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# **The FOMC in 1991: An Elusive Recovery**

**A**S 1991 BEGAN, the U.S. economy was in the second quarter of a downturn in aggregate economic activity. Real output, as measured by the gross national product (real GNP), had fallen in the fourth quarter of 1990 at a 2.5 percent annual rate; the first quarter of 1991 would turn out to be even worse, with output falling at a 2.8 percent annual rate. As the year wore on, the pace of real output growth turned positive, although it seemed to stall somewhat toward the fourth quarter. The recession and the subsequent slow recovery put pressure on the primary policymaking group of the Federal Reserve, the Federal Open Market Committee (FOMC), to take action to spur greater output growth in the short term.<sup>1</sup> This paper provides a chronologically based assessment of the Committee's policymaking in this environment. As such, it provides a case study in the making of monetary policy during the recovery phase of the business cycle.

In order to put FOMC decision making into context, a framework for discussion is outlined. The framework is intended to provide a basis for thinking about how monetary policy is made and why, in a broad brush sense, certain concerns reign paramount in Committee deliberations. The framework is meant to be qualitative and suggestive, so as not to belabor the technical details of theoretical arguments.

Generally speaking, the FOMC has well-defined goals but faces two daunting uncertainties when making decisions. One is that the immediate past, current and future path of real output is not easily surmised by considering current data. This inhibits the Committee's ability to assess the state of the economy in a timely fashion and, thus, to make short-run policy decisions. Secondly, the Committee has a difficult time assessing its own policy stance at a point in time, primarily because alternative measures of policy actions sometimes send conflicting signals.

The next section provides the framework for understanding FOMC decision making. The chronology is presented in the subsequent section. The final section provides summary comments.

## **A FRAMEWORK FOR ANALYZING FOMC POLICY ACTIONS**

To understand the FOMC's decision making in 1991, a general framework or reference point is useful in order to put into focus the arguments presented for various policy actions. For the most part, FOMC members and the Board staff, the primary participants in these meetings, present broad points of view and avoid technicalities. Disagreement, when it occurs, is often a matter of the interpretation of recent economic

<sup>1</sup>See the shaded insert on the following page for a discussion of the structure of the FOMC in 1991.

## The Organization of the FOMC

The Federal Reserve System consists of 12 regional Federal Reserve Banks located in major cities across the country, with the administrative offices of the Federal Reserve Board of Governors in Washington, D.C. The Federal Reserve Board consists of seven members, and each of these members has voting rights on the Federal Open Market Committee (FOMC). The president of the New York Federal Reserve Bank also is a permanent voting member of the FOMC. The remaining 11 Reserve Bank presidents attend meetings and present views, but only four of the 11 have voting privileges at any one meeting. The voting rights are held for terms of one calendar year and rotate among these presidents annually.

The Committee typically meets eight times per year, as it did in 1991, and sometimes consults by telephone between scheduled meetings. At the end of each meeting, the Committee agrees on a directive to issue to the Federal Reserve Bank of New York; the

directive is implemented by the Manager of Domestic Operations. The directive contains instructions for the conduct of open market operations until the next regularly scheduled meeting.

A summary of each FOMC meeting is released to the press within a few business days following the next regularly scheduled meeting and is subsequently published in the *Federal Reserve Bulletin*. The summary, known as the "Record of Policy Actions of the Federal Open Market Committee," is prepared by the Board staff and approved by the Board. It typically contains: (1) a synopsis of recent economic data, (2) a review of recent open market operations and money market conditions, (3) a Board staff projection of likely near-term economic developments, (4) a summary of Committee deliberations, (5) the policy directive along with a Record of votes and any dissenting comments, and (6) a summary of other policy matters discussed.

developments, but sometimes concerns the amount of weight to attach to certain broadly theoretical arguments. Before beginning an analysis of Committee deliberations, it is therefore helpful to consider, in a nontechnical way, the ideas that underlie Committee debate. A framework of this sort was presented in Bullard (1990), and this section briefly describes that approach.

### *FOMC Monetary Policy Objectives*

The Committee states its goals for monetary policy repeatedly in documents released to the public throughout the year. In particular, at the conclusion of each meeting, the Committee issues a directive which contains, with other information, a statement of the following type:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability, promote a resumption of sustainable growth in output, and contribute to an improved pattern of international transactions.<sup>2</sup>

This statement of objectives has three parts. The first goal, to foster price stability, is based on the idea that FOMC policy, over long periods of time, can influence the inflation rate. The second objective, to promote sustainable growth, is associated with the idea of countercyclical monetary policy, in particular that the FOMC can influence real output over short time horizons, say, less than a year.<sup>3</sup> The third part of the statement of objectives, an improved pattern of international transactions, is more oblique,

<sup>2</sup>Federal Reserve press release, March 29, 1991, p. 22. The Federal Open Market Committee releases its record of policy actions (in the remainder of this article, simply "the Record") for a particular meeting shortly after the next regularly scheduled meeting. The press releases referred to in the remainder of this article are dated May 17, 1991; July 5, 1991; August 23, 1991; October 4, 1991; November 8, 1991; December 20, 1991; and February 7, 1992. All press releases will be referred to by month.

<sup>3</sup>The statement of objectives quoted above is noteworthy for the inclusion of the words "a resumption of." Available information suggested that real output was declining at the time this statement was released, and hence the more standard phrase, "... promote sustainable growth in output," was modified. Later in the year, when real output again appeared to be growing, albeit rather slowly by historical standards, the term "resumption" was dropped.

and beginning about midyear, this phrase was dropped from the Committee's statement. Therefore, for the last five meetings of the year, the statement of objectives was:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output.<sup>4</sup>

In this article, focus will be placed on this last statement of objectives, as the price stability and real output goals are consistently mentioned throughout the year, and the international goal is not.

### *Controlling Inflation*

A widely held view among economists is that inflation, over long time periods, is closely related to the rate of money growth within a country. In fact, the idea is that the rate of money growth eventually translates directly to the rate of inflation. The theory, which dates to Hume (1742), is broadly supported by international cross-section evidence, which shows that countries choosing high rates of money growth over a decade or more tend to have the highest inflation rates. The United States, for instance, has experienced an average annual rate of inflation of 5.4 percent in the 1980s, which was associated with an average annual money growth (M2) rate of 7.5 percent. Iceland, on the other hand, experienced 32.1 percent average annual inflation over the same period, associated with a money growth rate of 38.2 percent. Similarly, Mexico had 50.1 percent average annual inflation associated with money growth of 45.9 percent. A look at other countries in which data are available reveals similar patterns.

Of course, despite the fact that such views are widely held, the theory is incomplete. It is not clear, for instance, what constitutes a sufficiently long time period. In addition, as the examples given above indicate, the relationship is far from exact, even over a decade or more. Finally, the theory by itself gives no indication of what to expect from, say, a short but intense burst of money growth. Despite these caveats, the theory and evidence are sufficiently strong to suggest that, in the long run, inflation is a policy-induced phenomena, and thus that control of inflation is an important aspect of central bank policymaking.

### *Sustaining Real Output Growth*

The notion that monetary policy actions can significantly affect the growth of real output over short time horizons, such as a quarter or a year, is deeply seated among macroeconomists. It is also controversial and largely unresolved. Nevertheless, the Committee has generally adopted the view that monetary policy actions do have material effects on real output growth within the following few quarters. It is not difficult, for instance, to find statements in the Record that attest to members' views in this regard. For instance, at the February meeting, there was talk that "inadequate monetary stimulus . . . could fail to cushion possible further deterioration in the economy."<sup>5</sup> Similarly, in March, "if the economy was indeed near its recession trough, additional easing would not be necessary;" in May, "the System's earlier easing actions . . . had provided a good deal of insurance against cumulative further weakening in business activity;" and in July, "policy was positioned to foster a sustainable economic expansion."<sup>6</sup> Statements of a similar sort can be found throughout the year.

Since the Committee operates in an environment in which the short-term effects of monetary policy on real output are taken for granted, in this paper these effects are simply assumed to exist and to be substantive, with due notice to the ongoing debate on that topic in academic circles. Generally speaking, it will be assumed that an "easing" of monetary policy is associated with a temporary gain in output (relative to what would have occurred without the easing) a few quarters hence, and that a "tightening" of policy has the reverse effect.

### *The Role of Forecasts in Short-Run Policy Actions*

It is important to note that these postulated real output effects occur only with a lag, which many economists suppose is at least one quarter and may be as long as a year or more. The notion of lagged policy effects is an important theme in Committee debates, as it forces members to form opinions about the path of real output several quarters into the future. Such forecasting is notoriously difficult. The inability to forecast accurately tends to produce uncer-

<sup>4</sup>February press release, p. 16.

<sup>5</sup>March press release, p. 15.

<sup>6</sup>Respectively, the May press release, p. 12, the July press release, p. 12, and the August press release, p. 14.

tainty among policymakers when choosing appropriate short-run policy actions.

If the members of the FOMC were concerned solely with long-run policy, as would be suggested by the available theory and evidence on inflation, they would presumably have much less concern for current forecasts of real activity over the next few quarters. But the Committee is not concerned solely with inflation, as their statement of objectives attests; therefore, the Committee members and Board staff have an acute concern for the daily goings-on of the U.S. economy. In fact, the Record consists primarily of a recitation of recent economic developments as captured in various measurements produced by the Federal Reserve or the U.S. government, often with an associated inference about what seems to be in store for real activity. The idea that policy actions taken today will affect real output in the not-too-distant future drives the concern for up-to-the-minute information about the status of economic activity. Short-run forecasting is a necessary ingredient of any strategy based on the notion of significant short-run monetary policy effects on real output.

