Records

Record of Policy Actions of the Board of Governors

Regulation B
Equal Credit Opportunity
[Docket No. R-1008]

On February 19, 2003, the Board approved amendments that, among other things, retain the general prohibition against inquiring about or noting applicant characteristics (such as race, national origin, religion, age, or sex) in nonmortgage credit transactions and create an exception when such data are collected as part of a creditor's self-test to determine compliance with the Equal Credit Opportunity Act. The amendments also require creditors to retain certain records related to prescreened credit solicitations for twenty-five months. The amendments are effective April 15, 2003, with mandatory compliance by April 15, 2004.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Olson, Bernanke, and Kohn. Absent and not voting: Governor Bies.

NOTE. Full texts of the policy actions are available from the electronic reading room on the Board's Freedom of Information Act web page (www.federalreserve.gov/generalinfo/foia/) by using the "Policy Statements and Staff Manuals" link or on request from the Board's Freedom of Information Office (Tel: 202-452-3684; TDD: 202-263-4869; Fax: 202-872-7565). Internet access to the Board's public web site is also available during regular business hours at the Freedom of Information Office, Martin Building, Room M-P-500, 20th and C Streets NW, Washington, DC 20551.

Regulation D
Reserve Requirements of Depository Institutions
[Docket No. R-1163]

On October 1, 2003, the Board approved amendments to reflect the annual indexing of the low reserve tranche and of the reserve requirement exemption for use in reserve requirement calculations in 2004. The amendments increase the 3 percent low reserve tranche for net transaction accounts to $45.4 million (from $42.1 million in 2003) and increase the reserve requirement exemption to $6.6 million (from $6 million in 2003).

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Regulation H
Membership of State Banking Institutions in the Federal Reserve System
[Docket No. R-1129]

On January 23, 2003, the Board approved amendments to administer and enforce several reporting, disclosure, and corporate-governance provisions of the Sarbanes–Oxley Act of 2002, which are applicable to state member banks that have securities registered under the Securities Exchange Act of 1934 (registered banks). The amendments generally require registered banks to comply with the rules, regulations, and forms adopted by the Securities and Exchange Commission to implement the provisions of the Sarbanes–Oxley Act specified in section 12(i) of the Securities Exchange Act of 1934, unless those requirements are modified by the Board. The amendments are effective April 1, 2003.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Regulation H

Membership of State Banking Institutions in the Federal Reserve System

Regulation K

International Banking Operations [Docket No. R-1127]

On April 21, 2003, the Board, acting with the Department of the Treasury and the federal financial institutions regulatory agencies, approved interagency amendments to implement section 326 of the USA Patriot Act of 2001 concerning customer identification programs. The amendments require that banks, savings associations, credit unions, private banks, and trust companies (1) implement reasonable procedures to verify the identity of any person who seeks to open an account, to the extent reasonable and practicable; (2) maintain records of the information used to verify the person's identity; and (3) determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency. The amendments are effective June 9, 2003, with mandatory compliance by October 1, 2003.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, Bernanke, and Kohn. Absent and not voting: Governor Gramlich.

Regulation H

Membership of State Banking Institutions in the Federal Reserve System

Regulation Y

Bank Holding Companies and Change in Bank Control [Docket No. R-1156]

On September 12, 2003, the Board, acting with the federal bank and thrift regulatory agencies, approved interim interagency amendments (with a request for comment) that provide an interim capital treatment for assets in asset-backed commercial paper programs that are consolidated on the balance sheets of sponsoring banks, bank holding companies, and thrifts as a result of a recently issued Financial Accounting Standards Board Interpretation (FASB No. 46). The interim capital treatment is in effect only for the regulatory reporting periods ending September 30 and December 31, 2003, and March 31, 2004.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Regulation K

International Banking Operations [Docket No. R-1143]

On February 7, 2003, the Board issued an interpretation of Regulation K to clarify that a foreign bank planning to engage in underwriting securities to be distributed in the United States must either be a financial holding company or have the authority to engage in underwriting activity under section 4(c)(8) of the Bank Holding Company Act. The interpretation is effective February 19, 2003.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Regulation V
Fair Credit Reporting
[Docket No. R-1172]

On December 16, 2003, the Board, acting with the Federal Trade Commission, approved new interim interagency rules (with a request for comment) that establish December 31, 2003, as the effective date for provisions of the Fair and Accurate Credit Transactions Act of 2003 that determine the relationship between the Fair Credit Reporting Act and state laws and provisions that authorize rulemakings or other implementing actions by various agencies.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Regulation Y
Bank Holding Companies and
Change in Bank Control
[Docket Nos. R-1146 and R-1092]

On June 27, 2003, the Board approved amendments that permit bank holding companies to enter into (1) commodity derivative contracts that are settled by the bank holding company receiving and transferring title to the underlying commodity instantaneously, by operation of contract, and without taking physical possession of the commodity and (2) certain commodity derivative contracts that do not require cash settlement or specifically provide for assignment, termination, or offset before delivery. The amendments are effective August 4, 2003.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

On November 26, 2003, the Board approved amendments to expand the ability of all bank holding companies, including financial holding companies, to process, store, and transmit nonfinancial data in connection with their financial data processing, storage, and transmission activities by raising the revenue limit on nonfinancial data processing activities from 30 percent to 49 percent of the company's total annual revenues derived from data processing, data storage, and data transmission activities. The Board also announced that it would consider, case by case in accordance with applicable procedures, proposals by financial holding companies to engage in, or acquire a company engaged in, other nonfinancial data processing, information portal, and technology-related activities that the financial holding company believes are complementary to financial activities. The amendments are effective January 8, 2004.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, and Bernanke. Absent and not voting: Governor Kohn.

Rules of Organization
[Docket No. R-1149]

On April 29, 2003, the Board amended its definition of a quorum to provide that a majority of the members in office constitutes a quorum of the Board, except that four members constitute a quorum if there are five members in office. The revised definition enhances the Board's ability to function in a national emergency, but does not alter the number of Board members required to constitute a quorum during normal operations when the Board has five or more members. The amendment is effective April 29, 2003.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Rules of Practice for Hearings

Subpart J—Removal, Suspension, and Debarment of Accountants from Performing Audit Services
[Docket No. R-1139]

On August 6, 2003, the Board, acting with the federal bank and thrift regulatory agencies, approved interagency amendments that establish procedures for removing, suspending, or debarring accountants, for good cause, from performing the audit services required under section 36 of the Federal Deposit Insurance Act for insured depository institutions with total assets of $500 million or more. The amendments are effective October 1, 2003.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Bies, Olson, Bernanke, and Kohn. Absent and not voting: Governor Gramlich.

Rules Regarding Equal Opportunity

[Docket No. R-1096]

On April 9, 2003, the Board approved amendments, adopted in January 2001 as interim amendments, to incorporate changes that the Equal Employment Opportunity Commission made to its parallel regulation on equal employment opportunity in the federal government generally. The amendments also incorporate changes to provisions of the commission's parallel regulation that address the Rehabilitation Act; the commission adopted these changes after the Board's interim rule. The amendments are effective April 15, 2003.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Policy Statements and Other Actions

Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System
[Docket No. R-1128]

On April 7, 2003, the Board, acting with the Office of the Comptroller of the Currency and the Securities and Exchange Commission, approved an interagency paper that, among other things, identifies (1) new business continuity objectives that have special importance for all financial firms and (2) sound practices to ensure the resilience of the U.S. financial system, with a focus on minimizing the immediate systemic effects of a wide-scale disruption on critical financial markets.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Expansion of the Operating Hours for the Online Fedwire Funds Service
[Docket No. R-1138]

On May 20, 2003, the Board approved an expansion of the operating hours for the online Fedwire Funds Service from eighteen to twenty-one and one-half hours each business day. The new opening time, 9:00 p.m. eastern time for online funds transfers with a business date of the following calendar day, is three and one-half hours earlier than the current 12:30 a.m. opening time. The closing time remains 6:30 p.m. eastern time. The new hours are effective in the second quarter of 2004.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Imputed Investment Income on Clearing Balances [Docket No. R-1152]

On October 22, 2003, the Board modified the method for imputing priced-services income from clearing-balance investments that is used each year when the Reserve Banks set fees for Federal Reserve priced services and measure priced-services' cost recovery. The new method, which expresses the imputed investment return as a constant annual spread over the rate for three-month Treasury bills, is based on an optimized underlying hypothetical investment portfolio that reflects the broader range of investments available to banks and bank holding companies. Selection of the portfolio investments is subject to a risk-management framework. The new method is effective in January 2004.

Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

Discount Rates in 2003

On October 31, 2002, the Board amended its Regulation A to establish two new forms of Reserve Bank discounts and advances, primary and secondary credit, that would replace adjustment and extended credit, effective January 9, 2003. On January 6, 2003, the Board voted to approve for all the Reserve Banks an initial primary credit rate of 2¼ percent and a formula for calculating a secondary credit rate that yielded an initial rate of 2¾ percent.

In 2003, the rates for primary and secondary credit consistently exceeded the federal funds rate target, which is set by the Federal Open Market Committee (FOMC), by 100 and 150 basis points respectively. On June 25, a reduction of ¼ percentage point in the federal funds rate target was accompanied by a similar reduction in both discount rates to levels of 2 percent and 2½ percent. The seasonal credit program was not affected by the Regulation A amendments. The rate for such credit in 2003 continued to be set on the basis of a market-related formula and was equal or close to the FOMC's target federal funds rate throughout the year.

Primary Credit Rate

The Board reached its decisions on the primary credit rate in conjunction with the FOMC's decisions on the target federal funds rate and related economic and financial developments. These developments are referenced below and are reviewed more fully in other parts of this report, including the compilation of minutes of FOMC meetings held in 2003.

Reduction in the Primary Credit Rate in June 2003

Against the background of a sluggish economic expansion but already stimulative monetary and fiscal policies, the Board took no action before June 25 on requests by various Federal Reserve

Banks to lower their primary credit rate by ¼ or ½ percentage point. The number of such requests increased from two in mid-March to eight by the latter part of June amid persisting indications that an anticipated strengthening in the expansion of economic activity was being held back by a high degree of business caution in investment and hiring decisions. On June 25 the Board approved a ¼ percentage point reduction, to a level of 2 percent, in the primary credit rate of the Federal Reserve Banks in conjunction with the FOMC's decision to reduce its target for the federal funds rate by the same amount. The Board and the FOMC concluded that a slightly more expansive monetary policy would add support for an economy that was expected to improve over time in the context of robust underlying growth in productivity, markedly improved financial conditions, and signs that labor and product markets were stabilizing.

In July and August, the Board took no action on biweekly requests by one Federal Reserve Bank to lower its primary credit rate by an additional ¼ percentage point. In light of increasing indications of a pronounced acceleration in economic activity, no further requests for changes in their credit rates were submitted by any of the Federal Reserve Banks over the remainder of the year.

Structure of Discount Rates

Under the new discount rate program that went into effect on January 9, 2003, primary credit is made available for very short terms as a backup source of liquidity to depository institutions that, in the judgment of the lending Federal Reserve Bank, are in generally sound financial condition. Primary credit is extended at a rate above the federal funds rate. Secondary credit is available in appropriate circumstances to depository institutions that do not qualify for primary credit; it is set on the basis of a formula that in 2003 produced a rate that was ½ percentage point higher than the primary credit rate. Seasonal credit, another type of discount window credit, is available under limited conditions to assist smaller depository institutions in managing liquidity needs that arise from regular swings in their loans and deposits. Rates on seasonal credit are calculated every two weeks in accordance with a formula based on market interest rates. Under that formula, the rates charged for seasonal credit in 2003 were close to the FOMC's target rate for the federal funds rate and ranged from 1.05 percent to 1.25 percent. Discount rates were as follows at year-end: primary credit at 2 percent, secondary credit at 2.50 percent, and seasonal credit at 1.05 percent.

Board Votes

Under the Federal Reserve Act, the boards of directors of the Federal Reserve Banks are required to establish rates on discounts and advances to depository institutions at least every fourteen days and must submit the rates to the Board of Governors for review and determination. Votes on the biweekly establishment of the prime credit rate without change and on the renewal of the formulas for calculating the rates on secondary and seasonal credit are not shown in this summary. All votes on discount rates taken by the Board of Governors in 2003 were unanimous.

Votes on Changes in the Primary Credit Rate

January 6, 2003. Effective January 9, 2003, the Board approved the establishment by the twelve Federal Reserve Banks of a primary credit rate of 2¼ percent and approved a formula for calculating a secondary credit rate that yielded a rate of 2¾ percent.

> Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn.

June 25, 2003. Effective this date, the Board approved actions taken by the directors of the Federal Reserve Banks of Boston, New York, Kansas City, and San Francisco to reduce their primary credit rate from 2¼ percent to 2 percent. The same decrease was approved for the remaining Federal Reserve Banks, effective June 26, 2003.

> Votes for this action: Chairman Greenspan, Vice Chairman Ferguson, and Governors Gramlich, Bies, Olson, Bernanke, and Kohn. ■

Minutes of Federal Open Market Committee Meetings

The policy actions of the Federal Open Market Committee, contained in the minutes of its meetings, are presented in the Annual Report of the Board of Governors pursuant to the requirements of section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each policy action, and that it shall include in its annual report to the Congress a full account of such actions.

The minutes of the meetings contain the votes on the policy decisions made at those meetings as well as a résumé of the information and discussions that led to the decisions. The summary descriptions of economic and financial conditions are based on the information that was available to the Committee at the time of the meetings rather than on data as they may have been revised later.

Members of the Committee voting for a particular action may differ among themselves as to the reasons for their votes; in such cases, the range of their views is noted in the minutes. When members dissent from a decision, they are identified in the minutes and a summary of the reasons for their dissent is provided.

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market operations, the Federal Reserve Bank of New York operates under three sets of instructions from the Federal Open Market Committee: an Authorization for Domestic Open Market Operations, Guidelines for the Conduct of System Open Market Operations in Federal Agency Issues, and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, the Committee operates under an Authorization for Foreign Currency Operations, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations. These policy instruments are shown below in the form in which they were in effect at the beginning of 2003. Changes in the instruments during the year are reported in the minutes for the individual meetings.

Authorization for Domestic Open Market Operations

In Effect January 1, 2003

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 $12.0 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;

(b) To buy U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 65 business 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;

(c) To sell U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 65 business 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.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding but that in no event shall be less than 1.0 percent per annum of the market value of the securities lent. The Federal Reserve Bank of New York shall apply reasonable limitations on the total amount of a specific issue that may be auctioned, and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 65 business days or less 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 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

4. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat

in exceptional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate. Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any adjustment.

Guidelines for the Conduct of System Open Market Operations in Federal Agency Issues

In Effect January 1, 2003

1. System open market operations in Federal agency issues are an integral part of total System open market operations designed to influence bank reserves, money market conditions, and monetary aggregates.

2. System open market operations in Federal agency issues are not designed to support individual sectors of the market or to channel funds into issues of particular agencies.

Domestic Policy Directive

In Effect January 1, 2003[1]

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 1¼ percent.

The Committee also approved the sentence below for inclusion in the press statement to be released shortly after the December 10, 2002, meeting:

Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks are balanced with respect to prospects for both goals in the foreseeable future.

Authorization for Foreign Currency Operations

In Effect January 1, 2003

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:

Canadian dollars	Mexican pesos
Danish kroner	Norwegian kroner
Euro	Swedish kronor
Pounds sterling	Swiss francs
Japanese yen	

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.

1. Adopted by the Committee at its meeting on December 10, 2002.

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)
Bank of Canada	2,000
Bank of Mexico	3,000

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 nonmarket 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 to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). 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.

Foreign Currency Directive

In Effect January 1, 2003

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.

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.

Procedural Instructions with Respect to Foreign Currency Operations

In Effect January 1, 2003

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.

Meeting Held on January 28–29, 2003

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 28, 2003, at 2:30 p.m. and continued on Wednesday, January 29, 2003, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, Messrs. Poole and Stewart, Alternate Members of the Federal Open Market Committee

Messrs. McTeer, Santomero, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Gillum, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Mattingly, General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Eisenbeis, Goodfriend, Howard, Hunter, Judd, Lindsey, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

Messrs. Ettin and Madigan, Deputy Directors, Divisions of Research and Statistics and Monetary Affairs, respectively, Board of Governors

Messrs. Slifman and Oliner, Associate Directors, Division of Research and Statistics, Board of Governors

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

Messrs. Clouse and Reifschneider,[2] Assistant Directors, Divisions of Monetary Affairs and Research and Statistics, respectively, Board of Governors

Mr. Simpson, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Fallon,[3] Senior Counsel, Legal Division, Board of Governors

Ms. Haltmaier,[4] Section Chief, Division of International Finance, Board of Governors

Messrs. Lebow,[4] Sack,[2] and Tetlow,[2] Senior Economists, Divisions of Research and Statistics, Monetary Affairs, and Research and Statistics, respectively, Board of Governors

Mr. Zakrajšek,[4] Economist, Division of Monetary Affairs, Board of Governors

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

Mr. Lyon, First Vice President, Federal Reserve Bank of Minneapolis

Messrs. Fuhrer and Hakkio, Ms. Mester, Messrs. Rasche and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Philadelphia, St. Louis, and Dallas respectively

Messrs. Altig and Croushore, Ms. Hargraves, Messrs. Miller and Rudebusch, Vice Presidents, Federal Reserve Banks of Cleveland, Philadelphia, New York, Minneapolis, and San Francisco respectively

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, 2003, and ending December 31, 2003, had been received and that these 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 Jamie B. Stewart, Jr., First Vice President of the Federal Reserve Bank of New York, as alternate.

J. Alfred Broaddus, Jr., President of the Federal Reserve Bank of Richmond, with Cathy E. Minehan, President of the Federal Reserve Bank of Boston, as alternate.

Jack Guynn, President of the Federal Reserve Bank of Atlanta, with William Poole, President of the Federal Reserve Bank of St. Louis, as alternate

Michael H. Moskow, President of the Federal Reserve Bank of Chicago, with Sandra Pianalto,[5] President of the Federal Reserve Bank of Cleveland, as alternate.

Robert T. Parry, President of the Federal Reserve Bank of San Francisco, with Thomas M. Hoenig, President of the Federal Reserve Bank of Kansas City, as alternate

By unanimous vote, the following officers of the Federal Open Market Committee were elected to serve until

2. Attended portion of meeting relating to discussion of gradualism in policymaking.

3. Attended portion of meeting relating to FOMC rule changes.

4. Attended portion of meeting relating to the FOMC's review of the economic outlook.

5. Election effective February 1, 2003.

the election of their successors at the first regularly scheduled meeting of the Committee after December 31, 2003, 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
Vincent R. Reinhart	Secretary and Economist
Normand R.V. Bernard	Deputy Secretary
Gary P. Gillum	Assistant Secretary
Michelle A. Smith	Assistant Secretary
J. Virgil Mattingly, Jr.	General Counsel
Thomas C. Baxter, Jr.	Deputy General Counsel
Karen H. Johnson	Economist
David J. Stockton	Economist

Thomas A. Connors, Christine Cumming, Robert A. Eisenbeis, Marvin S. Goodfriend, David H. Howard, William C. Hunter, John P. Judd, David E. Lindsey, Charles S. Struckmeyer, and David W. Wilcox, 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 regularly scheduled meeting of the Committee after December 31, 2003.

By unanimous vote, Dino Kos 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.[6]

6. Secretary's note: Advice subsequently was received that the selection of Mr. Kos as Manager was satisfactory to the board of directors of the New York Reserve Bank.

By unanimous vote, the Committee approved an amendment to paragraph 2 of the Authorization for Domestic Open Market Operations to give the Federal Reserve Bank of New York discretion to set the minimum lending fee for the System Open Market Account securities lending program below the existing 1.0 percent per annum rate. The Authorization as amended read as follows:

Authorization for Domestic Open Market Operations (Amended January 28, 2003)

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 $12.0 billion during the period commencing with the opening of business on the day following such a meeting and ending with the close of business on the day of the next such meeting;

(b) To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, from dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or obligations in 65 business 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.

(c) To sell U.S. Government securities and obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States to dealers for System Open Market Account under agreements for the resale by dealers of such securities or obligations in 65 business 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.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding. The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

3. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities in 65 business days or less 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 1(b), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

4. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat in exceptional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate. Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any adjustment.

With Mr. Broaddus dissenting, the Authorization for Foreign Currency Operations and the Foreign Currency Directive were reaffirmed as shown below.

