FEDERAL RESERVE press release

For Use at 4:30 p.m. September 25, 1987

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 August 18, 1987.

Such 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 August 18, 1987

1. Domestic policy directive

The information reviewed at this meeting suggested that economic activity has continued to expand at a moderate pace in the current quarter. Labor demand has been strong and the unemployment rate has declined further. The industrial sector apparently has benefited from increased international competitiveness. In addition, spending by domestic sectors has continued to advance with spending on business equipment remaining strong and retail sales picking up in recent months. Price increases, although still appreciable, have been somewhat smaller than in the early part of the year, and wage inflation has held at about the same slow pace as in 1986.

Household employment surged in July, and the civilian unemployment rate edged down 0.1 percentage point to 6.0 percent, bringing the cumulative decline so far this year to 0.7 percentage point. Payroll employment registered a sizable increase in July, after two months of slower growth. Hiring remained strong in services, but manufacturing employment recorded its largest monthly gain in three years, and construction employment was essentially unchanged in July following earlier declines.

Gains in employment were associated with a strong increase in industrial production in July. The industrial production index rose 0.8 percent and was revised upward for the previous two months. Advances in July were widespread among products and materials. Output of consumer goods rose noticeably with large increases in production of light trucks and consumer nondurables. Output of business equipment also registered a strong increase as a result of continued sharp advances for construction and mining, manufacturing, and commercial equipment.

Retail sales posted large increases in June and July, after a period of relatively sluggish growth earlier in the year. Automotive dealers and gasoline stations recorded sizable sales gains in July, although spending also increased at most other types of stores. Upward revisions to data for earlier months suggested that nominal spending had been well-maintained recently at stores specializing in general merchandise, apparel, and certain durable goods.

Housing activity has leveled off in recent months after declining earlier. Total starts were at an annual rate of 1.61 million units in July, essentially unchanged from the pace in May and June. During the month an increase in single-family starts offset a decline in multifamily units. Despite the rise in July, single-family homebuilding remained significantly below the robust pace recorded during the early months of the year when mortgage rates were at a nine-year low. The decline in multifamily starts reflected the continuing influence of high vacancy rates and tax law changes.

Capital spending appeared to be strengthening, especially for equipment. Real outlays for producers' durable goods rebounded in the second quarter, after a steep tax-related decline in the first quarter. In addition, recent data on new orders suggested further gains in spending on equipment in the period ahead. Outlays for nonresidential construction were little changed in the second quarter after sharp declines over most of the preceding two years; office building continued to decline in the second quarter, but spending was firm in most other sectors, especially in petroleum drilling, which rose for a third consecutive quarter.

Nonfarm inventory investment apparently slowed in the second quarter as auto dealers' inventories leveled off after a rapid first-quarter accumulation. Stockbuilding at nonauto trade establishments picked up fairly sharply in April and May, although serious inventory imbalances were not evident. In manufacturing, inventories increased slightly in the second quarter, but the inventory-sales ratio at the end of June fell to the lowest level of the current expansion.

The U.S. merchandise trade deficit in current dollars was higher in June than in any previous month of 1987, but it appeared to have changed little on average between the first and second quarters in nominal terms on a balance of payments basis. In real terms, the deficit recorded a further improvement in the second quarter despite an increase in the quantity of imports of petroleum and petroleum products. Available data indicated some improvement in economic activity in foreign industrial countries in the second quarter, compared with the generally weak first-quarter results. Indicators of economic activity in the United Kingdom suggested broad-based strength. German construction activity rebounded from its first-quarter drop, although other indicators of German economic activity showed less strength. In Japan, signs were mixed, but growth in the consumer and housing sectors seemed more robust in the latter part of the quarter.