### *Measuring the Policy Stance*

The Committee also has some difficulty in assessing the policy stance at a point in time because various measures of the thrust of policy can give conflicting signals. The Record and other Federal Reserve documents describe policy in terms of whether it is "tight" or "easy." These vague terms, which have a long history of use within the Federal Reserve, cannot be associated directly with System actions. This has created the situation in which two observers, and indeed Committee members themselves, can easily disagree about the thrust of monetary policy at a point in time. To see how this might be so, consider how most monetary policy actions are implemented.

Commercial banks must maintain reserves against certain types of deposits. Reserve positions are maintained on a two-week basis, so that a particular depository institution might find itself either over- or under-supplied with reserves at a point in time. These reserves are traded among banks on a daily basis in the federal funds market, and the interest rate in this

market is the federal funds rate. The Federal Reserve can supply or drain reserves from the system through intervention in this market. Such *open market operations* are carried out by the Federal Reserve Bank of New York based on the directives from the FOMC.

Given a conventional downward-sloping demand for reserves, the Federal Reserve can increase (decrease) the federal funds rate by decreasing (increasing) the supply of reserves. Total reserve supply is subject to close control by the System. A standard analysis relates the sum of total reserves and currency, the *monetary base*, and measures of the money supply, such as M2, by a proportional factor called the *money multiplier*.<sup>7</sup> Thus, increases in total reserves, increases in the money stock and decreases in the federal funds rate are simply different aspects of the same mechanism in this simple framework and are associated with the term "ease." "Tight" policy would involve movements of these variables in opposite directions.

Since, generally speaking, lower *long-term* interest rates are associated with higher rates of investment and greater consumer purchasing, which in turn are associated with higher levels of real output, easy policy is often thought to be stimulative in the short run. Tight policy is viewed as having the reverse effect. Of course, the federal funds rate is only a *short-term* interest rate, and there might be some question whether movements in a short rate will actually be reflected in the spectrum of interest rates. Theories on this topic abound, and, as will be apparent in the following chronology, members of the Committee sometimes disagree about the net interest rate effects of a lower federal funds rate.

The essential problem in practice is that total reserves, the federal funds rate and the money supply can, and sometimes do, give conflicting signals about whether monetary policy is actually easy or tight. Casual consideration of the above analysis suggests why this might be so. In particular, the demand for reserves is probably shifting over time in response to the level of economic activity, implying that the federal funds rate could rise or fall even when reserves are constant. Additional reserves, therefore, need not signal a lower federal funds rate. M2 growth might also be affected by vagaries in real activity.

<sup>7</sup>For a recent discussion, see Garfinkel and Thornton (1991).

These and other concerns produce the fundamental problems in assessing the FOMC's policy stance at a point in time.

The Federal Reserve also occasionally lends reserves to commercial banks directly through the *discount window*. The rate on these loans, the *discount rate*, is administered by the Board of Governors, and the FOMC plays no official role in changing it. The volume of loans made by the Federal Reserve at the discount rate is relatively small, so that the direct impact of a change is viewed as relatively unimportant. In the past, however, the discount rate has been set somewhat below the prevailing federal funds rate, so that, in 1991, when the federal funds rate declined through most of the year, a lower discount rate was sometimes taken by market participants as a signal of a lower federal funds rate at some point in the future. In fact, in 1991, the Committee often allowed a lower discount rate to *show through* to the federal funds rate, meaning that the funds rate was allowed to fall when the discount rate was lowered. Therefore, discount rate changes play an important role in the following chronology, even though the discount rate is not, strictly speaking, under the jurisdiction of the FOMC.

Based on the simple framework outlined above, the three indicators of policy that will be considered in this paper are the federal funds rate, the M2 monetary aggregate and total reserves.<sup>8</sup> The behavior of these indicator variables in 1991 is summarized in figures 1-3; reference will be made to these graphs throughout the chronology. Figures 4-7 provide a synopsis of the recent behavior of several other key variables—namely, real output, total nonfarm payroll employment, industrial production and consumer confidence.

The framework that will be used to summarize FOMC decision making is now complete. The Committee states its major objectives frequently: to control inflation and maintain sustained growth in real output. International evidence suggests that low inflation rates can be achieved by maintaining low rates of money growth. The real output effects of monetary policy are less certain, but summaries of Com-

mittee deliberations indicate that members believe temporary easing can mitigate downturns in economic activity. Pursuit of this objective requires an assessment of the current and future path of real output, but knowing whether the incoming data signal a change in direction for the economy is complicated by lags in data releases and errors in economic forecasts. To summarize FOMC policy actions, some measure of the monetary policy stance is required. Since various measures sometimes suggest differing interpretations of the thrust of monetary policy, several indicators will be employed.

### A CHRONOLOGY OF FOMC DECISION MAKING IN 1991

On the whole, the chronology in this section indicates that the FOMC became increasingly pessimistic about the prospects for a sustained recovery as 1991 progressed, and this led to particularly aggressive easing actions late in the year.<sup>9</sup> In the first meetings of 1991, when a substantial amount of information suggested a decline in real output, members were nevertheless hopeful that easing implemented since the December 1990 meeting would be enough to lay the groundwork for a moderate recovery beginning in the spring and summer. In fact, several directives in the first half of the year called for steady policy with no bias toward ease, although some easing actions actually were implemented according to the Record.<sup>10</sup> Beginning in August, in an atmosphere of increasing concern about the strength of the recovery, the Committee turned to asymmetric language toward ease in the directive. The trend toward easing actions peaked in the November directive, with the Committee voting to support immediate ease with additional bias toward ease during the intermeeting period.

As emphasized in the chronology, however, merely outlining the content of Committee directives does not provide a complete summary of monetary policy during this period. At times, for instance, the thrust of policy is open to interpretation. In addition, policy changes are sometimes implemented via other methods, such as intermeeting conference calls, or in concert with discount rate changes.

<sup>8</sup>While there are many other possible indicators of monetary policy, in this article these three are the only ones considered.

<sup>9</sup>A summary of FOMC actions in 1991 is contained in table 1.

<sup>10</sup>The Committee sometimes uses so-called asymmetric language in the directive, which is one way of making policy changes contingent on intermeeting developments. This phenomena is also sometimes described as "bias" in the directive.

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**Table 1**  
**Important Dates in the Chronology of 1991 FOMC Actions**

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The following summary is based solely on statements in the Record regarding policy actions. See the text for a discussion of measures of the thrust of policy.

*Early January.* An easing action is implemented.

*February 1.* The Board of Governors approves a reduction in the discount rate to 6 percent from 6.5 percent. The FOMC allows the entire amount of the cut to show through to the federal funds rate.

*February 5-6.* The FOMC meets. The target range for M2 growth is kept at 2.5 to 6.5 percent. The directive calls for an unchanged policy with some bias toward ease depending on intermeeting developments.

*Early March.* An easing action is implemented.

*March 26.* The FOMC meets. The directive calls for an unchanged policy without bias.

*End of April.* The Board of Governors cuts the discount rate from 6 percent to 5.5 percent. The FOMC allows part of the 50 basis-point decline to show through to the federal funds rate.

*May 14.* The FOMC meets. The directive calls for an unchanged policy without bias.

*July 2-3.* The FOMC meets. The target range for M2 growth is kept at 2.5 to 6.5 percent. The directive calls for an unchanged policy without bias.

*Early August.* An easing action is implemented.

*August 20.* The FOMC meets. The directive calls for an unchanged policy with some bias toward ease depending on intermeeting developments.

*Mid-September.* The Board of Governors lowers the discount rate from 5.5 percent to 5 percent. The FOMC allows part of the decline to show through to the federal funds rate.

*October 1.* The FOMC meets. The directive calls for an unchanged policy with some bias toward ease depending on intermeeting developments.

*End of October.* An easing action is implemented.

*November 5.* The FOMC meets. The directive calls for immediate ease with bias toward additional ease depending on intermeeting developments.

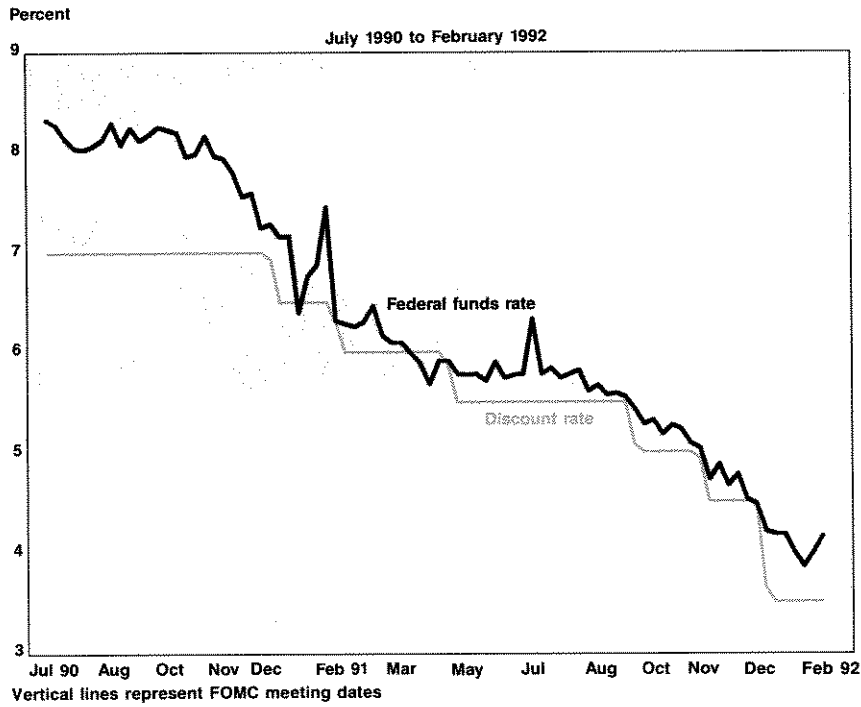
*November 6.* The Board of Governors lowers the discount rate to 4.5 percent. An easing action is implemented in concert with the discount rate cut.