Authorization for Foreign Currency Operations (Reaffirmed January 28, 2003)

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:

Canadian dollars	Mexican pesos
Danish kroner	Norwegian kroner
Euro	Swedish kronor
Pounds sterling	Swiss francs
Japanese yen	

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)
Bank of Canada	2,000
Bank of Mexico	3,000

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 nonmarket 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 to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). 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 Subcom-

mittee 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 3G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

Foreign Currency Directive (Reaffirmed January 28, 2003)

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 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.

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.

Mr. Broaddus dissented in the votes on the Authorization for Foreign Currency Operations and the Foreign Currency Directive because they provide the foundation for foreign exchange market intervention. For the same reasons he had given in the past when he had dissented on these policy instruments, he continued to believe that the Federal Reserve's participation in foreign exchange market intervention compromises its ability to conduct monetary policy effectively.

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

Procedural Instructions with Respect to Foreign Currency Operations (Reaffirmed January 28, 2003)

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.

By unanimous vote, the Committee approved the repeal of paragraphs 3 through 6 of the Guidelines for the Conduct of System Open Market Operations in Federal Agency Issues. The Committee initially suspended these paragraphs in August 1999 and subsequently extended the suspension annually for the years through 2002. Paragraphs 1 and 2, which provide general guidance for the conduct of System open market operations in federal agency obligations, were retained in their existing form.

Guidelines for the Conduct of System Open Market Operations in Federal Agency Issues (Amended January 28, 2003)

1. System open market operations in Federal agency issues are an integral part of total System open market operations designed to influence bank reserves, money market conditions, and monetary aggregates.

2. System open market operations in Federal agency issues are not designed to support individual sectors of the market or to channel funds into issues of particular agencies.

By unanimous vote, the Committee amended its Program for Security of FOMC Information on January 28, 2003, to update references to the classification of confidential documents and to clarify some of its instructions for safeguarding confidential information.

By unanimous vote, the Committee amended the Temporary Authority to Operate the System Account to authorize the Chairman to appoint an interim manager of the System Open Market Account in emergency circumstances. The amended Temporary Authority read as follows:

Temporary Authority to Operate the System Account (Amended January 28, 2003)

The Chairman of the Committee is authorized to appoint a Federal Reserve Bank as agent to operate the System Account temporarily in case the Federal Reserve Bank of New York is unable to function. In the event the Chairman exercises such authority, the Chairman also is authorized to appoint a Federal Reserve official to act temporarily as Manager of the System Account.

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 10, 2002, were approved.

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

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and securities issued or fully guaranteed by federal agencies during the period December 10, 2002, through January 28, 2003. By unanimous vote, the Committee ratified these transactions.

At this meeting the Committee discussed staff presentations on whether policy adjustments incorporating gradual movements in the federal funds rate were desirable in terms of optimally achieving the Committee's macroeconomic objectives. The staff presentations examined whether policy adjustments historically had been implemented gradually or whether, instead, the observed tendency for the federal funds rate to move slowly through time reflected the behavior of the underlying variables to which policy was responding. Members expressed a range of views regarding the evidence and its implications for policy, including potential situations that might call for relatively aggressive policy actions.

The Committee then turned to a discussion of the economic and financial outlook and the implementation of monetary policy over the intermeeting period ahead.

The information reviewed at this meeting suggested that economic growth was very slow in the fourth quarter. Housing demand and consumer spending firmed toward the end of the year, but capital spending remained quite weak in an environment of substantial business uncertainty and pessimism. A sharp drop in motor vehicle output held down overall industrial production, and the labor market deteriorated further. Core consumer price inflation continued to decline through the end of the year.

Private nonfarm payroll employment fell again in December and was at its lowest level since September 1999. Job losses in manufacturing continued to be sizable, and employment in retail trade plunged, although part of that decline might have been attributable to lower-than-usual hiring of temporary sales help for the holiday season. By contrast, hiring in the services industry picked up, and employment in the finance, insurance, and real estate group continued to expand. The unemployment rate held at 6 percent in December, a level consistent with other labor market indicators.

Industrial production slowed a little further in December, reflecting another sharp drop in motor vehicle assemblies and a decline in electricity generation. Excluding motor vehicles and parts, manufacturing output increased slightly following small declines in October and November. Production of high-tech goods continued to rise in December, and output in industries other than high-tech and transportation increased for the first time since August. Despite the uptick in production in some areas of manufacturing, capacity utilization in manufacturing fell again in December and was substantially below its long-run average.

Retail sales increased appreciably in November and December even though disposable personal income posted relatively modest gains and readings on consumer confidence were generally low. Purchases of new motor vehicles were brisk and were accompanied by moderate further increases in other categories of retail sales.

Residential housing activity remained strong through the end of the year, despite continued sluggish employment and additional declines in household wealth. With mortgage rates remaining near historical lows, single-family housing starts increased further in November and December, and the backlog of unused permits along with other information suggested that starts likely would remain strong in coming months. New home sales reached yet another record high in December, and existing home sales neared their record level established in January 2002. In the multifamily sector, starts rebounded in November and December from a sharp drop in October. Nonetheless, multifamily homebuilding was at a relatively low level at year-end, reflecting falling rents and high vacancy rates.

Business spending on equipment and software appeared to have little or no forward momentum in the fourth quarter and to have been weaker than might have been suggested by the recent pattern of business output, corporate cash flow, and the user cost of capital. Both shipments of and orders for nondefense capital goods turned down in the fourth quarter, with aircraft and communications equipment registering the steepest declines in shipments. In the nonresidential sector, construction activity slowed only a little further in October and November following a sharp drop in the third quarter. However, current weakness in rents and property values suggested continued deterioration in activity.

The book value of manufacturing and trade inventories excluding motor vehicles dropped sharply in October and changed little in November. Manufacturers trimmed stocks in both months, though durable goods manufacturers increased their inventories sharply in December. Wholesalers cut their inventories substantially in October and held them steady in November. Retail inventories changed little over the two-month period. Aggregate inventory–sales ratios in all three categories remained at very low levels.

The U.S. trade deficit in goods and services widened significantly in November, with the value of imports rising more than that of exports. Combining October and November, imports increased from the third-quarter average while exports declined somewhat. Available information on economic activity abroad in the fourth quarter suggested slower growth on average in the major foreign economies. Economic expansion in Japan appeared to have slowed markedly, and growth in the euro area remained sluggish. By contrast, the Canadian economy continued to expand briskly while activity in the United Kingdom seemed to be growing more moderately. In the emerging market economies, conditions in South America were generally still fragile, the pace of economic recovery in Mexico appeared to have slowed, and growth had softened in much of emerging Asia. Economic growth in China remained strong.

Core consumer price inflation, as measured by the consumer price index (CPI) and the chain-weighted personal consumption expenditure (PCE) index, continued to edge lower through the end of the year. However, the sizable run-up in energy prices last year boosted overall consumer price inflation somewhat on a year-over-year basis. At the producer level, core prices for finished goods declined in November and December, but for the year as a whole the jump in energy prices pushed overall producer prices for finished goods up slightly. With regard to labor costs, average hourly earnings of production or nonsupervisory workers increased moderately in December, but the change in those earnings over the year was considerably smaller than in 2001, evidently reflecting the slack in labor markets.

At its meeting on December 10, 2002, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with keeping the federal funds rate around 1¼ percent and retained an assessment that the risks to its longer-term objectives were balanced. The Committee noted that monetary policy was quite accommodative and well positioned to support a strengthening economic expansion in line with the members’ expectations for coming quarters. The Committee’s decision was widely anticipated and elicited little reaction. Financial markets were sensitive, however, to shifting perceptions of global risks, economic releases that generally were seen as having a disappointing tone, pessimistic expectations for fourth-quarter corporate profits, and the Administration’s announcement of an economic stimulus package larger than had been anticipated. Against that backdrop, longer-term Treasury yields declined somewhat while, in private debt markets, a sense of reduced concern about governance issues and perhaps some increased appetite for risk-taking led to a substantial decline in yields across the credit spectrum that further narrowed risk spreads. Major stock price indexes moved widely during the intermeeting period, but most finished the period a little lower.

The dollar depreciated substantially in terms of an index of major foreign currencies, with particularly large declines against the euro, the yen, and the Swiss franc. Market worries about growing tensions over Iraq and North Korea appeared to be a key factor, but concerns about the downbeat tone of recent U.S. economic data and the potential vulnerability of the dollar to a general pullback of international capital further damped market sentiment. The drop of the dollar occurred despite continued signs of weak growth in the euro area and Japan and sizable reductions in the yields of their long-term government securities.

Growth of M2 fell considerably in December. Much of the deceleration was concentrated in the liquid components of the aggregate, likely reflecting in part an adjustment in the volume of mortgage refinancings and the associated prepayments on mortgage-backed securities.

The staff forecast prepared for this meeting suggested that the expansion of economic activity would be muted in the very near term. Faced with intensified geopolitical tensions as well as continuing pessimism about the near-term course of economic activity, labor market conditions, and corporate earnings, businesses and consumers were likely to hold down their spending. In addition, continued sluggish economic growth among most major trading partners would tend to damp U.S. exports. However, those restraining influences were expected to abate over time. The considerable monetary ease already in place, the prospect of significantly more fiscal stimulus, the continuing strong gains in structural productivity, and the anticipated improvement in business confidence would provide significant impetus to spending. Inventory overhangs had been largely eliminated, and business capital stocks had moved closer to desired levels. As a consequence, a slowly improving outlook for sales and profits, low financing costs, and the temporary federal tax incentive for investment in new equipment and software were expected to gradually boost business investment spending. The persistence of underutilized resources would tend to foster some moderation in core price inflation.

In the Committee's discussion of current and prospective economic developments, members emphasized that their forecasts were subject to substantial uncertainties, dominated at this point by the geopolitical situation, but they continued to view a pickup in economic growth as a reasonable expectation for the year ahead. Household spending had been well maintained over the course of recent months, but a high degree of caution had induced business firms to continue to hold down their spending and hiring. It was suggested that the uncertainties relating to geopolitical tensions and possible war in Iraq, important factors contributing to business caution, might be at least partly resolved in the near term, helping to roll back some of the recent increase in oil prices and likely having favorable implications for consumer and business spending. Even so, the response of the economy was hard to anticipate because of the difficulty of disentangling the effects of current geopolitical tensions from the underlying momentum of the economy. Moreover, even a short and successful military campaign could give rise to a variety of disruptions that might limit at least for a time an improvement in business and consumer confidence.

The members nonetheless saw a number of favorable factors that could be expected to foster a relatively robust economic expansion over time. These included a stimulative monetary policy along with generally accommodative financial conditions, the prospect of additional fiscal stimulus, an increasing need for expenditures by business firms to replace depreciated equipment and to maintain acceptable inventory levels, and continued vigorous growth in productivity that would support profits and incomes. With regard to the outlook for inflation, prospective growth of spending in line with the members' forecasts likely would continue to be associated with only muted pressures on labor and other resources over the year ahead, and given current trends in productivity, members anticipated that consumer price inflation would remain subdued; indeed, modest further disinflation might occur over the year ahead.

In preparing for the semiannual monetary policy report to Congress, the Board members and Reserve Bank presidents provided individual projections of the growth of GDP, civilian unemployment, and consumer price inflation for the year 2003. The members agreed that because of the unusual uncertainties that clouded their current forecasts, the latter should be viewed as having extremely wide confidence bands. Their forecasts envisaged a strengthening economic recovery but not one that was likely to induce a material, if any, decline in the unemployment rate over the year ahead. Their forecasts of growth in real GDP for 2003 had a central tendency of 3¼ to 3½ percent and a full range of 3 to 3¾ percent, measured as the change between the fourth quarter of 2002 and the fourth quarter of 2003. Their projections of the civilian unemployment rate in the fourth quarter of the year were all in a range of 5¾ to 6 percent. Their forecasts of consumer price inflation for the year, as measured by the PCE chain-type price index, were centered in a range of 1¼ to 1½ percent, with a full range of 1¼ to 1¾ percent.

In the Committee's discussion of developments in key sectors of the economy, members continued to place emphasis on the critical role of business spending and hiring decisions in determining the strength of the expansion. An elevated level of business caution clearly was holding back investment spending, and there were few signs of a pickup in the near term. Given an eventual reduction in prevailing uncertainties, however, a number of members noted that the outlook for business spending was favorable, and they did not rule out a sharp snapback in business expenditures as the year progressed. Factors cited in support of this view included the wide availability and low cost of capital, the increasing need for replacing worn and outdated capital equipment with the passage of time, a decline in overall stocks of capital in relation to the economy's growing potential, and the anticipated continuation of what appeared to be an upward trend in sales, cash flows, and profits. Some members also referred to the positive effects on some business decisions of the temporary federal tax incentives for expenditures on business equipment and software. The members agreed that the strength and timing of the prospective improvement remained subject to a high degree of uncertainty. Indeed, a number of members commented that it was possible that some easing of geopolitical tensions would not lead to a major near-term upturn in business confidence and business expenditures. Such an outcome would be especially likely if oil supplies were disrupted, a threat that could not be ruled out, with adverse consequences for oil prices and business costs. Moreover, the current excess capacity would permit many firms to meet likely demands for some period of time without a significant increase in capital investments.

The evident uncertainty and pessimism in the business community were also reflected in tight inventory control policies. Despite continuing gains in final sales, inventories were estimated to have changed little in the fourth quarter and currently were at levels that were widely viewed as unusually low in relation to sales. In these circumstances, an easing at some point of current uncertainties and strengthening confidence should induce inventory rebuilding, with positive implications, at least for a time, for the expansion of economic activity.

The household sector had continued to provide vital support to overall demand in recent months despite a deteriorating trend in consumer confidence. While numerous contacts reported generally disappointing holiday sales in an environment of atypically large and widespread discounting, a surge in motor vehicle sales in December fostered by aggressive sales incentives and some pickup in retail sales late in the holiday season helped to sustain moderate overall growth in consumer spending through the year-end. Looking ahead, a number of factors seemed likely to undergird consumer spending, including the positive effects on permanent incomes of robust ongoing growth in productivity, the possibly accelerated phase-in of tax reductions stemming from earlier legislation, the prospects for additional reductions in federal taxes affecting household incomes, and more generally the continued favorable effects of low interest rates and widely available financing on consumer purchases of motor vehicles and other durables. At the same time, some members expressed concern about the potential for adverse effects on consumer incomes and confidence should stagnant conditions persist in labor markets and equity markets weaken further. Reference also was made to the possibility suggested by some analysts that the value of housing wealth might be leveling off. In that event mortgage refinancings might moderate once mortgage rates stabilized, reducing the impetus to consumer spending from this source.

Statistical indicators of housing activity and anecdotal reports from numerous parts of the country pointed to persisting strength in homebuilding, with no signs of a slowdown in most areas. Members generally anticipated that activity in this sector of the economy would be well maintained in the context of low mortgage rates and further growth in incomes, but a few expressed reservations about forecasts of a further pickup this year.

The members anticipated the enactment of new legislation that would add to the fiscal stimulus that was already incorporated in earlier legislation. While greater fiscal stimulus appeared to be desirable to counter near-term weakness in the economy, the new legislation probably could not be enacted in time to begin to exert an expansionary impact on the economy before the latter part of this year when the anticipated strengthening of the economy might already be well under way. Members also observed that, given the competing legislative proposals currently under consideration, the eventual components and size of that legislation were very uncertain at this point, though they were likely to be importantly influenced by the performance of the economy and especially labor market conditions over coming months. A number of members expressed the hope that the legislation would not encompass provisions that would lead to permanently large federal deficits with negative consequences for the economy over the longer term.

As they had at previous meetings, members also commented on the severe fiscal problems being experienced by numerous state and local governments. It was noted that state revenue shortfalls were being aggravated by federally mandated costs related to homeland security that were not, at least currently, being reimbursed by the federal government. Another problem related to certain tax proposals under consideration in the Congress, notably the exclusion of dividends from income, that could have adverse consequences for the revenues of numerous state and local governments that linked their taxable incomes to those reported on federal returns. More generally, while state and local efforts to redress budget imbalances were likely to offset only a small part of the probable stimulus in forthcoming federal legislation, some members commented that those efforts might well involve more fiscal restraint than was currently foreseen by some analysts.

Largely reflecting their expectations of ongoing, albeit diminishing, slack in labor and product markets, the members anticipated that consumer price inflation probably would edge down over the next several quarters from an already low level. Members also referred to a number of crosscurrents bearing on the outlook for prices that included the adverse effects of recent declines in the dollar and higher oil prices but also the opposing effects of a strong uptrend in productivity and highly competitive markets in holding down prices and costs. With regard to labor costs, members cited anecdotal evidence of persisting weakness in numerous regional labor markets and, given the current reluctance of employers to add to their workforces, the prospect that job gains and labor compensation would tend to lag the anticipated strengthening in economic activity, as they often had in the past.

In the Committee's discussion of policy for the intermeeting period, all the members supported a proposal to maintain an unchanged policy stance. While the economy had continued to grow slowly, monetary policy and overall financial conditions had remained accommodative and the prospects for an appreciable strengthening of the economic expansion over time were favorable. As some of the prevailing uncertainties currently impairing spending began to lift, possibly in the near term with regard to military developments in the Middle East, the Committee should be in a much better position to assess the underlying strength of the economy and the appropriate policy response. At this point, the Committee could not rule out a range of plausible economic outcomes, including the possibility of a persisting subpar economic performance or a much stronger than forecast acceleration of the expansion. Indeed, the Committee could envision circumstances when it might find it desirable to adjust its policy stance substantially and promptly in one direction or the other in the months ahead. The members concluded that a wait-and-see policy stance was desirable pending an improved basis for judging the ongoing performance of the economy. They also agreed that the accommodative stance of policy, developments over the intermeeting period, and their current forecasts in the context of tensions abroad argued for retaining a balanced risks assessment to be included in the statement that would be made public shortly after this meeting.

At the conclusion of this discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 1¼ percent.

The votes encompassed approval of the sentence below for inclusion in the press statement to be released shortly after the meeting.

> Against the background of its long-run goals of price stability and sustainable economic growth and of the information currently available, the Committee believes that the risks are balanced with respect to prospects for both goals in the foreseeable future.

Votes for this action: Messrs. Greenspan, McDonough, and Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, and Parry. Vote against this action: None.

It also was agreed that the next meeting of the Committee would be held on Tuesday, March 18, 2003.

The meeting adjourned at 12:55 p.m. on January 29, 2003.

Vincent R. Reinhart
Secretary

Meeting Held on March 18, 2003

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, March 18, 2003, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, and Mr. Poole, Alternate Members of the Federal Open Market Committee

Messrs. McTeer, Santomero, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Gillum, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Eisenbeis, Goodfriend, Howard, Hunter, Lindsey, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

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

Messrs. Slifman and Oliner, Associate Directors, Division of Research and Statistics, Board of Governors

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

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

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

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

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

Messrs. Fuhrer and Hakkio, Mses. Mester and Perelmuter, Messrs. Rasche, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Philadelphia, New York, St. Louis, Dallas, and Cleveland respectively

Mr. Rudebusch, Vice President, Federal Reserve Bank of San Francisco

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on January 28–29, 2003, were approved.

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

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and securities issued or fully guaranteed by federal agencies during the period January 29, 2003, through March 17, 2003. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook and the conduct of monetary policy over the intermeeting period.

The information reviewed at this meeting suggested that growth of economic activity remained subpar in the opening months of the year. While the underlying demand for residential housing continued to be robust and government outlays evidently were rising, the expansion of consumer spending seemed to have slowed, and outlays for capital spending were still very sluggish in an environment of business uncertainty and pessimism. Declining motor vehicle output held down overall industrial production, and the labor market weakened further. Consumer price inflation as measured by the core CPI decelerated over the past year, but steep increases in energy prices boosted overall price inflation.

Private nonfarm payroll employment had fallen sharply on balance in recent months, though the quite large February decline may have been exaggerated by bad weather, military reserve call-ups, and seasonal adjustment difficulties. February job losses in manufacturing were at about the same pace as seen over the past year. However, layoffs in construction surged, likely reflecting the unusually adverse winter weather conditions over much of the country. There were widespread declines in employment in the service sector, particularly in industries that had experienced steady growth last year. Job losses in the transportation industry seemed to have been associated in part with higher fuel costs. The unemployment rate inched up to 5.8 percent in February, and the most recent readings on initial claims for unemployment insurance suggested that labor market conditions remained soft in March.

