Chapter 5

The FOMC Meeting: Developing a Policy Directive

At each of its eight scheduled meetings a year, the Federal Open Market Committee (FOMC) develops its policy priorities and writes a directive containing guidelines for implementation. At the February and July meetings, the FOMC also shapes decisions to be covered in the Chairman's semiannual testimony before the House and Senate Banking Committees as required by the Humphrey-Hawkins Act.[1] At those two meetings, the FOMC by law must choose annual growth ranges for specified monetary and credit aggregates. It also has adopted the practice of setting forth the range and central tendency of expectations among FOMC members and other Reserve Bank presidents for nominal GDP, real GDP, inflation, and employment.

At all of its meetings, the FOMC develops policy specifications to guide the open market operations carried out by the Federal Reserve Bank of New York. The FOMC discusses the outlook for economic activity, inflation, financial market conditions, and the monetary and credit aggregates. It weighs information from a variety of sources and considers the likely consequences of alternative policy prescriptions. The table presents a typical FOMC meeting agenda.

sample agenda for federal open market committee meeting

1. Approval of minutes of actions taken at the last meeting of the Federal Open Market Committee.
2. Foreign currency and domestic open market operations.
   A. Report on market developments and operations since the last meeting.
   B. Action to ratify foreign currency transactions, if any, since the last meeting.
   C. Action to ratify domestic open market transactions since the last meeting.
3. Economic situation.
   A. Staff report on economic situation.
   B. Committee discussion.
4. Longer run ranges for monetary and debt aggregates.*
   A. Staff comments.
   B. Committee discussion and actions on longer run ranges.
      1. Review of ranges for year in progress.
      2. Establishment of tentative ranges for the following year (July meeting).
5. Current monetary policy and domestic policy directive.
   A. Staff comments.
   B. Committee discussion.
   C. Action to adopt directive.
6. Confirmation of date of next meeting.

* At the February and July meetings.

Preparation

In advance of each FOMC meeting, documents are prepared and circulated to those who will attend and to other staff members at the Reserve Banks who brief their presidents. Three of these documents are described by the colors of their covers—the green book, the blue book, and the beige book.

The green book, prepared by staff members at the Board of Governors, presents the staff's interpretations of a wide range of economic and financial variables. The book is divided into two parts: the first summarizes recent events and presents a series of forecasts, while the second offers detailed, sector-by-sector descriptions of recent economic developments.

The first part of the green book describes and interprets significant developments in U.S. economic activity, prices, interest rates, flows of money and credit, and the international sector that have occurred in recent months or

quarters. It presents a series of key baseline assumptions concerning likely monetary and fiscal policy over the next one or two years that are used in making the forecasts. Typically, the baseline assumes a continuation of the existing monetary policy stance, although it may include policy changes if economic and price developments would give strong support to such moves. The section presents forecasts of a number of variables for the next six to eight quarters using the baseline assumptions. The textual descriptions of economic and financial variables are supplemented by extensive tables showing past data and forecasts. It also briefly presents alternative policy scenarios—usually one more restrictive and one less restrictive than the baseline—along with indications of how such policy choices would be expected to change the forecasts for economic activity, unemployment, and prices.

The second part of the green book provides additional information about recent developments. It describes trends in employment, production, and prices and the factors influencing them. The second part also includes sector-by-sector analyses, commenting on such areas as housing, motor vehicle production, inventories, and spending by federal, state, and local governments. It reviews a range of developments in domestic financial markets, including credit patterns for banks, other financial intermediaries, nonfinancial businesses, and consumers. Finally, international developments are reviewed, with commentary on trade statistics, international financial transactions, foreign exchange markets, and economic activity in a number of foreign countries.

The blue book provides the Board staff's view of recent and prospective developments related to the behavior of interest rates, bank reserves, and money. The blue books written for the February and July meetings contain two extra sections to assist the Committee in its preparation for the Humphrey-Hawkins testimony. The first of these sections provides longer term simulations, covering the next five or six years. One of these simulations represents a judgmental baseline, while two or three alternative forecasts use a Board staff econometric model to derive the deviations from the judgmental baseline under different policy approaches. Typically, at least two scenarios are explored: one incorporates a policy path that is designed to bring economic activity and employment close to their perceived long-run potential paths fairly quickly, and another is intended to achieve a more rapid approach to stable prices. The section also offers estimates of how different assumptions about such factors as fiscal policy, the equilibrium unemployment rate, or the speed of adjustment to changed inflationary expectations would affect the predicted outcome.