Inflation rates have slowed in recent months but have continued to run above the pace in 1986. The recent slowdown has been concentrated among items other than food and energy; after increasing rapidly in the first four months of the year, the CPI excluding food and energy rose 0.3 percent in May and 0.2 percent in June. Consumer food prices rose sharply in May and June; however, farm commodity prices have fallen recently. Upward pressures on energy prices have persisted, partly reflecting heightened tensions in the Persian Gulf which pushed crude oil prices up further in July. Prices of imports other than oil rose sharply in the second quarter for a fairly wide range of intermediate materials and products. In addition, domestic producers have raised prices for materials. Wage inflation remained comparatively moderate in the first half of 1987.

At its meeting on July 7, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. The members decided that somewhat greater or lesser reserve restraint would be acceptable depending on indications of inflationary pressures and on developments in foreign exchange markets, as well as on the behavior of the monetary aggregates and the strength of the business expansion. M2 and M3 were expected to grow at annual rates of 5 and 7-1/2 percent, respectively, from June through September, while growth in M1 was expected to remain below its pace in 1986 but to pick up from recent levels. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

Growth in M2 picked up a little in July but remained sluggish; for the year through July cumulative M2 growth fell further below the 5-1/2 percent lower bound of the range established by the Committee for 1987. The slightly faster growth of M2 reflected a turnaround in M1, which edged up in July; demand deposits contracted, albeit less than in June, while other checkable deposits rose moderately. M3 expanded at only a 2 percent rate in July as banks, experiencing low loan demand, ran off large CD's; in July this aggregate was somewhat below the growth cone associated with the Committee's 5-1/2 to 8-1/2 percent range for this year. Total reserves continued to decline in July, but at a reduced rate; the decline largely reflected weakness in transactions deposits and decreases in excess reserves. Adjustment plus seasonal borrowing at the discount window averaged $466 million for the three reserve maintenance periods that ended since the meeting of the Committee on July 7.

Federal funds traded generally at 6-1/2 to 6-3/4 percent during the intermeeting period. Most other private short-term rates were essentially unchanged, but rates on Treasury bills backed up considerably, particularly after legislative action to raise the debt ceiling permitted a resumption of auctions. At the same time, paydowns of bills in weekly auctions slowed from the pace earlier in the year. In the longer-term markets, yields on Treasury and corporate bonds rose 25 to 35 basis points since the July meeting. The pressures on prices of petroleum coupled with relatively strong economic data appeared to increase concerns about inflation and credit demands in the future. Even so, stock prices increased appreciably over the intermeeting period.

The dollar was about unchanged on balance since the July meeting of the Committee in terms of a weighted average of other G-10 currencies. It rose substantially through much of the period, primarily in response to the tensions in the Middle East and the relative strength of the U.S. economy, but it subsequently fell back after the publication of the June trade figures in mid August. The dollar was stronger against the mark than against the yen, perhaps reflecting a relatively sluggish outlook for the German economy. Money market conditions tightened somewhat in Germany and more in the United Kingdom and remained unchanged in Japan. Long-term rates rose significantly in all these countries, with the largest rise occurring in Japan. The increase in Japanese rates was attributed to signs of stronger economic activity and concerns about the inflation implications of mid-East tensions.

The staff projections suggested that real GNP would grow at a moderate rate through the end of 1988. Improvement in the external sector was expected to provide substantial impetus for real growth, as changes in the foreign exchange value of the dollar helped to boost U.S. exports and damp import growth. In contrast, growth in domestic spending was anticipated to be relatively subdued. Rising import prices associated with the fall in the value of the dollar were likely to limit increases in real income and consumer spending; budgetary pressures would constrain government purchases; and the rise in mortgage interest rates and high vacancy rates were expected to curtail construction activity. Business equipment spending, however, should rise at a moderate pace in coming quarters. After slowing in the second half of the year, inflation was expected to move back up in 1988 reflecting pressures from non-oil import prices. Moreover, with the civilian unemployment rate projected to remain around 6 percent, slack in the labor market would not have much of a damping influence on wages. As a result, compensation increases were expected to rise noticeably next year.

