FEDERAL RESERVE press release

For Use at 4:30 p.m. December 19, 1986

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on November 5, 1986. This record also includes policy actions taken during the period between the meeting on November 5, 1986, and the next regularly scheduled meeting held on December 15-16, 1986.

Records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS OF THE
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on November 5, 1986

1. Domestic policy directive

The information reviewed at this meeting suggested that economic activity grew at a moderate rate in the third quarter, after rising only slightly in the previous quarter. Payroll employment expanded somewhat further in September, although manufacturing jobs declined following little change in August. Consumer spending, which had been quite robust in the first half of the year, strengthened further in the third quarter. Business capital spending, however, remained sluggish reflecting declines in outlays for nonresidential construction; new orders rose in September and equipment spending picked up. Residential constuction expenditures advanced further in the third quarter, but housing starts fell in September. Wage increases have continued to moderate, while prices have increased a bit because of developments in food and energy markets.

Industrial production rose another 0.1 percent in September. The gain partly reflected a surge in the production of cars and light trucks. Other production was unchanged on balance; production of defense equipment rose, but output of nondefense goods edged down and materials production remained sluggish. Domestic automakers apparently cut back assemblies during October, but still were planning relatively large production for the fourth quarter as a whole. Capacity utilization in manufacturing, mining, and utilities was unchanged in September at 79.2 percent. The utilization rate in mining continued to decline, while the rate in manufacturing edged up reflecting the pickup in motor vehicle production.

Total nonfarm payroll employment grew somewhat further in September. The sluggish pace of industrial production was reflected in a decline in manufacturing jobs that more than offset the increase reported for August. Employment in trade, finance, and services advanced further in September, but at a less rapid rate than in earlier months of the year. The civilian unemployment rate moved back up to 7 percent in September, close to its average level earlier in the year.

Total retail sales increased 4.6 percent in September because of a substantial jump in auto sales following the expansion of sales incentive programs by domestic automakers in late August. During September, domestic cars sold at a record 11-3/4 million unit annual rate, compared with an average 8-1/4 million unit pace in the preceding five months. Light trucks and foreign cars also sold at record monthly rates in September. Outside of the auto group, sales were virtually unchanged from August levels.

In the business sector, spending has remained sluggish. Business purchases of motor vehicles were up sharply in the third quarter, but spending for other equipment declined, and outlays for nonresidential structures dropped substantially further. However, new orders for nondefense capital goods rose sharply in September; although aircraft orders accounted for half of the increase, bookings for many other types of equipment also posted sizable gains. For structures, data on new commitments have continued to point to further declines in office building, but the drop in oil- and gas-well drilling appears to have ended.

Housing starts have declined since earlier in the year but residential construction expenditures rose through the summer. Total private housing starts dropped in September to an annual rate of 1.68 million units from a rate of about 1.8 million units during July and August. Single family starts fell somewhat in September, registering the lowest monthly reading since December, but sales of new and existing homes increased during the month. Multifamily housing starts declined further apparently reflecting in part record high vacancy rates and prospectively diminished rates of return on rental properties as a result of tax reform.

Labor cost increases have moderated further over the past year, but price increases have been a bit higher in recent months than earlier in the year due mainly to developments in food and energy markets. Consumer food prices rose sharply during the summer reflecting in part weather-related disruptions in some supplies. By September conditions had improved, and increases in retail food prices slowed noticeably. In the energy sector, petroleum prices moved up at the wellhead and refinery levels in the September PPI, reflecting the OPEC agreement in early August to curtail production. This increase in crude oil costs apparently has already reached the retail level as gasoline and heating oil prices turned up in the September CPI, after steep declines throughout much of the year. Excluding food and energy, consumer prices have risen recently at about the same pace as earlier in the year.

The trade-weighted value of the dollar against major foreign currencies continued to decline for several weeks after the September 23 FOMC meeting, but it subsequently recovered and has risen somewhat on balance. Short-term and long-term interest rate differentials increased a bit during the intermeeting period; foreign rates moved up, particularly at the short end, while rates in the United States eased slightly. Real net exports of goods and services dropped further in the third quarter, mainly reflecting a surge in the volume of oil imports. After the recovery in real economic activity in most major foreign industrial countries in the second quarter, available data for the third quarter indicate further moderate expansion in Germany, France, the United Kingdom and to a lesser extent in Japan.