The second additional section in the February and July blue books sets out alternative annual ranges for growth of the monetary aggregates. The

section alludes to the well-publicized difficulties in forecasting the relationships between monetary growth rates and economic activity and prices (described in Chapter 1). In keeping with the Humphrey-Hawkins requirements, the FOMC has continued to set annual ranges for M2, M3, and domestic nonfinancial debt, even though the measures have suffered considerable variability, with sharp deviations from expectations that have not been captured by the staff's models. Nevertheless, efforts continue to extract useful information from the measures and to derive growth rate forecasts that are consistent with the policy priorities emerging from the long-run scenarios.

The February and July blue books then provide forecasts of the aggregates based on the green book's baseline and alternative policy scenarios for the year in progress and the next year. The assumptions and risks underlying the forecasts are explained. The blue books present two or three alternative annual growth ranges for M2, M3, and debt and offer comments on the logic for each. For February, the blue book presents alternatives for the year just beginning, and in July it presents potential revisions to the ranges adopted in February and preliminary ranges for the following year.

All eight blue books present the Board staff's view of monetary and financial developments for the few months surrounding the meeting in question. Each book first reviews recent developments in policy variables, including the Federal funds rate, reserve measures, and the monetary aggregates. It often comments on the behavior of these variables relative to what the Committee had expected and explains any deviations.

Each blue book presents two or three alternative policy scenarios for the upcoming intermeeting period. Generally, the middle alternative, labeled Alternative B, retains the existing Federal funds rate. Alternative A is associated with a lower funds rate, and Alternative C a higher funds rate. For each alternative, the blue book presents expectations for the key monetary aggregates. The blue books present reasons why the Committee might want to adopt each of these alternatives. The staff also presents estimates of the likely interest and exchange rate responses to the alternatives. Sometimes, either Alternative A or Alternative C may be omitted if recent developments make it appear highly unlikely that the FOMC would contemplate a move in that direction.

The beige book, made available to the public almost two weeks before each FOMC meeting, presents reports on regional economic conditions in each of the twelve Federal Reserve Districts. The reports are compiled from conversations with local business contacts and analyses of statistical reports for the area. The beige books begin with a summary of the conditions described by each Reserve Bank.

Before every FOMC meeting, a series of briefings and discussions is held. Members of the Board staff review their economic forecasts with the governors at a regular briefing held shortly before the FOMC meeting. The Reserve Bank presidents also meet with selected staff members. Research officers present their own review of economic and financial developments and forecasts, delineating any differences they may have with the Board staff's outlook. Other staff presentations illuminate new developments or underlying relationships among economic and financial variables.

The Meeting

The FOMC meetings take place in the boardroom of the Board of Governors in Washington, D.C. The seven governors and twelve Reserve Bank presidents gather around a conference table along with the Secretary of the FOMC, Board staff members serving as advisers to the FOMC, and one or two officers from the area of the New York Reserve Bank that manages domestic and foreign open market operations. Senior research officers of the Reserve Banks and other senior Board officials are seated along the sides of the room.

1. Preliminaries

The Chairman generally opens the meeting by seeking approval of the minutes of the previous meeting. At one meeting, however, usually the initial meeting of the year, the first order of business is the election of the officers of the FOMC. The Chairman of the FOMC, who is also the Chairman of the Board of Governors, and the Vice Chairman of the FOMC (traditionally the President of the New York Federal Reserve Bank) must be elected by the members. The membership of the FOMC changes each year because the presidents from the Federal Reserve Districts other than New York serve on a rotating basis. (The new member presidents will have already taken their oaths of office.) Senior officers, generally the Directors of Research from the voting members' Districts, are elected as staff officers of the FOMC along with several Board staff officers. The Manager or Managers of the System Open Market Account are also elected. A number of procedural items are reviewed at the meeting. The FOMC also renews authorizations for the New York Federal Reserve to carry out open market operations and reviews guidelines for those operations.

2. Report of the Manager

Typically, the next order of business is the report of the Manager of the System Open Market Account at the New York Federal Reserve. (In some years, two separate Managers have had responsibility for the domestic and foreign exchange portfolios; currently one person oversees both portfolios.) The report describes domestic open market operations, any foreign exchange intervention, and the reasons for them. It reviews developments in both domestic financial markets and foreign exchange markets. The presentation at the meeting highlights key elements from a more detailed written report, which is prepared and distributed in advance by the staffs who are responsible for domestic open market and foreign exchange operations at the Federal Reserve Bank of New York.