Industrial production edged up in February after a sharp rise in January. Electricity generation increased substantially in response to unseasonably cold weather in much of the East, and mining production picked up. Manufacturing was pulled down in February by a slump in motor vehicle assemblies, but the output of high-tech goods registered another sizable gain, reflecting continuing growth in the production of semiconductors and computers, and output of goods other than motor vehicles and high-tech goods was unchanged. With manufacturing production lower, capacity utilization in manufacturing slipped somewhat in February to a rate substantially below its long-run average.

Retail sales were lower on balance in January and February, partly reflecting a decline in motor vehicle sales in both months and snowstorms that kept many consumers at home in February. In addition, rising energy prices eroded part of the sluggish gains in consumer incomes, and both consumer sentiment and net worth deteriorated noticeably.

With mortgage rates remaining near historical lows, strength in residential housing demand carried through the early part of this year. However, bad weather in February disrupted single-family construction activity and single-family starts fell sharply from January's very high level. Sales of both new and existing homes slipped noticeably in January but remained at elevated levels. In the multifamily sector, where vacancy rates are high and rents have fallen, starts dropped considerably to about the average pace recorded over the past three years.

Business investment on equipment and software increased briskly in the fourth quarter of last year as outlays for aircraft climbed sharply and other major categories recorded gains. In January, a rise in shipments of nontransportation capital equipment suggested that the demand for such goods on the part of businesses was beginning to respond to continued increases in output and further declines in the cost of capital. In the high-tech sector, shipments of computing equipment surged in January, and shipments of communications equipment registered sizable gains. Outside the high-tech sector, however, shipments edged down. Data on orders for durable equipment placed in December and January suggested that shipments could strengthen in the coming months. In the nonresidential sector, construction activity slowed further in the fourth quarter, with most categories recording sizable declines in expenditures. Many indicators of market conditions in the nonresidential sector continued to weaken, with vacancy rates rising and rents generally falling, but an upturn in property values suggested that a turnaround in rents might be near.

The book value of manufacturing and trade inventories excluding motor vehicles edged down in January following buildups of stocks in the third and fourth quarters of last year. The aggregate inventory–sales ratio for this sector had trended down from the high levels recorded in mid-2001 and reached a new low in January, with few imbalances evident across industries.

The U.S. trade deficit in goods and services narrowed substantially in January as the value of exports partially reversed a large December decline and the value of imports fell from elevated November and December levels. The rise in exports and the drop in imports were broadly spread across goods categories. Available information on economic activity abroad indicated that most of the major foreign economies experienced sluggish growth late in 2002 that seemed likely to persist in the first quarter. Economic expansion in the euro area weakened further in the fourth quarter and Canadian output decelerated sharply, but growth in Japan was relatively well sustained at a modest pace. In the emerging-market economies, conditions in South America generally remained fragile, the pace of economic recovery in Mexico appeared to have slowed somewhat, and growth was generally restrained in much of emerging Asia. Economic growth in China remained strong.

Most measures of core consumer prices and labor costs decelerated in the twelve-month period ended in January. However, the recent jump in gasoline and heating oil prices, reflecting a sharp run-up in crude oil prices and unusually cold weather in the Midwest and East, significantly boosted overall consumer price inflation in the twelve months ended in January. At the producer level, core price inflation for finished goods eased in the twelve-month interval ending in February. With regard to labor costs, hourly compensation for private industry workers decelerated noticeably in 2002, with growth of both the salary and benefits components slowing on a year-over-year basis. Growth in average hourly earnings of production or nonsupervisory workers also slowed in the twelve months ending in February. The deceleration in both labor measures likely reflected in part the slack in labor markets.

At its meeting on January 28–29, 2003, the Committee agreed on a directive that called for maintaining conditions in reserve markets consistent with keeping the federal funds rate around 1¼ percent and retained a balanced risks assessment. The Committee noted that the economy continued to grow slowly, but monetary policy and financial conditions were quite accommodative and the prospects for an appreciable strengthening of the economic expansion over time remained favorable. The Committee concluded that a wait-and-see policy stance was desirable pending an improved basis for judging the ongoing performance of the economy. The Committee's decision was widely anticipated and elicited little reaction in financial markets. However, with the likelihood of war perceived to have increased, investor wariness apparently intensified downward pressure on equity prices and interest rates over the intermeeting period. Treasury bond yields declined somewhat, perhaps reflecting both expectations of lower policy rates and greater investor demands for safety. Rates in private debt markets fell by somewhat more than comparable-maturity Treasury yields. Declines in major equity indexes were amplified by lackluster earnings reports and disappointing data on auto sales, labor market conditions, and consumer confidence.

The dollar changed little on balance over the intermeeting period in terms of an index of major foreign currencies, though the dollar fluctuated widely in the latter part of the period in reflection of market concerns about geopolitical uncertainties. The dollar depreciated against the Canadian dollar, which was supported by a small monetary tightening action by the Bank of Canada to trim inflationary pressures. By contrast, the dollar appreciated slightly against the British pound, partly in response to an unexpected easing by the Bank of England to counter downward pressures on economic activity. The European Central Bank also cut its key policy rates in response to further signs of economic weakness in major euro-area countries. The dollar was also little changed against an index of the currencies of other important U.S. trading partners.

M2 grew rapidly in February, owing mainly to robust inflows to liquid deposits. Earlier filings for tax refunds and hefty mortgage prepayments associated with refinancing activity likely were factors in the strength of M2. In addition, investors might have seen liquid deposits as a safe haven at a time of considerable volatility in equity markets.

The staff forecast prepared for this meeting continued to suggest that economic expansion would be muted for a time. Faced with the likely onset of war in the very near term and the large uncertainties relating to its aftermath, businesses and consumers were likely to hold down their spending. In addition, continued sluggish economic growth among most major U.S. trading partners was expected to damp U.S. exports. Nonetheless, those restraining influences were expected to abate over time. The considerable monetary ease already in place and the likely prospect of significantly more fiscal stimulus would combine with expected continuing strong gains in structural productivity and improving business and consumer confidence to provide significant impetus to spending. Inventory overhangs had been largely eliminated and business capital stocks had moved closer to desired levels. As a consequence, a slowly improving outlook for sales and profits, low financing costs, and the temporary federal tax incentive for investment in new equipment and software were expected to gradually boost business investment spending. The persistence of underutilized resources was expected to maintain some downward pressure on core price inflation over the forecast period.

In the Committee's discussion of current and prospective economic developments, members commented that an unusually high degree of uncertainty had made it very difficult to assess the factors underlying the performance of the economy. Widespread indications of a strengthening economy near the end of last year through the first part of this year had given way to a disappointing economic performance more recently. It seemed clear that an outbreak of war with Iraq was imminent and that this prospect was having a damping effect on the economy. Uncertainty about the effects of the war had contributed to higher energy prices, lower equity prices, declines in measures of household confidence, and a tendency for households and especially businesses to postpone making commitments. But it was also possible that a part of the recent weakness might reflect underlying economic conditions. In the circumstances, some clarification of the Iraqi situation, which might occur in the relatively near future, should improve the Committee's ability to assess ongoing developments, though uncertainties would remain. Beyond the near term, members acknowledged that relatively subdued growth for a time could not be ruled out, but many commented that the conditions were in place for a strengthening expansion. In this regard they referred to the positive effects on business profits and consumer incomes of persisting gains in productivity, stimulative monetary and fiscal policies, and accommodative financial and bank lending markets. The likelihood of continued low or even declining inflation was high, especially given expectations of persisting slack in resource utilization.

In the course of the Committee's review of developments in key sectors of the economy, members underscored the retarding effects of reduced confidence and heightened caution on household and business spending but noted that it was difficult to attribute the relative contributions of geopolitical risk and worries about the economy to the emergence of weaker spending. In any event, consumer expenditures appeared to have been held back recently by the impact of higher energy costs, weak labor markets, and severe winter weather in the eastern part of the United States. Sales of motor vehicles had declined substantially since the start of the year despite the introduction of enhanced sales incentives. Nonautomotive retail sales, after a pickup at the end of 2002 that had extended through the first several weeks of this year, had weakened more recently. Whether the recent experience augured further softening in consumer spending was uncertain, but some members commented that this weak performance was not reassuring with regard to forecasts of substantial strengthening of the expansion later this year. Many observed, however, that a favorable outcome to the hostilities in the Middle East and lower oil prices in line with quotations in futures markets should generate a positive response in equity markets, boost consumer sentiment, and foster a rebound in consumer spending as the year progressed.

Housing activity had held up well on the whole, despite a negative report on housing starts for February, and indeed was displaying continued strength in many parts of the nation. In numerous areas, however, sales of high-end homes had continued to lag and there were reports of a softening in the middle-market single-family sector in some areas. Members also cited indications of overbuilding in some parts of the country, notably of multifamily housing. On balance, generally robust homebuilding activity was expected to persist against the backdrop of low mortgage interest rates and rising household incomes.

With regard to the outlook for business capital expenditures, members commented that a variety of factors likely would induce business firms to continue to hold back on new investment initiatives, at least over the near term. Indeed, there was as yet no persuasive evidence that business fixed investment would provide the needed support for the strengthening in overall economic activity. Geopolitical uncertainties, notably those relating to developments in Iraq, frequently were cited by business contacts as a major reason for caution, but other factors inhibiting capital expenditures evidently included excess capacity and limited prospects for profits because of increased energy, insurance, pension, and other costs and a concomitant inability to raise selling prices. At the same time, there was only limited evidence thus far that the partial-expensing tax incentive, scheduled to expire in September 2004, was having a measurable effect on outlays for new equipment and software. The outlook for commercial construction activity was especially downbeat because of high vacancy rates in industrial and office structures in many areas, and a general upturn in such construction was viewed as unlikely to occur for an extended period of time. While resolution of some of the uncertainties relating to Iraq seemed likely in the relatively near term, many business contacts reported that they would continue to hold down their capital investments until demand for their goods and services and related profit opportunities displayed clear signs of significant improvement. Some members nonetheless referred to indications of increasing expenditures for various categories of high-tech equipment and software, and they noted that impetus to demand from a positive outcome in the war against Iraq should have a favorable effect on business capital spending, especially if it were accompanied by a rally in the stock market.

Many firms were trying to keep their inventories at especially low levels in light of their concerns that projected sales might not materialize. Members cited the resulting lean inventories as a positive element in the outlook for economic activity, given likely efforts by business firms to maintain inventories in broad aligment with anticipated growth over time in final sales.

Federal government spending continued to rise rapidly, led by large increases in defense and homeland security expenditures, and members noted that the resulting impetus to growth might be augmented by passage of a fiscal stimulus package in line with that proposed by the Administration. Considerable uncertainty surrounded the eventual size of such a package or even whether it would be enacted this year. A partial offset to the federal fiscal stimulus stemmed from efforts to address deepening budget crises in a number of states and their adverse implications for many local economies.

Against the background of persistent strength in productivity growth and continued low levels of capital and labor utilization, inflation would likely remain subdued going forward. Indeed, members saw further disinflation in core prices as a distinct possibility over the next several quarters. At the same time, the outlook for oil prices and energy prices more generally was uncertain and, despite market expectations, oil prices might remain relatively high in the event of adverse developments in Iraq and in some other major oil producing countries that were experiencing serious economic and political problems. However, high oil prices, should they persist, were likely to have more of an effect in damping demand than in raising inflation, given well-entrenched expectations of low inflation.

In the Committee's discussion of policy for the intermeeting period ahead, the members unanimously supported a proposal to maintain an unchanged policy stance. While the economic expansion had displayed signs of faltering in recent weeks, the reasons for and hence the duration of any period of weakness could not be reliably ascertained. In that regard, members commented that as key geopolitical uncertainties diminished or were resolved, the Committee would be in a much better position to assess economic trends and a desirable course for monetary policy. Monetary policy was positioned to accommodate a strengthening economic performance that seemed likely to materialize once key uncertainties and related concerns began to decrease, perhaps in the relatively near future, and business and consumer sentiment started to improve. To be sure, the timing and speed of a pickup in economic activity were not clear, and some members saw continued growth below potential as the primary risk for the near term. The members concluded that the prudent course in current circumstances was to maintain a steady policy stance, a high degree of vigilance, and a readiness to respond promptly as needed to the emergence of clearer evidence relating to the performance of the economy. In the latter regard, some members cautioned that the Committee might well need to adjust its policy in circumstances that continued to be characterized by a substantial degree of uncertainty.

The Committee decided to omit its usual statement regarding the balance of risks from the press release to be made public shortly after the meeting. Most members believed that the major uncertainties surrounding the geopolitical situation made it impossible to assign reasonable probabilities to plausible alternative economic outcomes and that any effort to do so would provide a misleading impression of the Committee's confidence and knowledge about the economic outlook. In light of these considerable uncertainties, the members agreed that heightened surveillance of evolving economic trends would be especially useful in the weeks ahead. At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 1¼ percent.

> Votes for this action: Messrs. Greenspan, McDonough, Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, and Parry. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, May 6, 2003.

The meeting adjourned at 12:50 p.m.

Following the outbreak of war in Iraq, the members of the Committee participated in a series of conference calls held on March 25, April 1, April 8, and April 16 in order to keep abreast of the latest information and to exchange views regarding the possible implications of current developments for the economic outlook and monetary policy.

No policy decisions were made in this period.

Vincent R. Reinhart
Secretary

Meeting Held on May 6, 2003

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, May 6, 2003, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, Messrs. Poole and Stewart, Alternate Members of the Federal Open Market Committee

Messrs. McTeer, Santomero, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Gillum, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Eisenbeis, Goodfriend, Howard, Hunter, Judd, Lindsey, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

Messrs. Ettin and Madigan, Deputy Directors, Divisions of Research and Statistics and Monetary Affairs respectively, Board of Governors

Messrs. Slifman and Oliner, Associate Directors, Division of Research and Statistics, Board of Governors

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

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

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors

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

Messrs. Fuhrer and Hakkio, Mses. Mester and Perelmuter, Messrs. Rasche, Rosenblum, Rolnick, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Philadelphia, New York, St. Louis, Dallas, Minneapolis, and Cleveland respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 18, 2003, were approved.

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

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and securities issued or fully guaranteed by federal agencies during the period March 18, 2003, through May 5, 2003. By unanimous vote, the Committee ratified these transactions.

With Mr. Broaddus dissenting, the Committee voted to extend for one year beginning in mid-December 2003 the reciprocal currency (''swap'') arrangements with the Bank of Canada and the Bank of Mexico. The arrangement with the Bank of Canada is in the amount of $2 billion equivalent and that with the Bank of Mexico in the amount of $3 billion equivalent. Both arrangements are associated with the Federal Reserve's participation in the North American Framework Agreement. The vote to renew the System's participation in the swap arrangements maturing in December was taken at this meeting because of the provision that each party must provide six months prior notice of an intention to terminate its participation. Mr. Broaddus dissented because he believed that the swap lines exist primarily to facilitate foreign exchange market intervention, and he was opposed to such intervention for the reasons he had expressed at the January meeting.

The Committee then turned to a discussion of the economic and financial outlook and the conduct of monetary policy over the intermeeting period.

The information reviewed at this meeting suggested that economic activity continued to grow at a subpar pace in recent months. Consumer spending advanced slightly in the first quarter and housing activity remained at a high level, but business investment slowed. Industrial production was sluggish, and additional slack accumulated in the labor market. Core consumer inflation had moved lower, but overall consumer prices had been pushed up recently by sharp rises in energy prices.

Private nonfarm payroll employment continued to fall in April. Manufacturing employment registered widespread losses, and the retail trade, transportation, and utilities industries extended their declines of prior months. The unemployment rate rose to 6 percent in April, with increases spread widely across most demographic groups. Initial claims for unemployment insurance remained at an elevated level, suggesting further labor market weakness in May.

Industrial production fell in March, and weekly physical product data and other indicators pointed to another drop in April. Lower output at utilities accounted for some of the decline in overall production in March but manufacturing output, especially motor vehicle assemblies, fell again. Total industrial capacity utilization declined in March, with capacity utilization in manufacturing reaching a twenty-year low.

Real personal consumer expenditures rose in March and for the first quarter as a whole. Spending on durable goods increased in March but was down a bit for the full quarter. By contrast, spending on services and nondurable goods fell in March but was up on balance in the first quarter. Disposable income was unchanged in March. Measures of consumer confidence rebounded sharply in April after sizable declines in February and March.

Residential housing activity remained solid, though some signs of potential moderation emerged. Supported by continued low mortgage rates, first-quarter housing starts in the single-family sector stayed at the high level of the fourth quarter. Multifamily starts also changed little in the first three months of the year and vacancy rates in the sector remained high. Sales of existing homes were off a bit in March, but sales for the first quarter as a whole edged up from the fourth-quarter rate. New home sales, however, were down from their fourth-quarter pace.

Real outlays on equipment and software declined in the first quarter after rising moderately over the three preceding quarters. A sharp drop in purchases of transportation equipment more than accounted for the first-quarter decline. The weakness in the transportation category reflected sluggish expenditures for aircraft, medium and heavy trucks, and light vehicles. By contrast, the high-tech category recorded strong growth owing to a surge in spending for computer and peripheral equipment and an upturn in purchases of communications equipment. Although investment fundamentals, such as corporate cash flows and reduced costs of capital, remained favorable, reports from businesses were downbeat. The extended decline in real investment spending on nonresidential structures moderated further in the first quarter, with the smallest decline since the first quarter of 2001.

Real nonfarm inventories excluding motor vehicles appeared to have declined a little in the first quarter after accumulating in recent quarters. The buildup of manufacturing and trade inventories, however, continued in January and February at an average pace similar to that of the second half of 2002. Relative to sales, non-auto inventory stocks in most sectors were low by recent standards. According to industry reports, inventories in the motor vehicle industry apparently had risen above desired levels.

The U.S. trade deficit in goods and services narrowed slightly in February and brought the average deficit for January and February to an annual rate near that of the fourth quarter. The narrowing in February was accounted for by a small decline in imports and a marginal rise in exports. Recent indicators suggested continued sluggish economic growth in most foreign industrial nations. The Japanese economy was about flat in the early months of the year, activity in the euro area remained subdued, and first-quarter growth in the United Kingdom was lackluster. Canadian domestic demand remained relatively robust but appeared to be slowing. Economic conditions in other countries were mixed. In Latin America, Mexican data releases pointed toward increases in economic activity, and the Argentine economy continued to show signs of recovery. In contrast, Venezuela remained in crisis, and economic activity in Brazil appeared to have moderated despite improved financial market conditions. In developing Asia, indicators suggested that economic growth had slowed in much of the region. China, however, registered robust growth in the first quarter.

Core consumer price inflation moved down further in the first quarter from its already low level. A sharp run-up in energy prices, however, pushed up overall consumer prices in the first quarter and in the year ended in March (measured by both the consumer price index and the chain-type personal consumption expenditure index). Producer prices also were boosted significantly by the jump in energy prices in recent months. Core producer prices were up appreciably in the first quarter but at a slower pace than overall producer prices. With regard to labor costs, the employment cost index for hourly compensation of private industry workers rose at a faster rate during the three months ended in March, reflecting increases in wages and salaries and in benefit costs. The expansion of compensation costs over the twelve months ended in March was virtually the same as in the previous twelve-month period.

When the Committee met on March 18, 2003, the nation appeared to be on the brink of war. At the end of that meeting, the Committee adopted a directive that called for maintaining conditions in reserve markets consistent with keeping the federal funds rate around 1¼ percent. The Committee agreed to indicate in its announcement that in light of the unusually large uncertainties clouding the geopolitical situation in the short run and their apparent effects on economic decisionmaking, it could not at that time usefully characterize the current balance of risks with respect to the prospects for its long-run goals of price stability and sustainable economic growth. The Committee also agreed that heightened surveillance would be particularly informative. It was noted that while the recent economic data were mixed, the hesitancy of the economic expansion appeared to owe significantly to oil price premiums and other aspects of geopolitical uncertainties. The Committee believed that as those uncertainties lifted, the accommodative stance of monetary policy, coupled with the ongoing growth in productivity, would provide vital support toward fostering improving economic performance over time.

The decision to leave policy on hold had been largely anticipated by market participants, but the inclusion in the policy announcement of a reference to "heightened surveillance" led initially to downward revisions to expectations for the future path of the federal funds rate. The abatement of war-related risks was reflected in sizable declines in forward-looking measures of uncertainty in short- and long-term interest rates, exchange rates, and oil and equity prices. Nearer-term Treasury yields had fallen, but longer-term Treasury yields had changed little since the March meeting. Risk spreads on corporate debt securities narrowed across the credit quality spectrum. Broad equity indexes registered notable gains related to better-than-expected corporate earnings reports.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the major foreign currencies declined over the intermeeting period. The dollar depreciated somewhat more against the euro and the Canadian dollar and only slightly against the Japanese yen. The dollar also declined against an index of currencies of other important trading partners. Equity markets in the major industrial economies, except Japan, had risen significantly since the March FOMC meeting.