*Early December.* An easing action is implemented.

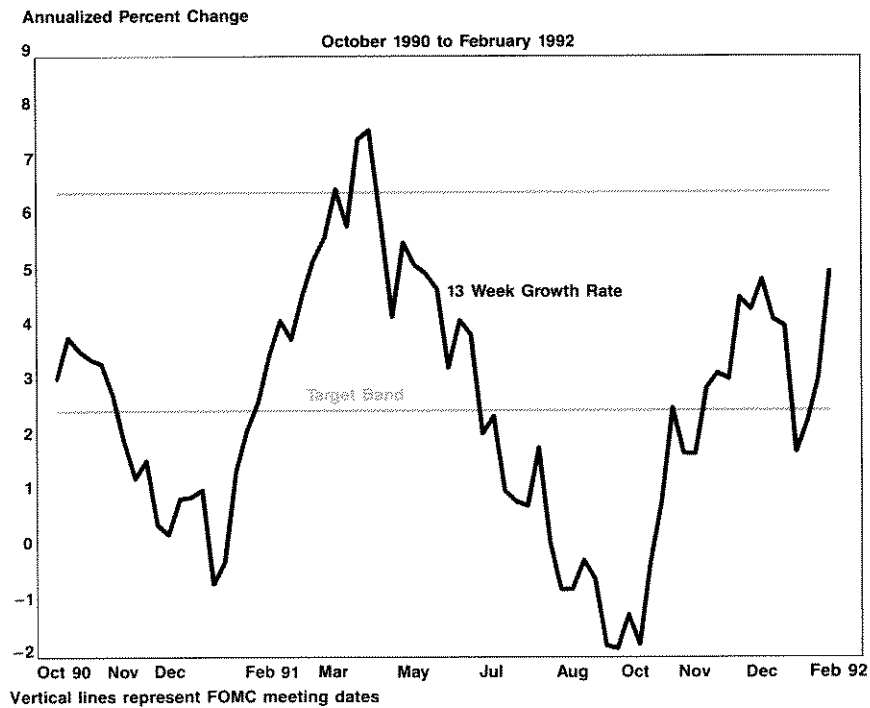
*December 17.* The FOMC meets. The directive calls for an unchanged policy with bias toward ease depending on intermeeting developments.

*December 20.* The Board of Governors lowers the discount rate by a full percentage point to 3.5 percent. The FOMC allows partial show-through to the federal funds rate.

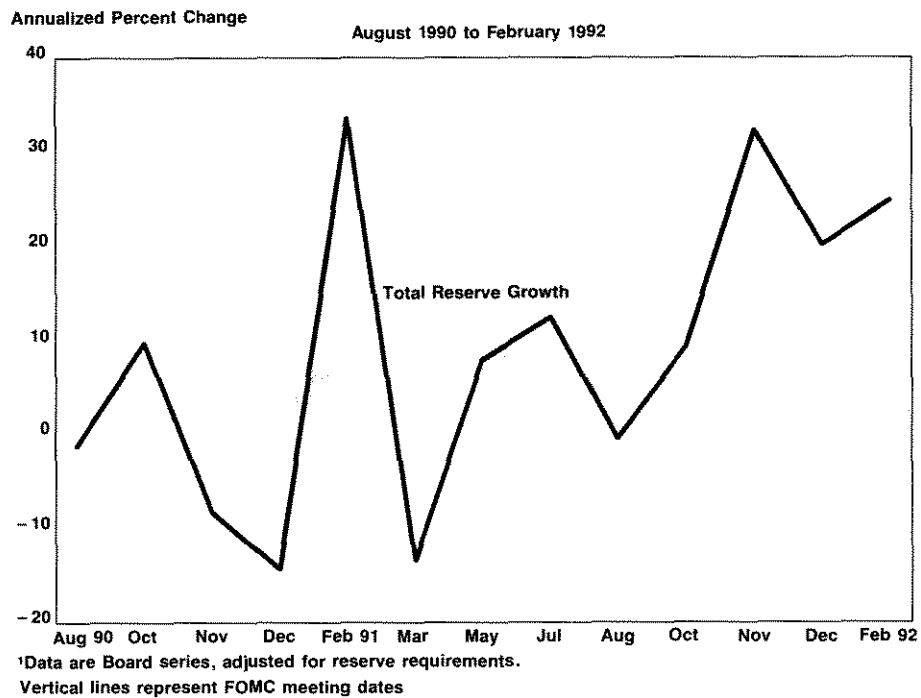
**Figure 1**  
**Weekly Federal Funds Rate**



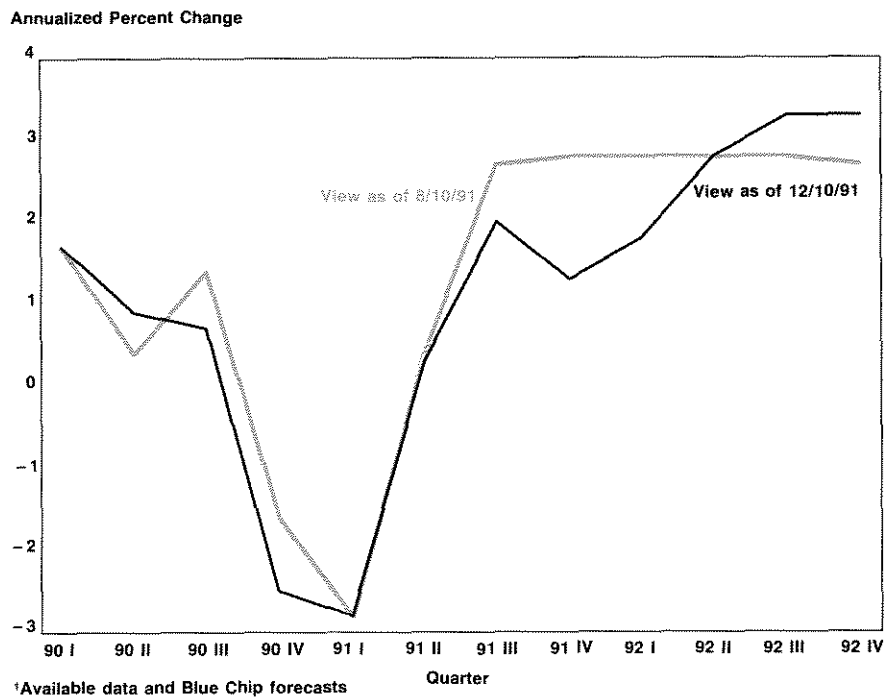
**Figure 2**  
**13 Week Growth Rates of M2**



