

F O U R

Decisions of the Federal Open Market Committee

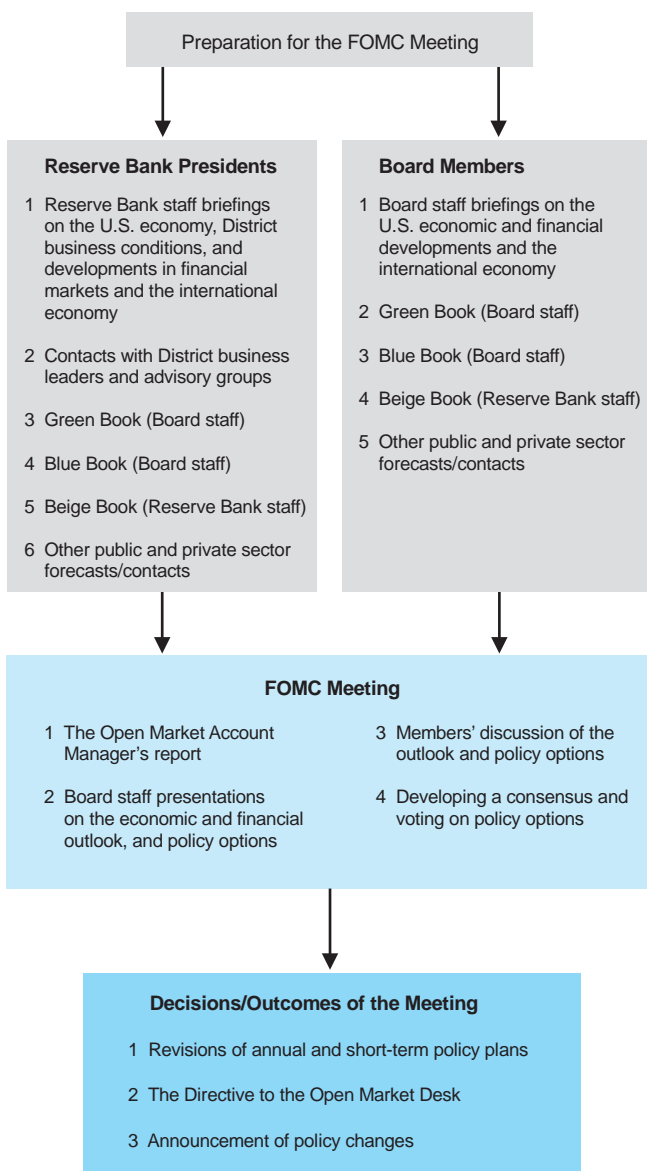
The decision-making process for U.S. monetary policy centers on the FOMC's annual policy objectives and semi-annual reports to Congress. Each year, in February, the Chairman of the FOMC, who is also the Chairman of the Board of Governors, reports to the Congress on the FOMC's expectations about the performance of the economy and its monetary policy plans for the current calendar year. The report is based on a comprehensive review of the economic and financial situation. It reviews a wide range of indicators for determining the course of monetary policy and includes specific annual growth ranges for money and debt aggregates, consistent with expectations for inflation and growth of employment and output. In July, after further consideration by the FOMC, the Chairman reports any revisions to the plans for the current year, along with preliminary plans for the following year.

In late January or early February, Board members and Reserve Bank presidents assemble in Washington, D.C., for the first FOMC meeting of the year. At present, they participate in seven other similar meet-

ings, roughly six weeks apart, during the course of a year. Each participant considers a variety of information sources on the economic and financial situation to prepare for the FOMC meeting. (Figure 4-1 provides a schematic description of the FOMC deliberations.) All of them carefully examine the Board staff's Green Book forecasts of the economy and the relevant policy and other assumptions underlying those forecasts. These forecasts draw on large, complex models that are based on historical relationships among major sectors, but the projections presented are essentially judgmental. Participants also are familiar with many other private and public sector forecasts of the national economy as well as with Reserve Bank staff's Beige Book commentaries on regional economic conditions. The Reserve Bank presidents have considered their own staff forecasts for the national economy, and also have carefully reviewed the economic situation in their particular regions. Both Board members and Reserve Bank presidents also have looked at various monetary policy options presented in the Board staff's Blue Book.

Figure 4-1

The FOMC Deliberations



At FOMC meetings, before the Committee begins the discussion of the economic outlook and monetary policy, the Manager of the System Open Market Account reports on (1) foreign exchange market developments, along with any System open market transactions in foreign currencies since the last FOMC meeting, and (2) domestic financial market developments and System open market transactions in Government securities and federal agency obligations during the preceding intermeeting period.