In discussing domestic operations, the Manager reports on the implementation of monetary policy through open market operations since the last Committee meeting. The Manager indicates how reserve measures and the Federal funds rate behaved in relation to expectations and explains significant deviations. The Manager reports on other factors that are of particular interest at the time, for example, financial market participants' expectations concerning the interest rate outlook, economic activity, prices, and the likely course of Federal Reserve policy. The presentation also describes domestic market reactions to items of current interest, such as budgetary and foreign exchange developments.

If an unusually large need to add or drain reserves is expected to develop in the period before the next meeting, the Manager may ask the Committee to amend the authorization for domestic operations to permit a larger than normal net change over the period in the System's portfolio of government securities. As of 1996, the standard intermeeting "leeway" for the net portfolio change was $8 billion, an amount that is usually adequate to handle needed reserve adjustments.[2] (Chapter 7 describes the authorization for domestic operations.)

Recently, intervention by U.S. monetary authorities in the foreign exchange markets has occurred only a handful of times a year. When intervention has taken place since the last meeting, the Manager explains the reasons for the intervention and indicates the exchange market response. The Manager also describes exchange market developments more generally and may comment on other countries' exchange market activity. In contrast to domestic monetary policy, foreign exchange policy is primarily the responsibility of the U.S. Treasury as part of its overall role in formulating international financial policy. Nonetheless, the Federal Reserve, through the FOMC and the New York Reserve Bank, plays

important roles. Specifically, it monitors foreign exchange developments and participates in decisions of whether to intervene in the markets. Exchange rate policies and operations are the subject of frequent conversations between Treasury and Federal Reserve officials. The actual intervention operations and the investment of foreign exchange reserves on behalf of both the Federal Reserve System and the Treasury are carried out by the Federal Reserve Bank of New York.[3]

The FOMC is also responsible for monitoring operations under the Federal Reserve "swap" network. The swap network actually comprises individual bilateral facilities between the Federal Reserve and fourteen central banks and the Bank for International Settlements. A swap is an exchange of currencies between two central banks for a fixed period of time, after which the transaction is unwound or extended by mutual agreement. The swap network was created in 1962 to allow central banks to supplement their holdings of foreign currencies for intervention in the foreign exchange markets. The Federal Reserve last drew on the network in 1980. During the early part of the 1980s, there was essentially no intervention. Thereafter, the Federal Reserve's foreign currency holdings were built up to levels that were adequate to finance intervention activity. Drawings by other central banks to help finance intervention have also trailed off.

Before agreeing to a swap transaction, the FOMC will seek to satisfy itself that the other central bank has assured means of repayment to unwind the swap at maturity. Swap drawings are typically arranged for three-month periods and can be renewed for additional three-month terms by mutual consent, but they typically do not extend beyond one year from the date of the initial drawing. The Manager reports on any recent swap line activity and alerts the FOMC to upcoming renewals of outstanding swap lines.[4]

Following the Manager's report, FOMC members have the opportunity to comment on or raise questions about operations or market developments. They may ask about market expectations concerning future monetary policy or the exchange market's likely reaction to a policy action. Finally, the Committee is asked to ratify the operations conducted over the interval.

3. Sizing up the Economic Situation

A. The Board Staff Presentation

Members of the Board staff then review current and prospective economic and financial developments, presenting highlights of the material in the green book. Typically, the

forecast horizon includes both the current year and the following year. The domestic staff presentations explain the green book's forecasts and comment on estimates of a number of measures, including output, employment, and prices. The staff members examine factors underlying the forecasts. The analysis may touch on specific issues that are important at the time, such as debate within the federal government about the appropriate size and scope of government activity and the best ways to reduce the federal deficit.

The international staff presents its expectations for the behavior of output, prices, and interest rates abroad in relation to U.S. performance. The staff analyzes the implications for trade and current account balances and for the exchange rate of the dollar relative to currencies of its major trading partners.

Following the staff presentation on the economy, FOMC members generally ask a number of specific questions about the assumptions underlying the forecasts. For example, they may ask how economic forecasts would change if certain factors behaved differently. They often ask senior staff members about their perception of the risks of different outcomes.