**Figure 3**  
**Intermeeting Growth of Total Reserves<sup>1</sup>**

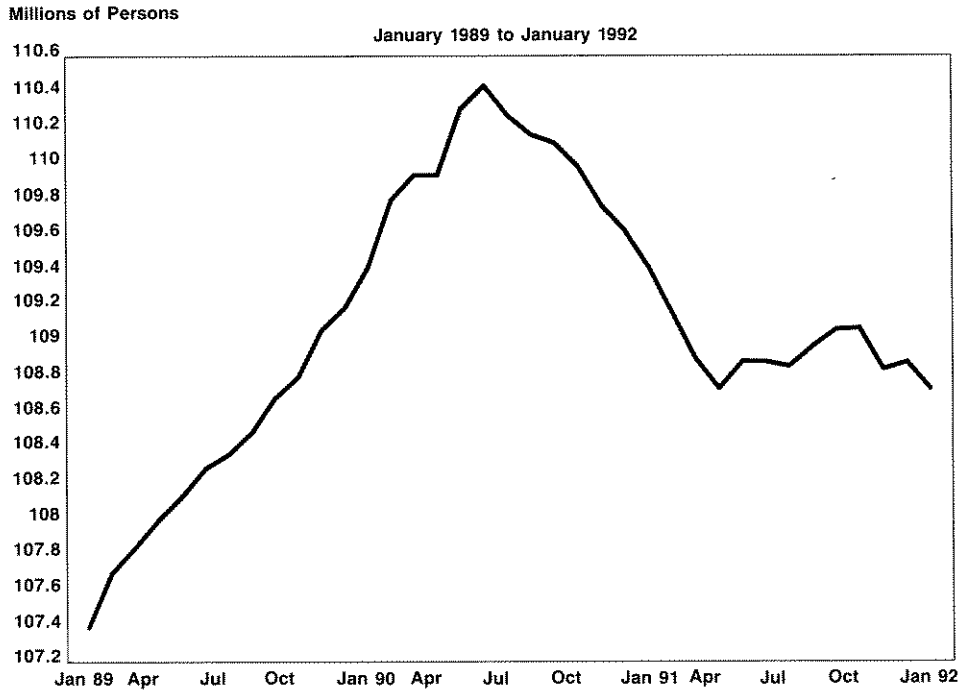


**Figure 4**  
**Private Forecasters' View of Real Output<sup>1</sup>**

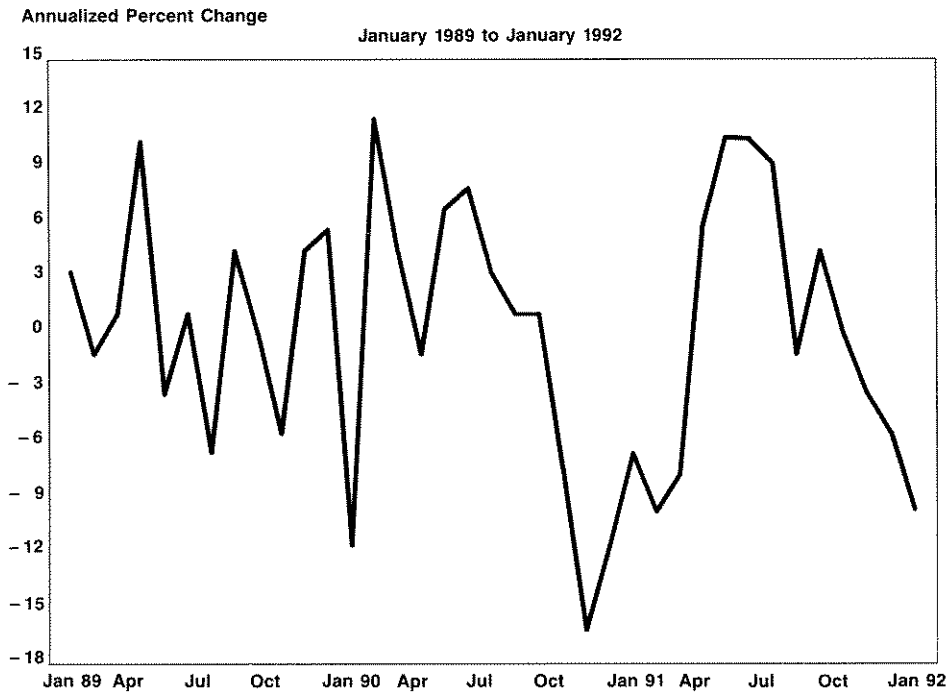




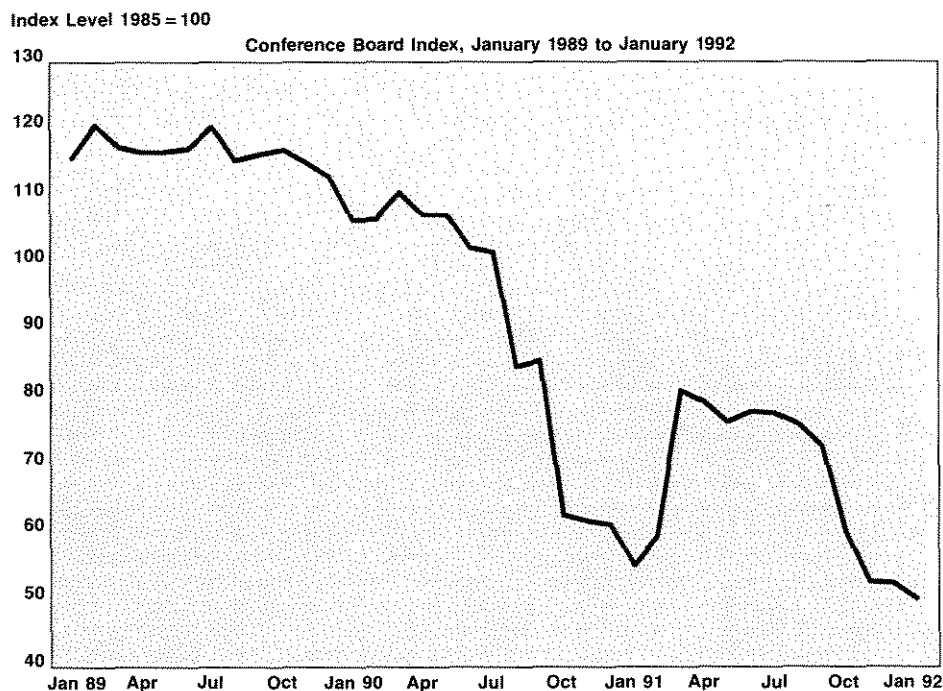
**Figure 5**  
**Total Nonfarm Payroll Employment**



**Figure 6**  
**Industrial Production**



**Figure 7**  
**Consumer Confidence**



### *Meeting of February 5-6, 1991*

In keeping with standard practice and Congressional requirements, the FOMC took up a review of long-range policy at the February meeting. As in the past, most of the discussion focused on target ranges for monetary and debt aggregates, primarily the M2 monetary aggregate. In July 1990, the Committee had tentatively set the 1991 target range for M2 growth at 2.5 to 6.5 percent, measured from the fourth quarter of 1990 to the fourth quarter of 1991. As can be seen from figure 2, the recent 13-week growth rates for M2, at the time of this meeting, had mostly been below the target band.<sup>11</sup>

In recent years, the FOMC has pursued a strategy of gradually reducing the target ranges for M2 growth, usually in increments of 0.5 percent per year, with the idea of eventually attaining a range consistent with price stability.<sup>12</sup>

At this meeting, however, "most of the members indicated a preference for affirming the ranges that had been established on a tentative basis in July."<sup>13</sup> The essential reason for the interruption in the usual sequence was the weak economy, in particular, that "lowering [the target range]. . . could lead to concerns about the System's objective of fostering an upturn in business activity."<sup>14</sup> On the other hand, increasing the ranges, perhaps in an effort to show recession-fighting resolve, was also viewed with suspicion, since it "could raise questions about the System's commitment to its anti-inflationary goals."<sup>15</sup> After further debate on these points, the Committee agreed to a directive calling for maintenance of the tentative M2 target ranges, that is, with the lower end at 2.5 percent and the upper end at 6.5 percent.<sup>16</sup>

In terms of short-run policy, that is, policy for the immediately upcoming intermeeting period,

<sup>11</sup>Of course, it is not necessarily of concern that the 13-week M2 growth rates sometimes fall outside the target band; it is the growth rate over the entire year that is of importance.

<sup>12</sup>March press release, p. 14.

<sup>13</sup>March press release, p. 14.

<sup>14</sup>March press release, p. 15.

<sup>15</sup>March press release, p. 15.

<sup>16</sup>March press release, p. 17.

the developments since the previous FOMC meeting were an important consideration. The December 1990 directive had called for some initial easing along with additional easing should conditions warrant. The Board of Governors, which exercises authority over discount rate changes separately from the FOMC, voted to lower the discount rate to 6.5 percent immediately following the December meeting, and, according to the Record, some of this decline was allowed to show through to the federal funds rate.<sup>17</sup> Further easing followed in January, and, when the Board of Governors approved a further discount rate cut on February 1 to 6 percent, the entire amount of the cut was allowed to show through to the federal funds rate.<sup>18</sup> As figure 1 shows, the federal funds rate, although relatively volatile, had dropped approximately 100 basis points during the intermeeting period. By this measure, dramatic ease had taken place during the intermeeting period.

The intermeeting growth rate of total reserves, graphed in figure 3, also seemed to indicate substantial ease in the period since the December meeting. The annualized growth rate for this period was in excess of 30 percent. M2 growth had begun to pick up somewhat by February, with the 13-week growth rate moving slightly higher than 2.5 percent at the time of the meeting. According to the Record, "the continuing weakness in M2. . . appeared to reflect in part heightened concerns about the financial condition of many depository institutions in the wake of the closing of privately insured banks and credit unions in Rhode Island and the failure of the Bank of New England."<sup>19</sup>

At the time of this meeting, it appeared that real output had declined in the fourth quarter of 1990 and was on a path of further decline in the current quarter. In particular, total nonfarm payroll employment fell in January, on the heels of a December decline. Industrial production declined sharply in the fourth quarter of 1990, as had capacity utilization. Consumer spending, "partly reflecting [a] lackluster. . . holiday sea-

son," was weak in the fourth quarter.<sup>20</sup> These factors were somewhat offset by a relatively strong nonagricultural export performance.<sup>21</sup>

The Board staff's forecast for real output prepared for the February meeting suggested that "some further decline in economic activity" was likely in the near term.<sup>22</sup> The staff forecast assumed that the war in the Persian Gulf, which was just getting under way, would be short-lived, perhaps lasting a few months, and that further disruption of oil supplies would be avoided for the foreseeable future. The economy was expected to begin growing again "subsequently," aided by export growth, falling oil prices and interest rates, and improved consumer confidence.<sup>23</sup>

Committee members saw the economic situation at the time of the February meeting as marked by "heightened. . . uncertainties," due in part to the outbreak of war in the Persian Gulf.<sup>24</sup> In general, members saw a "relatively mild recession followed by a moderate upturn in economic activity. . . as a reasonable expectation."<sup>25</sup> "Risks," however, "were clearly on the downside," and even a "relatively long recession could not be ruled out."<sup>26</sup> In assessing the outlook, members were particularly concerned about business and consumer confidence. Indices of sentiment were already at low levels and were poised, in the eyes of the Committee, to go lower, owing not only to the unfolding conflict in the Middle East, but also to "financial excesses of the past decade."<sup>27</sup> Nonetheless, not all of the news was gloomy, as the Committee noted that a lower spectrum of interest rates, lower oil prices and a depreciating dollar would probably contribute to a rebound in aggregate activity.<sup>28</sup> On the inflation front, "several members stressed that the slowing in monetary growth over a period of years was likely to be reflected increasingly in lower inflation."<sup>29</sup>

According to the Record, "the considerable easing of monetary policy. . . [in] recent months" encouraged members to endorse unanimously

<sup>17</sup>March press release, p. 4.