Annual Policy Plans

The discussion of the economic outlook and monetary policy is usually quite detailed, but it is particularly comprehensive at the first meeting of the year, since that meeting precedes the Chairman's testimony to Congress on annual monetary policy plans. The outlook review begins with the Board staff's presentation on how the U.S. economy and its trade and other external account balances are likely to evolve over the current and following years. The presentation covers a wide range of key economic variables and usually provides a comparison of the Board staff's forecasts for output, employment and prices with those of the Administration. The Board staff also presents an analysis of recent monetary and financial developments, and growth ranges for money and credit aggregates from the fourth quarter of the year just ended to the fourth quarter of the current year that

would be consistent with the Committee's broad policy goals. Estimates of appropriate monetary growth ranges involve considerable judgment about the future evolution of monetary velocities—ratios of nominal GDP (gross domestic product) to monetary aggregates—while taking into account their recent behavior and past business cycle experience.

In considering monetary policy options, policymakers discuss a wide range of issues. They usually consider the likelihood that economic growth or inflation will turn out to be higher or lower than the most likely outcomes in the staff forecasts. The discussion brings out the range of participants' views and concerns about prospects for the economy. Policymakers may differ on the economic outlook for a variety of reasons: different expectations about the spending and saving behavior of businesses and households; different views on the workings of labor and product markets; different regional perspectives; different perceptions of the impact of monetary policy on key sectors of the economy.

Mindful of potential instability in monetary velocities, policymakers consider alternative monetary growth ranges and the consistency of each with desirable outcomes for economic performance. In considering alternatives, policymakers also are keenly aware of the difficulties of specifying the relationship between monetary growth ranges and the Open Market Desk operations in reserves. Thus, even if all participants agreed that a par-

ticular outcome for the economy is both attainable and desirable, they may differ significantly on the monetary growth ranges and on the reserve market conditions needed to achieve those policy goals.

Given such wide-ranging issues, it is obviously a challenge for FOMC members to find a common ground on many aspects of monetary policy. Yet, the Chairman attempts to forge a reasonable consensus on the background considerations; efforts to build a consensus are helped by the fact that there is a collegial desire to be as united as possible in approaching policy decisions. Even after agreement, however, FOMC members may hold different expectations about future inflation and economic performance.

Against this background, and in keeping with the requirements of the Humphrey-Hawkins Act, the FOMC establishes annual monetary growth ranges. At present, growth ranges are specified, on a fourth-quarter-to-fourth-quarter basis, for the broader monetary aggregates, M2 and M3. (M2 consists of M1—currency, checkable deposits and travelers checks of nonbank issuers—plus savings and small time deposits, and retail-type money market mutual fund balances, while M3 is made up of M2 plus large time deposits, institution-only money market mutual funds, repurchase agreements and Eurodollars.) The Committee expects these monetary growth ranges to be consistent with achieving its broader policy goals for inflation and economic

growth. The Committee also sets an annual monitoring range for the growth of aggregate debt of all nonfinancial sectors.

While the FOMC continues to set annual monetary growth ranges, it has not found them to be reliable guides for monetary policy over the past several years. The Committee evaluates the behavior of the monetary aggregates in conjunction with progress on meeting its broader policy goals, movements of monetary velocities and other developments in the economy and financial markets. Nevertheless, annual monetary growth ranges play a useful role in policy deliberations and in communicating monetary policy intentions.

Short-Term Policy Directives

Concerning the implementation of short-term policy actions, at each of the eight FOMC meetings during the year, participants review monetary policy operations since the last meeting, discuss the economic and financial outlook and consider the implementation of policy over the intermeeting period ahead.

In formulating policy strategy for the near term, the Committee reviews various options presented by the Board staff in the Blue Book. Typically, each option specifies a level of the federal funds rate. Also included is an assessment of the expected evolution of financial condi-

tions and possible monetary growth rates over the near term that are consistent with each option.

Individual policymakers, including the Chairman, indicate which option seems most appropriate to them, given their views on the economic outlook and the Committee's long-run policy objectives. After extensive discussion, the Chairman usually is able to present an option with appropriate specifications that commands widespread support among members. He also may outline the conditions under which the policy might be modified between meetings, i.e., before the

next formal meeting. At times, further discussion may result in modifications of the option presented by the Chairman. Finally, the vote on policy is taken by the 12 voting members.

At the conclusion of the meeting, the Committee issues the domestic policy directive to the Federal Reserve Bank of New York. If there is a change in the FOMC's stance on monetary policy, it is announced to the public shortly after the meeting, on the same day. The announcement gives the new intended average level of the federal funds rate, along with a brief rationale for the change in policy stance.

The directive provides instructions to the Open Market Desk on the FOMC's desired degree of pressure on reserve positions until the next FOMC meeting,

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against the background of short-run developments in the economy and financial markets. This degree of reserve pressure is associated with the intended average level of the federal funds rate during the intermeeting period; greater reserve pressure implies a higher level of the funds rate, while smaller reserve pressure means a lower level of the funds rate. The directive also offers guidance

on the FOMC's inclination to move policy before the next meeting, and includes the Committee's qualitative expectation about the implications of the contemplated reserve conditions for short-run growth in the monetary aggregates.¹ In its implementation of policy for the immediate future, the Committee seeks to remain consistent with its general long-run policy objectives.

¹ A summary of the FOMC meeting, along with the directive, is released to the public shortly after the next FOMC meeting. A complete transcript of the record is made available to the public about five years later.