B. Discussion of the Economy

The Committee members (and the nonvoting Reserve Bank presidents) then present their views on the outlook for the economy. At the February and July meetings, they will have submitted in advance their individual estimates of nominal and real economic growth, inflation, and unemployment. They may defend or modify those forecasts as a result of the discussion. The ranges and central tendencies of these forecasts are included in the Humphrey-Hawkins report.

Much of the commentary uses the Board staff's green book forecasts as a benchmark. In giving their assessments of economic activity and the outlook for prices, the governors and presidents typically note the areas of agreement or disagreement with the staff. The speakers employ a range of analytical approaches. Some build their conclusions on the economy from the spending dynamics they observe in the consumer, business, and government sectors. Others may give special weight to particular indicators that they believe to be especially important to understanding economic and price developments. For instance, a policymaker may emphasize estimates of real interest rates, the behavior of commodity prices, or the exchange value of the dollar. Some may cite monetary or credit expansion, taking into account any known distorting factors.

The Reserve Bank presidents generally remark on developments in their regions, often highlighting key points from their District's beige book section and offering insights from recent conversations they may have had with industry leaders. They may suggest that developments in their District are illustrative of those in the nation as a whole, or they may emphasize differences from the national economy related to the mix of local industry.

4. Preparation for Humphrey-Hawkins Testimony

A. Presentation

Generally at this stage of the February and July meetings, the Committee turns its attention to the longer run outlook and prepares to set annual ranges for money and credit growth. At the start of the discussion, a senior Board staff member, usually the Director of the Division of Monetary Affairs (the key staff member responsible for dealing with monetary policy issues), highlights the various multiyear scenarios that were described in the blue book and assesses how the different annual growth rate ranges for the money and debt measures correspond to the Committee's policy goals. In reviewing the alternative long-run scenarios, the Director may amplify certain characteristics of the model used to derive them, possibly describing the model's response to shocks and to the effects of making different assumptions about underlying relationships. The Director may remind the Committee of the risks inherent in this type of exercise, since a small distortion to a one-year forecast can become magnified in later years.

The Director then turns to the specific alternative annual growth rate ranges for the monetary aggregates presented in the blue book and reviews the arguments for each. The Director describes staff procedures used to develop the ranges, including analysis of special factors that may have caused the aggregates to deviate from earlier patterns, and evaluates the likelihood that the different annual ranges will encompass the contingent risks to the forecasts.

After the presentation and before the general discussion of longer run policy decisions, meeting participants may ask the Director specific questions about the aggregates. For instance, a member may ask how inflows to bond and stock mutual funds are expected to affect the growth rate of M2 in coming quarters.

B. Developing a Policy Strategy

Following the staff presentation, the Chairman may start off with a general discussion of policy priorities, presenting some concerns and preferences. (Policy priorities may be discussed at any meeting.) The subsequent deliberations generally draw from both the Chairman's remarks and the blue book's multi-year scenarios. Discussions have often focused on the best approach for dealing with inflationary pressures. When inflation was relatively high, members generally favored strong measures to combat it because of the distortions that rising prices were imposing on economic decision making and resource allocation. At times when relatively low rates of inflation have been expected to prevail, however, views have often differed on how to proceed.

Some members have supported a policy strategy that aggressively sought price stability, arguing that an economic climate promoting efficient resource allocation and sustainable economic expansion depends on expectations of reasonably stable prices. Others, however, have cited studies suggesting that forcing the inflation rate down further when it was already modest would result in only a small long-run benefit for the economy. These policymakers have argued that in fact the costs of pushing for an additional reduction in inflation could be significant, including a prolonged period of below-trend economic expansion. The latter group has generally supported a less restrictive monetary strategy, so long as it did not seem to risk rising inflation.

In addition to differences concerning the relative costs and benefits of working toward lower inflation, views have differed about the potential rate of growth in economic activity that could be sustained without accelerating inflation. Some participants have argued that seeking growth rates above the recent trend would be risky, while others have cited a belief that productivity or labor force growth could support more rapid expansion. Discussion of the topic has often focused on the nonaccelerating inflation rate of unemployment (NAIRU). At times when the actual unemployment rate has been above the estimated value of NAIRU, members were generally more willing to support an accommodative monetary policy than when the unemployment rate was already at or below NAIRU. The value of NAIRU, which depends upon a number of structural and expectational characteristics of the labor force, has itself been open to debate. Thus, members have sometimes disagreed as to how close actual unemployment was to

NAIRU. In discussing these issues, the Committee has attempted to identify areas of agreement about the general direction of policy.