At its meeting in September, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. The members expected such an approach to policy to be consistent with growth in M2 and M3 from August to December at annual rates of 7 to 9 percent. Growth in M1 over the same period was expected to moderate from the exceptionally large increase during the previous several months. The Committee agreed that the growth in M1 would continue to be evaluated in view of the behavior of the broader aggregates and other factors. The members also decided that slightly greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on the behavior of the monetary aggregates, taking into account the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The intermeeting range for the federal funds rate was maintained at 4 to 8 percent.

M2 and M3 increased at annual rates of 8-3/4 and 7-1/2 percent, respectively, on average over September and October, well below their rates of growth since early spring. Through October, both aggregates were very close to the upper ends of their 6 to 9 percent annual growth ranges established by the Committee for 1986. Growth in M1 still was quite strong over September and October, but down substantially from its average over the previous several months.

Adjustment plus seasonal borrowing at the discount window averaged about $325 million in the two complete maintenance periods after the September meeting. Federal funds generally continued to trade close to 5-7/8 percent over the intermeeting period. Most other interest rates eased somewhat on balance, with short-term rates about unchanged to down 15 basis points and long-term rates off as much as 35 basis points. Bond prices increased in the days just before the meeting in part reflecting perceptions of stronger foreign demand for dollar assets, prompted to some extent by the cut in the Japanese discount rate on October 31. In addition, market participants reportedly interpreted the cut in the Japanese rate as giving the Federal Reserve more leeway to ease domestic monetary policy.

The staff projections presented at this meeting suggested that real GNP would continue to grow at a moderate rate through the end of 1987. Anticipations of sustained growth in real exports, reflecting the improvement in the price competitiveness of U.S. goods, continued to be a key element supporting the expected expansion in domestic production. Growth in domestic spending was projected to be relatively sluggish over the forecast horizon. The staff's projection for inflation continued to show some step-up early next year associated with the effects of rapidly rising import prices on the prices of U.S. goods and with the turnaround in energy prices.

In the Committee's discussion of the economic situation and outlook, the members agreed that incoming data on business activity and reports on specific conditions in many industries were broadly consistent with the staff forecast of continuing expansion at a moderate pace. There were uncertainties nonetheless about the prospective performance of individual sectors of the economy and thus of the economy generally. In the view of most members the risks of a deviation from the staff projection appeared to be evenly balanced, but a few felt the risks were greater in the direction of less growth.

As they had at several previous meetings, the members focused on the performance of net exports as a key factor in the outlook for economic activity. The most recent data could be interpreted as suggesting that the trade balance was no longer worsening. However, clear evidence of an actual turnaround in the trade balance had not yet emerged and it was far from certain that there would be significant improvement during the months ahead. Some members reported that a growing number of firms were experiencing increases in orders from abroad, a development that lent support to expectations of a significant pickup in export sales over the next few quarters. To an important degree, the outlook for U.S. exports remained contingent on growing demands from major industrial nations. In that regard it was noted that the evidence was mixed. Domestic expansion -- and also the demand for foreign goods -- appeared to be strengthening in some major countries, but the outlook was less promising in others. On the import side, members observed that foreign competition remained intense, notably from countries whose exchange rates had not appreciated against the dollar. Nonetheless, there were reports that rising import prices were improving the competitive position of at least some domestic producers.