Growth in M2 slowed over March and April, but most of the deceleration appeared to be attributable to temporary tax-related flows of funds. A movement toward earlier electronic filing apparently weakened M2 in March by shifting refund distributions into February. Reduced M2 growth in April reflected, in part, slower-than-average buildups of deposits associated with final tax payments by individuals. Substantial net inflows to equity mutual funds occurred during the same period.

The staff forecast prepared for this meeting continued to suggest that economic expansion would be sluggish in the near term. Faced with persisting weakness in product and labor markets, businesses and consumers were likely to hold down their spending. In addition, continued slow economic growth in most of the nation's major trading partners would tend to restrain U.S. exports, though those restraints were expected to abate over time. The cumulative effects of an accommodative monetary policy, likely further reduction in taxes, and robust gains in structural productivity would provide significant impetus to spending. Inventory overhangs had been substantially reduced, and business capital stocks had moved closer to desired levels. As a consequence, a slowly improving outlook for sales and profits, low financing costs, and the temporary federal tax incentive for investment in new equipment and software were expected to gradually boost business investment spending. Given the ongoing slack in resource utilization, downward restraint on core price inflation was expected to persist over the forecast period.

In the Committee's discussion, members commented that the recent information bearing on the economic outlook was mixed. The latest reports on economic activity generally were disappointing, notably those relating to employment and production, but members noted that most of these reports covered developments occurring before the end of hostilities in Iraq. The successful prosecution of the war had served to reduce geopolitical uncertainties and in turn had helped to foster a marked strengthening of domestic financial markets, a sizable decline in oil prices, and an apparent upturn in consumer confidence. In this improved environment, members anticipated that near-term sluggishness in economic growth would give way to more vigorous expansion as the year progressed. In support of this expectation, it was noted that if the substantial gains in financial markets experienced recently persisted, experience indicated that a stronger economic performance generally would follow. Favorable factors in the outlook mentioned by members included an accommodative monetary policy, prospective legislation that would increase an already stimulative fiscal policy, and evidence of a persisting uptrend in productivity that provided enhanced investment opportunities and ongoing support for household incomes. Continued progress in lifting various constraints on economic growth, including the unwinding of excessive or misdirected capital expenditures undertaken in earlier years and the steps taken to address corporate governance and credit problems were also working to strengthen the expansion. Against that backdrop, it was noteworthy that many private-sector forecasters predicted a pronounced upturn in economic growth in the third quarter. Despite underlying factors that seemed increasingly conducive to an accelerating expansion, members noted that the timing and vigor of a pickup in economic activity remained uncertain, especially in the context of a persistently high degree of caution in the business community with regard to investment and hiring decisions. With the removal of key uncertainties associated with the Iraqi war, the information that would become available in the weeks ahead was expected to provide a clearer basis for assessing future trends in business spending and, more generally, the underlying strength of the economy. Members anticipated that inflation would remain at a low level for an extended period and indeed that the probability of further disinflation was higher than that of a pickup in inflation, given the current high levels of excess capacity in labor and product markets, which seemed likely to diminish only gradually.

Business fixed investment remained a key factor in the prospects for overall economic activity, and persisting weakness in such spending in association with gloomy sentiment and a high degree of risk aversion among business decisionmakers did not bode well for the capital investment outlook, at least for the near term. Anecdotal reports by business contacts tended to emphasize widespread excess capacity as a reason for holding down business capital spending, including high vacancy rates in office and other business structures. In this atmosphere, most business decisionmakers evidently preferred to rely on the increasingly efficient or fuller utilization of existing producer facilities rather than expanding the latter to meet growth in demand. Indeed, according to business contacts, investment expenditures generally were limited to replacement and to some extent to upgrading of existing facilities rather than for expansion. In some cases, businesses reportedly were acquiring used capital equipment and unoccupied building space at greatly reduced costs, thereby holding down the current production of new capital but also relieving selling firms of some excess capacity.

Members nonetheless saw a number of favorable elements in the outlook for business investment expenditures. These included a decline in the cost of business capital, a recent rise in orders and backlogs of nondefense capital goods, persisting gains in productivity that undoubtedly pointed to growing profit opportunities, progress in strengthening business balance sheets, and reduced capital overhangs. With regard to business attitudes, members reported very recent but also widespread indications from their contacts that business confidence might be in the process of improving, though the upturn in confidence was not likely to show through to investment outlays for some time.

In the household sector, an appreciable decline in sales of motor vehicles and slower growth in other consumer spending in the first quarter appeared to reflect concerns relating to the Iraqi war and adverse weather conditions in some parts of the country. More recently, attractive sales incentives had boosted consumer purchases of motor vehicles, albeit not as much as some industry contacts had hoped, and members referred to tentative signs of a pickup in retail sales. On balance, however, the members did not see any firm indications of significant acceleration in consumer spending. More positively, they cited recent survey and anecdotal evidence of improving consumer confidence and referred to the gains in the stock market as a source of potential impetus going forward. In the housing markets, activity currently was somewhat uneven across the nation but had remained at a high overall level. While favorable financing would help to sustain the housing sector, members anticipated that any further impetus to growth from that sector was likely to be limited.

The members expected economic activity to be supported by substantial fiscal stimulus in coming quarters, with that already built into existing federal legislation likely to be augmented by further initiatives under active consideration in the Congress. However, budgets of numerous state and local governments remained under severe pressure, and efforts to contain spending and raise taxes by those governments would offset some of the federal stimulus this year and next. It was not clear at this point how some state and local governments would resolve their current budgetary crises and what the effects would be on many local economies.

A weakening dollar and sluggish economic conditions abroad were key factors impinging on the prospective contribution of the foreign sector to U.S. economic activity. While foreign demand for U.S. products and services would be supported by the dollar's depreciation, relatively weak foreign economic activity would tend to hold down such demand. On balance, the nation's trade deficit was likely to remain at an elevated level, with moderate gains in exports more than offset by larger increases in imports if forecasts of relatively robust U.S. growth in fact materialized.

Even assuming a pickup in the expansion of economic activity in line with current forecasts for this year and next, excess capacity in labor and product markets would remain elevated and might well foster further disinflation over coming quarters. The decline in inflation might be limited to some extent by the depreciated value of the dollar in foreign exchange markets and by the anticipated effects of further large increases in worker benefit costs. Given the pressure of a considerable amount of unused resources, any adverse developments that held down economic expansion would increase the probability of further disinflation. Members commented that substantial additional disinflation would be unwelcome because of the likely negative effects on economic activity and the functioning of financial institutions and markets, and the increased difficulty of conducting an effective monetary policy, at least potentially in the event the economy was subjected to adverse shocks. Members also agreed that there was only a remote possibility that the process of disinflation would cumulate to the point of a decline for an extended period in the general price level.

In the Committee's discussion of policy for the intermeeting period ahead, all the members indicated that they could support a proposal to maintain an unchanged policy stance. The members acknowledged that a case could be made for easing policy immediately in light of the generally disappointing reports on the recent performance of the economy, the ongoing disinflation trend in a period of already low inflation, and forecasts of persisting excess capacity. Nonetheless, they concluded that, on balance, an easing action was not desirable at this time. They noted that not enough time had elapsed since the end of the Iraqi war to sort out the underlying forces at work in the economy. In particular, the lifting of key uncertainties relating to the war would provide an improved opportunity to assess whether the favorable factors in the outlook would in fact lead to the anticipated strengthening in economic activity and, at the same time, diminish the risk of appreciable further disinflation. Some members cautioned that persisting uncertainty regarding economic trends should not provide a basis for prolonged inaction in light of the risks of further disinflation and subpar economic growth. In the absence of convincing indications of an appreciable pickup in economic growth, an easing move might be desirable in the near term, perhaps at the June meeting.

With regard to the press announcement to be released shortly after this meeting, the members supported new language that provided separate assessments of the risks to the goal for acceptable economic growth and the risks to the goal of price stability. They recognized that the usual summary statement did not allow for the circumstances in which the Committee saw some probability, albeit minor, of a significant further decline in inflation to an unwelcome level. After discussion, the members generally agreed on separate sentences indicating that the risks to its goal of sustainable economic growth were about balanced but that the probability of some disinflation from an already low level exceeded that of a pickup in inflation. The members also accepted a summary statement stating that, taken together, the balance of risks to the Committee's dual goals was tilted toward the downside over the foreseeable future. There was some concern that including such a summary sentence in the press release might be mistakenly interpreted as an indication of Committee concern about the outlook for economic activity rather than a judgment about the relative odds on further inflation. Two members saw merit in adopting a balanced risks assessment at this meeting despite the evident shortcomings in present circumstances of the form of such statements in use in recent years.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive. Consistent with the decision made at the March meeting, the vote did not formally encompass the wording of the press statement to be released shortly after this meeting.

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 1¼ percent.

> Votes for this action: Messrs. Greenspan, McDonough, Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, and Parry. Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, June 24–25, 2003.

The meeting adjourned at 1:25 p.m.

Notation Vote

By notation vote completed on May 20, 2003, the Committee authorized Vice Chairman McDonough to accept the "Order of the Aztec Eagle" honor to be awarded by the government of Mexico.

> Votes for this action: Messrs. Greenspan, Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, and Parry. Votes against this action: None. Abstention: Mr. McDonough.

Vincent R. Reinhart
Secretary

Meeting Held on June 24–25, 2003

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., starting on Tuesday, June 24, 2003, at 2:30 p.m. and continuing on Wednesday, June 25, 2003, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, Messrs. Poole and Stewart, Alternate Members of the Federal Open Market Committee

Messrs. McTeer, Santomero, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Gillum, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Mattingly, General Counsel

Ms. Johnson, Economist
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Eisenbeis, Goodfriend, Howard, Judd, Lindsey, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

Messrs. Ettin and Madigan, Deputy Directors, Divisions of Research and Statistics and Monetary Affairs respectively, Board of Governors

Messrs. Slifman and Oliner, Associate Directors, Division of Research and Statistics, Board of Governors

Messrs. Clouse and Whitesell, Deputy Associate Directors, Division of Monetary Affairs, Board of Governors

Mr. Reifschneider,[7] Assistant Director, Division of Research and Statistics, Board of Governors

Mr. Orphanides,[8] Adviser, Division of Monetary Affairs, Board of Governors

Mr. Elmendorf,[7] Section Chief, Division of Research and Statistics, Board of Governors

Ms. Kusko,[7] Senior Economist, Division of Research and Statistics, Board of Governors

Messrs. Bassett[7] and Wood,[7] Economists, Divisions of Monetary Affairs and International Finance respectively, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors

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

Mr. Barron, First Vice President, Federal Reserve Bank of Atlanta

Messrs. Fuhrer and Hakkio, Ms. Mester, Messrs. Rasche, Rolnick, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Philadelphia, St. Louis, Minneapolis, Dallas, and Cleveland respectively

Messrs. Evans, Hilton, and Kuttner,[8] Vice Presidents, Federal Reserve Banks of Chicago, New York, and New York respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 6, 2003, were approved.

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

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and securities issued or fully guaranteed by federal agencies during the period May 6, 2003, through June 24, 2003. By unanimous vote, the Committee ratified these transactions.

The Committee discussed at length alternative means of providing mone-

7. Attended portion of meeting relating to the discussion of economic developments.

8. Attended portion of meeting relating to the discussion of the conduct of monetary policy in a period of very low interest rates.

tary stimulus should the target federal funds rate be reduced to a point where there was little or no latitude for additional easing through this conventional policy instrument. The members agreed that current economic conditions and the prevailing stances of monetary and fiscal policy made the need to use unusual monetary policy tools a quite remote possibility. Even so, they believed it was useful to discuss that possibility because of the implications for financial markets and institutions and for the conduct of monetary policy of reducing short-term interest rates to very low levels. An environment involving such interest rates could have adverse repercussions on the functioning of some sectors of the money market, but the members agreed that the potential extent of such disruptions would not be sufficient to prevent the Committee from taking advantage of the full scope of conventional easing of the federal funds rate, should that become necessary. Beyond that, a variety of nonconventional measures for further easing was available. In this regard, the members discussed the advantages and disadvantages of various approaches that, possibly employed in some combination, would alter the size and composition of the System's balance sheet. They also considered aspects of the Committee's communications as a means of underscoring to the public its willingness to follow a sufficiently accommodative path of monetary policy for as long as necessary to foster improved economic performance. The members did not see the need at this time to reach a consensus on the desirability of any specific nontraditional approach to the implementation of monetary policy, particularly given the low probability of its near-term use. As experience had shown, at times of economic and financial market stress the specific policy tools used would depend on circumstances. For now, however, they believed that arriving at an understanding of the various options that might be employed prepared them to respond more flexibly and effectively to unanticipated developments. While considerable uncertainty surrounded each individual policy option, the members agreed that the effectiveness of these alternative tools, along with the 125 basis points of conventional easing still available, would allow monetary policy to combat economic weakness and forestall any unexpected tendency for a pernicious deflation to develop.

The information reviewed at this meeting suggested that the economy continued to expand at a subpar pace in recent months. Consumer spending increased moderately, housing activity held at a high level, and government outlays grew substantially. Business investment, however, was still soft. Industrial production and employment appeared to have stabilized after an extended period of weakness. Consumer price inflation remained at a very low level.

Private nonfarm payrolls changed little on balance in April and May after declines earlier in the year. Although employment in manufacturing continued to fall in May, hiring in temporary help services, which supplies many of its workers to manufacturing, picked up noticeably. Construction and financial services continued to add jobs. Unemployment edged up further in May, to 6.1 percent, and the number of both short-term job losers and longer-term unemployed increased as well. Initial claims for unemployment insurance remained high.

Industrial production increased slightly in May after sizable declines in the preceding two months. The manufacturing sector recorded broad-based improvement, though automobile assemblies and the output of communications equipment continued to slide. The effects of strength in the mining sector on the industrial production index were more than offset by a reduction in utility output. Overall capacity utilization remained very low, with manufacturing utilization near a twenty-year low.

Real consumer outlays, excluding cars and trucks, were flat in April but turned up in May. Spending on motor vehicles rose over the two months from the first-quarter pace. At the same time, the fundamentals underlying household spending became more favorable: Real disposable income posted solid gains, and both the stock market and consumer confidence recovered from earlier in the year.

Activity in the housing market was reasonably well maintained in April and May. Despite unusually wet weather in many areas, starts of single-family and multifamily units in the two months were just a little below their strong first-quarter levels. Building permits for new single-family and multifamily homes were up from a depressed March level. Sales of both existing and new homes in April and May were above the high levels recorded in recent quarters.

Orders and shipments of nondefense capital goods were lackluster in April and May. This sluggish performance followed a first-quarter decline in real outlays on equipment and software that had more than reversed the fourth-quarter gains. Excluding purchases of transportation equipment, however, outlays grew a bit over the first quarter. Real investment in nonresidential structures dropped further in that quarter, though the rate of decline slowed. Outlays for office buildings and industrial structures were down sharply, and falling rents and rising vacancy rates in April suggested further weakness in the second quarter.

The book value of manufacturing inventories rose moderately further in the first quarter and in April. Relative to shipments and sales, inventories of manufacturers, wholesalers, and retailers have remained at quite low levels thus far this year.

The U.S. trade deficit in goods and services edged up in April from the first-quarter rate. Real GDP growth in the major foreign industrial countries remained weak in the first quarter as external demand sagged amid heightened geopolitical uncertainties. Real GDP growth continued to slow in the first quarter in Japan and the United Kingdom, and economic activity in the euro area was flat. By contrast, economic activity accelerated in Canada in the first quarter.

Sharp declines in energy prices pulled down overall consumer prices in April and May, but core consumer prices edged up. On a year-over-year basis, however, core consumer price inflation eased noticeably. Core producer price inflation also declined over the year ending in May. With regard to labor costs, average hourly earnings of production or nonsupervisory workers were flat in April and increased moderately in May. The twelve-month change was somewhat above that for the year earlier.

At its May 6, 2003, meeting the Federal Open Market Committee adopted a directive that called for maintaining conditions in reserve markets consistent with keeping the federal funds rate at around 1¼ percent. The Committee discussed a post-meeting release to the press stating that over the next few quarters the upside and downside risks to the attainment of sustainable growth were roughly equal, but that, in contrast, over the same period the probability of an unwelcome substantial fall in inflation, though minor, exceeded that of a pickup in inflation from its already low level.

The Committee also agreed to a statement that, taken together, the balance of risks to achieving its goals was weighted toward weakness over the foreseeable future. The Committee noted that, while the geopolitical tensions that had inhibited economic expansion in earlier months appeared to have diminished, the timing and extent of an improving economic performance could not be reliably ascertained. In the current circumstances, the members concluded the prudent course was to maintain a steady policy stance, a high degree of vigilance, and a readiness to respond promptly as needed to the emergence of clearer evidence relating to the performance of the economy.

The Committee's decision at the May meeting relating to the federal funds rate was not a surprise to most market participants. However, splitting the balance of risks statement into separate assessments about growth and inflation, in addition to noting a concern about a further possible decline of inflation from an already low level, led market participants to mark down their expectations for the federal funds rate. Consistent with those expectations, Treasury coupon yields declined 35 to 60 basis points. Yields on corporate bonds also fell about in line with rates on Treasuries even though capital markets absorbed a surge in bond issuance by highly rated firms. Equity prices, buoyed by the decline in bond yields as well as the improved outlook for economic growth, registered sizable gains over the intermeeting period.

The dollar continued to depreciate in terms of an index of major foreign currencies amid growing concerns about the financing burden of the large and growing U.S. current account deficit and questions by market participants about the commitment of U.S authorities to a "strong dollar" policy. Long-term interest rates fell in all major industrial economies, while equity prices rose substantially.

Growth of M2 surged in May. At least part of the acceleration was due to special factors related to strong mortgage refinancing activity and to the flow of funds associated with tax payments.

The staff forecast prepared for this meeting once again suggested that the economic expansion would strengthen substantially as the year progressed. Accommodative financial conditions, recent additional fiscal stimulus, and robust gains in structural productivity would provide significant impetus to spending over the months ahead. Inventory overhangs had been substantially reduced, and business capital stocks likely had moved closer to desired levels. As a consequence, improving sales and profits, low financing costs, and the temporary federal tax incentive for investment in new equipment and software were expected gradually to boost business investment spending. Given the ongoing slack in resource utilization, downward pressure on core price inflation was expected over the forecast period.

In the Committee's discussion of current and prospective economic developments, members referred to signs of improvement in some sectors of the economy, but they saw no conclusive evidence of an appreciable overall strengthening in the sluggish economic expansion. On the positive side, they pointed to reports of some pickup in retail sales, indications that labor and product markets might be stabilizing, continued robust activity in housing markets, and ongoing impetus from the federal government sector. Concurrently, however, weakness persisted in business capital expenditures, which members continued to view as the critical factor inhibiting the economic expansion. Looking ahead, they emphasized that favorable underlying conditions were in place to support a substantial acceleration of the expansion, though the timing and dimensions of a significantly improved economic performance remained uncertain. Positive factors bearing on the outlook mentioned by members included the accommodative stance of monetary policy and supportive financial conditions more generally, the persistence of rapid growth in labor productivity, sizable declines in energy prices from elevated levels earlier in the year, and indications of rising consumer confidence and of less negative business sentiment. Members also gave considerable emphasis to the anticipated effects of recent legislation that in short order would add substantially to the degree of fiscal stimulus.

In their review of the outlook for inflation, members commented that currently elevated levels of unused labor and other resources were likely to persist for an extended period, even if economic growth turned out to be robust. And until it was substantially reduced, the output gap would undoubtedly preclude any significant acceleration in inflation and could well cause inflation to edge down from its already low level. At the same time, a substantial further decline in inflation was viewed as having a low probability, though disinflation would remain a matter of concern until a sustained pickup in overall economic activity was firmly established.

In preparation for the midyear monetary policy report to Congress, the members of the Board of Governors and the presidents of the Federal Reserve Banks submitted individual projections of the growth of GDP, the rate of unemployment, and the rate of inflation for the years 2003 and 2004. The members based these forecasts on their individual views as to the appropriate path of policy over the projection period and had the opportunity to update them until July 3. The forecasts of the rate of expansion in real GDP had central tendencies of 2½ to 2¾ percent for 2003, implying that economic growth would accelerate noticeably in the second half of the year, and 3¾ to 4¾ percent for 2004. These rates of growth were associated with central tendencies for the civilian rate of unemployment of 6 to 6¼ percent in the fourth quarter of 2003 and 5½ to 6 percent in the fourth quarter of 2004. Forecasts of inflation, as measured by the chain-type price index for personal consumption expenditures, pointed to the persistence of quite low inflation rates centered on ranges of 1¼ to 1½ percent for this year and 1 to 1½ percent in 2004.