<sup>18</sup>March press release, p. 4.

<sup>19</sup>March press release, p. 6.

<sup>20</sup>March press release, p. 2.

<sup>21</sup>March press release, p. 3.

<sup>22</sup>March press release, p. 6.

<sup>23</sup>March press release, p. 7.

<sup>24</sup>March press release, p. 7.

<sup>25</sup>March press release, p. 7.

<sup>26</sup>March press release, p. 8.

<sup>27</sup>March press release, p. 9.

<sup>28</sup>March press release, p. 10.

<sup>29</sup>March press release, p. 13.

an unchanged policy for the intermeeting period ahead.<sup>30</sup> In particular, "sufficient time had not yet elapsed for the effects of the lower [interest] rates to be felt in the economy or indeed to any measurable extent in the growth of the monetary aggregates."<sup>31</sup> While many members mentioned sluggish M2 growth as an area of concern, most seemed to agree with a staff analysis that suggested faster rates of growth by the end of March, given a steady policy course. Some members, however, reiterated a call for a "relatively high priority [on] achieving satisfactory rates of growth in reserves and money."<sup>32</sup>

The degree of bias in the directive, if any, was a slightly more contentious issue. One view held out for a tilt toward ease in the weeks ahead, owing primarily to "the downside risks to the economy and the potential for inadequate monetary growth."<sup>33</sup> Some members were especially concerned that there would be "a high premium on avoiding any tendency for the weakness in the economy to cumulate because [of] . . . the severe consequences of a potentially deep and prolonged recession."<sup>34</sup> An alternative view held by some members was that, while easing might be necessary in the future, there were "considerable risks of overreacting" and that "conditions for a recovery in economic activity already appeared to be in place."<sup>35</sup> The former view, however, carried the day, and the directive contained bias toward ease, giving "special weight to potential developments that might require some easing during the intermeeting period."<sup>36</sup>

### *Meeting of March 26, 1991*

During the intermeeting period, the bias toward ease in the directive was acted upon. According to the Record, "in early March, in response to information suggesting that economic activity had continued to decline through February, pressures on reserve positions were eased slightly."<sup>37</sup> The indications that economic activity was weakening further included a sharp decline in total nonfarm payroll employment

and a fall in industrial output.<sup>38</sup> Accordingly, the federal funds rate, depicted in figure 1, fell to a level just over 6 percent by the time of the March meeting. Money growth, as measured by 13-week M2 growth rates, continued to pick up during this period and seemed to indicate ease relative to previous rates, as outlined in figure 2. According to the Record, members cited "the strengthening in M2 growth in February and March [as] a welcome development following an extended period of limited expansion."<sup>39</sup> Total reserves, shown in figure 3, were more puzzling during this period, as they actually declined, indicating a net drainage of reserves from the system instead of an injection. The reserves measure, therefore, seemed to indicate a relatively tight intermeeting policy.

The Board staff expected a resumption of real output growth within a few months of the March meeting.<sup>40</sup> Positive factors cited included the end of the war in the Persian Gulf (which presumably would brighten consumer and business attitudes), lower nominal interest rates and oil prices, and expected improvement in exports.<sup>41</sup> The staff felt that "reduced availability of credit" and "a moderately restrictive fiscal policy" were factors restraining near-term growth.<sup>42</sup>

The Committee's assessment of the outlook was essentially in agreement with that of the Board staff. Members were especially encouraged by the improvement in consumer confidence at the end of the war and felt that "an upturn in economic activity was widely expected."<sup>43</sup> Many members emphasized, however, that little hard evidence of growth in real output had accumulated thus far and that, in fact, "there was some risk that the recession could deepen considerably further."<sup>44</sup> Many members did not share the staff's optimism about a significant contribution to the recovery coming from export growth, as such effects were likely to be "curtailed by slower growth abroad."<sup>45</sup> Ac-

<sup>30</sup>March press release, p. 18.

<sup>31</sup>March press release, p. 18.

<sup>32</sup>March press release, p. 19.

<sup>33</sup>March press release, p. 20.

<sup>34</sup>March press release, p. 20.

<sup>35</sup>March press release, p. 20.

<sup>36</sup>March press release, p. 21.

<sup>37</sup>May press release, p. 4.

<sup>38</sup>May press release, pp. 1-2.

<sup>39</sup>May press release, p. 12.

<sup>40</sup>May press release, p. 6.

<sup>41</sup>May press release, p. 6.

<sup>42</sup>May press release, pp. 6-7.

<sup>43</sup>May press release, p. 7.

<sup>44</sup>May press release, p. 7.

<sup>45</sup>May press release, p. 10.

ording to the Record, real output growth had slowed in Germany and Japan, and "some weakening in activity apparently had occurred in several other major industrial countries."<sup>46</sup>

Most members supported the notion, with regard to short-run policy action, that sufficient easing had already taken place to foster a recovery.<sup>47</sup> In fact, some members commented that "the most likely direction of the next policy move was not clear at this point and. . . caution was needed before any action was taken."<sup>48</sup> In particular, further easing was a "possibility" due to "prevailing uncertainties," but, "if the economy was indeed near its recession trough, additional easing would not be necessary."<sup>49</sup> Firming was viewed as "premature," although there might be a "potential need to tighten reserve conditions promptly if emerging economic and financial conditions. . . threatened progress toward price stability."<sup>50</sup> Given these considerations, all of the members agreed to support a directive calling for an unchanged policy in the weeks ahead.<sup>51</sup>

While the members "expressed a range of views" relating to the possible degree of bias in the directive, the directive issued was symmetric.<sup>52</sup> As noted in the Record, the symmetry represented a deviation from the policies adopted since July 1990, as virtually all of the directives since that time had been biased toward ease.<sup>53</sup> The policy shift was consistent with the "assessment that the risks to the economy. . . were now more evenly balanced."<sup>54</sup> In one view, the recession had bottomed out, and therefore little could be achieved through further easing. In fact, "policy adjustments should be made only in the event of particularly conclusive evidence. . . that the recession might be deeper. . . than anticipated."<sup>55</sup> An alternative view was that downside risks still predominated and that "the Committee should react relatively promptly" should real output appear to decline further.<sup>56</sup> One member suggested that recoveries tend to be stronger than expected, and therefore the

"[greatest] risks were in the direction of too much ease and of persisting or increasing inflation."<sup>57</sup> In this view, the bias in the directive should be toward a tighter policy, especially considering the lags in monetary policy effects. Considering all of these views, however, the Committee elected to issue the symmetric directive.

The Committee also discussed the interaction between discount rate changes and open market operations as a technical matter of operating procedure.<sup>58</sup> The policy in recent years has been to keep the discount rate somewhat below the federal funds rate. Discount rate changes, which again are governed directly by the Board, "usually had been allowed to pass through automatically to the federal funds rate" in the recent past, although there were some exceptions.<sup>59</sup> Therefore, actions implemented by the Board alone might influence open market operations without explicit FOMC approval. Comments by members indicated the practice of show through should be continued, in general, "but that consultation among members of the Committee would be particularly appropriate in [some] circumstances."<sup>60</sup> In particular, the members mentioned cases in which a partial show through was more appropriate or particularly large policy actions were being considered.<sup>61</sup>

### *Meeting of May 14, 1991*

Immediately following the March FOMC meeting, a steady open market policy was maintained.<sup>62</sup> As figure 1 shows, however, the federal funds rate began declining immediately after the March meeting; the Record notes, "the rate was under downward pressure at times from market expectations of some further easing."<sup>63</sup> At the end of April, two weeks before the May meeting, an easing action was implemented when the Board voted to reduce the discount rate to 5.5 percent and a portion of the drop was allowed to show through to the federal funds rate. Federal funds traded at about

<sup>46</sup>May press release, p. 3.

<sup>47</sup>May press release, p. 11.

<sup>48</sup>May press release, p. 12.

<sup>49</sup>May press release, p. 12.

<sup>50</sup>May press release, p. 12.

<sup>51</sup>May press release, p. 11.

<sup>52</sup>May press release, p. 13.

<sup>53</sup>May press release, p. 13.

<sup>54</sup>May press release, p. 13.

<sup>55</sup>May press release, p. 13.

<sup>56</sup>May press release, p. 13.

<sup>57</sup>May press release, p. 14.

<sup>58</sup>May press release, p. 14.

<sup>59</sup>May press release, p. 14.

<sup>60</sup>May press release, p. 14.

<sup>61</sup>May press release, p. 14.

<sup>62</sup>July press release, p. 4.

<sup>63</sup>July press release, p. 4.

5.75 percent as the FOMC convened in May. Quarterly money growth rates had begun to slow at the time of this meeting, as shown in figure 2, but remained squarely within the target band. Reserve growth had resumed, eliminating some of the puzzle of the sharp decline recorded in the previous intermeeting period.

