressures on food prices stemming from disappointing harvests in some areas and relatively low grain supplies. More generally, resource utilization was expected to remain high and greater pressures could emerge in labor and product markets. Members noted that one broad measure of wages had picked up and that there was a small rise in the number of anecdotal reports indicating that labor shortages were contributing to higher wages in some parts of the country. In addition, unusually muted increases in the costs of worker benefits had been holding down overall compensation costs, and this pattern might not persist. On the other hand, high levels of resource utilization had been associated for some time with lower rates of growth in costs than would have been anticipated on the basis of historical experience. In particular, a general sense of job insecurity in a period of major business restructurings was holding down increases in labor compensation. In an environment of strong competition, which was preventing many businesses from passing on rising costs through higher prices, firms continued to focus on efforts to control costs by improving the efficiency of their operations, and this was helping to hold down inflation. An apparent decline in inflationary expectations also would provide a moderating influence on inflation trends in the period ahead. While most of the members saw little reason to anticipate appreciably lower inflation over the year ahead, they also viewed the odds on a pickup in inflation as fairly low; they could see possible reasons for optimism on the long-run trend in inflation; and they generally remained confident that further progress toward price stability would be made over the longer term.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee reviewed the ranges for growth of the monetary and debt aggregates in 1996 that it had established on a tentative basis at its meeting in July 1995. The tentative ranges included expansion of 1 to 5 percent for M2 and 2 to 6 percent for M3, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was provisionally set at 3 to 7 percent for 1996. The tentative ranges for 1996 were unchanged from the actual ranges for 1995. In July, the range for M3 had been raised by two percentage points to reflect developments that seemed to be fostering a return to the historical pattern of somewhat faster growth in M3 than in M2.

In their discussion, the members took note of a staff analysis which indicated that monetary expansion consistent with the moderate growth of nominal GDP that the members were projecting for 1996 most likely would be around the upper ends of the tentative ranges adopted last July. M2 and M3 velocity over the past couple of years had conformed more closely on balance with historical patterns, and the projections assumed that this behavior would continue in 1996. In light of the experience of earlier years, however, when the velocities of these aggregates had exhibited pronounced atypical behavior, substantial uncertainty still surrounded any projections of monetary expansion and the linkage between particular rates of money growth and the basic objectives of monetary policy.

Most members endorsed a proposal to adopt the relatively low ranges for growth of M2 and M3 in 1996 that the Committee had set on a tentative basis in July 1995. These members favored retention of the tentative ranges because they could be viewed as benchmarks for money growth that would be associated with price stability, assuming behavior of velocity in line with historical experience, and a reaffirmation of those ranges would underscore the Committee's commitment to a policy of achieving price stability over the longer term. Some members also noted that any adjustment of these ranges to align them more fully with projections of money growth consistent with the Committee's expectations for expansion of the economy and prices in 1996 could be misinterpreted. Such an action might be seen as suggesting that the Committee had a greater degree of confidence in the relationship between money growth and broad measures of economic performance than was warranted by its

current understanding of that relationship or that the Committee was now placing greater emphasis on the broad monetary aggregates as a gauge of the thrust of monetary policy.

Two members favored somewhat higher growth ranges for M2 and M3 in 1996. They noted that the expansion of these broad aggregates was anticipated to be around the upper ends of their tentative ranges, and perhaps even higher, given the Committee's expectations for the performance of the economy and prices. In their view, the higher ranges would be more consistent with what they saw as the Committee's obligations under the Federal Reserve Act to set ranges consistent with expected or desired economic outcomes for the year, and the reasons for establishing those ranges could easily be set forth and understood as an appropriate technical adjustment that would not imply any lessened commitment to the Committee's price stability goal.

The Committee unanimously preferred to retain the 3 to 7 percent range for total domestic nonfinancial debt in 1996. This position took account of a staff projection indicating that the debt aggregate was likely to continue to grow at a rate generally in line with the expansion of nominal GDP, although some moderation in private credit demands was anticipated and there were indications that lenders were no longer easing their terms and conditions for granting credit to consumers and businesses.

At the conclusion of its discussion, the Committee voted to approve without change the tentative ranges for 1996 that it 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 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was set at 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, Boehne, Jordan, Kelley, McTeer, Ms. Phillips, and Mr. Stern.
>
> **Votes against this action:** Mr. Lindsey and Ms. Yellen.

Mr. Lindsey and Ms. Yellen dissented because they preferred somewhat higher ranges for M2 and M3. They recognized that the relationships between the ranges for the monetary aggregates and broad measures of economic performance were subject to substantial uncertainty, but ranges higher than those adopted on a tentative basis in July 1995 were more likely to encompass monetary expansion consistent with the central tendency of members' current forecasts of nominal GDP growth for 1996. Raising the ranges for M2 and M3 would in their view conform those ranges more closely with the provisions in the Federal Reserve Act that require the System to communicate to the Congress its objectives and plans for the growth of the aggregates for the calendar year. They believed the Committee could readily explain that such an adjustment to the ranges did not represent a lessened commitment to its

price stability goal or an increased emphasis on the monetary aggregates in policy formulation.