C. Choosing Annual Ranges for the Aggregates

After the broad discussion of policy priorities, the FOMC must select the annual growth ranges for the monetary and debt aggregates. The participants want the message conveyed by the choice of objectives consistent with the desired future performance of prices. Because the relationships between the aggregates and economic outcomes are uncertain, at least over the one- to two-year horizons for which monetary targets are set, a particular policy direction does not lead directly to one set of monetary target ranges. The FOMC must evaluate the staff's assessment of the most likely trends in the velocity of the aggregates and then choose growth rate ranges that seem to best reflect policy intentions.

At this point, if the discussion points to a consensus or a near consensus, the Chairman may suggest adopting the blue book's formulation of annual growth rates for the monetary and debt aggregates that most closely captures prevailing preferences. The Chairman then calls for a vote of the FOMC members. At the February meeting, only the current year's ranges must be chosen. At the July meeting, the current year's ranges must be modified or reaffirmed and tentative ranges selected for the following year. The members usually vote separately for each year's specifications.

Once long-run ranges have been approved by a majority of members present, the FOMC considers how to express its choices in the policy directive. The blue book contains suggested wording for the paragraph on the longer run aggregates. Generally, the Committee uses that wording, but occasionally it may make some modifications to highlight a particular concern. (Box A presents wording from two past directives.)

5. Short-Run Policy Alternatives

A. Presentation

The Monetary Affairs Division Director then discusses alternatives for policy over the five to eight weeks preceding the next FOMC meeting. The presentation draws upon and amplifies the material presented in the blue book. The Monetary Affairs Division Director may review the recent

behavior of the aggregates, giving particular attention to any factors that have been upsetting the forecast relationships. The Director may also discuss noteworthy developments in the financial markets.

The Director refers to the two or three alternative specifications presented in the blue book and explores their strengths and shortcomings. The Director describes likely financial market responses to each policy option. For short-term rates, the response is reasonably predictable. Rates typically adjust in line with the move in policy action when the policy step is not anticipated. When the action is widely anticipated, however, rates will often complete most of the adjustment in advance of the action and show only slight additional movement as a result of the policy decision.

Box A

Paragraphs from Directives Describing Annual Monetary Ranges

From the meeting held July 5-6, 1995

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the range it had established on January 31-February 1 for growth of M2 of 1 to 5 percent, measured from the fourth quarter of 1994 to the fourth quarter of 1995. The Committee also retained the monitoring range of 3 to 7 percent for the year that it had set for growth of total domestic nonfinancial debt. The Committee raised the 1995 range for M3 to 2 to 6 percent as a technical adjustment to take account of changing intermediation patterns. For 1996, the Committee established on a tentative basis the same ranges as in 1995 for growth of the monetary aggregates and debt, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

From the meeting held January 30-31, 1996

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee at this meeting established ranges for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was set at 3 to 7 percent for the year. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

For long-term rates, the likely market response is less straightforward. The market reaction would depend on how the policy decision is perceived and on its implications for future policy and economic developments. For instance, if a tightening move is interpreted as a precursor of many more such steps, long-term rates may build in this expectation and move up in line with or possibly even more than short-term rates. In contrast, if a tightening is not considered sustainable, long-term rates may actually fall as the markets build in an anticipated policy reversal. Rates may remain volatile for a few days as market participants sort through their thoughts about the implications of the policy action.

Once the Director's presentation is completed, Committee members may ask questions about the behavior of the aggregates or other issues.

B. Choosing a Policy Option

Generally, the Chairman opens the discussion of the short-run specifications by offering some remarks designed to provide focus. The Chairman may discuss specific economic indicators that seem to be pointing to future developments in the economy or in prices. Possible topics include the behavior of credit demands and supplies, inventories, and commodity prices and the implications of the budget process. The Chairman may review the pros and cons of the policy choices that seem most consistent with the indicators, sometimes expressing a preference for a particular option while at other times leaving the question more open.