In the Committee's discussion of the economic situation and outlook, members commented that recent indicators of business activity had a relatively strong tone and tended to reinforce earlier expectations that a moderate rate of economic expansion would be sustained. Indeed, in the view of several members, the chances of any deviation from such expectations were on the side of faster economic growth with attendant risks of intensifying inflationary pressures. Others, stressing the uncertainties that continued to cloud the outlook for economic activity, viewed the likelihood of a deviation from a moderate growth scenario as more evenly balanced and the risks of inflation as less worrisome.

During the Committee's discussion several members reported that local business conditions appeared to have strengthened, including evidence that some previously depressed manufacturing industries and also oil drilling and agriculture had tended to stabilize or were showing increased signs of recovery. Business optimism also was reported to have improved recently in many areas. With regard to the outlook for investment, it was noted that a number of recent statistical indicators pointed on balance to stronger business capital spending. Other favorable developments cited in this connection included the surge in stock prices, indications of potentially sizable profit gains in some sectors of the economy, and the prospect that with the depreciation of the dollar a larger share of the demand for business equipment was likely to be met by domestic producers. Some members commented that consumer spending probably would be reasonably well maintained, if not robust, in light of the impact of income tax changes on disposable incomes, the strength of the stock market, and other factors. On the negative side, it was suggested that the growth in consumer expenditures might be relatively restrained, in part because sales of automobiles were likely in this view to remain weak on balance despite the temporary fillip from sales incentive programs. Some members also referred to the emergence of unusually conservative attitudes among business borrowers and farmers, at least in some parts of the country.

The members continued to view an improvement in the trade balance as a key factor but also a major uncertainty in the outlook for economic expansion; in particular, a number of members again questioned whether such improvement would be substantial enough to provide more than very modest support to the expansion. In this view relatively sluggish growth in the economies of major trading partners and the persistence of numerous trade barriers pointed to relatively limited gains in net exports, at least over the quarters immediately ahead. Other members were somewhat more optimistic about the outlook for trade despite recently disappointing trade data. They felt that the depreciation of the dollar and ongoing increases in the prices of many imports had strengthened the competitive position of U.S. firms in both domestic and foreign markets. Such competitive gains were already reflected in the stronger performance of many domestic manufacturing industries and reports of increasing export opportunities were multiplying.

The members expressed some divergence of views with regard to the outlook for inflation, but they generally agreed that domestic pressures on prices did not appear to be intensifying currently and that wage increases had remained moderate despite the faster rise in prices experienced earlier in the year. Nonetheless, several members stressed the risks of greater inflation over the next several quarters, particularly if the expansion in economic activity proved to be on the high side of their current expectations.

These members were concerned that the economy might be at or near the point where relatively rapid growth would result in more inflation, given the substantial drop in unemployment to a relatively low level this year; long-term debt markets already reflected heightened inflationary expectations. Another substantial increase in energy prices clearly would exacerbate the inflationary pressures, but the outlook for energy was highly uncertain.

Other members agreed that inflation was a potentially serious problem, but they saw a lesser risk of intensifying inflationary pressures. These members tended to emphasize the possibility that economic growth would remain relatively moderate or that gains would tend to be concentrated in previously depressed industries that had greater margins of available labor and production capacity. Moreover, business managers were likely to persist in their efforts to cut costs and improve operating efficiencies, as evidenced by recent labor negotiations. Reference also was made to broadly deflationary factors including the moderate growth in the monetary aggregates this year and an ample availability of labor and productive capacity, especially for basic commodities, in world markets. All of the members agreed that a critical element in the inflation outlook was the potential for rising prices to be reflected at some point in rising wages. Such a development would represent a dangerous setback in the fight against inflation and would greatly increase the costs of bringing inflation under control.