Despite some differences with regard to the timing and strength of the anticipated upturn in the expansion, the members agreed that accommodative monetary and fiscal policies along with much improved financial conditions were likely to foster a better economic performance over time. Growing market perceptions that monetary policy would remain stimulative for a longer period than previously anticipated appeared to have contributed to significant declines in interest rates across maturities and risk classes, and to rising prices in equity markets. The gains in equity prices and a narrowing of risk spreads also appeared to reflect more upbeat assessments of underlying business conditions and, partly in concert with reduced geopolitical risks since the end of major military activity in Iraq, growing convictions that the downside vulnerability of the domestic economy had diminished. Both business firms and households had continued to take advantage of generally improving financial conditions to strengthen their balance sheets through debt restructuring activities, thereby helping to buttress the economy's financial underpinnings and foster sustained expansion.

The ongoing stimulative effects of earlier tax cuts and large increases in defense spending had recently been enhanced by added fiscal stimulus that would provide households with more spendable income in the months immediately ahead than had been anticipated earlier. The expected result would be a relatively prompt and sizable boost to consumer expenditures and, over time, to business spending. Some members expressed reservations, however, about the extent of the near-term effects of tax rate reductions on overall consumer spending, given the likelihood that some portion of the funds transferred to households would be used to reduce personal debts or to add to various savings vehicles. Members also noted that measures taken by many state and local governments to raise taxes and trim spending in order to resolve fiscal crises would offset an uncertain—though in the view of most a small—part of the federal sector stimulus over the period ahead. On balance, given the combined effects of lower tax rates and the outlook for continued high levels of defense spending, the federal sector generally was seen as an important source of stimulus to the economy, both in the near term and over the forecast horizon.

With regard to the outlook for key expenditure sectors of the economy, members again commented that the prospects for robust and sustained expansion would depend importantly on business fixed investment, a sector where significant recovery had thus far failed to materialize. A high degree of caution continued to dominate business decisionmaking in the context of weak markets for the output of numerous firms and the related absence of pricing power. And while the low cost and ample availability of financing for most business firms along with the recently raised partial tax expensing provision for certain investment outlays were positive factors, reports from business executives indicated that a key factor inhibiting decisions to invest at this point was the unfavorable outlook for sales growth in the context of substantial margins of excess capacity. Members also noted that the attention of many boards of directors and other senior corporate officials remained focused on corporate governance and accounting issues rather than potential capital projects, and that concerns about vulnerabilities relating to such issues had damped appetites for taking risks. In this environment, investment outlays tended to be limited to the replacement and upgrading of existing facilities rather than expansion. A number of members nonetheless cited faint signs of more positive investment prospects, though not of currently increasing investment expenditures, gleaned from anecdotal commentary and responses to recent capital spending surveys. The latest readings on orders and shipments of durable goods were also seen as a favorable, though not a conclusive, sign of higher investment spending. In general, the members anticipated that current restraints on business investment spending would lift slowly as the expansion gathered momentum and business caution in investing and hiring diminished further in response to increasing demand.

Outside the motor vehicle industry, business inventories appeared to be at generally low levels, with many retailers and others reported to be following cautious inventory policies in anticipation of sluggish sales over coming months. As a consequence, some inventory accumulation appeared likely if final demand accelerated in line with the members' current forecasts.

Consumer spending, though elevated, had grown at a reduced pace in recent quarters and the members generally saw some acceleration as a likely but not inevitable prospect. An important factor in this outlook was the anticipated effects of sizable additions to disposable incomes stemming from the recent tax legislation. Other favorable factors referenced by the members included indications of growing consumer confidence, the effects of rising stock market wealth on consumer balance sheets, continued opportunities for many consumers to extract equity from the appreciated value of their homes and to reduce interest service burdens by refinancing mortgages, and more fundamentally a continuing uptrend in disposable personal incomes associated in part with robust gains in labor productivity. Some members nonetheless raised a note of caution regarding the potential strength of consumer spending. They commented in particular that the lack of significant job growth resulting from persisting business reluctance to hire new workers could undermine consumer confidence and spending at some point, though they noted that there was little evidence of this as yet. Some members also referred to the drain on disposable incomes stemming from rising local taxes and fees intended to address the severe budget problems of many state and local governments. On balance, while they acknowledged the risks of a weaker outcome, the members generally expected the consumer sector to play a key role in their forecasts of a significantly strengthening expansion.

The members continued to report a high level of housing demand in numerous parts of the country, with housing construction described as a notably robust sector in many regional economies. The strong performance of the housing industry continued to be attributed in large measure to the lowest mortgage interest rates in several decades. On a more negative note, multifamily construction was reported to be weak in a number of areas, evidently reflecting low occupancy rates and rents.

Although current growth in demand from abroad was being held down by the relatively sluggish economies of major U.S. trading partners, the weaker dollar was expected to foster somewhat faster expansion in U.S. exports. However, downward revisions to foreign growth forecasts for the balance of this year implied continuing restraint on the expansion in foreign demand for U.S. goods and services. Members nonetheless cited some anecdotal evidence of a pickup in foreign orders from U.S. manufacturers. At the same time, many U.S. business contacts continued to express concern about the strength of foreign competition for their products in domestic markets.

With the economy thought likely to continue to operate below its potential for an extended period and productivity growth expected to remain robust, the members believed that the current low-inflation environment would persist over the next several quarters and indeed that some further disinflation could be in store. In this regard, there was concern that inflation could be approaching a level that would begin to complicate the implementation of monetary policy if economic weakness unexpectedly persisted or the economy was subjected to another negative demand shock. However, in the view of at least some members, recent developments had reduced the unwelcome prospect of substantial additional disinflation. Those developments included a recent uptick in core measures of consumer prices, a drop in the dollar on foreign exchange markets, and still elevated energy prices—all against the backdrop of longer-term inflation expectations that were firmly anchored. More importantly, however, the outlook for a strengthening expansion, which might well materialize in the near future, should limit any further disinflationary trend.

In the Committee's discussion of policy for the intermeeting period ahead, all but one of the members indicated that they could support a proposal to reduce the target federal funds rate ¼ percentage point to a level of 1 percent. While a significant step-up in the pace of the expansion appeared to be a likely prospect, such an outcome was still a forecast whose eventual realization, including both its timing and extent, remained uncertain. In the circumstances and given currently large margins of unemployed labor and other resources, the members agreed that an easing move was desirable to provide additional insurance that a stronger economy would in fact materialize. Some members noted that at the May meeting they had contemplated the need for an easing action at this meeting unless compelling evidence developed in the interim that the hoped-for acceleration in economic activity was clearly under way. The incoming information since the May meeting, while mildly encouraging, did not provide compelling evidence to warrant forestalling an easing action.

Members saw virtually no prospect that the proposed easing, though it would reinforce an already accommodative monetary policy, would incur any significant risk of contributing to rising inflationary pressures, even if the strengthening of the economy proved to be somewhat greater than they had incorporated in their forecasts. Indeed, the proposed reduction in the nominal federal funds rate would about offset the apparent increase in the real federal funds rate stemming from a recent decline in inflation. In this regard, further disinflation seemed likely to be a more significant concern than rising inflation for a considerable period of time.

Most of the members expressed a preference for limiting the reduction to ¼ percentage point. Some commented that a good case could be made for a ½ percentage point easing, though all but one of these members could support the smaller decrease. Views cited in favor of the ¼ percentage point easing included the emergence of firmer signs of a possible upturn in economic activity, the near-term prospect of substantial added fiscal stimulus, and an already very accommodative stance of monetary policy. No member expressed the opinion that a smaller move should be favored because of concerns about dislocations resulting from a very low level of the overnight interest rate. However, some members commented that a larger reduction might be misread as an indication of more concern among policymakers about the economic outlook than was in fact the case. Moreover, a 50 basis point reduction that was associated with the communication of a Committee view that the risks to achieving its objectives for economic activity were balanced might be mistakenly interpreted in the view of some members as a signal that the Committee had come to the end of its policy easing moves—a judgment they were not prepared to make at this time. The case for a larger 50 basis point reduction in the target federal funds rate focused on the desirability of a relatively forceful policy move that would be more likely to promote a strengthening economic expansion and at the same time provide greater assurance of countering any significant disinflation. One member, who interpreted recent economic developments as providing fairly persuasive indications that an upturn in the expansion was already under way, saw merit in keeping policy unchanged but did not oppose a ¼ percentage point easing.

Concerning the press statement to be released to the public shortly after today's meeting, the members agreed that it should include a reference to signs of firming economic activity and should highlight the key factors underlying the members' outlook for a more robust economic performance over time. Nonetheless, inflation could edge lower and the Committee needed to be cognizant of the risk of substantial further disinflation, which could have potentially adverse effects. With regard to the Committee's assessment of the risks to be incorporated in the press release, the members generally agreed that the risks to the goal of sustainable economic growth were about balanced for the next few quarters and that the probability of appreciable further disinflation from an already low level of inflation exceeded the probability of a rise in inflation. The members also endorsed a general statement stating that, taken together, the balance of risks to the Committee's dual goals was tilted toward the downside for the foreseeable future. During the discussion, several members also stressed the importance of communicating clearly the reasons for the Committee's decisions, thereby helping to assure the success of the Committee's policymaking efforts.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with reducing the federal funds rate to an average of around 1 percent.

The vote encompassed the following statement whose substance would be included in the press release to be made available shortly after the meeting:

> The risks to the Committee's outlook for sustainable economic growth over the next several quarters are balanced; the risks to its outlook for inflation over the next several quarters are weighted toward the downside; and, taken together, the balance of risks to its objectives is weighted toward the downside in the foreseeable future.

Votes for this action: Messrs. Greenspan, Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, and Stewart. (Mr. Stewart voted as an alternate member.) Votes against this action: Mr. Parry.

Mr. Parry dissented because he preferred a 50 basis point reduction in the federal funds rate target as insurance against continued sluggishness in economic activity and further declines in inflation measures to undesirably low rates. While he believed that a significant increase in the pace of activity over the next several quarters was likely, he had not yet seen convincing evidence that this process was under way. Moreover, the current slack in labor and product markets was likely to persist for some time even with a significant pickup in real GDP growth, and this prospect threatened to reduce inflation further. Finally, recent declines in inflation expectations had raised the real federal funds rate. In order to offset that increase and provide additional stimulus, he saw a 50 basis point reduction in the rate as desirable.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 12, 2003.

The meeting adjourned at 1:25 p.m.

Vincent R. Reinhart
Secretary

Meeting Held on August 12, 2003

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, August 12, 2003, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, Messrs. Poole and Stewart, Alternate Members of the Federal Open Market Committee

Messrs. McTeer, Santomero, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Gillum, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Baxter, Deputy General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Eisenbeis, Evans, Goodfriend, Howard, Judd, Madigan, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

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

Messrs. Slifman and Oliner, Associate Directors, Division of Research and Statistics, Board of Governors

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

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

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors

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

Mr. Moore, First Vice President, Federal Reserve Bank of Cleveland

Mr. Hakkio, Ms. Mester, Messrs. Rasche and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Kansas City, Philadelphia, St. Louis, and Cleveland respectively

Ms. Hargraves and Mr. Tootell, Vice Presidents, Federal Reserve Banks of New York and Boston respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 24–25, 2003, were approved.

By unanimous vote, Charles L. Evans and Brian F. Madigan were elected as Associate Economists of the Committee to serve until the election of their successors at the first regularly scheduled meeting of the Committee after December 31, 2003, 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.

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

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and securities issued or fully guaranteed by federal agencies during the period May 6, 2003, through June 24, 2003. By unanimous vote, the Committee ratified these transactions.

The information reviewed at this meeting suggested that economic activity was mixed in late spring and early summer. The labor market remained weak, and industrial production improved only slightly. Consumer spending, however, advanced further, with brisk growth in expenditures on autos and other durables and more modest expansion in other categories. Homebuilding continued at a robust rate, business spending improved somewhat, and federal government expenditures remained elevated, but these gains were partially offset by fiscal restraint at the state and local government levels. Despite a recent uptick in consumer prices, year-over-year consumer inflation remained at a very low level.

Private nonfarm payroll employment fell in both June and July. Notable losses occurred in manufacturing over the two months, continuing the trend of previous months. Wholesale and retail trade, transportation and utilities, as well as information sectors also reduced their workforces further, while the construction, financial activities, and temporary help sectors continued to add jobs. The average workweek edged down, on net, over June and July. After rising to 6.4 percent in June, the unemployment rate fell to 6.2 percent in July.

Industrial production edged up again in June, with gains in manufacturing offset to some extent by significant weather-related declines in utility production. Available data for July indicated advances in motor vehicle assemblies and in iron and steel output, and also a surge in energy production that was due to abnormally warm weather. Overall industry capacity utilization was about unchanged in June as higher usage in manufacturing and mining was balanced by a sharp decrease at utilities.

Real personal consumption expenditures grew in June and in the second quarter as a whole, largely reflecting a brisk rise in purchases of motor vehicles and other durable goods. Consumption of other goods rose more moderately. Declines in spending on energy in June held down growth in services expenditures. Real disposable income posted a modest gain in the second quarter, and likely was lifted further in July by reduced tax withholding and by refund checks that were mailed out. Consumer confidence readings were mixed in June and July but remained well above their lows earlier in the year.

Boosted by declining mortgage rates, housing construction and sales were robust through June. Single-family housing starts rose in June to one of the highest levels in the past twenty-five years, and new permit issuance was also strong. Multifamily housing starts stayed at about the average level of the previous year and a half. New home sales surged in June, but existing home sales edged down.

Business outlays on equipment and software jumped in the second quarter following a lackluster performance over the preceding half year. Spending on computers and software accelerated sharply, and purchases of communications equipment increased considerably. The transportation category, by contrast, contracted as business spending on motor vehicles stagnated and investment in aircraft decreased. Data on orders and shipments for nondefense capital goods in June pointed to growth in nearly all categories. Expenditures on nonresidential structures turned up in the second quarter as increases in spending on institutional and other structures more than offset declines in expenditures for office and industrial buildings. Office building vacancy rates changed little in the second quarter, while vacancies in industrial buildings rose to record levels.

Nonfarm inventories shrank in the second quarter, with notable declines in manufacturing and wholesale stocks. Inventories relative to shipments and sales were at low levels by historical standards.

The U.S. international trade deficit edged up in May as imports of goods and services increased slightly more than exports. Recent data generally indicated that growth in foreign industrial countries was weak in the second quarter. The economies of Japan and the euro area appeared to have remained stagnant. Canadian economic growth was held back by both the SARS outbreak and the discovery of mad cow disease, although a rebound in employment in June suggested that the weakness was temporary. GDP growth in the United Kingdom showed a moderate rebound in the second quarter.

Overall consumer prices rose a bit in June, led by increases in the volatile food and energy categories. Core consumer prices, however, were unchanged for the month. Over the twelve-month period ending in June, the increase in core consumer prices as measured by both the consumer price index and the chain-type personal consumption expenditure index was notably lower than the rise of the previous year. Higher energy costs pushed up the producer price index in June, but core producer prices ticked down for the month, leaving them slightly below their levels twelve months prior. With regard to labor costs, July average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls advanced at about the same rate as in June. The employment cost index for hourly compensation of private industry workers rose less in the second quarter than in the first quarter. The twelve-month increase was somewhat lower than that for the previous year.

At its meeting on June 24–25, the Committee adopted a directive that called for lowering the target for the intended federal funds rate 25 basis points, to 1 percent. In reaching this decision, the Committee members generally perceived the upside and downside risks to the attainment of sustainable growth for the next few quarters as roughly equal; however, they viewed the probability, though minor, of a substantial and unwelcome fall in inflation as exceeding that of a pickup in inflation from its already low level. On balance, the Committee believed that the concern about appreciable disinflation was likely to predominate for the foreseeable future.

Longer-term interest rates began to back up after the announcement of the Committee's decision, as market participants had placed substantial odds on a larger policy move and, perhaps, even the release of details on potential unconventional policy actions. Ten-year Treasury yields rose dramatically over the following weeks. The increase appeared to be based on a number of factors, including investors' interpretation of the Chairman's congressional testimony, the release of Committee members' relatively bullish economic projections, and incoming news regarding the economy and corporate earnings that was seen as signaling a more likely upturn in economic growth. In these circumstances, substantial further disinflation probably would not materialize, and the need for further reductions in the federal funds rate or unconventional policy measures would thus be obviated. Yields on high-grade corporate bonds moved up roughly in line with those on Treasury securities, leaving spreads about unchanged. Rates on low-grade corporate bonds rose much less, and spreads over Treasuries on such obligations narrowed significantly. Despite the sharp step-up in Treasury yields, broad equity indexes advanced over the intermeeting period, supported by positive earning reports, strong profit forecasts, and increased confidence regarding economic prospects.

The exchange value of the dollar, as measured by the major foreign currencies index, rose over the intermeeting period as long-term interest rate differentials moved sharply in favor of dollar-denominated assets. Yields on longer-dated government debt of major foreign economies also increased as did many foreign equity indexes.

M2 continued to grow briskly in June and July, reflecting in large part the near-zero opportunity cost of holding money, the effects of mortgage refinancing activity, and the reduction in personal income tax withholdings.

The staff forecast prepared for this meeting continued to suggest that the economic expansion would strengthen substantially as the year progressed. Accommodative financial conditions, recent additional fiscal stimulus, and robust gains in structural productivity would provide significant impetus to business and consumer spending over the months ahead. Concurrently, household expenditures, buoyed by recent tax cuts, were expected to be well maintained. Inventory levels had been substantially reduced, and business capital stocks apparently had continued to move closer to acceptable levels. As a consequence, improving sales and profits, low financing costs, and the temporary federal tax incentive for investment in new equipment and software were expected to boost business investment spending gradually. Given the substantial ongoing slack in resource utilization, some downward pressure on core price inflation was considered a risk in the staff forecast.

In their review of current and prospective economic developments, members commented that they were encouraged by the recent data on economic activity and the tone of related anecdotal commentary. In their view these developments, in the context of stimulative fiscal and monetary policies, receptive financial conditions, and apparently improving business and consumer confidence, had brightened the prospects for substantial further strengthening of the economy. The members acknowledged that the magnitude of the improvement remained subject to considerable uncertainty, notably with regard to the prospects for business expenditures, and they cited both upside and downside risks to forecasts of a more vigorous expansion. Concerning the prospects for inflation, members expressed the view that even if growth somewhat above the economy's potential were to materialize over the next several quarters, which many regarded as a likely scenario, substantial excess margins of labor and other resources would remain and would continue to hold down overall inflation. Indeed, a number of members saw merit in the staff forecast that some further disinflation was a likely prospect in such circumstances.

Members commented that current financial conditions remained a positive factor in the outlook for the economy even after the recent rise in long-term interest rates. To be sure, the increase would have some restraining effect. Indeed, mortgage refinancing activity appeared to have declined substantially according to some reports, prospectively lessening the support for some consumer and other spending fostered by the extraction of equity from housing. Even so, a number of factors suggested that the risks from higher interest rates might not be large. These included the possibility that the higher rates in part reflected growing optimism about the economic outlook that would engender a faster pace of business spending, more than offsetting the effects of the higher rates on consumer spending. Moreover, long-term interest rates were still relatively low, risk spreads had narrowed in recent months, and stock prices had held firm recently, perhaps in part as a result of several upside surprises in second-quarter profit reports.

Several members reiterated that business spending was the critical factor that would govern to a substantial degree the timing and extent of the acceleration in overall economic activity. Since the year 2000, business capital expenditures had been mostly limited to replacement demand for equipment and software and, with nonresidential construction activity displaying pronounced weakness, total business fixed investment had until recently been on a declining trend. Members were encouraged, however, by evidence in recent months that an upswing in spending for capital equipment and software might be under way, including more purchases by firms of non-high-tech equipment as well as an ongoing rise in purchases of computing equipment and related peripherals. Members also reported some signs of renewed venture capital activity. Several noted that nonresidential building appeared to have stabilized in various parts of the country after a long period of decline, and there were reports that new construction projects had been initiated in some areas. It was clear, nonetheless, that business sentiment toward capital expenditures remained exceptionally cautious. Looking ahead, much would depend on further growth in demand for business products and services and associated evidence of rising profits, building on indications of strengthening in both in recent months. For now, survey and anecdotal reports on business capital spending intentions were somewhat more encouraging than earlier but were still generally mixed, with only a small number of firms planning robust capital spending programs. Indeed, in light of the persistence of substantial margins of underutilized capital, many business contacts indicated that they intended to meet growing demand by adding staff before increasing output capacity.