Decisions must be made in two areas. First, the FOMC has to decide whether to take some action to change the Federal funds rate at the meeting; if a change is selected, the Committee must then decide on the appropriate size of the move. Second, the FOMC chooses whether to express in the operating paragraph of the directive a predisposition to make a move between meetings. In some instances, Committee members do not expect conditions before the next scheduled meeting to call for a policy change. In those cases, the members generally choose what is referred to as symmetric wording for the directive. Such a directive does not preclude a move if significant unexpected developments make such an action appropriate. In other cases, a leaning to move in one direction between meetings is expressed through a so-called asymmetric directive. The members discuss the conditions that would call for such a move.[5] (Potential wording of alternative directives is discussed in the following subsection.)

After expressing thoughts concerning policy issues and the general form of the directive, the Chairman asks the other eleven members of the FOMC and the seven nonvoting presidents for their policy preferences. The speakers may, for example, indicate that they favor an unchanged policy stance consistent with the specifications contained in the blue book's Alternative B. Sometimes, speakers prefer an action that falls between two of the blue book alternatives. For example, they may want to see the Federal funds rate rise slightly, but by less than the amount suggested in Alternative C. If the Chairman has expressed a clear preference for one policy formulation, the others may phrase their choices by indicating agreement or disagreement with the Chairman's suggestion.

Sometimes, when the FOMC is considering a change in the Federal funds rate, the question may arise as to whether the discount rate should also be changed. During the 1980s, when the FOMC was encouraging specific amounts of borrowing, it expected the funds rate to be above the discount rate by a spread determined from the specified amount of borrowing. If policy was set in a way that resulted in the funds rate being at or below the discount rate, keeping the funds rate relatively steady would have been more difficult, as was discussed in Chapter 2. The relationship between the funds and discount rates is less critical when the funds rate itself, rather than borrowed reserves, is the primary target, but the FOMC still prefers the two rates to be reasonably in line.

As discussed in Chapter 1, the FOMC does not have the authority to change the discount rate. The Boards of Directors of the twelve Reserve Banks must initiate requests for a change in the discount rate, and the change must be approved by a majority of the members of the Board of Governors. In recent years, the Board members have generally reviewed recommendations for discount window changes before the FOMC meeting to discover their preferences if the FOMC were to take a step consistent with a discount rate action. The leanings of the Board may be indicated at the FOMC meeting. In most cases, the FOMC proceeds with its policy decisions in the expectation that the Board will approve a discount rate change after the FOMC meeting if such a change seems appropriate. Recently, public announcements of FOMC and Board actions have been combined in a single press release. (See the first example in Box B.)

Once the FOMC members and other presidents have completed their comments on policy preferences, the Chair-

man summarizes the results and offers an informal tally of voting members. If there is a clear preponderance of support for a particular approach, it is noted, and the Committee proceeds directly to the language of the directive. However, if a range of views is expressed, with members pushing for different policy prescriptions, the Chairman may have to explore several alternatives to see if any intermediate position can command broad support. If, for example, some members want to cut rates immediately while others do not, the Chairman might suggest choosing Alternative B with an asymmetric directive. In other words, specifications would

Box B

Press Releases Announcing Changing Reserve Pressures

Announcement made on February 1, 1995, following the January 31-February 1, 1995, FOMC meeting

The Federal Reserve Board approved on February 1, 1995, an increase in the discount rate from 4 3/4 percent to 5 1/4 percent, effective that day.

In a related move, the Federal Open Market Committee agreed that this increase should be reflected fully in interest rates in the reserve markets.

Despite tentative signs of some moderation in growth, economic activity has continued to advance at a substantial pace, while resource utilization has risen further. In these circumstances, the Federal Reserve views these actions as necessary to keep inflation contained, and thereby foster sustainable economic growth.

In taking the discount action, the Board approved requests submitted by the Boards of Directors of the Federal Reserve Banks of Boston, New York, Richmond, Chicago, St. Louis, Kansas City, and San Francisco. (Subsequently, the Boards of Directors at the other Reserve Banks submitted requests that were also approved.)

Announcement following the FOMC meeting held on December 19, 1995

Chairman Alan Greenspan announced on December 19, 1995, that the Federal Open Market Committee had decided to decrease slightly the degree of pressure on reserve positions.

Since the last easing of monetary policy in July, inflation has been somewhat more favorable than anticipated, and this result along with an associated moderation in inflation expectations warrants a modest easing in monetary conditions.

This action is expected to be reflected in a decline in the Federal funds rate of 25 basis points, from about 5 3/4 percent to about 5 1/2 percent.

remain the same initially but would point toward a possible easing between meetings.

