

Meeting of the Federal Open Market Committee

July 8-9, 1986

Minutes of Actions

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, July 8, 1986, at 3:00 p.m., and continuing on Wednesday, July 9, 1986, at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Guffey
Mrs. Horn
Mr. Johnson
Mr. Melzer
Mr. Morris
Mr. Rice
Ms. Seger
Mr. Wallich

Messrs. Boehne, Boykin, Keehn, and Stern, Alternate
Members of the Federal Open Market Committee

Messrs. Black, Forrestal, and Parry, Presidents of the Federal
Reserve Banks of Richmond, Atlanta, and San Francisco,
respectively

Mr. Bernard, Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Oltman, 1/ Deputy General Counsel
Mr. Kichline, Economist
Mr. Truman, Economist (International)

Messrs. Balbach, J. Davis, R. Davis, T. Davis, Kohn,
Lindsey, Prell, and Siegman, Associate Economists

1/ Attended Wednesday session only.

Mr. Coyne, Assistant to the Board, Board of Governors
Mr. Roberts, Assistant to the Chairman, Board of Governors
Mr. Gemmill, Staff Adviser, Division of International
Finance, Board of Governors
Mrs. Loney, Economist, Office of the Staff Director for
Monetary and Financial Policy, Board of Governors
Mrs. Danker 1/and Mr. Struckmeyer, 1/ Economists, Division of
Research and Statistics, Board of Governors
Mrs. Low, Open Market Secretariat Assistant,
Board of Governors

Mr. Broadus, Ms. Greene, Messrs. Lang, Rolnick,
Rosenblum, Scadding, Scheld, Thieke, and Ms. Tschinkel,
Senior Vice Presidents, Federal Reserve Banks of
Richmond, New York, Philadelphia, Minneapolis, Dallas,
San Francisco, Chicago, New York, and Atlanta,
respectively

Mr. McNees, Vice President, Federal Reserve Bank
of Boston

Ms. Lovett, Assistant Vice President, Federal Reserve
Bank of New York

By unanimous vote, the minutes of actions taken at the meeting of
the Federal Open Market Committee held on May 20, 1986, were approved.

By unanimous vote, System open market transactions in Government
securities and Federal agency obligations during the period May 20, 1986,
through July 8, 1986, were ratified.

By unanimous vote, the following longer-run policy for 1986 was
approved by the Committee:

The Committee agreed at this meeting to reaffirm
the ranges established in February for growth of
6 to 9 percent for both M2 and M3, measured from
the fourth quarter of 1985 to the fourth quarter of
1986. With respect to M1, the Committee recognized
that, based on the experience of recent years, the

1/ Attended portion of meeting on Tuesday and Wednesday related to
consideration of the Committee's longer-run objectives for
monetary and debt aggregates.

behavior of that aggregate is subject to substantial uncertainties in relation to economic activity and prices, depending among other things on the responsiveness of M1 growth to changes in interest rates. In light of these uncertainties and of the substantial decline in velocity in the first half of the year, the Committee decided that growth of M1 in excess of the previously established 3 to 8 percent range for 1986 would be acceptable. Acceptable growth of M1 over the remainder of the year will depend on the behavior of velocity, growth in the other monetary aggregates, developments in the economy and financial markets, and price pressures. Given its rapid growth in the early part of the year, the Committee recognized that the increase in total domestic nonfinancial debt in 1986 may exceed its monitoring range of 8 to 11 percent, but felt an increase in that range would provide an inappropriate benchmark for evaluating longer-term trends in that aggregate.

With Ms. Seger dissenting, the following longer-run policy for 1987 was adopted by the Committee:

For 1987 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1986 to the fourth quarter of 1987, of 5-1/2 to 8-1/2 percent for M2 and M3. While a range of 3 to 8 percent for M1 in 1987 would appear appropriate in the light of most historical experience, the Committee recognized that the exceptional uncertainties surrounding the behavior of M1 velocity over the more recent period would require careful appraisal of the target range at the beginning of 1987. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1987.

With Mr. Melzer dissenting from the short-run operational paragraph, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting indicates a mixed pattern of developments but suggests on balance that economic activity expanded slowly in the second quarter. In June total nonfarm payroll employment grew

little after accounting for striking workers, with continued weakness in the industrial sector reflected in further declines in employment in manufacturing and mining. The civilian unemployment rate moved down to 7.1 percent from 7.3 percent in May. Industrial production declined in May. Total retail sales were about unchanged during the month, although consumer spending rose considerably for the second quarter as a whole. Housing starts fell somewhat in May from a relatively high level. Weakness in the energy sector has contributed to a slowing of business capital spending. Preliminary data for the U.S. merchandise trade balance in April show a somewhat larger deficit than the rate recorded in the first quarter. Both consumer and producer prices turned up in May but have fallen on balance since late 1985, largely reflecting declines in energy prices.

M1 growth in June, though less than in May, was still rapid; through June, M1 grew at a rate well above the Committee's range for 1986. Growth of M2 slowed somewhat and expansion of M3 remained relatively moderate in June, keeping these two aggregates close to the middle of their respective ranges for the year. Expansion in total domestic nonfinancial debt remains appreciably above the monitoring range for 1986. Most short-term interest rates have declined on balance since the May 20 meeting of the Committee. Rates on Treasury bonds also have moved lower while rates on private long-term obligations are about unchanged to somewhat higher. The trade-weighted value of the dollar against major foreign currencies has declined somewhat on balance since the May meeting.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at this meeting to reaffirm the ranges established in February for growth of 6 to 9 percent for both M2 and M3, measured from the fourth quarter of 1985 to the fourth quarter of 1986. With respect to M1, the Committee recognized that, based on the experience of recent years, the behavior of that aggregate is subject to substantial uncertainties in relation to economic activity and prices, depending among other things on the responsiveness of M1 growth to changes in interest rates. In light of these uncertainties and of the substantial decline in velocity in the first half of the year, the Committee decided that growth of M1 in excess of the previously established 3 to 8 percent range for 1986 would be acceptable.

Acceptable growth of M1 over the remainder of the year will depend on the behavior of velocity, growth in the other monetary aggregates, developments in the economy and financial markets, and price pressures. Given its rapid growth in the early part of the year, the Committee recognized that the increase in total domestic non-financial debt in 1986 may exceed its monitoring range of 8 to 11 percent, but felt an increase in that range would provide an inappropriate benchmark for evaluating longer-term trends in that aggregate.

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In the implementation of policy for the immediate future, the Committee seeks to decrease somewhat the existing degree of pressure on reserve positions, taking account of the possibility of a change in the discount rate. This action is expected to be consistent with growth in M2 and M3 over the period from June to September at annual rates of about 7 to 9 percent. While growth in M1 is expected to moderate from the exceptionally large increase during the second quarter, that growth will continue to be judged in the light of the behavior of M2 and M3 and other factors. Somewhat greater or lesser reserve restraint might be acceptable depending on the behavior of the aggregates, the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 4 to 8 percent.

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It was agreed that the next meeting of the Committee would be held on August 19, 1986.

The meeting adjourned.

Assistant Secretary