The easing action was taken in response to "indications of [continuing] weakness in the economy."<sup>64</sup> The Record describes incoming data as "mixed," perhaps broadly suggestive that real output growth might be flat or slightly positive after declining in the fourth quarter of 1990 and the first quarter of 1991.<sup>65</sup> While total nonfarm payroll employment fell again in April, the rate of decline was less than in previous months. Industrial output was flat in April. The available data on foreign economies suggested that they grew at a relatively slow pace in the first quarter.

Calling an upswing in economic activity "imminent," the Board staff at this meeting forecast a recovery fully under way in the summer months of 1991 and continuing through 1992.<sup>66</sup> The growth in real output was expected to be slower than that experienced during other postwar recoveries.<sup>67</sup> Restraint in the recovery was suggested, according to the staff, by "the absence of further significant impetus from net exports" and "moderately restrictive" fiscal policy, at all levels of government.<sup>68</sup> The staff's changing view on the contribution of net exports, relative to its forecast from the previous meeting, was consistent with the evidence that major foreign industrial economies continued to slow in the first months of 1991.

The Committee "generally viewed a business recovery in the months ahead as a reasonable expectation."<sup>69</sup> While most members felt that signals were "mixed," many felt that "a variety of developments appeared to have laid the groundwork for a recovery."<sup>70</sup> An important

factor would be the evolution of consumer and business sentiment.<sup>71</sup> Many members seemed to concur with the staff forecast that the strength of the recovery was questionable, as "current conditions did not point to major sources of stimulus."<sup>72</sup> Some members, however, did discuss inventory investment and housing construction in such a role. As for inflation, "the members continued to express confidence that the ongoing effects of earlier monetary policy actions and reduced monetary growth over an extended period. . . would tend with some lag to exert a favorable restraining effect on prices."<sup>73</sup>

The Committee unanimously supported a directive with the thrust of policy unchanged from that of the previous meeting, and virtually all members supported instructions avoiding bias.<sup>74</sup> At this point, in members' eyes, "a steady monetary policy appeared to. . . [reflect] an appropriate balancing of the risks of an overly stimulative policy that would threaten progress against inflation versus the risks of a deepening recession or an overly delayed recovery."<sup>75</sup> While some members felt that the costs of a further fall in real output were much more severe than an unexpectedly strong burst of growth, most agreed that the easing actions that had already been taken, given the presumed lags in effects on real output, were enough to insure against a further downturn.<sup>76</sup> In particular, "the System's commitment to the goal of reducing inflation argued for a cautious approach to any further easing at a time when the economy might be close to its recession trough."<sup>77</sup>

The growth rate of the Committee's primary monetary aggregate, M2, was a point of discussion at the May meeting. The Board staff prepared a report suggesting that M2 growth would improve in the summer following a flat performance in April. Members showed some

<sup>64</sup>July press release, p. 4.

<sup>65</sup>July press release, p. 1.

<sup>66</sup>July press release, p. 6.

<sup>67</sup>July press release, p. 6.

<sup>68</sup>July press release, p. 6.

<sup>69</sup>July press release, p. 7.

<sup>70</sup>July press release, p. 7.

<sup>71</sup>July press release, p. 7.

<sup>72</sup>July press release, p. 8.

<sup>73</sup>July press release, p. 11.

<sup>74</sup>July press release, p. 12.

<sup>75</sup>July press release, p. 12.

<sup>76</sup>July press release, p. 12.

<sup>77</sup>July press release, p. 12.

concern that, in particular, "subnormal monetary growth might be an indication that monetary policy was still too tight."<sup>78</sup> For this reason, according to the Record, "a number of members underscored the desirability of achieving monetary growth within the Committee's ranges for the year."<sup>79</sup>

### *Meeting of July 2-3, 1991*

The midyear meeting of the FOMC included a review of long-term objectives as required by law. The target range for M2 was the focus of discussion. The growth of this monetary aggregate was slowing at the time of this meeting, to the point where the 13-week growth rate had dropped to just over 2 percent, as illustrated in figure 2. For the year, however, M2 growth was in the middle of the target range, thanks to faster growth rates earlier.<sup>80</sup> Nevertheless, members felt that the "growth of this aggregate thus far in 1991 had fallen short of what might have been expected on the basis of historical relationships with nominal income and interest rates."<sup>81</sup> Furthermore, "the reasons for the shortfalls were not fully understood."<sup>82</sup> The view of the Committee seemed to be that there was simply a good deal of uncertainty surrounding the behavior of M2, but that "the four-percentage point range provided adequate leeway for any adjustments that might be needed."<sup>83</sup> As in February, the Committee decided to leave the target range unchanged.

With regard to short-run policy, operations had focused on maintaining the existing policy stance since the last meeting. The federal funds rate seemed to bear this out, as the weekly average rate shown in figure 1 remained steady for the most part at about 5.75 percent, except for a 50 basis-point spike on the week of the July meeting. According to the Record, there was some upward pressure on interest rates in the intermeeting period due in part to "expectations that no further easing of monetary policy was likely in the near term."<sup>84</sup> While figure 2 shows that M2 growth continued to slow, meas-

ured on a 13-week basis, intermeeting reserve growth as captured in figure 3 appeared satisfactory.

The Board staff forecast "considerable growth" through the end of 1991.<sup>85</sup> Again at this meeting, the staff felt that this phase of the recovery would be slow relative to past experience. The restraint was attributed, in part, to weakness in nonresidential construction, which would be "depressed by high vacancy rates," and "fairly restrictive" fiscal policy, again at all levels of government.<sup>86</sup>

Members of the Committee "generally agreed that a recovery very likely was under way." While "puzzling aspects" were noted, it was also pointed out that "sources of strength in an economic expansion often have been difficult to anticipate near a cycle trough."<sup>87</sup> The Committee's policy of moderate money growth over the last several years was expected to pay off in the form of lower inflation in the upcoming quarters.<sup>88</sup> Many members agreed with the staff regarding the restrictive effects of fiscal policies at all levels of government relative to past recovery phases. In particular, "despite burgeoning [federal] borrowing requirements in the near term, cutbacks in defense spending and other efforts to curb expenditures" had the earmarks of a restrictive fiscal approach.<sup>89</sup>

The Committee unanimously supported a directive that called for an unchanged policy in the weeks until the next meeting. According to the Record, "an unchanged policy course [was viewed as offering] the greatest promise of reconciling the Committee's goals of sustaining the nascent business recovery while also fostering further progress against inflation."<sup>90</sup> Imminent policy change was viewed as "unlikely," despite "obvious. . . uncertainty."<sup>91</sup> Recent sluggishness in M2 growth, which can be seen in figure 2 as the declining 13-week growth rates in May and June, was a concern of some members, who commented that perhaps "monetary policy had not been eased sufficiently in recent

<sup>78</sup>July press release, p. 13.

<sup>79</sup>July press release, p. 13.

<sup>80</sup>August press release, p. 13.

<sup>81</sup>August press release, p. 13.

<sup>82</sup>August press release, p. 13.

<sup>83</sup>August press release, p. 14.

<sup>84</sup>August press release, p. 4.

<sup>85</sup>August press release, p. 5.

<sup>86</sup>August press release, p. 6.

<sup>87</sup>August press release, p. 6.

<sup>88</sup>August press release, p. 7.

<sup>89</sup>August press release, p. 12.

<sup>90</sup>August press release, p. 18.

<sup>91</sup>August press release, p. 18.

months."<sup>92</sup> It was pointed out, however, that other measures, "especially. . . reserves," seemed to show growth that was relatively strong. Most members felt that "the behavior of M2 . . . did not call for any policy adjustments at this point."<sup>93</sup> In any event, the staff projected faster M2 growth in the near future, under a presumption of an unchanged policy stance.

### *Meeting of August 20, 1991*

As the Committee convened in August, the "recovery was proving to be sluggish."<sup>94</sup> While operations during the intermeeting period initially had been directed toward maintaining existing policy, an easing move was implemented in early August.<sup>95</sup> One reason for the unscheduled action was weakness in M2 growth; as can be seen in figure 2, the 13-week growth rates were approaching zero at the time of the easing action and had turned negative by the time of the meeting. By any of the measures of the policy stance considered here, however, an easier policy was not obvious. Federal funds, which had been trading at about 5.75 percent, moved only slightly lower by the time of the meeting according to the weekly averages graphed in figure 1. M2 growth continued to falter as the Committee convened. Intermeeting total reserve growth was flat, perhaps suggesting a relatively tight policy.

The Record again describes the information on the economy at this juncture as "mixed," but generally suggestive that sluggish growth in real output would continue in the near term.<sup>96</sup> Industrial production increased in July, in part because of a rise in automobile production. July total nonfarm payroll employment increased slightly, as did retail sales, but business fixed investment declined in the second quarter and was expected to remain weak.<sup>97</sup> Interest rates generally fell in the intermeeting period; one reason cited, in the case of short-term Treasury securities, was the attempted coup in the Soviet Union.<sup>98</sup>

The Board staff forecast a "moderate expansion over the next several quarters."<sup>99</sup> The

growth rate of real output for the second half of the year, however, was now forecast to be somewhat lower than previously suggested. The staff outlook emphasized "a cyclical swing from substantial liquidation to modest accumulation in business inventories" as a stimulus for recovery. As in previous forecasts, restrictive fiscal policy was thought to be retarding real output growth rates from their more usual cyclical pattern.