Most policymakers view the monetary policy process as one of evolutionary adjustments and therefore are willing to accept a prescription that moves in the direction they favor even if at a modestly faster or slower pace than they would prefer. Consequently, it is usually possible to find some shading that captures the support of most members. On rare occasions, however, the divisions may be deep and the views strongly held. In such cases, a number of options must be suggested before a majority of members give their support to a particular policy prescription.

C. Preparing the Directive

Once the general outlines of the near-term specifications for reserve conditions have been established, the FOMC addresses the wording of the directive that will guide open market operations at the Federal Reserve Bank of New York. The blue book suggests language that normally follows the pattern of the previous directive unless the staff saw a need to make some modification.[6]

The conversation focuses on the final, operational paragraph of the directive. Box C contains two examples. The first sentence indicates the degree of pressure on reserve positions desired in the immediate future. The usual phrasing is “maintain the existing degree of pressure on reserve positions” or “increase” or “decrease” such pressure. The degree of change in pressure desired can be indicated with the modifier “slightly” or “somewhat.” A preference for Alternative B is conveyed by the first expression. The alternative phrasings are associated with the selection of Alternative C or A, respectively. The first example in Box C was prepared at a meeting when the economy was expanding rapidly and the Committee was concerned about inflation. As a result, Alternative C was chosen.

The directive then reviews the conditions that are expected to prevail during the period before the next FOMC meeting and indicates the Committee’s inclination with regard to potential changes in the degree of reserve pressure. This passage has undergone several revisions in the past. In the 1970s and early 1980s, it listed conditions that could lead to an intermeeting change. It gave prominence to deviations in the behavior of the monetary aggregates. Later in the 1980s, as the demand for money became more variable, the Committee included a range of factors in addition to the monetary aggre-

gates and periodically re-ranked the factors as its primary concerns shifted. In 1991, the Committee adopted a standard list, choosing to use the items presented to reinforce its longer term priorities. The current phrasing is, "in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments. . . ."

To express the Committee's leanings with respect to changes in reserve pressures between meetings, the directive uses certain key words. If the Committee were more inclined to tighten than ease, the directive probably would express that preference by saying greater reserve restraint "would" be acceptable, while lesser reserve restraint "might" be acceptable. The potential size of an adjustment is indicated by the use of "somewhat" or "slightly." (See the second example in Box C.) In contrast, if the FOMC is more inclined to ease, it reverses the use of "would" and "might."

The FOMC typically chooses symmetrical phrasing when it is not inclined to make a change in reserve pressures between meetings because it considers the risks to be essen-

Box C

Operating Paragraphs from FOMC Domestic Policy Directives

From the meeting held on August 16, 1994

In the implementation of policy for the immediate future, the Committee seeks to increase somewhat the existing degree of pressure on reserve positions, taking account of a possible increase in the discount rate. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in M2 and M3 over coming months.

From the meeting held on March 28, 1995

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

tially balanced or, as in the case of the first example in Box C, because it believes the move made at the meeting should be sufficient for the upcoming period. The FOMC may adopt such phrasing even though it thinks the next move is likely to lean in one particular direction if it doubts any action will be needed before the next meeting. It may use either "would" or "might" in conjunction with both phrases about the degree of restraint.

Once the directive's wording has been completed, the Chairman calls for a vote. All voting members indicate their approval or disapproval. By that point, majority support is assured, as the directive has been constructed to encompass the majority view. The Deputy Secretary of the FOMC records the votes and reports the results.

If the FOMC makes a change in reserve pressures at the meeting, a press release is prepared. Suggested wording is read by the Chairman. The statement is released early in the afternoon. (See the examples in Box B.) If no change is made in reserve pressures, standard practice is to forgo a press release; the Board's press officer indicates that the meeting has ended and that no statement will be released. At the end of the meeting, the Chairman confirms the next regular meeting date, and the meeting is adjourned.

Following the meeting, copies of the directive are sent to participants. Later, the office of the FOMC secretariat prepares extensive minutes that report the substance of the meeting's discussion. These minutes are sent to Committee members for review and correction. They are published along with the directive a few days after the following meeting. Any member who voted against the directive includes with the minutes an account of his or her reasons for dissenting. A lightly edited transcript is also prepared, which will be released about five years after the meeting.