

# FEDERAL RESERVE press release



For Use at 4:30 p.m.

April 1, 1988

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 February 9-10, 1988.

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 February 9-10, 1988

Domestic policy directive

The information reviewed at this meeting indicated that economic activity continued to expand rapidly in the fourth quarter, although gains in output appeared to have moderated around year-end. Over the quarter as a whole, manufacturing output recorded a sizable further increase, supported by continued strong demands for exports. Domestic final sales weakened, however, with consumption outlays and business fixed investment declining, and much of the rise in production apparently went into inventories. The rate of inflation was held down late in the year by declines in energy prices, while wage trends showed little change.

Industrial production rose considerably over the fourth quarter, but the increase slowed in November and moderated further in December. Output of consumer goods, which changed little in both months, was held down by reductions in automobile assemblies. Also, output of business equipment edged lower after substantial growth over the summer and early autumn. Nonfarm payroll employment grew at a brisk pace in the fourth quarter, but slowed substantially in January. In manufacturing, employment gains moderated in January as sizable increases in a few industries were partly offset by layoffs elsewhere. In contrast to the payroll survey, total employment as measured by the household survey was up sharply in January, bringing the rise over the past four months into line with the advance in payroll employment. The growth in the labor force about matched the rise in household employment in January, and the civilian unemployment rate was unchanged at 5.8 percent.

Consumer spending remained sluggish in recent months. Excluding motor vehicles, real outlays on goods and services were essentially unchanged during the last three months of 1987. Sales of new automobiles improved after incentives were reintroduced in mid-November, but dealer inventories remained high. With consumer spending weak and growth in disposable income stronger in the fourth quarter, the saving rate rose considerably to 4.9 percent.

Housing starts fell to an annual rate of 1.37 million units in December, reflecting a sharp drop in the multifamily sector after a surge in November and some decline in the single-family area. Sales of new and existing homes also decreased in late 1987. For the fourth quarter as a whole, total starts were down appreciably from their averages in the previous two quarters.

Business fixed investment fell somewhat in the fourth quarter, after an exceptionally large rise in the previous quarter. Spending on information-processing equipment, which earlier had grown rapidly, appeared to slow, and business purchases of motor vehicles declined. At the same time, expenditures for industrial equipment continued to expand as did spending for nonresidential construction, including sizable increases in outlays for office structures and other commercial buildings. New orders for nondefense capital goods, excluding aircraft, were little changed in the fourth quarter, after appreciable gains earlier in the year, while new building commitments continued to increase.

Inventory investment rose strongly in October and November. The increase was concentrated in the trade sector, particularly at automobile dealers and merchant wholesalers. Stocks at nonauto retailers also continued

to expand at a faster rate than sales, especially at general merchandise, apparel, and furniture stores. In contrast, manufacturers' inventories remained low relative to shipments.

Increases in consumer prices moderated in late 1987, reflecting a decline in retail energy prices in response to earlier decreases in crude oil prices. The consumer price index was up only slightly in December, when prices of consumer goods also were held down by extensive markdowns on holiday merchandise and by the latest round of incentives for automobile sales. At the producer level, prices of finished goods fell somewhat in late 1987. Hourly compensation in the private nonfarm sector increased at a moderate pace over recent months, little changed from earlier trends.

The nominal deficit in U.S. merchandise trade was estimated to have increased slightly over October and November from the average rate in the third quarter, but in real terms the trade deficit as measured in the GNP accounts appeared to have narrowed further. Nonagricultural exports rose somewhat over the first two months of the quarter, but agricultural exports fell slightly. Non-oil imports rose considerably in the October-November period from the third-quarter pace, with the increases widespread. Oil imports, however, fell somewhat as both price and volume declined. The increases in prices of exports and of non-oil imports accelerated in the fourth quarter to rates experienced in the first two quarters of 1987, reversing the slower increases in the third quarter. Recent indicators of economic performance in major foreign industrial nations were mixed, after strong growth of real GNP in most of those countries in the third quarter of 1987. Data continued to suggest relatively vigorous growth in Japan, the United Kingdom, and Canada.

In contrast, expansion appeared to have slowed during the fourth quarter in Germany, France, and Italy.

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies increased about 3 percent over the period since the December meeting. The dollar rose about 1-1/2 percent in terms of the yen and about 4 percent in terms of the mark during the intermeeting period. Early in the period, the dollar fell sharply owing to heightened concerns about prospects for adjustment of U.S. external imbalances and reports that G-7 authorities no longer supported the Louvre accord. The G-7 authorities released a statement in late December reaffirming the objectives and economic policy commitments of the Louvre accord and the dollar retraced its decline in early January when heavy intervention by central banks associated with the G-7 statement became particularly visible. The dollar strengthened further in mid-January following the release of better-than-expected data for the U.S. trade balance in November.