At its meeting in July the Committee had reviewed the basic policy objectives established in February for growth of the monetary and debt aggrega es in 1987 and had set tentative objectives for growth in 1988. For the period from the fourth quarter of 1986 to the fourth quarter of 1987, the Committee had reaffirmed the ranges established in February for growth of 5-1/2 to 8-1/2 percent for both M2 and M3. The Committee agreed that growth in these aggregates around the lower ends of their ranges might be appropriate, depending on the circumstances. The monitoring range for expansion in total domestic nonfinancial debt also was left unchanged at 8 to 11 percent for 1987. For 1988 the Committee had agreed on tentative objectives for monetary growth that included reductions of 1/2 percentage point to ranges of 5 to 8 percent for both M2 and M3. The Committee had also reduced the associated range for growth in total domestic nonfinancial debt by 1/2 percentage point to 7-1/2 to 10-1/2 percent for 1988. With respect to M1, the Committee had decided at the July meeting not to set a specific target for growth over the remainder of 1987 or to establish a tentative range for 1988. It was understood that all the ranges for 1988 were provisional and that they would be reviewed early next year in the light of intervening developments. The issues involved with establishing a target for M1 would be carefully reappraised at the beginning of 1988.

In the Committee's discussion of policy implementation for the weeks immediately ahead, a majority of the members favored unchanged conditions of reserve availability, at least initially during the intermeeting period, but some indicated a preference for a modest firming. The members recognized that monetary policy exerted its effects with a lag and that inflationary forces should not be allowed to gather momentum. However, several stressed the uncertainties that surrounded the outlook for prices and wages, and in the view of a majority, more evidence of sustained strength in the economy or of intensifying inflation was needed before action toward firmer reserve conditions should be taken, particularly in the context of relatively slow monetary expansion. Some of these members also commented that the Committee would have an opportunity to review its decision within a few weeks, given the relatively short interval until the next scheduled meeting. Other members gave somewhat greater emphasis to the potential for more inflation. In this view some slight firming at this point would have a favorable effect on inflationary expectations and would incur very little recessionary risk. Moreover, such a move could be readily reversed if changing conditions seemed to warrant such a step later.

In their review of the outlook for monetary growth, the members took account of a staff analysis that suggested that monetary expansion was likely to accelerate from its sluggish pace in recent months, assuming that interest rates remained around their current levels. The analysis contemplated that growth in the broader aggregates would return to a pace closer to that in nominal GNP as the interactive effects of earlier increases in interest rates and the lagged adjustments in offering rates on various types of interest-bearing deposits abated. Recent monetary data tended to support that expectation. It was noted, however, that such faster monetary growth was still likely to leave cumulative expansion in the broad aggregates through September below the Committee's ranges for the year, especially in the case of M2. Some members commented that relatively slow monetary growth appeared appropriate in light of the higher inflation and the increase in inflationary expectations experienced this year. The latter had contributed to higher market interest rates which had curbed demand for assets in the monetary aggregates and had raised velocity. The possibility of some further rise in velocity implied that limited monetary expansion might remain consistent with satisfactory economic performance. However, given the shortfall in the growth of the broader aggregates from their 1987 ranges, a number of members indicated that they would find acceptable somewhat faster growth in these aggregates than was currently projected, provided that price pressures did not appear to be worsening and the dollar was not subject to substantial weakness.

The members differed to some extent in their views regarding the emphasis that should be given to various factors that might trigger intermeeting adjustments, if any, in the degree of pressure on reserve positions. Most felt that policy implementation should be especially alert to developments that might call for somewhat firmer reserve conditions, particularly if the Committee decided against any initial firming in those conditions. Other members believed that there should be no presumptions about the likely direction of any intermeeting adjustments, but they could accept a directive that looked to firming action as the more likely direction of any adjustment. The members generally agreed that developments relating to the outlook for inflation should continue to receive important weight in judging the need for any policy changes during the intermeeting period. There was also considerable sentiment in favor of giving increased attention to the overall performance of the economy in this period, given the recent signs of strength. In addition, several members commented that a possible weakening of the dollar in the foreign exchange markets might call for a policy response in the period ahead, but some other members cautioned that dollar developments would need to be interpreted with particular care. It was noted in this regard that the dollar was still appreciably above the lows it had reached in the spring, and in this view a judgment would need to be made as to whether any weakness in the dollar related more to uncertainties about oil market developments than to fundamental concerns about underlying inflationary pressures in the economy. Nevertheless, Committee members generally remained sensitive to developments relating to the dollar.