FOMC members saw an economy that was "uneven," although they appeared to agree with the staff in principle that real output growth would be positive over the next several quarters. In particular, a "sustained expansion . . . was still viewed as a reasonable expectation, [but] many members now believed that the risks were tilted toward the downside."<sup>100</sup> The coup attempt in the Soviet Union, the outcome of which was unknown at the time of the meeting, added in the view of the Committee additional uncertainty to the outlook. Closer to home, weakness in M2 growth was cited as "a matter of increasing concern to the extent that it implied. . . a faltering economic expansion."<sup>101</sup> Again at this meeting, according to the Record, the FOMC seemed to concur with the staff assessment that fiscal policy effects would probably be "somewhat negative" for the immediate future.<sup>102</sup>

The shift toward pessimism in the Committee's outlook is reflected in private sector forecasts from August 1991 and December 1991 for quarterly growth in real output, as illustrated in figure 4. As of August, projections for the fourth quarter of 1991 and the first quarter of 1992 were relatively robust, although perhaps somewhat low relative to previous recoveries. By December, however, the projected growth rates for these quarters had dropped substantially, far below that which might have been expected based on historical experience.

The Committee voted to issue a directive maintaining current policy for the immediate future but with an asymmetry toward ease. According to the Record, "an immediate easing

<sup>92</sup>August press release, p. 19.

<sup>93</sup>August press release, p. 19.

<sup>94</sup>October press release, p. 4.

<sup>95</sup>October press release, p. 4.

<sup>96</sup>October press release, p. 1.

<sup>97</sup>October press release, p. 2.

<sup>98</sup>October press release, p. 4.

<sup>99</sup>October press release, p. 5.

<sup>100</sup>October press release, p. 6.

<sup>101</sup>October press release, p. 7.

<sup>102</sup>October press release, p. 11.



move would be premature because the most recent economic information, although mixed, still suggested a moderate rate of economic expansion."<sup>103</sup> Advocates of asymmetry argued that "risks. . . were largely on the side of a weaker-than-projected economy" and that the Committee should "react promptly" if any cumulative decline should become apparent.<sup>104</sup> Some members disagreed, however, because they "were concerned about responding to what might prove to be short-lived fluctuations in the economic data and anecdotal information."<sup>105</sup> Even these members, however, could accept some asymmetry toward ease in the directive.<sup>106</sup>

The Record indicates that members paid "considerable attention" in their discussion to sagging M2 growth rates.<sup>107</sup> While members found explanations "difficult to disentangle," some saw the slow growth to be of "little import" if it merely reflected shifts into alternative investment instruments that are not counted in the broad monetary aggregates.<sup>108</sup> On the other hand, the "behavior. . . might be indicative of. . . a monetary policy stance that was too tight." The Board staff analysis continued to forecast some pick-up in the growth of M2 in the near term.<sup>109</sup>

Some members suggested that, in current circumstances, the Board should emphasize movements in M2 more explicitly when "guiding possible intermeeting adjustments in policy." The majority, however, did not support this idea, for at least three reasons. One was that broad monetary aggregates like M2 were viewed by some as "unreliable indicators" of real output growth paths. Another was that narrower measures, such as M1 and total reserves, "might be more indicative of the underlying thrust of monetary policy." Finally, some members felt that including stronger reference to monetary aggregates in the directive might "misconstrue the views of many members," who might not be willing to support a policy response to "aberrant fluctuations" in money growth.<sup>110</sup>

### *Meeting of October 1, 1991*

Again, the bias in the August directive was acted upon during the intermeeting period. The Board voted to lower the discount rate to 5 percent in mid-September and part of the 50 basis-point decline was allowed to show through to the federal funds rate. Accordingly, federal funds traded at about 5.25 percent by the time the Committee met in October, as shown in figure 1. Monetary growth, as measured by the 13-week M2 growth rate displayed in figure 2, was actually negative at the time of the meeting, but apparently the fall in this growth rate had stalled somewhat relative to the deceleration apparent in the graph since the spring of the year. Figure 3 indicates that intermeeting growth in total reserves had resumed, almost reaching the rates observed at the May and July meetings; by this measure, policy appeared to have been eased somewhat since August.

According to the Record, the information on the economy reviewed at the October meeting suggested a continuing recovery, but one that was "uneven across sectors."<sup>111</sup> Total nonfarm payroll employment had been essentially flat since March. Industrial production had increased in August. Consumer spending was rising, but retail sales fell in August. Overseas, the growth rates of the Japanese and German economies fell in the second quarter, although real output growth appeared to have strengthened in other large economies.<sup>112</sup>

The Board staff projected continued recovery, tempered by downside risks and somewhat slow relative to previous cyclical upturns because of "persisting weaknesses in some sectors of the economy."<sup>113</sup> In this forecast, consumer spending would be a significant positive factor, with "a swing from inventory liquidation" providing an "additional boost."<sup>114</sup> Other sources of stimulus included business equipment spending and housing construction.<sup>115</sup> Dampening factors were still seen on the fiscal policy side and also in commercial construction, where high vacancy rates were viewed as a deterrent to building.<sup>116</sup>

<sup>103</sup>October press release, p. 12.

<sup>104</sup>October press release, p. 12.

<sup>105</sup>October press release, p. 12.

<sup>106</sup>October press release, p. 13.

<sup>107</sup>October press release, p. 13.

<sup>108</sup>October press release, p. 13.

<sup>109</sup>October press release, p. 14.

<sup>110</sup>October press release, pp. 14-15.

<sup>111</sup>November press release, p. 1.

<sup>112</sup>November press release, pp. 1-3.

<sup>113</sup>November press release, p. 5.

<sup>114</sup>November press release, p. 6.

<sup>115</sup>November press release, p. 6.

<sup>116</sup>November press release, p. 6.

Committee members seemed to agree with the staff prognosis, viewing the fledgling recovery as somewhat threatened.<sup>117</sup> According to the Record, "members commented that the anecdotal reports on economic conditions and on business and consumer sentiment continued to have a generally negative tone that did not appear to be fully consistent with the available economic statistics."<sup>118</sup> Reports on business attitudes in particular seemed to suggest that key participants in the economy thought momentum in economic activity was stalled.<sup>119</sup> Members were concerned about risks to the recovery arising from "financial strains in the economy" as well as slow money growth. On the whole, however, the Committee appeared to feel that "the prospects remained favorable for a sustained expansion [in economic activity] at a moderate pace over the next several quarters."<sup>120</sup>

In the discussion about operating instructions for the upcoming few weeks, all of the members of the FOMC supported language leaving the policy stance initially unchanged. According to the Record, "the present policy stance provided an appropriate balance between the risks of a faltering economic expansion and the risks of little or no progress toward price stability."<sup>121</sup> Some previous easing had not yet filtered through to effects on real output growth.<sup>122</sup> Several members asserted, however, that the Committee should remain "particularly alert to indications of renewed weakening in business activity," in part because they felt a second downturn might be less responsive to monetary stimulus.<sup>123</sup> Other members emphasized the adverse consequences of easing too much, focusing on the prospect of higher long-term interest rates due to increased inflationary expectations which might then retard growth.<sup>124</sup> On balance, however, a steady course proved to be the consensus.

The slow growth of M2 continued to be a concern. While some members emphasized special factors that might be depressing otherwise

robust growth, such as the resolution of the crisis in the thrift industry, others felt that the broad monetary aggregates "needed to be monitored with special care."<sup>125</sup> As at previous meetings, the Board staff continued to predict some pick-up in the growth of M2, even in the absence of further easing action.

As for contingencies in the directive, most of the members "indicated a preference for a directive that was biased at least marginally toward easing."<sup>126</sup> The downside risks cited earlier provided the primary justification in the majority view. A minority preferred a symmetric directive, citing likely cumulative effects from previous easing actions as a sufficient safeguard against further declines in real output.<sup>127</sup> Nevertheless, these members indicated a willingness to accept an asymmetric directive.<sup>128</sup> In the discussion, some members in the majority emphasized that "there should be no strong presumption that any easing would be undertaken during the intermeeting period ahead."<sup>129</sup>

#### *Meeting of November 5, 1991*

Because the recovery appeared to be weakening during the intermeeting period, an easing action, consistent with the bias toward ease contained in the October directive, was implemented at the end of October.<sup>130</sup> According to the Record, a key concern in taking this action was evidence on "flagging consumer and business confidence."<sup>131</sup> The federal funds rate fell after the easing action to just above 5 percent by the time of the November meeting. The 13-week growth rates of M2 accelerated substantially, even before the easing action, and turned positive during the intermeeting period. Growth for the year remained near the lower end of the Committee's range. Intermeeting total reserve growth was substantial, hitting the second highest level of the year, as outlined in figure 3. All measures of the policy stance therefore seemed to indicate at least some ease.

The Board staff, concerned about "recent reports on business and consumer confidence

<sup>117</sup>November press release, p. 6.

<sup>118</sup>November press release, p. 7.

<sup>119</sup>November press release, p. 7.

<sup>120</sup>November press release, p. 6.

<sup>121</sup>November press release, p. 11.

<sup>122</sup>November press release, p. 11.

<sup>123</sup>November press release, p. 11.

<sup>124</sup>November press release, p. 11.

<sup>125</sup>November press release, p. 12.

<sup>126</sup>November press release, p. 12.

<sup>127</sup>November press release, p. 12.

<sup>128</sup>November press release, p. 12.

<sup>129</sup>November press release, p. 12.

<sup>130</sup>December press release, p. 4.