The weakness in business inventories that had damped the expansion thus far this year appeared to be continuing in the current quarter according to numerous business contacts. However, cautious inventory policies generally had reduced stocks to very low levels in relation to growing sales, and members saw inventory accumulation, starting perhaps late this year, as a plausible expectation. Indeed, in the view of some members, a normal cyclical swing in the accumulation of inventories that would bring the latter into a more usual alignment with growing sales could begin relatively soon and might well be markedly more pronounced than many now anticipated. The potential for such a development constituted a sizable upside risk to current economic forecasts for the quarters ahead.

Consumer spending, buttressed by sales of motor vehicles and other consumer durables, had accelerated in the second quarter from an already elevated level and appeared more recently to be increasing considerably further. The available data pointing to improvement in early summer were limited but were supported by anecdotal information from around the country. Positive factors mentioned with regard to the outlook for the consumer sector included the recent tax cuts, the improved performance of the stock market, the ample availability of household credit, and more generally the effects of rapidly rising productivity in sustaining growth in household incomes. A potential negative cited by some members was the possibility that a weak job market, should it persist, would at some point adversely affect overall consumer sentiment and willingness to spend.

Residential housing sales and construction had remained at elevated levels, evidently stimulated to an important extent by earlier declines in mortgage rates to unusually low levels. Although the appreciable upturn in those rates since midyear appeared to have slowed mortgage refinancing activity, at least in some areas, housing demand had remained buoyant perhaps in part because many homebuyers were attempting to lock in mortgage financing while rates were still low in relation to historical norms. The potential extent of retardation in housing activity stemming from higher mortgage rates was uncertain, but demand for housing was expected to be relatively well maintained, assuming the realization of forecasts of accelerating economic activity and associated growth in personal incomes.

In their comments about the outlook for the foreign sector of the economy, members referred to recent signs of some strengthening in the economies of the nation’s important trading partners. However, domestic demand in most of those economies remained relatively weak, and developments abroad were likely to provide little impetus to demand for U.S. exports in the near term. At this point, business contacts tended to emphasize the persistence of strong foreign competition that was constraining their sales in both foreign and domestic markets.

In their review of the outlook for prices, members generally anticipated that key inflation measures would remain near their currently low levels for an extended period. Their assessment focused on the likely persistence of substantial margins of unemployed labor and other resources even if, in line with their expectations, business activity strengthened substantially over coming quarters. Indeed, a number of members expressed the view that some further disinflation was probable over the year ahead. To be sure, inflation would remain subject to a number of crosscurrents. Upward pressures on prices would continue to be exerted by increasing medical insurance and pension costs and, for many manufacturing firms, the rising cost of materials. At the same time, the persistence of very strong competitive pressures, including those arising from foreign competitors, was preventing most business firms from passing on higher costs by raising prices, and this lack of pricing power did not appear to be diminishing. Concurrently, however, many firms were able to maintain or even to increase their profit margins through a variety of cost-cutting and productivity-enhancing measures.

In the Committee's discussion of policy for the intermeeting period ahead, all the members endorsed a proposal to maintain an unchanged policy stance involving reserve conditions consistent with a target federal funds rate of 1 percent. Members noted that the current stance of monetary policy remained quite accommodative and, given the tenor of the latest information on the performance of the economy in the context of generally favorable financial conditions, they believed that policy was appropriately positioned to foster further strengthening of the economic expansion. While the Committee could not commit itself to a particular policy course over time, many of the members referred to the likelihood that the Committee would want to keep policy accommodative for a longer period than had been the practice in past periods of accelerating economic activity. Reasons for such an approach to policy stemmed from the need to encourage progress toward closing the economy's currently wide output gap and, with inflation already near the low end of what some members regarded as an acceptable range, to resist significant further disinflation. In the view of these members, appreciable added disinflation would potentially blunt the effectiveness of further policy easing in the event of strong adverse shocks to the economy. At the same time, maintaining an accommodative policy stance was seen as involving little risk of inducing rising inflation so long as high levels of excess capacity and very competitive markets continued to characterize economic conditions.

The members agreed that, although economic activity had shown signs of firming, the risks to the outlook remained about the same as they had indicated in the previous statement issued after the June meeting. In particular, the risks to the goal of sustainable economic growth were about balanced for the next few quarters and the probability of an unwelcome fall in inflation, though minor, exceeded that of a rise in inflation from its currently low level. On balance, the risk of undesirably low inflation was likely to be the Committee's predominant concern for the foreseeable future. The Committee also decided to include a reference in the announcement to its judgment that under anticipated circumstances policy accommodation could be maintained for a considerable period.

Several members commented that the nature of the Committee's communications had evolved substantially over recent meetings and that it might be useful to schedule a separate session to review current practices. They agreed to do so prior to the next scheduled meeting on September 16.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 1 percent.

Votes for this action: Messrs. Greenspan, Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, Parry, and Stewart. (Mr. Stewart voted as an alternate member.) Votes against this action: None.

The vote encompassed the substance of the following statements concerning risks that would be conveyed in the Committee's press release to be made available shortly after the meeting:

The risks to the Committee's outlook for sustainable economic growth over the next several quarters are balanced; the risks to its outlook for inflation over the next several quarters are weighted toward the downside; and, taken together, the balance of risks to its objectives is weighted toward the downside in the foreseeable future.

It was agreed that the next regular meeting of the Committee would be held on Tuesday, September 16, 2003.

The meeting adjourned at 1:15 p.m.

On September 15, 2003, the Committee met to review its practices regarding the communication of its policy decisions and its assessment of the risks to its objectives of fostering sustainable economic growth and price stability. After a detailed discussion of the issues, the Committee elected not to make substantial changes in its current approach to the policy announcement at this time. Although a variety of views was expressed, most members felt that current practices were generally appropriate in providing information to the public about the rationale for the Committee's decisions and its views about the risks to future economic performance. Nonetheless, members recognized that going forward they might, from time to time, consider changes that might improve the Committee's communication of its assessment of the economic situation.

Vincent R. Reinhart
Secretary

Meeting Held on September 16, 2003

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, September 16, 2003, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, Messrs. Poole and Stewart, Alternate Members of the Federal Open Market Committee

Messrs. McTeer, Santomero, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Mattingly, General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Eisenbeis, Evans, Goodfriend, Howard, Judd, Madigan, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

Mr. Hambley, Assistant to the Board, Congressional Liaison Office, Board of Governors

Messrs. Slifman and Oliner, Associate Directors, Division of Research and Statistics, Board of Governors

Messrs. Clouse, Kamin, and Whitesell, Deputy Associate Directors, Divisions of Monetary Affairs, International Finance, and Monetary Affairs respectively, Board of Governors

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

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors

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

Messrs. Fuhrer and Hakkio, Mses. Mester and Perelmuter, Messrs. Rolnick, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Philadelphia, New York, Minneapolis, Dallas, and Cleveland respectively

Mr. Bullard, Vice President, Federal Reserve Bank of St. Louis

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 12, 2003, were approved.

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

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and securities issued or fully guaranteed by federal agencies during the period August 12, 2003, through September 15, 2003. By unanimous vote, the Committee ratified these transactions.

The information reviewed at this meeting suggested that economic activity had been picking up in recent months, although the data were not uniformly positive. Domestic final demand had strengthened appreciably, with solid gains in both household and business spending. While industrial production was growing, job losses continued. Inventories were again drawn down. Consumer prices had edged up in recent months, but year-over-year consumer inflation remained at a very low level.

Private nonfarm payroll employment fell again in August, with a decline similar to those in June and July. Employment continued to fall in the manufacturing, wholesale and retail trade, transportation and utilities, and information categories. Employment in the service industry was about unchanged as job losses in professional and business services largely offset expansion in nonbusiness services. Growth in construction employment continued. Aggregate hours of private production workers edged down in August, reflecting the employment declines, while the average workweek was unchanged. The unemployment rate fell to 6.1 percent in August.

Industrial production posted a solid increase in July after no change in June. Data available for August suggested increased output at utilities, reflecting abnormally hot weather, but little net change in manufacturing. Overall capacity utilization rose in July, led by the increase in utility production.

Retail sales rose a bit further in August after surging in July. Real personal consumption spending advanced briskly through July (latest data) as all major categories of outlays recorded increases. Real disposable income rose substantially in July largely because of the reduction in tax withholdings and the delivery of advance refund checks relating to higher childcare deductions. The further delivery of such checks in August was expected to have a positive effect on spending in that month as well. Although the index of consumer sentiment ticked down in August and early September, it remained well above its March low.

Housing construction and sales remained very strong in July. Single-family housing starts rose a bit further from the record level in June, while multifamily housing starts were unchanged. Sales of existing homes were up sharply in July, and new home sales remained robust but were off slightly from their rapid June advance.

Data on orders and shipments of nondefense capital goods in July suggested that the upward trend in real business outlays for equipment and software had carried into the third quarter. Total shipments of nondefense capital goods rose moderately in July, with continued notable strength in computers and peripheral equipment. Shipments of communications equipment were off only slightly in July after a surge in June. Orders for nondefense capital goods overall were little changed in July. A drop in nonresidential construction expenditures in July reversed the gains made in the second quarter, with declines in all categories except nonoffice commercial structures.

Inventories contracted in the second quarter, and partial data for July suggested that the runoff continued into the third quarter. The book value of manufacturing inventories declined for the month, led by stocks of durable goods. However, inventories of wholesale goods edged up. Inventory shipment ratios for the manufacturing sector at book value moved down considerably in July, and book value inventory–sales ratios for wholesalers remained at very low levels by historical standards.

The U.S. international trade deficit edged down in June as exports of goods and services increased and imports were unchanged. For the major foreign industrial countries, economic data for the second quarter were mixed. While real GDP grew strongly in Japan and growth picked up in the United Kingdom, real GDP edged down in Canada and the euro area.

Core consumer prices rose slightly less in August than in July. Both consumer food and energy prices rose somewhat faster than the core components, leaving the overall consumer inflation rate in August slightly higher than in July. Over the twelve-month period ending in August, overall consumer prices were up a bit from the previous year, while core consumer prices decelerated. After significant declines during the second quarter, overall producer prices edged up in July and rose a bit further in August. Core producer prices, however, were little changed for the two months and posted only a slight increase over the twelve-month period. With regard to labor costs, average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls ticked up in August. The twelve-month change in average hourly earnings was about the same as that in the previous year.

At its meeting on August 12, 2003, the Federal Open Market Committee adopted a directive that called for maintaining conditions in reserve markets consistent with keeping the federal funds rate at around 1 percent. In reaching this decision, the Committee members generally perceived the upside and downside risks to the attainment of sustainable growth for the next few quarters to be roughly equal; however, they viewed the probability, though minor, of an unwelcome fall in inflation as exceeding that of a rise in inflation from its already low level. The Committee judged that, on balance, the risk of inflation becoming undesirably low would remain the predominant concern for the foreseeable future. In those circumstances, the Committee believed that policy accommodation could be maintained for a considerable period.

The Committee's decision to leave its target for the federal funds rate and assessment of risks unchanged at the August meeting was widely anticipated. On net over the intermeeting period, market expectations for the federal funds rate changed little. However, intermediate- and longer-term interest rates were volatile over the period, with yields on Treasury coupons declining slightly on balance. Yields on most investment-grade securities moved in line with those on Treasury obligations, but a more optimistic economic outlook among investors contributed to a substantial decline in speculative-grade yields. Broad stock price indexes rose notably, boosted by improved economic growth prospects and the associated upwardly revised expectations for earnings.

On balance, the nominal value of the dollar changed little on a broad trade-weighted basis over the intermeeting period. Optimism about global recovery reportedly prompted gains in the equity markets of major industrial countries. Benchmark government bond yields rose in most foreign industrial economies.

M2 grew briskly again in August, boosted by the effects of mortgage refinancing activity, a temporary bulge in liquid deposits caused by payment delays related to power outages, and tax rebate disbursements.

The staff forecast prepared for this meeting continued to suggest a substantially stronger economic expansion than had occurred earlier in the year. Accommodative financial conditions, recent additional fiscal stimulus, and robust gains in structural productivity would provide significant impetus to business and consumer spending over the months ahead. Concurrently, household expenditures, buoyed by recent tax cuts, were expected to be well maintained. Inventory levels had been substantially reduced, and the size of business capital stocks apparently had continued to move closer to acceptable levels. As a consequence, improving sales and profits, low financing costs, and the temporary federal tax incentive for investment in new equipment and software were expected to boost business investment spending over time. Given the substantial ongoing slack in resource utilization, some slight downward pressure on core consumer price inflation was anticipated in the staff forecast.

In the Committee's discussion of current and prospective economic developments, the members focused both on the increased evidence of a pickup in the pace of the expansion and on the persisting weakness in labor markets. The advance in economic activity in recent months reflected continued strength in household spending, reinforced by an increasing contribution from business investment expenditures. The members viewed these and related developments as supporting forecasts of robust growth in economic activity over coming quarters, consistent with the stimulative monetary and fiscal policies, accommodative conditions in financial markets, and the positive implications of strong productivity growth for both incomes and investment outlays. Members nonetheless cited a number of factors that had the potential to retard the expansion, including the persistence of notably cautious business sentiment, the potential that weak employment conditions, should they persist, would at some point depress consumer spending, and the prospect that sluggish economic activity abroad would curb the growth in U.S. exports. On balance, the members saw favorable prospects for strong economic growth over the forecast horizon, though they also expected that the gap between actual output and potential output would close only slowly and that growth in employment would remain limited. Against this background and taking into account the outlook for continued strength in productivity, members anticipated that inflation would remain subdued and perhaps even edge lower despite the expected strength in economic activity.

In their comments about developments in various parts of the country, members cited increased examples of an upturn in confidence among their business contacts. This improvement was not universal, notably within manufacturing sectors of the economy, and overall business attitudes toward hiring and investment decisions continued to be described as exceptionally cautious. Members anticipated, however, that such business attitudes would give way to optimism at some point, possibly quite suddenly, as uncertainties relating to the outlook for final demand were replaced by concerns about missing profit opportunities in a strengthening expansion. Comments by many contacts in the banking sector were already quite upbeat with regard to the outlook for business spending and optimism in financial markets clearly had been improving for several months. In general, financial markets were viewed as well positioned to support more vigorous expansion in economic activity.

In their comments about prospective developments in the major components of aggregate demand, members anticipated that the household sector would remain the mainstay of the expansion and that it would be significantly reinforced going forward by an acceleration in business expenditures and, at least over the next several quarters, by substantial further increases in federal government spending. Some softening in motor vehicle sales from the exceptional pace in recent months seemed likely, but overall consumer spending probably would be sustained at a high level by further anticipated gains in disposable incomes bolstered by the stimulus from recent federal tax cuts. A potential negative in this outlook was the possibility that weakness in employment, if it continued, would at some point exert a more pronounced negative effect on consumer sentiment.

In the housing area, residential sales and construction stayed at elevated levels during the summer months, with at least some portion of the strength reportedly stemming from efforts by many homebuyers to move ahead of further increases in mortgage interest rates. The run-up in mortgage rates since the latter part of June was expected to curb housing demand to a limited extent in coming months, but the outlook for housing activity remained favorable, given an overall economic performance in line with current forecasts of a robust expansion, related growth in incomes, and still relatively attractive mortgage interest rates.

Business fixed investment remained a critical factor and also a major source of uncertainty in the outlook for overall economic activity, with the strength of such investment having a key bearing on the pace of the overall expansion. In this regard, the second-quarter increase in expenditures for equipment and software was an encouraging sign and the available evidence pointed to a larger advance in the third quarter. Looking beyond the near term, members mentioned a number of developments that supported an optimistic outlook for capital expenditures. These included an appreciable acceleration in final sales since the first quarter, sizable increases in business profits and cash flow this year, the ready availability of business financing on attractive terms, and the temporarily accelerated expensing provision in the tax code. On the constraining side were the persistence of high levels of excess capacity and significant business uncertainty and caution regarding the extent and durability of the acceleration in final sales. To date, businesses had displayed only limited signs of undertaking any investments other than for replacement and cost-cutting purposes. Even so, the recent firming of orders and shipments along with somewhat more upbeat anecdotal reports and surveys of business spending plans pointed to a relatively brisk further advance in business spending for equipment and software, at least over the near term. Nonresidential construction activity remained at a generally depressed level but appeared to have bottomed out, with signs of an upturn in new or planned construction in some areas.

Increasing business inventory expenditures to accommodate strengthening final sales were seen as a likely positive factor in the expansion of overall economic activity in coming quarters, though the degree and timing of the impetus from a prospective buildup in inventories were subject to considerable uncertainty. Pointing to anticipated strength in inventory accumulation was the substantial drawdown in stocks that had occurred as final sales picked up this year, a marked resulting drop in inventory-sales ratios, and expectations of accelerating final demand. At the same time, however, the persistence of business uncertainty and related caution were, with some exceptions, continuing to inhibit inventory investment. Moreover, the trend toward improved communication and delivery systems was encouraging business firms to hold inventories at increasingly low levels in relation to expected sales. According to anecdotal reports, even service firms were now increasingly adopting advanced management techniques to hold down their inventories of items used in the process of providing their services. Against this background, it seemed unlikely that businesses would seek to rebuild their inventories sufficiently to restore earlier inventory–sales ratios. Even so, further increases in sales would eventually lead to improved business confidence and induce efforts to accumulate inventories, though probably to a lesser extent than had occurred in earlier cyclical recoveries.

Fiscal policy was likely to remain a key source of stimulus to the expansion. Federal spending was expected to increase substantially further, albeit at a diminishing pace over the next year and beyond, and reduced taxes should buoy both consumer and business expenditures. It was not clear at this point to what extent the partial expensing provision was boosting business investment in equipment and software, but the high level of consumer spending clearly was playing a role in fostering such investment. Members commented that the current degree of fiscal stimulus was at its highest level since the World War II period, and some expressed concern in this regard that little legislative consideration was being given to reapplying fiscal restraint as changing economic conditions would warrant over time. The fiscal condition of many state and local governments remained severely stressed, and ongoing efforts by these governments to curb spending and increase tax and other revenues provided a partial offset to the federal sector stimulus. Some members reported, however, that tax receipts recently had improved noticeably in a number of states.

In their comments about the outlook for the foreign sector of the economy, members referred to indications of some overall improvement in foreign economic activity, which augured well for the growth in exports. They also noted that the prospective performance of foreign economies would depend to a significant extent on the strength of the U.S. economy. With the latter displaying relative vigor, the value of domestic imports was likely to continue to exceed that of exports by a substantial margin, thereby tending to perpetuate the large current account deficits that had worrisome implications for the future. Members also expressed concern about indications of growing protectionism, which characteristically tended to increase in periods of substantial underutilization of labor and other resources, and the adverse effects of that development on competition and inflation.

The members agreed that inflation was likely to remain subdued for an extended period, given current forecasts of economic activity and labor productivity trends. Specific views regarding the most probable course of inflation differed to some degree, but many members expected little change over the year ahead and even beyond. Several saw a significant risk of some further disinflation over that period even assuming economic growth at a pace that somewhat exceeded the economy's long-run potential. In this regard, members referred to their expectations that the gap between actual and potential output was likely to narrow only slowly and possibly not close completely over their forecast horizon. They also noted that the substantial margins of excess capacity in question likely would continue to characterize the international as well as the domestic economy for a considerable period. Tending to counter the resulting disinflationary effects were signs that the expansion in globalization might be slowing. In particular, difficulties in reaching global trade agreements along with a rise in protectionism could tend to inhibit the increasingly strong competition in worldwide markets that had been a key factor in holding down inflation. The members also cited other factors that would tend to maintain some upward pressure on prices, notably the relatively rapid rise in costs of labor benefits, especially medical and pension benefits. Increases in the prices of some raw materials were also noted. In general, the members concluded that the economy would need to grow at a pace above potential for a time before they could be confident that the risks of further unwelcome disinflation had materially diminished.

