

Meeting of the Federal Open Market Committee

February 10-11, 1987

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, February 10, 1987, at 3:00 p.m. and continuing on Wednesday, February 11, 1987, at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Guffey
Mr. Heller
Mr. Johnson
Mr. Melzer
Mr. Morris 1/
Ms. Seger
Mr. Keehn, Alternate for Mrs. Horn

Messrs. Boehne, Boykin, Stern, and Timlen, 2/ 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. Kichline, Economist
Mr. Truman, Economist (International)

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

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account

Mr. Cross, Manager for Foreign Operations, System Open Market Account

1/ Entered the meeting after action to approve the minutes from the December meeting.

2/ Attended Tuesday afternoon session only.

Mr. Coyne, Assistant to the Board, 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
Mr. Simpson, Deputy Associate Director, Division of
Research and Statistics, Board of Governors
Ms. Kusko 1/ and Mr. Moran, 1/ Economists, Division of
Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Office of
Staff Director for Monetary and Financial Policy,
Board of Governors

Mr. Fousek, Executive Vice President, Federal Reserve Bank
of New York

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

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

Mr. Keleher, Research Officer, Federal Reserve Bank of Atlanta

Ms. Meulendyke, Manager, 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 December 15-16, 1986, were approved.

By unanimous vote, System open market transactions in foreign
currencies during the period December 16, 1986, through February 10, 1987,
were ratified.

By unanimous vote, System open market transactions in government
securities and federal agency obligations during the period December 16, 1986,
through February 10, 1987, were ratified.

Secretary's Note: The following actions were taken at the
Wednesday session.

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

By unanimous vote, the following longer-run policy for 1987 was approved by the Committee:

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 established growth ranges of 5-1/2 to 8-1/2 percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for 1987.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. During 1987, the Committee anticipates that growth in M1 should slow. However, in the light of its sensitivity to a variety of influences, the Committee decided not to establish a precise target for its growth over the year as a whole at this time. Instead, the appropriateness of changes in M1 during the course of the year will be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In that connection, the Committee believes that, particularly in the light of the extraordinary expansion of this aggregate in recent years, much slower monetary growth would be appropriate in the context of continuing economic expansion accompanied by signs of intensifying price pressures, perhaps related to significant weakness of the dollar in exchange markets, and relatively strong growth in the broad monetary aggregates. Conversely, continuing sizable increases in M1 could be accommodated in circumstances characterized by sluggish business activity, maintenance of progress toward underlying price stability, and progress toward international equilibrium. As this implies, the Committee in reaching operational decisions during the year, might target appropriate growth in M1 from time to time in the light of circumstances then prevailing, including the rate of growth of the broader aggregates.

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 suggests on balance that economic activity continues to grow at a moderate pace. Total nonfarm payroll employment grew sharply in January in part reflecting unusual seasonal developments. The civilian unemployment rate remained at 6.7 percent in January. Industrial production increased considerably in December and over the fourth quarter as a whole. Total retail sales rose substantially in December, largely reflecting a year-end surge in automobile sales, but were little changed on balance in the fourth quarter. Housing starts also strengthened in December after trending lower since late spring. Business capital spending generally appears to have remained sluggish. Available data for the U.S. merchandise trade deficit in the fourth quarter suggest a slight increase from the third quarter; however, after allowing for price changes, net exports of goods and services improved somewhat during the quarter. In late 1986 consumer and producer prices generally were continuing to rise at moderate rates, although prices of crude oil and some other industrial commodities firmed. Labor cost increases were more restrained in 1986 than in other recent years.

Growth of M2 and M3 picked up substantially in December before slowing a little in January. For 1986 as a whole, expansion of these two aggregates was near the upper end of their respective ranges established by the Committee for the year. Growth of M1 slowed in January from an exceptionally rapid pace in late 1986. Expansion in total domestic nonfinancial debt remained appreciably above the Committee's monitoring range for 1986. Although short-term interest rates generally firmed around year-end, on balance interest rates have shown small mixed changes since the December 15-16 meeting of the Committee; rates on Treasury securities, including bonds, have risen a little over the period while rates on most private obligations have declined slightly. In foreign exchange markets the trade-weighted value of the dollar against the other G-10 currencies has declined substantially on balance since the December 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 established growth ranges of 5-1/2 to 8-1/2 percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for 1987.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. During 1987, the Committee anticipates that growth in M1 should slow. However, in the light of its sensitivity to a variety of influences, the Committee decided not to establish a precise target for its growth over the year as a whole at this time. Instead, the appropriateness of changes in M1 during the course of the year will be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In that connection, the Committee believes that, particularly in the light of the extraordinary expansion of this aggregate in recent years, much slower monetary growth would be appropriate in the context of continuing economic expansion accompanied by signs of intensifying price pressures, perhaps related to significant weakness of the dollar in exchange markets, and relatively strong growth in the broad monetary aggregates. Conversely, continuing sizable increases in M1 could be accommodated in circumstances characterized by sluggish business activity, maintenance of progress toward underlying price stability, and progress toward international equilibrium. As this implies, the Committee in reaching operational decisions during the year, might target appropriate growth in M1 from time to time in the light of circumstances then prevailing, including the rate of growth of the broader aggregates.

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 January through March at annual rates of about 6 to 7 percent. Growth in M1 is expected to slow substantially from the high rate of earlier months. Somewhat greater reserve restraint would, 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.

It was agreed that the next meeting of the Committee would be held on March 31, 1987.

The meeting adjourned.

Assistant Secretary