<sup>131</sup>December press release, p. 4.

combined with other information," continued to forecast an expanding economy in the quarters ahead but made an "appreciable markdown" in the expected rates of growth in real output relative to past forecasts.<sup>132</sup> The staff saw the downside risks to the forecast as "predominant."<sup>133</sup> In particular, real output was expected to grow quite slowly over the winter months, with the more robust growth normally associated with cyclical upswings a possibility in the spring of 1992 or later.<sup>134</sup> Except for the decline in the measures of sentiment contributing to less consumption than previously predicted, the staff foresaw the same sources of strength and the same retarding factors that were given appreciable weight in previous forecasts.

FOMC members were concerned about the recent developments in the measures of confidence, but "generally concluded that the available economic data appeared consistent with continuing, albeit sluggish, expansion in overall economic activity."<sup>135</sup> Some commented that the measures of business and consumer sentiment "had to be viewed with caution because they had tended in the past to be coincident rather than leading indicators of economic activity."<sup>136</sup> In terms of downside risk, several members indicated concern for "the vulnerability of the expansion stemming from the troubled condition of many financial institutions," while others felt risks were symmetric or even on the upside.<sup>137</sup> Some members noted that any potential downturn was expected to be confined to the fourth quarter of 1991 or the first quarter of 1992 and that "a resumption of growth next year. . . [was] a reasonable expectation."<sup>138</sup> Given the lags associated with short-run policy actions, these members believed that stimulus already in the economy should be given a chance to take effect, and any actions taken to stimulate real activity within the quarter might be viewed as somewhat late.<sup>139</sup>

At the end of the meeting, a majority of the voting members supported a proposal to ease immediately and to bias the directive toward further ease should conditions warrant. While recognition that "monetary policy had been eased considerably over the course of recent months" was forthcoming from most members, many felt that "further modest easing . . . [might] provide some added insurance" against a decline in real output.<sup>140</sup> The majority felt that additional easing would help bolster consumer confidence and lead to further declines in key long-term rates.<sup>141</sup> The Record indicates that there was "considerable" discussion of a proposal to make "a somewhat stronger move," mainly because "small moves would lack the visibility. . . needed."<sup>142</sup>

A minority of members argued against substantial easing.<sup>143</sup> The notion that confidence could be appreciably affected by monetary policy actions was questioned.<sup>144</sup> Long-term interest rates, it was argued, might well increase on a substantial easing move, as fears of rekindled inflation took hold among investors. Several members also reiterated that several easing steps recently taken should be allowed to work through the economy before further action was taken.<sup>145</sup>

### *Meeting of December 17, 1991*

On November 6, the Board of Governors approved a 0.5 percentage-point reduction in the discount rate, and a "slight easing" was carried out in concert with this move.<sup>146</sup> The bias in the November directive was acted upon in the intermeeting period, as "an additional slight easing" was implemented in early December.<sup>147</sup> The second move was made, according to the Record, "as economic indicators continued to point to a faltering recovery and growth of the broad monetary aggregates remained sluggish."<sup>148</sup> The

<sup>132</sup>December press release, p. 6.

<sup>133</sup>December press release, p. 6.

<sup>134</sup>December press release, p. 6.

<sup>135</sup>December press release, p. 7.

<sup>136</sup>December press release, p. 8.

<sup>137</sup>December press release, p. 7.

<sup>138</sup>December press release, p. 7.

<sup>139</sup>December press release, p. 7.

<sup>140</sup>December press release, p. 11.

<sup>141</sup>December press release, p. 11.

<sup>142</sup>December press release, p. 11.

<sup>143</sup>December press release, p. 12.

<sup>144</sup>December press release, p. 12.

<sup>145</sup>December press release, p. 12. The timing of the easing action was also discussed "at some length," as the Treasury auction beginning the day of the FOMC meeting would normally not be an appropriate time to intervene in the market for reserves. In particular, an immediate action could hurt the participants in the auction. Nevertheless, the Committee did not wish to delay action, and the directive contained no delay.

<sup>146</sup>February press release, p. 4.

<sup>147</sup>February press release, p. 4.

<sup>148</sup>February press release, p. 4.

federal funds rate fell 0.5 percentage points between the November and the December meetings, indicating substantial ease. The 13-week M2 growth rates continued to accelerate during the intermeeting period, as illustrated in figure 2, also indicating a relatively easy policy. Similar interpretations are possible for intermeeting total reserve growth, which, while down somewhat from the previous meeting, was still robust.

Growth in real output appeared at this meeting to be slow and perhaps waning.<sup>149</sup> Depressed levels of business and consumer confidence, a fall in November industrial production and weakness in consumption expenditures led the Board staff to suggest, according to the Record, that "a pause in the recovery. . . might extend into early 1992."<sup>150</sup> Faster growth was expected to return at that time in part because of "the cumulative effects of declines in interest rates in recent months."<sup>151</sup> The staff felt that key sources of growth would be provided by "increases in residential construction, somewhat larger consumption expenditures and some pick-up in business equipment spending."<sup>152</sup> Restrictive fiscal policy was still viewed as a key element retarding growth relative to what expectations might warrant based on historical relationships in past recoveries.<sup>153</sup>

The members seemed to agree with the staff that past policy actions would eventually lead to increased growth and that "the economy might well remain quite sluggish over the months immediately ahead."<sup>154</sup> Focus was placed on the "evident pause in the business recovery and its interaction with very gloomy business and consumer sentiment."<sup>155</sup> Factors that had been previously identified as dampening growth "had in fact proved to be stronger and more persistent than anticipated."<sup>156</sup> The measures of sentiment combined with some anecdotal reports on business confidence received "considerable emphasis" in the Committee's deliberations, although the reasons behind the dismal attitudes were "difficult to ascertain."<sup>157</sup> Growth in the mone-

tary aggregates was viewed as a positive sign by some members.<sup>158</sup>

In the discussion of short-term policy for the period immediately ahead, the Committee supported a directive that left unchanged the policy stance for the time being, but which contained an "especially strong presumption" that an easing action would be necessary, "unless improvement in the economy became evident fairly promptly or there was significant evidence of a pick-up in M2 growth."<sup>159</sup> Some members again argued for "a more substantial policy move at some point."<sup>160</sup> They hoped that "a larger and more visible policy action. . . would have greater effectiveness in part because it would be more likely to bolster confidence."<sup>161</sup>

Other members argued for more deliberate policymaking.<sup>162</sup> According to the Record, they "expressed reservations about the urgency to ease in the near term" and suggested that "monetary policy could do little" to alter the factors that were restraining the economy at this point.<sup>163</sup> In this minority view, the fact that the extent of recent easing actions was substantial and the effects on real output were yet to be realized was given a good deal of weight.

Any easing action needed to be coordinated with the Board's approach to the discount rate. On December 20, the Board voted to move the discount rate down by a full percentage point. The FOMC then considered, in a telephone conference, reactions to the move and decided to allow part of the cut to show through to the federal funds rate.<sup>164</sup> As shown in figure 1, the funds rate fell below 4 percent on a weekly average basis by the end of the year.

## SUMMARY

In 1991, the FOMC operated in an environment in which growth in real output was resuming. This paper has therefore provided a case study of the making of monetary policy during the recovery phase of the business cycle.

<sup>149</sup>February press release, p. 1.

<sup>150</sup>February press release, p. 6.

<sup>151</sup>February press release, p. 6.

<sup>152</sup>February press release, p. 6.

<sup>153</sup>February press release, p. 6.

<sup>154</sup>February press release, p. 7.

<sup>155</sup>February press release, p. 7.

<sup>156</sup>February press release, p. 7.

<sup>157</sup>February press release, p. 7.

<sup>158</sup>February press release, p. 8.

<sup>159</sup>February press release, p. 11.

<sup>160</sup>February press release, p. 12.

<sup>161</sup>February press release, p. 12.

<sup>162</sup>February press release, p. 12.

<sup>163</sup>February press release, p. 12.

<sup>164</sup>February press release, pp. 16-17.

Relative to past cyclical upswings in economic activity, growth in 1991 was slow, and the recovery itself seemed at times elusive.

The Committee states its objectives on a regular basis, and members support policy actions primarily based on their assessment of the outlook for inflation and real output. Since growth in economic activity was sluggish in 1991 and since inflation was low by recent standards, the Committee's objective of sustaining real output growth played a predominant role. Repeatedly, members wrestled with arguments about the lagged effects of monetary policy actions, noting that if the economy had bottomed out, easing to mitigate real output declines would be unnecessary. Still, at times, incoming data seemed to suggest a renewed decline in economic activity, and the Committee took actions throughout the year in the hope of avoiding this possibility.

Measuring the thrust of monetary policy at a point in time was a continual topic of discussion at FOMC meetings in 1991. While the federal funds rate played a dominant role in this capacity, the Committee devoted a considerable amount of time to analyses of M2 growth, which seemed to falter at times during the year. In general, conflicting signals of the thrust of monetary policy played a significant role in Committee deliberations.

During the first half of 1991, the FOMC displayed considerable optimism that a recovery

would begin and gain momentum as the year progressed. Three of the first four directives of the year called for an unchanged policy without bias, although, as indicated in the chronology and table 1, some easing was implemented during this period. Beginning about August, however, the Committee's confidence in the recovery began to wane. The four directives issued in the second half of the year all contained bias toward ease, as Committee members expressed deep concern about declines in industrial production and consumer confidence. By the end of the year, the FOMC had approved a number of easing actions designed to provide insurance against further declines in real output.

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