In the Committee's review of the outlook for spending by domestic sectors of the economy, the members generally expected demand to continue to increase, but at a slower pace than in recent quarters. Individual members again highlighted the uneven conditions in different industries and parts of the country. One member commented that the complex tax reform legislation constituted a major source of uncertainty. The members agreed that total consumer spending would tend to be held down in the current quarter by reduced purchases of automobiles following the bulge associated with attractive incentive programs. One member observed, however, that some offsetting expenditures on high-priced items might be induced before yearend because the deductibility of sales taxes in computing personal income taxes would be terminated starting in 1987. On the negative side, one member suggested that the adjustment in automobile sales might take longer than many observers currently expected and also stressed that consumer debt burdens were an important inhibiting factor on spending. In the area of business investment, members noted that construction activity would probably be held down by relatively high vacancy rates in office buildings, multi-family housing, and other commercial facilities such as hotels, especially in the context of the reportedly adverse impact of the tax reform legislation on such investments. Members also referred to a number of plant closings in the manufacturing sector. On the other hand, some current economic indicators pointed to a strengthening in the demand for business equipment. One member also commented that the prospects for improvement in the nation's balance of trade, if realized, would require more investment in domestic productive facilities over time. In regard to agriculture current conditions were mixed, but one member indicated that the overall situation in that industry and also in energy no longer appeared to be worsening and accordingly those key sectors of the economy had probably ceased to exert a negative influence on general economic activity. Likewise, the outlook for reduced government deficits, including surpluses for state and local governments, and the apparently favorable prospects for foreign trade implied a reduction in major structural imbalances and an improved basis for sustained economic expansion.

With regard to the outlook for inflation, the members agreed that the lagged impacts of the dollar's depreciation along with developments in energy markets were likely to contribute to somewhat faster price increases during the year ahead. Many domestic businesses reportedly continued to look for competitive opportunities to raise prices and widen profit margins. One member observed that a potential inflation risk, and one for business activity generally, would be the emergence of new protectionist measures in response to unsatisfactory progress in reducing the nation's trade deficit. On the favorable side, wages generally appeared to be continuing to rise more slowly than earlier and businesses were continuing to devote considerable attention to paring costs and improving their productivity. Some food prices might also tend to decline following increases in recent months. More generally, the prospect that capacity utilization rates were likely to remain relatively low in most industries over the year ahead implied that inflationary pressures would be muted during that period.

At its meeting in July the Committee reviewed the basic policy objectives that it had established in February for growth of the monetary and credit aggregates in 1986 and it set tentative objectives for expansion in 1987. For the period from the fourth quarter of 1985 to the fourth quarter of 1986, the Committee reaffirmed the ranges established in February for growth of 6 to 9 percent for both M2 and M3. The associated range for expansion in total domestic nonfinancial debt also was reaffirmed at 8 to 11 percent for the current year. With respect to M1, the Committee decided that growth in excess of the 3 to 8 percent range set in February would be acceptable and that such growth would be evaluated in relation to the velocity of M1, the expansion of the broader aggregates, developments in the economy and financial markets, and price pressures. For 1987 the Committee agreed on tentative monetary growth objectives that included reductions of 1/2 percentage point to ranges of 5-1/2 to 8-1/2 percent for both M2 and M3. In the case of M1 the Committee expressed the preliminary view that retaining the 1986 range of 3 to 8 percent, which implied a considerable reduction from the likely rate of growth in 1986, appeared appropriate for 1987 in the light of most historical experience. The Committee also retained the range of 8 to 11 percent for growth of total domestic nonfinancial debt in 1987. It was understood that all the ranges were provisional and that, notably in the case of M1, they would be reviewed in early 1987 against the background of intervening developments.

The Committee's discussion of policy implementation for the weeks immediately ahead reflected the sense that the economy was continuing to expand at a moderate rate and that, while price pressures could be strengthening somewhat in response to higher import prices, those price increases should be well contained. Externally, some signs of greater stability seemed to be emerging in exchange markets. In those circumstances, all of the members indicated that they were in favor of continuing to direct open market operations toward maintaining unchanged conditions of reserve availability. That conclusion was also warranted by indications that monetary growth had moderated somewhat over September and October, and an expectation that the broad aggregates might stay close to the Committee's earlier expectations for growth near the upper ends of their long-term ranges in the closing months of the year, assuming no significant changes in reserve conditions and in short-term interest rates.

In the Committee's discussion of possible intermeeting adjustments in the degree of reserve pressure, the members suggested that developments calling for more than a slight change in reserve conditions would be unlikely during the weeks ahead. Although a few members felt that policy implementation should remain especially alert to the potential need for some easing of reserve conditions, notably the need to respond to emerging indications, if any, of relatively weak business activity, most felt that there should be no presumptions about the likely direction of any small intermeeting adjustments, should they be desirable. With respect to the monetary aggregates, some members commented that a shortfall from current expectations would be a welcome development, given the rapid growth earlier in the year, and within limits a shortfall should be tolerated provided it occurred in the context of satisfactory economic performance and did not appear to be associated with upward pressures on market interest rates. One member commented, however, that a sharp and abrupt slowdown in M1 growth might well signal a weaker economy and, depending on the circumstances, might require more than a slight adjustment in policy implementation.