At the conclusion of the Committee's discussion, all of the members indicated that they favored or could accept a directive that called for no change, at least initially, in the degree of pressure on reserve positions. With regard to possible adjustments during the intermeeting period, the members indicated that somewhat greater reserve restraint would be acceptable, while slightly lesser reserve restraint might be acceptable, depending on developments relating to inflation, the strength of the business expansion, the performance of the dollar in foreign exchange markets, while also taking account of the behavior of the monetary aggregates. Unchanged conditions of reserve availability were expected to be consistent with growth in M2 and M3 at annual rates of around 5 percent for the three-month period from June to September; given its performance in July, expansion in M3 was expected to be somewhat less than had been anticipated at the time of the July meeting. Over the same period growth in M1 was expected to pick up from its average pace over the past several months but to remain well below its rate of expansion in 1986. Because the behavior of M1 was still subject to unusual uncertainty and in keeping with the decision not to set a longer-run target for M1, the Committee decided to continue the practice of not specifying a numerical expectation for its short-run growth. 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 suggests on balance that economic activity is expanding at a moderate pace in the current quarter. In July, total nonfarm payroll employment rose considerably further; the increase included continuing large gains in the service-producing sector and a sizable advance in manufacturing. The civilian unemployment rate fell slightly further to 6.0 percent. Industrial production increased strongly in July after rising moderately on balance in the first half of the year. Consumer spending grew at a reduced pace earlier in the year but retail sales posted large increases in June and July. Housing starts were unchanged in July and remained at their reduced second-quarter level. Recent indicators of business capital spending point to some strength, particularly in equipment outlays. The rise in consumer and producer prices has been moderate in recent months, but for the year to date prices generally have risen more rapidly than in 1986, primarily reflecting sizable increases in prices of energy and non-oil imports. Wage increases have remained relatively moderate in recent months.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was unchanged on balance since the meeting of the Committee on July 7. In the second quarter the merchandise trade deficit in current dollars was about the same as in the first quarter.

The monetary aggregates grew slowly in July. For 1987 through July, expansion of both M2 and M3 has been below the lower ends of the ranges established by the Committee for the year, while growth in M1 has been well below its pace in 1986. Expansion in total domestic nonfinancial debt has moderated this year. Most long-term interest rates have risen somewhat since the July meeting; in short-term markets, Treasury bill rates also have increased somewhat while private rates are little changed. Stock prices have risen substantially since the latest 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 its meeting in July to reaffirm the ranges established in February for growth 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 Committee agreed that growth in these aggregates around the lower ends of their ranges may be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity is expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the year was left unchanged at 8 to 11 percent.

For 1988, the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7-1/2 to 10-1/2 percent.

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. Because of this sensitivity, which has been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided at the July meeting not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range was set for 1988. The appropriateness of changes in M1 this year will continue to 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. The Committee welcomes substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee in reaching operational decisions over the balance of the year will take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully reappraised at the beginning of 1988.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange markets, as well as the behavior of the aggregates. This approach is expected to be consistent with growth in M2 and M3 over the period from June through September at annual rates of around 5 percent. Growth in M1, while picking up from recent levels, 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.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

2. Authorization for Domestic Open Market Operations

Effective August 19, 1987, the Committee approved a temporary increase of $6 billion, to $12 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 Operations. The increase was effective for the intermeeting period ending with the close of business on September 22, 1987.

Votes for this action: Messrs. Greenspan, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that the normal leeway of $6 billion for changes in the System's account would not be sufficient over the intermeeting period because a large buildup in the Treasury cash balance at Federal Reserve Banks was expected after the September tax date.