In the Committee's discussion of policy for the intermeeting period ahead, all the members endorsed a proposal to maintain an unchanged policy stance involving reserve conditions consistent with a target rate of 1 percent for the federal funds rate. The members agreed that despite the increasing evidence of some acceleration in the expansion of economic activity, an accommodative policy stance remained appropriate in the context of the currently large and persisting margins of unemployed labor and other resources and very low inflation. Several commented that the recent strengthening of the economy had served to alleviate but had not eliminated their concerns about the possibility of further disinflation. While both downside and upside risks continued to cloud the outlook for economic activity and thus for monetary policy, the economy's sizable output gap strongly suggested that inflation would remain muted over coming quarters even assuming relatively robust economic growth in line with current forecasts. Accordingly, the economy might well expand at a brisk pace for an extended period before inflationary pressures began to emerge and call for an adjustment to monetary policy.

In their discussion of the press statement to be issued shortly after this meeting, the members indicated that the Committee's risk assessments relating to economic activity and inflation to be referenced in that statement should remain the same as those in use since the May meeting. In particular, the risks to the goal of sustainable economic growth were about balanced for the next few quarters and the probability of an unwelcome fall in inflation, though minor, exceeded that of a rise in inflation from its currently low level. On balance, the risk of undesirably low inflation was likely to be the Committee's predominant concern for the foreseeable future.

The members also reviewed the further use of the reference concerning the maintenance of an accommodative policy stance "for a considerable period" that was included in the press statement issued for the August meeting. Given the uncertainties that characteristically surround the economic outlook and the need for an appropriate policy response to changing economic conditions, the members generally agreed that the Committee should not usually commit itself to a particular policy stance over some pre-established, extended time frame. The course of policy would be determined by the evaluation of the outlook, not the passage of time. The unusual configuration of already low interest rates and reservations about the strength of the expansion had justified the inclusion of the phrase "for a considerable period" in the statement issued in August. While changing circumstances would call for removal of that reference at some point, doing so at this meeting might suggest the members' views on the economy had changed markedly. Accordingly, the Committee decided to release a statement after this meeting that was virtually identical to that used after the August meeting apart from some minor updating to reflect ongoing economic developments.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 1 percent.

Votes for this action: Messrs. Greenspan, Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, Parry, and Stewart. (Mr. Stewart voted as an alternate member.) Votes against this action: None.

The vote encompassed the substance of the following statements concerning risks that would be conveyed in the Committee's press release to be made available shortly after the meeting:

The risks to the Committee's outlook for sustainable economic growth over the next several quarters are balanced; the risks to its outlook for inflation over the next several quarters are weighted toward the downside; and, taken together, the balance of risks to its objectives is weighted toward the downside in the foreseeable future.

It was agreed that the next meeting of the Committee would be held on Tuesday, October 28, 2003.

The meeting adjourned at 1:05 p.m.

Vincent R. Reinhart
Secretary

Meeting Held on October 28, 2003

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, October 28, 2003, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, Messrs. Poole and Stewart, Alternate Members of the Federal Open Market Committee

Messrs. McTeer, Santomero, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Mattingly, General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Goodfriend, Howard, Madigan, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

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

Messrs. Slifman and Oliner, Associate Directors, Division of Research and Statistics, Board of Governors

Messrs. Clouse, Kamin, and Whitesell, Deputy Associate Directors, Divisions of Monetary Affairs, International Finance, and Monetary Affairs respectively, Board of Governors

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

Mr. Hambley, Assistant to the Board and Director for Congressional Liaison, Office of Board Members, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors

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

Messrs. Fuhrer and Hakkio,
Ms. Mester, Messrs. Rasche, Rolnick, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Philadelphia, St. Louis, Minneapolis, Dallas, and Cleveland respectively

Mr. Dwyer, Ms. Hargraves,
Messrs. Krane and Rudebusch, Vice Presidents, Federal Reserve Banks of Atlanta, New York, Chicago, and San Francisco respectively

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 16, 2003, were approved.

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

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and securities issued or fully guaranteed by federal agencies during the period September 16, 2003, through October 27, 2003. By unanimous vote, the Committee ratified these transactions.

The pace of the economic expansion appeared to have picked up substantially. Consumer spending and the demand for housing were quite strong in the third quarter and business outlays for capital evidently accelerated. At the same time, labor markets seemed to be leveling out, and industrial production had firmed in recent months. While core consumer prices had risen faster in recent months than earlier in the year, the twelve-month increase through September was notably lower than during the preceding year.

Labor markets appeared to be stabilizing as private nonfarm payrolls grew in September for the first time since January, and employment losses in July and August turned out to be smaller than data initially had indicated. The largest employment gain in September was in the business services sector, which includes temporary help supply firms. Employment also increased in most other major industries in September, with the exceptions of manufacturing and wholesale trade. Even in these sectors, the pace of job loss was somewhat slower than the declines of previous months. Aggregate hours of private production workers and the average workweek were both unchanged in September. The unemployment rate in September remained at 6.1 percent.

Conditions in the industrial sector had improved somewhat in the previous months. Industrial output displayed solid growth in the third quarter after declining earlier in the year. A downturn in motor vehicle assemblies depressed overall manufacturing somewhat in August, but a step-up in auto production boosted it significantly in September. The strength in manufacturing in September was somewhat offset, however, by a decrease in energy production as temperatures returned to more normal ranges after being unusually high in July and August. In line with these patterns in output, capacity utilization in manufacturing, which had been at historically low levels, decreased slightly in August, then firmed in September.

Real personal consumption expenditures surged in July and August, but available data suggested that consumer spending had fallen back in September, largely reflecting a swing in consumer purchases of motor vehicles. Even apart from motor vehicles, outlays rose at a solid pace in August, and they seemed to have declined only slightly in September. Spending was supported in recent months by the sizable boost to disposable personal income from tax cuts as well as by levels of wealth and confidence that were considerably above their values earlier in the year.

Housing construction and sales remained very strong in August and September despite some rise in mortgage rates from the very low levels reached in the early summer. The rapid pace of new single-family home construction eased slightly in August but advanced again in September. Multifamily home construction remained around its pace of the past several years. Sales of existing homes reached a record high in August and then climbed further in September. New home sales rose in August and September at a rate just a bit below the record set in June.

Real outlays for equipment and software in the third quarter appeared to have advanced at a faster rate than in the second quarter. Shipments of nondefense capital goods excluding aircraft moved up in September, more than reversing a decline in August. Orders for these goods rose moderately in September after being flat in August. Nominal outlays for construction of privately owned buildings were about unchanged, on net, during the twelve months ending in August. Continued strength in the construction of private institutional structures such as schools, churches, and hospitals was about offset by weakness in other areas of nonresidential construction.

Manufacturing and trade inventories excluding motor vehicles fell further in August after edging down in July. Manufacturers ran off stocks at a fairly rapid pace in both months, while wholesalers and retailers excluding motor vehicle and parts dealers recorded small declines in stocks in August after accumulations in July. Generally small changes in shipments and sales in the July–August period kept book-value inventory–sales ratios about flat at very low levels.

The U.S. international trade deficit declined in August to its lowest level since February as imports fell more than exports. Available data for the third quarter generally suggested moderate growth in the major foreign industrial countries. Evidence pointed to a likely resumption of real GDP growth in the third quarter in Canada and the euro area and continued expansion in Japan and the United Kingdom.

Core consumer prices rose slightly in August and September, but headline consumer inflation was up a bit more, largely reflecting a run-up in gasoline prices. Energy prices also boosted overall consumer inflation over the past twelve months, while core consumer inflation moved lower over the same period. At the producer level, core prices were about unchanged during August and September, but rising energy and food prices led to somewhat larger increases in the prices of total finished goods. With regard to labor costs, average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls edged down in September. The increase in earnings during the previous twelve months was a bit below that during the previous year.

At its meeting on September 16, 2003, the Federal Open Market Committee adopted a directive that called for maintaining conditions in reserve markets consistent with keeping the federal funds rate at around 1 percent. In reaching this decision, the Committee members generally perceived the upside and downside risks to the attainment of sustainable growth for the next few quarters to be roughly equal; however, they viewed the probability, though minor, of an unwelcome fall in inflation as exceeding that of a rise in inflation from its already low level. The Committee judged that, on balance, the risk of inflation becoming undesirably low would remain the predominant concern for the foreseeable future. In those circumstances, the Committee believed that policy accommodation could be maintained for a considerable period.

The Committee's decision to leave its target for the federal funds rate and assessment of risks unchanged at the September meeting was widely anticipated. Although there was relatively little shift in market expectations for the federal funds rate following the policy decision, longer-dated federal funds futures rates rose significantly in the weeks before the October meeting in the context of better-than-expected economic data, positive announcements of corporate earnings, and a pronounced weakening of the dollar. Short- and intermediate-term Treasury yields also increased somewhat over the intermeeting period, but yields on longer-term Treasuries were about unchanged. While rates on investment-grade securities moved about in line with those on Treasuries, yields and spreads on lower-tier obligations registered further significant and broad-based declines. Major equity indexes rose roughly 2 percent over the intermeeting period.

The exchange value of the dollar, as measured by the major currencies index, fell significantly over the intermeeting period. Negative market sentiment toward the dollar, apparently reinforced by market participants' interpretation of the G-7 communiqué from Dubai on September 20, was not overcome by several better-than-expected U.S. economic reports, though there were some short-lived gains related to the data releases during the period.

M2 contracted moderately in September after growing rapidly in July and August. The reversal appears to have stemmed mainly from a contraction in deposits resulting from reduced mortgage refinancing activity. In addition, the temporary effects of a major power blackout in August had boosted M2 growth in that month, and the subsequent runoff of those deposits likely depressed M2 in September.

The staff forecast prepared for this meeting continued to point to a substantial strengthening in the economic expansion during the second half of the year. Accommodative financial conditions, recent additional fiscal stimulus, and robust gains in structural productivity were evidently providing significant impetus to business and consumer spending. Inventory levels had been substantially reduced, and the size of business capital stocks apparently had continued to move closer to acceptable levels. As a consequence, improving sales and profits, low financing costs, and the temporary federal tax incentive for investment in new equipment and software were projected to boost business investment spending over time. Given the substantial ongoing slack in resource utilization, the staff forecast anticipated some slight downward pressure on core consumer price inflation.

In the Committee's discussion of current and prospective economic developments, members referred to widespread indications of a marked strengthening in the growth of economic activity. While views regarding the probable vigor of the expansion differed to some extent, the members generally anticipated growth at a pace near or somewhat above the economy's potential over the forecast horizon, assuming no major shocks to the economy. Factors cited as likely to encourage robust and sustained economic growth included substantial fiscal and monetary policy stimulus, accommodative financial conditions, indications of strengthening foreign economies, much improved business earnings and cash flows, and the favorable implications of strongly rising productivity for business investment and worker earnings. Members nonetheless saw some factors that could restrain the degree of vigor in household and business spending and present downside risks to their forecasts. Among the negatives mentioned were the still-cautious business attitudes that continued to inhibit hiring and investment decisions, the potentially adverse effect on household confidence if appreciable further gains in employment should fail to materialize, and the waning impetus over time of the tax reductions that had taken effect this year. On balance, while the factors pointing to a vigorous expansion seemed to predominate, members acknowledged that the economy was emerging from an atypical period that limited the guidance that historical experience provided for evaluating the economic outlook. Developments in the next few months, notably including the strength of holiday sales, should provide an improved basis for judging the underlying momentum of the expansion.

In contrast to the usual experience in economic recoveries during recent decades, the expansion appeared to be gathering momentum at a time when key measures of inflation suggested that price stability had essentially been achieved. Looking ahead, members generally anticipated that an economic performance in line with their expectations would not entirely eliminate currently large margins of unemployed labor and other resources until perhaps the latter part of 2005 or even later. Accordingly and given the presumed persistence of strong worldwide competition, significant inflationary pressures were not seen as likely.

Members commented that the strengthening in final sales had fostered some firming in industrial production and had led purchasing managers to report an improvement in current and anticipated business conditions. Moreover, labor demand had begun to show signs of stabilizing after an extended period of weakness. Anecdotal reports of plans to increase hiring and of actual increases had multiplied. However, the extent to which recently positive labor market developments might be harbingers of substantial further employment gains was unclear at this point, given evidently continuing business efforts to respond to growing demand by improving productivity rather than hiring new workers. Members nonetheless expressed optimism regarding the prospects for substantial employment gains once business firms were persuaded that a major uptrend in final sales was firmly established.

In their comments about the outlook for demand in key sectors of the economy, members continued to view business capital spending as a critical factor in the prospects for the performance of the overall economy. Business expenditures for new equipment and software clearly had turned up since earlier in the year, but anecdotal reports from around the nation continued to suggest that much of this spending was for replacement and upgrading purposes rather than expansion. Such reports also indicated that business contacts, while more confident, remained very cautious, with most firms hesitant to expand their facilities or hire permanent workers until they saw firmer indications that the recent upturn in business activity would be sustained. Some firms reportedly were directing capital investments to foreign markets rather than domestically, apparently largely to take advantage of lower labor costs abroad. Members nonetheless expressed the view that in the context of further anticipated increases in profits and sales, business confidence would continue to improve and induce greater investment and workforce expansions. On the negative side, there were few indications of a possible upturn in commercial construction activity.

The recent strength in final sales was associated with sizable inventory liquidation by business firms, and recent surveys and anecdotal commentary suggested that inventories were at unusually low levels in relation to sales, notably in manufacturing. In the circumstances, a continuation of robust final demand could be expected to foster efforts to rebuild inventories, with potentially substantial short-run stimulus to the economy. However, the timing and extent of such restocking were subject to uncertainty, and for now available reports indicated that business firms were continuing to follow a highly cautious approach to inventory investment.

As had been true for an extended period, household spending had continued to be the mainstay of what until recent months had been a sluggish economic recovery. Personal consumption expenditures had posted quarterly increases throughout the recent period of limited economic growth. During the summer months, consumer spending evidently was boosted by a surge of disposable income generated by the federal tax cuts, but how long that income effect would stimulate increases in consumer spending remained uncertain. On the encouraging side, according to a number of reports retailers were optimistic about the outlook for sales during the holiday period and about the economy more generally. However, some members expressed concern that unless the recent improvement in labor market conditions was sustained, there could be adverse repercussions on consumer attitudes and spending.

Propelled by still low mortgage interest rates, housing demand had remained at a very high level in recent months. Indeed, record sales were being reported in some regions. There were, however, indications of concern about the longer-term outlook for housing on the part of some real estate contacts.

Fiscal policy was expected to be somewhat less expansionary next year, though still an important contributor to economic growth. Members again mentioned concerns on the part of business contacts regarding the adverse economic implications of very large deficits for the economy over the longer term.

In their comments about the external sector of the economy, members referred to indications of strengthening economic activity abroad that in conjunction with a weaker dollar was fostering some improvement in exports. At the same time, imports continued to expand rapidly, reflecting not only growth in U.S. domestic demand but also the increased availability of foreign products at attractive prices stemming from the rapid expansion of output capacity in a number of foreign countries. In this regard, many business contacts continued to note pressures on their domestic operations from foreign competition.

In their review of the outlook for inflation, members emphasized that the prospects for persisting slack in labor and other resources in combination with substantial further increases in productivity were likely to hold inflation to very low levels over the next year or two. Indeed, many saw modest further disinflation as likely, at least over the year ahead, though they also agreed that the probability of substantial and worrisome disinflation had become increasingly remote in light of the recent strengthening in economic activity. Members also cited the weakness in the dollar as a factor that would tend to reduce the degree of any domestic disinflation. Some members emphasized that the outlook for inflation was clouded by a high degree of uncertainty about the underlying trend in productivity. The growth in productivity could remain higher than had earlier been anticipated, damping employment, labor costs, and price pressures. On balance, the members did not view changes in inflation in either direction as likely to generate significant policy concerns over the forecast horizon.

In the Committee's discussion of policy for the intermeeting period ahead, all the members agreed that an unchanged target of 1 percent remained appropriate for the federal funds rate. The current degree of policy ease evidently was contributing to an upturn in the expansion of economic activity. The strengthening economy had reduced concerns of significant further disinflation, but those concerns had not been eliminated. The pickup in demand had yet to materially narrow currently wide margins of idle labor and other resources, and these margins along with the uncertainties that still surrounded current forecasts of robust economic growth suggested that an accommodative monetary policy might remain desirable for a considerable period of time. Members referred to the contrast between their current policy expectations and the typical experience during earlier cyclical upturns when it was felt that policy adjustments needed to be made quite promptly to gain greater assurance that inflation would not rise from what were already relatively elevated levels. In present circumstances, the degree of slack in resources and a rate of inflation that was essentially consistent with price stability suggested that the Committee could wait for more definitive signs that economic expansion would otherwise generate inflationary pressures before making a significant adjustment to its current policy stance.

In their discussion of the press statement to be issued shortly after this meeting, the members indicated that the Committee's risk assessments relating to economic activity and inflation to be referenced in that statement should remain the same as those in use since the May meeting. Some members, while expressing support for this view, also commented that the time for some changes in the current risk assessments might be approaching if the economy continued to strengthen in line with recent experience. At this meeting, the members agreed that the risks to the goal of sustainable economic growth were roughly balanced for the next few quarters and the probability of an unwelcome fall in inflation, though minor, exceeded that of a rise in inflation from its currently low level. On balance, the risk of undesirably low inflation was likely to remain the Committee's predominant concern for the foreseeable future. At the conclusion of this discussion, the Committee agreed to the release of a press statement after this meeting that was virtually identical to the one used after the September meeting apart from some updating to reflect ongoing economic developments.

The Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sus-

tainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 1 percent.

Votes for this action: Messrs. Greenspan, Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, Parry, and Stewart. (Mr. Stewart voted as an alternate member.) Votes against this action: None.

The vote encompassed the substance of the following statements concerning risks that would be conveyed in the Committee's press release to be made available shortly after the meeting:

The risks to the Committee's outlook for sustainable economic growth over the next several quarters are balanced; the risks to its outlook for inflation over the next several quarters are weighted toward the downside; and, taken together, the balance of risks to its objectives is weighted toward the downside in the foreseeable future.

At this meeting the members continued their earlier discussion of how best to communicate the Committee's general assessment of the outlook for economic activity and inflation. The members recognized that changing circumstances required adaptations in the Committee's communications with the ultimate objective of fostering the best possible public understanding of monetary policy decisions. A number of alternative approaches and specific suggestions were discussed, and in the absence of a consensus at this meeting the members agreed that further study under the guidance of a working group comprised of Committee members was desirable. The working group would develop a limited number of specific proposals for consideration at a later meeting.

It was agreed that the next meeting of the Committee would be held on Tuesday, December 9, 2003.

The meeting adjourned at 2:00 p.m.

Vincent R. Reinhart
Secretary

Meeting Held on December 9, 2003

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, December 9, 2003, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. Geithner, Vice Chairman
Mr. Bernanke
Ms. Bies
Mr. Broaddus
Mr. Ferguson
Mr. Gramlich
Mr. Guynn
Mr. Kohn
Mr. Moskow
Mr. Olson
Mr. Parry

Mr. Hoenig, Mses. Minehan and Pianalto, Messrs. Poole and Stewart, Alternate Members of the Federal Open Market Committee

Messrs. McTeer and Santomero, Presidents of the Federal Reserve Banks of Dallas and Philadelphia respectively

Mr. Reinhart, Secretary and Economist
Mr. Bernard, Deputy Secretary
Ms. Smith, Assistant Secretary
Mr. Mattingly, General Counsel
Ms. Johnson, Economist
Mr. Stockton, Economist

Mr. Connors, Ms. Cumming, Messrs. Eisenbeis, Goodfriend, Howard, Madigan, Struckmeyer, and Wilcox, Associate Economists

Mr. Kos, Manager, System Open Market Account

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

Messrs. Slifman and Oliner, Associate Directors, Division of Research and Statistics, Board of Governors

Messrs. Clouse, Kamin, and Whitesell, Deputy Associate Directors, Divisions of Monetary Affairs, International Finance, and Monetary Affairs, respectively, Board of Governors

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

Mr. Hambley, Assistant to the Board and Director for Congressional Liaison, Office of Board Members, Board of Governors

Mr. Skidmore, Special Assistant to the Board, Office of Board Members, Board of Governors

Mr. Nelson, Senior Economist, Division of Monetary Affairs, Board of Governors

Mr. Luecke, Senior Financial Analyst, Division of Monetary Affairs, Board of Governors

Mr. Kumasaka, Financial Analyst, Division of Monetary Affairs, Board of Governors

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

Messrs. Lyon and Werkema, First Vice Presidents, Federal Reserve Banks of Minneapolis and Chicago respectively

Messrs. Fuhrer and Hakkio, Ms. Mester, Messrs. Rasche and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of Boston, Kansas City, Philadelphia, St. Louis, and Dallas respectively

Messrs. Bryan, Elsasser, Sullivan, and Weber, Vice Presidents, Federal Reserve Banks of Cleveland, New York, Chicago, and Minneapolis respectively

Mr. Trehan, Economist, Federal Reserve Bank of San Francisco

By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 28, 2003, were approved.

