

Meeting of the Federal Open Market Committee

May 19, 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, May 19, 1987, at 9:10 a.m.

PRESENT: Mr. Volcker, Chairman  
Mr. Corrigan, Vice Chairman  
Mr. Angell  
Mr. Boehne  
Mr. Boykin  
Mr. Heller  
Mr. Johnson  
Mr. Keehn  
Ms. Seger  
Mr. Stern

Messrs. Black, Forrestal, and Parry, Alternate  
Members of the Federal Open Market Committee

Messrs. Guffey, Melzer, and Morris, Presidents of the Federal  
Reserve Banks of Kansas City, St. Louis, and Boston,  
respectively

Mr. Kohn, Secretary and Staff Adviser  
Mr. Bernard, Assistant Secretary  
Mrs. Loney, Deputy Assistant Secretary  
Mr. Bradfield, General Counsel  
Mr. Kichline, Economist  
Mr. Truman, Economist (International)

Messrs. Lang, Lindsey, Prell, Rolnick, Rosenblum,  
Scheld, Siegman, and Simpson, Associate Economists

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

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

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Mr. Coyne, Assistant to the Board, Board of Governors  
Mr. Gemmill, Staff Adviser, Division of International  
Finance, Board of Governors  
Ms. Low, Open Market Secretariat Assistant, Office of  
Staff Director for Monetary and Financial Policy,  
Board of Governors

Mr. Hendricks, First Vice President, Federal Reserve Bank  
of Cleveland

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

Messrs. J. Davis, T. Davis, Mmes. Munnell and Tshinkel,  
Senior Vice Presidents, Federal Reserve Banks of  
Cleveland, Kansas City, Boston, and Atlanta,  
respectively

Messrs. Beebe, Burger, and Cook, Vice Presidents,  
Federal Reserve Banks of San Francisco, St. Louis,  
and Richmond, respectively

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 March 31, 1987, were approved.

The report of examination of the System Open Market Account, made  
by the Board's Division of Federal Reserve Bank Operations as of the close  
of business October 31, 1986, was accepted.

By unanimous vote, System open market transactions in foreign  
currencies during the period March 31, 1987, through May 18, 1987,  
were ratified.

By unanimous vote, System open market transactions in government  
securities and federal agency obligations during the period March 31, 1987,  
through May 18, 1987, were ratified.

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With Ms. Seger dissenting, 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 policy directive:

The information reviewed at this meeting suggests on balance that economic activity is expanding at a moderate pace in the current quarter. Total nonfarm payroll employment rose considerably further in April, with most of the gains continuing to be in the service-producing sectors. The civilian unemployment rate fell to 6.3 percent from 6.6 percent in March. In April, industrial production declined after increasing at a moderate rate in the first quarter. Total retail sales changed little but were up somewhat from their average level in the first quarter. Housing starts were down somewhat in April from their first-quarter average. Recent indicators of business capital spending point to some recovery over the near term from a depressed level in the first quarter. Consumer and producer prices have risen more rapidly this year, primarily reflecting sizable increases in prices of energy and non-oil imports. Labor cost increases have remained relatively moderate in recent months.

Growth of M2 and M3 strengthened in April from a sluggish pace in February and March, but for 1987 to date expansion of these two aggregates has been slightly below the lower ends of their respective ranges established by the Committee for the year. M1 surged in April prompted by exceptionally large tax payments. Expansion in total domestic nonfinancial debt has moderated somewhat thus far this year. Most interest rates have risen considerably since the March 31 meeting of the Committee, with the largest increases occurring in longer-term markets.

In foreign exchange markets, the dollar was under heavy downward pressure over most of the intermeeting period and intervention purchases of dollars were substantial. Recently the dollar has tended to stabilize, but on balance its trade-weighted value against the other G-10 currencies declined over the period. In March the merchandise trade deficit was close to the average for January and February.

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 at its February meeting 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 at the February meeting not to establish a precise target for its growth over the year as a whole. 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.

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In the implementation of policy for the immediate future, the Committee seeks to increase somewhat the degree of reserve pressure sought in recent weeks, taking into account the possibility of a change in the discount rate. Somewhat greater reserve restraint would, or somewhat lesser reserve restraint might, be acceptable depending on indications of inflationary pressures and on developments in foreign exchange markets, as well as the behavior of the aggregates and the strength of the business expansion. This approach is expected to be consistent with growth in M2 and M3 over the period from March through June at annual rates of around 6 percent or less. Growth in M1 is expected to remain well below its pace during 1986. 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 July 7-8, 1987.

The meeting adjourned.

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Secretary