The Committee also discussed alternatives to the monetary aggregates for communicating its intentions with regard to the course of inflation over the longer run. Some members thought that explicit numerical goals or forecasts for inflation over a period of years would have several important benefits, including enhanced credibility that could reduce the costs of achieving price stability and greater flexibility to respond to the emergence of economic weakness by easing policy for a limited period of time without arousing inflation concerns. Other members, while endorsing fully the long-term goal of price stability, had a number of reservations about implementing such proposals, especially at this time. Based on experience in the United States and elsewhere, many were skeptical about the payoff in terms of greater credibility or flexibility in policy implementation. Moreover, they believed that substantially more study and deliberation were required to explore fully the alternatives and the consequences of changes in the way the Committee formulated and communicated its objectives. They also thought that any such assessment would need to take account of the prospects for, or disposition of, closely related legislation that was now being considered in the Congress. The Committee did not take any action on this issue at this meeting, but it recognized that the matter would need to be revisited from time to time.

In the Committee's discussion of policy for the intermeeting period ahead, the members supported a proposal calling for some slight easing in reserve conditions. Although a pickup to an acceptable rate of expansion was seen as the most likely course for the economy in coming quarters, the risks of a shortfall in growth were believed to be significant. At the same time, while most members were forecasting high levels of resource use and little change in the rate of inflation this year, they saw only a very limited risk that a slight easing move might foster higher inflation under prevailing circumstances, and some felt that there were favorable prospects for a slightly improved inflation performance. Under the circumstances, a slight decrease was warranted in the real federal funds rate from a level that a number of members considered still a bit to the firm side--a stance that seemed less appropriate in light of the reduced threat over the last year of a pickup in inflation. One member pointed out that such a decrease would tend to counter the effects on aggregate demand of the recent rise in the foreign exchange value of the dollar, which might continue to move higher if interest rate declines expected by the markets were not forthcoming. It was noted that postponing a decision in this uncertain economic climate could be defended on the ground that more evidence was needed to ascertain whether the weakness in the economy was quite temporary or more lasting; if it was the former, inflationary pressures could re-emerge at lower interest rates. On the other hand, a few members commented that the currently sluggish performance of the economy could be read as calling for a more pronounced easing move, but they preferred a cautious approach to policy in light of current inflation trends and the uncertainties that surrounded their forecasts of some strengthening in the economy.

The Chairman informed the Committee that he had asked the members of the Board of Governors to convene immediately after this meeting to consider a reduction of 1/4 percentage point in the discount rate. Such a reduction had been proposed by a total of six Federal Reserve Banks at this point. Given the easing in reserve markets favored by the Committee and the possibility of a lower discount rate, the members did not believe that a further policy move was likely to be needed during the intermeeting period. Accordingly, they favored an unbiased directive that did not incorporate a presumption about the likely direction of any adjustments to policy during the next several weeks. In keeping with its usual practice, the Committee did not rule out the possibility of an intermeeting policy change on the basis of unanticipated economic or financial developments.

At the conclusion of the Committee's discussion, all the members supported a directive that called for a slight reduction in the degree of pressure on reserve positions and that did not include a bias about the likely direction of an adjustment to policy during the intermeeting period, should unanticipated developments warrant a change in policy. Accordingly, the Committee decided that in the context of its long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth in M2 and M3 over coming months.

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 that the economy has been growing rather slowly in recent months. Nonfarm payroll employment continued to expand moderately in December, and the civilian unemployment rate remained at 5.6 percent. Industrial production increased only slightly further in the fourth quarter. Growth of consumer spending was modest, on balance, over the past several months. Housing starts rebounded in November from a sizable October decline. Orders for nondefense capital goods point to a moderation in the expansion of spending on business equipment, and nonresidential construction has risen appreciably further. The nominal deficit on U.S. trade in goods and services narrowed in October from its average rate in the third quarter. There has been no clear change in underlying inflation trends.
>
> Most market interest rates have declined somewhat since the Committee meeting on December 19. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has risen further over the intermeeting period.
>
> Growth of M2 and M3 strengthened in December and January. From the fourth quarter of 1994 to the fourth quarter of 1995, M2 expanded in the upper half of its range and M3 grew at the upper end of its range. Growth in total domestic nonfinancial debt has been moderate in recent months, placing this aggregate near the midpoint of its monitoring range for the year.
>
> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stabil- ity 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 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was set at 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 decrease slightly the existing degree of pressure on reserve positions, taking account of a possible reduction 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, slightly greater reserve restraint or slightly lesser reserve restraint

would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for short-run policy: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Ms. Phillips, Mr. Stern and Ms. Yellen.

Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 26, 1996.

The meeting adjourned at 12:00 p.m.

Donald L. Kohn
Secretary

Footnotes

1-Attended portions of meeting relating to the Committee's review of the economic outlook and establishment of its monetary and debt ranges for 1996.

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