Advice had been received that Mr. Timothy F. Geithner had been elected by the directors of the Federal Reserve Bank of New York as a member of the Federal Open Market Committee for the period commencing November 14, 2003, and ending December 31, 2003, and that he had executed his oath of office.

By unanimous vote, Timothy F. Geithner was elected to serve as Vice Chairman until the first regularly scheduled meeting of the Committee after December 31, 2003, with the understanding that in the event of the discontinuance of his official connection with a Federal Reserve Bank or the Board of Governors, he would cease to have any official connection to the Committee.

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

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and securities issued or fully guaranteed by federal agencies during the period October 28, 2003, through December 8, 2003. By unanimous vote, the Committee ratified these transactions.

Real GDP appeared to be advancing at a solid rate in the fourth quarter, albeit well below its extraordinary pace in the third quarter. Consumer spending appeared to be on a flatter trajectory, but spending for equipment and software and residential construction continued to surge. Meanwhile, the labor market had finally shown signs of some improvement in recent months, and activity in the industrial sector was continuing to rise. Consumer price inflation remained quiescent: The twelve-month change in core consumer prices was notably lower than the increase during the preceding year.

Private nonfarm payrolls rose moderately in November, although by less than the substantial gains in September and October. The increases in November were fairly widespread, with notable advances in temporary help services, nonbusiness services, and construction. Although employment continued to fall in manufacturing, the losses had tapered off since the first half of the year. The average workweek and aggregate hours worked by nonfarm employees increased significantly, and the average level of nonfarm employee hours in October and November was noticeably above the average in the third quarter. The unemployment rate fell to 5.9 percent in November, down from a recent peak of 6.4 percent at midyear.

Industrial production grew solidly in the third quarter, and the momentum continued in October apart from the production of motor vehicles and parts, which fell back from an elevated third-quarter level. High-tech output accelerated in the third quarter to the fastest pace since the middle of 2000, and production gains continued at a rapid pace in October. Outside the manufacturing sector, unseasonably warm weather contributed to an increase in output at utilities in October, while mining production declined a bit, largely reflecting a decrease in the production of crude oil. Capacity utilization edged up in October but remained well below its longer-term average.

Consumer spending slipped a little on balance in September and October after soaring in July and August. Much of the recent decline was the result of a pullback in purchases of motor vehicles; elsewhere, expenditures were about unchanged in September and rose modestly in October. Spending was supported by the upturn in employment, continued impetus from the recently enacted tax cuts, improved confidence, and a level of wealth that was considerably above that of earlier in the year.

Housing activity surged in October. Single-family housing starts reached a record high, while multifamily starts moved down but remained in line with the average pace during the previous two years. Sales of existing single-family homes in October were only a bit below the record level set in September. The pace of new home sales also remained brisk in October, albeit down somewhat from September.

The data on orders for, and shipments of, nondefense capital goods through October suggested continued momentum in spending on equipment and software, which grew in the third quarter at the fastest pace since 1998. Robust gains in spending were posted in the third quarter in all the major categories except aircraft. The gains were associated with recent increases in business output and corporate cash flow and with a decline this year in the user cost of capital. Shipments of high-tech equipment climbed further in October, while shipments in other nondefense sectors excluding aircraft edged down. New orders of nondefense equipment excluding aircraft in October continued the upward trend in place since the beginning of the year and were consistent with ongoing gains in equipment spending. Outlays for the construction of private-sector nonresidential buildings fell a bit in October, but the extended contraction in spending on nonresidential construction appeared to be ending. Nominal spending on office space edged up in September and October, while outlays for the construction of other commercial buildings moved lower. Expenditures on institutional buildings changed little in recent months.

Real nonfarm inventories fell moderately in the third quarter after declining substantially in the second. Manufacturers liquidated stocks by a larger amount in the third quarter than in the previous quarter but added slightly to their inventories in October. Wholesalers and retailers (excluding those selling motor vehicles and parts) built up inventories in the third quarter, and, for wholesalers, the stockbuilding continued in October (data on retail inventories in October were unavailable). Still, inventory–sales ratios in all three categories declined a bit further in the third quarter from already very low levels.

The international trade deficit increased in September as imports of goods and services rose more than exports. Recent data suggested that a recovery had taken hold in the major foreign industrial countries. Growth in real GDP picked up in the third quarter in the euro area, the United Kingdom, and Canada, and indicators in Japan were consistent with continued economic expansion.

Core consumer price inflation remained subdued in October, although it was up from even lower levels in the first part of the year, when it was depressed by transitory factors. Over the twelve months ending in October, core consumer prices rose only slightly and noticeably less than in the previous twelve-month period. Total twelve-month consumer inflation was unchanged over the period owing to accelerations in food and energy prices. Producer prices for both core and total finished goods posted unusually large increases in October, reflecting in part a sizable advance in the prices of motor vehicles. Twelve-month core producer price inflation, however, was on balance unchanged over the year ending October, although the twelve-month change in overall producer prices stood well above its year-earlier level owing to a jump in food and energy price inflation. With regard to labor costs, the average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls rose slightly in the twelve months ending in November; the increase was a bit below that in the previous twelve months. By contrast, the increase in the employment cost index for hourly compensation in private industry for the twelve months ending in September was a bit higher than a year earlier, reflecting a pickup in benefit costs.

At its meeting of October 28, 2003, the Federal Open Market Committee adopted a directive that called for maintaining conditions in reserve markets consistent with keeping the federal funds rate at around 1 percent. In reaching this decision, the Committee members generally perceived the upside and downside risks to the attainment of sustainable growth for the next few quarters to be roughly equal; however, they viewed the probability, though minor, of an unwelcome fall in inflation as exceeding that of a rise in inflation from its already low level. The Committee judged that, on balance, the risk of inflation becoming undesirably low remained the predominant concern for the foreseeable future. In those circumstances, the Committee believed that policy accommodation could be maintained for a considerable period.

The Committee's decision at the October meeting to leave its target for the federal funds rate unchanged had been widely anticipated, and rates on near-dated federal funds futures were virtually unchanged. However, the Committee's retention of both an unchanged risk assessment and its indication that policy could remain accommodative for a considerable period, which market participants apparently had seen as less certain outcomes, precipitated a brief rally in Treasury markets. Over the intermeeting period as a whole, intermediate- and longer-term Treasury yields were basically unchanged. Upward movements in response to data releases showing an economy building momentum were offset by the market response to several statements by policymakers reiterating that policy could remain accommodative and to the November employment report, which included a smaller gain in private nonfarm payrolls than market participants had expected. Yields on investment-grade corporate securities were also essentially unchanged, while yields on speculative-grade securities declined, continuing the narrowing of their risk spreads. Major equity indexes were up moderately over the intermeeting period.

The exchange value of the dollar, as measured by the major currencies index, declined somewhat, on net, over the intermeeting period. The dollar had appreciated in late October and early November following several stronger-than-expected U.S. economic data releases. But the dollar depreciated, on net, over the remainder of the intermeeting period, reflecting concerns about an escalation of trade frictions prompted by the U.S. imposition of import quotas on Chinese textiles, the ability of the United States to continue to finance its current account deficit, and risks stemming from developments in Afghanistan, Iraq, and Turkey.

M2 contracted significantly in November for the third consecutive month. A sizable part of the declines in these three months appeared to be due to the falloff in mortgage refinancing activity and the resulting reductions in associated deposit balances. In addition, rising equity markets may have made M2 accounts relatively less attractive.

The staff forecast prepared for this meeting indicated that the economic expansion was likely to be sufficiently robust to reduce economic slack substantially in coming quarters. Accommodative financial conditions, fiscal stimulus, and substantial gains in structural productivity would continue to provide significant impetus to business and consumer spending over the months ahead. In addition, businesses appeared to be shedding some of the caution that had characterized their behavior for the previous three years. As a consequence, with sales, profits, and stock prices higher, the liquidation of inventories appeared to be ending, and the strengthening of capital investment and pickup in hiring already evident in the data were projected to continue. Even though the unemployment rate was projected to decline over coming quarters, some slight downward pressure on core consumer price inflation was anticipated in the forecast, given ongoing slack in resource utilization.

In the Committee's discussion of current and prospective economic developments, members referred to widespread indications that the pickup in the economic expansion was broadening and becoming more entrenched. The members noted that spending by households had remained strong even as the effects of tax cuts and mortgage refinancing began to wane. And with business confidence on the mend, investment outlays had increased rapidly and employment had revived. While assessments by individual members of the likely pace of the expansion going forward differed somewhat, they generally expected growth to run at a rate that would trim slack in labor and goods markets over the forecast period, assuming no major shocks to the economy. Factors supporting this view included stimulative monetary and fiscal policies, accommodative conditions in financial markets, building business confidence, a rebound in profits, and the effects on the external sector of the weaker dollar and pickup in growth abroad. While downside risks to the outlook had diminished, some members remained concerned that spending could slow somewhat next year as the effects of fiscal stimulus and mortgage refinancing faded. Rapid productivity growth also could limit employment gains and so weigh on consumer confidence. With relatively strong economic growth nonetheless seemingly more assured, members regarded the risks to inflation as more nearly balanced than earlier in the year.

In their comments about recent developments around the nation, members reported improving economic conditions in virtually all regions, with strength in household spending increasingly augmented by gains in business outlays. Consumer spending remained firm, and residential construction continued at a high level. Committee members' business contacts generally expressed increasing confidence that the expansion would be sustained, and they anticipated further increases in investment outlays and employment going forward. Even in manufacturing, which had lagged the recovery in the rest of the economy until recently, output was rising in many subsectors and employment displayed signs of stabilizing. Some members reported an easing of downward pressures on prices in selected industries, but anecdotal reports suggested that competition, including especially competition from foreign producers, continued to constrain pricing.

In their comments about the outlook for demand in key sectors of the economy, members indicated greater confidence that the sizable gains in business spending in recent quarters would continue. It now appeared that the increase in outlays for equipment and software in the third quarter was even larger than had been thought, and data on orders and shipments, as well as anecdotal reports, pointed to further increases. These gains owed to rising business confidence, substantial gains in profits and cash flow, and accommodative financial markets. In addition, businesses were expected to step up investment outlays next year in advance of the expiration of temporary tax incentives. Some members noted that the commercial real estate sector, which had been very weak with high vacancy rates and falling rents, was showing signs of bottoming, as the strengthening economy boosted demand for office and retail space.

An easing of business caution was also suggested by growing indications that business firms were shifting from inventory liquidation to restocking. With the level of inventories still quite low relative to sales and sales expected to strengthen further, a number of members noted that inventory investment could be expected to contribute to growth in aggregate demand in coming quarters.

Household spending had remained solid even as the effects of tax refunds and mortgage refinancing, which had boosted spending substantially in the summer, waned. While consumption spending had slowed earlier in the fall, retail contacts suggested some strengthening more recently and reported that holiday sales appeared to be running somewhat above last year's pace. Looking forward, members anticipated that consumer spending would be supported by further gains in employment as well as by substantial tax refunds in the first half of next year. And with the expansion picking up momentum, the risk of a slowdown in such spending clearly seemed to have diminished. Some members pointed, however, to signs of increased financial stress that could limit the ability of many households to hold spending at recent levels, especially if incomes did not rise at a robust pace in line with current forecasts. In the housing sector, activity remained elevated despite some increase in mortgage rates since early summer.

Members anticipated that growth in federal government spending, which had been boosted in recent quarters by a buildup in defense outlays, would slow going forward, while budget pressures would continue to limit increases in state and local spending. Although fiscal policy more generally would probably continue to strengthen aggregate demand next year, this effect was expected to diminish somewhat even though very large deficits were likely to persist. Over a longer horizon, some members expressed concern about the possible adverse effects of such deficits on financial markets and the economy.

In their remarks about the external sector of the economy, members noted that an improvement in the economic outlook in many foreign economies, as well as the lower dollar, was likely to foster a pickup in exports. While some of the improvement abroad was probably the result of faster growth in the United States, domestic demand in several major trading partners appeared to be strengthening. Nonetheless, the value of U.S. imports was likely to continue to exceed that of exports by a wide margin, and the resulting large current account deficits and their potential correction added to uncertainty about the longer-term prospects for the U.S. economy.

In their review of the outlook for prices, members generally anticipated that persisting, though decreasing, margins of slack in labor and goods markets and further gains in productivity would keep inflation low, with a number of members seeing a small further decline in inflation as a distinct possibility. Even if growth proved fairly robust, downward pressure on prices could come from a narrowing of profit margins, which were currently quite high, or from further surprising strength in productivity, which would reduce labor costs. In addition, some members noted that the current unemployment rate likely understated the slack in labor markets, since the labor market participation rate had fallen significantly of late, and changes in payment and hiring practices had perhaps reduced the level of unemployment that could be sustained without upward pressure on wages. However, with growth now seen as more assured, downward risks to inflation were viewed as considerably reduced relative to earlier in the year, and the risk of a pernicious deflation in which declining prices reinforced weakness in demand—a risk that the members had always viewed as small—was now regarded by most as virtually nil. Indeed, the weaker dollar, higher commodity prices, and outsized increases in benefit costs were seen as suggesting some countervailing upward pressure on costs and prices even though changes in exchange rates and commodity prices generally had not had a large effect on retail prices in the past. Members also expressed concern about the potential for an increase in inflation expectations given highly stimulative macroeconomic policies and economic growth that seemed to be gathering momentum. Some noted that the rise in recent months in inflation compensation, as measured by the difference between the yields on nominal and indexed Treasury securities, could potentially point in this direction. Nonetheless, on balance, most members currently considered the upside risks to inflation to be a bit less pressing than those on the downside for the next few quarters.

In the Committee's discussion of policy for the intermeeting period ahead, all the members favored an unchanged policy that continued to incorporate a target of 1 percent for the federal funds rate. The data and anecdotal evidence becoming available since the last meeting had made the members more confident that robust growth in economic activity would persist. Nonetheless, they felt that the currently accommodative policy stance remained appropriate in a period characterized by very low inflation, wide margins of unused labor and other resources, and still considerable uncertainty about the speed with which those margins would be worked down. In these circumstances, inflationary pressures appeared likely to remain subdued well into the future. To be sure, the Committee needed to remain attentive to any indications of rising inflation pressures and to be prepared to adjust its policy stance if emerging economic conditions warranted such a move. At some point, a move in the direction of a less accommodative and more neutral policy posture might well be necessary should the apparently vigorous expansion continue and over time promote fuller utilization of resources. For the near term, however, members saw substantial benefit in maintaining an unchanged policy stance and considerable risk in taking preemptive action that could prove to be unneeded against potential inflation, with associated costs to economic performance.

In their discussion of the announcement to be issued shortly after this meeting, the members agreed that in addition to updating to reflect recent economic developments, some rewording was needed to reflect their evolving assessment of the risks to the economy. In light of the recent acceleration in economic activity and their expectations of relatively robust growth ahead, the members believed that the clearest way to convey their changed assessment was to note that the risks of substantial disinflation had diminished appreciably. While a number of members saw some slight further disinflation as the most plausible outcome, no one expected a material change in inflation. All could agree that the risks of further disinflation were substantially reduced and close to balance for overall inflation. In the circumstances, most members endorsed a proposal to delete as no longer necessary the previous summary statement relating to the risks to growth and inflation taken together.

Views differed with regard to the reference in recent statements to maintaining an accommodative monetary policy "for a considerable period." A number of members argued that its deletion would serve to enhance the Committee's flexibility to adjust monetary policy at a later date when that was deemed appropriate on the basis of evolving economic circumstances. A majority, however, preferred to retain the phrase, at least for now. They noted that the changes in their assessment of risk would convey the evolving views of the Committee and they believed the ‘‘considerable period’’ reference still accurately conveyed the Committee’s policy intentions. Given the decision to retain the reference in question, all the members saw merit in associating it more clearly with economic conditions, specifically the persistence of quite low inflation and slack in resource use, as opposed to having it appear to be linked only to the passage of time.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive.

‘‘The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with maintaining the federal funds rate at an average of around 1 percent.’’

The vote encompassed the following statements concerning the risks to the Committee’s outlook for economic growth and inflation. These statements would be included in the press release to be made available shortly after the meeting.

The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal. The probability of an unwelcome fall in inflation has diminished in recent months and now appears almost equal to that of a rise in inflation.

Votes for this action: Messrs. Greenspan, Geithner, Bernanke, Ms. Bies, Messrs. Broaddus, Ferguson, Gramlich, Guynn, Kohn, Moskow, Olson, and Parry. Vote against this action: None.

At this meeting Mr. Ferguson reported on the progress of the working group that was charged at the October 28 meeting with developing some specific proposals regarding how best to communicate the Committee’s assessment of the outlook for economic activity and inflation. The working group had solicited and received comments from the members of the Board of Governors and from the presidents of the Federal Reserve Banks regarding potential approaches for improving communications with the public and enhancing thereby the latter’s understanding of monetary policy decisions. It was agreed that the working group, with the assistance of staff at the Board of Governors and the Federal Reserve Banks, would prepare more detailed proposals together with supporting staff documentation for consideration at a later meeting of the Committee.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, January 27–28, 2004.

The meeting adjourned at 2:00 p.m.

Vincent R. Reinhart
Secretary

Litigation

During 2003, the Board of Governors was a party in six lawsuits or appeals filed that year and was a party in six other cases pending from previous years, for a total of twelve cases; in 2002, the Board had been a party in a total of ten cases. None of the lawsuits or appeals filed in 2003 raised questions under the Bank Holding Company Act. As of December 31, 2003, nine cases were pending.

Litigation under the Financial Institutions Supervisory Act

Ulrich v. Board of Governors, No. 03-73854 (9th Circuit, filed October 24, 2003), and *Diehl McCarthy v. Board of Governors*, No. 03-73997 (9th Circuit, filed October 28, 2003), are petitions for review of orders of prohibition issued by the Board on October 15, 2003. On December 12, 2003, the court consolidated these cases with related petitions for review of orders issued by the Office of the Comptroller of the Currency imposing civil money penalties and restitution against the petitioners.

Other Actions

Laigo v. Board of Governors, No. 03-CV-03576-MJP (W.D. Washington, filed November 19, 2003), is a claim regarding redemption of U.S. savings bonds.

In *Tavera v. Von Nothaus, et al.*, No. 03-763 (D. Oregon, filed June 5, 2003), the plaintiff claimed that his civil rights were violated when he was prosecuted for passing “Liberty dollar coins” as lawful money. On December 10, 2003, the court granted the Board’s motion to dismiss the action.

Apffel v. Board of Governors, No. 03-343 (S.D. Texas, filed May 20, 2003), is a case brought under the Freedom of Information Act.

Carter v. Greenspan, No. 03-1026 (D. District of Columbia, filed May 9, 2003), is an employment discrimination action.

Sedgwick v. United States, No. 02-5378 (D.C. Circuit, filed November 26, 2002), was an appeal of the dismissal of appellant’s claim for a declaratory judgment under the Federal Tort Claims Act and the Constitution regarding the banking agencies’ alleged failure to intervene on his behalf in civil litigation involving a regulated institution. On March 20, 2003, the court of appeals summarily affirmed the district court’s dismissal.

Albrecht v. Board of Governors, No. 02-5235 (D.C. Circuit, filed October 18, 2002), is an appeal of a district court order dismissing a challenge to the pension funding method applicable to certain Board employees under the Board’s retirement plan.

Caesar v. United States, No. 02-0612 (EGS) (D. District of Columbia, removed April 1, 2002, from the Superior Court of the District of Columbia), was an action seeking damages for personal injury. On March 30, 2003, the court granted the government’s motion to dismiss the action.

Community Bank & Trust v. United States, No. 01-571C (Court of Federal Claims, filed October 3, 2001), is an action challenging on constitutional grounds the failure to pay interest on reserve accounts held at Federal Reserve Banks.

Artis v. Greenspan, No. 01-0400

(D. District of Columbia, filed February 22, 2001), is an employment discrimination action. An identical action, No. 99-2073 (EGS) (D. District of Columbia, filed August 3, 1999), was consolidated with this action on August 15, 2001.

Fraternal Order of Police v. Board of Governors, No. 98-3116 (D. District of Columbia, filed December 22, 1998), is an action seeking a declaratory judgment regarding the Board's labor policy governing Federal Reserve Banks. ■