At the conclusion of the Committee's discussion, all of the members indicated that they favored a directive that called for no change in the current degree of pressure on reserve positions. The members expected this approach to policy implementation to be consistent with growth of M2 and M3 at annual rates of 7 to 9 percent over the fourth quarter from a September base. Over the same period, growth in M1 was expected to moderate from its exceptional pace during most of the period since early spring. Because the behavior of M1 remained subject to unusual uncertainty, the Committee decided to continue its recent practice of not specifying a rate of expected growth for purposes of short-run policy implementation but to evaluate this aggregate in the light of the performance of the broader monetary aggregates and other factors. The members indicated that slightly greater or slightly lesser reserve pressures might be acceptable over the intermeeting period depending on the behavior of the monetary aggregates, taking into account the strength of the business expansion, the performance of the dollar in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The members agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 4 to 8 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting indicates that economic activity grew at a moderate pace in the third quarter. In September total nonfarm payroll employment grew somewhat further, although employment in manufacturing fell after changing little in August. The civilian unemployment rate moved back up to 7.0 percent in September, close to its average level earlier in the year. Industrial production rose slightly further in September and posted a moderate gain over the third quarter. Consumer spending has remained strong in recent months, with gains in retail sales in August and especially in September paced by a sharp rise in auto sales. Housing starts fell in September, but residential investment increased further in the third quarter as a whole. Business capital spending appears to have remained sluggish; equipment spending picked up in the third quarter and new orders were strong in September, but outlays for nonresidential construction continued to decline. Real net exports of goods and services dropped further in the third quarter, reflecting in large part a surge in the volume of oil imports. Increases in labor compensation have slowed over the course of the year, while broad measures of prices have firmed somewhat recently due to developments in food and energy markets.
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> Growth of M2 moderated further in September, but appears to have picked up in October, while growth of M3 has tended to slow. Expansion of these two aggregates for the year through September has been at the upper end of their respective ranges established by the Committee for 1986. Growth of M1 slowed in the September-October period from the very rapid pace experienced since early spring. Expansion in total domestic nonfinancial debt remains appreciably above the Committee's monitoring range for 1986. Most interest rates have declined somewhat since the September 23 meeting of the Committee. Although the trade-weighted value of the dollar against major foreign currencies continued to decline for several weeks after the September meeting, it subsequently recovered and has risen somewhat on balance.

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 the July 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 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.

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 nonfinanical debt was provisionally set at 8 to 11 percent for 1987.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. This action is expected to be consistent with growth in M2 and M3 over the period from September to December at annual rates of 7 to 9 percent. While growth in M1 over the same period is expected to moderate from its exceptional pace during the previous several months, growth in this aggregate will continue to be judged in the light of the behavior of M2 and M3 and other factors. Slightly greater reserve restraint or slightly lesser reserve restraint might be acceptable depending on the behavior of the aggregates, taking into account 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.

Votes for this action: Messrs. Volcker, Corrigan, Angell, Guffey, Heller, Mrs. Horn, Messrs. Johnson, Melzer, Morris, Rice, and Ms. Seger. Votes against this action: None. Absent and not voting: Mr. Wallich.

2. Authorization for Domestic Open Market Operations

Effective December 3, 1986, the Committee approved a temporary increase of $1 billion, to $7 billion, in the limit between Committee meetings on changes in System Account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations. The increase was effective for the intermeeting period ending with the close of business on December 16, 1986.

Votes for this action: Messrs. Volcker, Corrigan, Angell, Guffey, Heller, Mrs. Horn, Messrs. Johnson, Melzer, Morris, Rice, and Ms. Seger. Votes against this action: None. Absent and not voting: Mr. Wallich.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that outright purchases of securities in the intermeeting interval through December 1, 1986, had reduced the leeway under the usual $6 billion limit to about $3.5 billion. Additional purchases of securities in excess of that leeway likely would be necessary over the remainder of the intermeeting period, chiefly reflecting seasonal increases in currency in circulation and required reserves.