At its meetings on December 15-16, 1987, and January 5, 1988,<sup>1</sup> the Committee adopted directives that called for maintaining the existing degree of pressure on reserve positions. In December, the Committee recognized that still sensitive conditions in financial markets and uncertainties in the economic outlook might continue to require a special degree of flexibility in the conduct of open market operations. In early January, the Committee agreed that the passing of time and of year-end pressures in the money market should permit further progress toward restoring a normal approach to open market operations. At the same time the members recognized that some

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1/ Meeting via telephone conference.

flexibility might continue to be needed in the conduct of operations. At both meetings, the Committee decided that, taking account of conditions in financial markets, somewhat lesser or somewhat greater reserve restraint would be acceptable depending on the strength of the business expansion, indications of inflationary pressures, developments in the foreign exchange markets, as well as the behavior of the monetary aggregates. The intermeeting range for the federal funds rate was left unchanged at 4 to 8 percent.

Over the course of the intermeeting period and especially after early January, the conduct of open market operations involved placing more emphasis on reserve positions and correspondingly less on influencing money market conditions on a day-to-day basis. Even so, adjustments in the provision of reserves were made on a number of occasions during the intermeeting period in light of unusual developments affecting reserve and money market conditions. Those developments included heavy borrowing over the 4-day New Year's weekend and sizable borrowing subsequently stemming from a data processing problem at a large bank. In the ensuing reserve maintenance period, demands for discount credit were very limited. In late January and early February, with incoming data suggesting some weakening in the economic expansion and in the context of a more stable dollar in foreign exchange markets, some easing was sought in the degree of pressure on reserve positions. Thus far in the current maintenance period, borrowing had remained relatively low. Total reserves contracted in December, reflecting continued weakness in transactions deposits, but rebounded strongly in January as most categories of reservable deposits grew rapidly and excess reserves also increased.

The federal funds rate averaged 6.82 percent over the three complete reserve maintenance periods since the December meeting; in recent days, the rate moved down toward 6-1/2 percent. Year-end pressures in the money market were much milder than most market participants had expected, partly because of a greatly reduced need for funds compared with that a year earlier, more planning in advance by banks and others, and a relatively generous provision of reserves. With the easing of concerns about year-end pressures, rates on private money market instruments fell sharply in late December. Yields on Treasury securities of all maturities and on longer-term debt of private borrowers changed little on balance over the first several weeks of the intermeeting period. More recently, such rates declined as the dollar tended to stabilize and economic data were viewed as pointing to a softer economy, more subdued inflation, and easier monetary policy. Early in February, banks lowered their prime rate. Broad indexes of stock prices increased somewhat on balance since mid-December, though price fluctuations were relatively large on occasion.

Preliminary data showed that money growth rebounded strongly in January after the marked weakening in November and December. For 1987 as a whole, M2 expanded at a rate well below the 5-1/2 percent lower boundary of the target range that the Committee had established for the year. M3 growth was at the lower end of its range. M1 grew sharply in January, after declining in late 1987. Demand deposits were particularly weak in late 1987, possibly reflecting in part incentives to adjust compensating balances downward before year-end, but other checkable deposits also fell in November and December without a corresponding increase in other M2 deposits. The strengthening of money growth in January was spread widely over various components of the

monetary aggregates and appeared to be related in part to the general decline in interest rates since mid-October.

The staff projection for economic activity continued to suggest relatively sluggish growth in output in the first half of 1988 and a pickup later in the year. This pattern primarily reflected variations in the growth of inventories. A sharp slowing in the pace of investment in nonfarm inventories, notably automobile inventories, was expected early in the year following the buildup in the fourth quarter. Final domestic demand was projected to expand sluggishly in 1988, given an erosion in the growth of real income associated in part with higher import prices and a moderately restraining fiscal policy. Over 1988 as a whole, the primary impetus to growth was anticipated to come from further strong demand for U.S. exports. Prices were projected to rise at a moderate rate during the year. Prices of nonpetroleum imports were believed likely to increase substantially, but the price of imported petroleum was assumed to rise only slowly. Nominal gains in compensation were expected to pick up, as wage demands responded to increases in consumer prices. With unemployment rates remaining near current levels, however, labor market conditions were not expected to put much additional pressure on wage rates, especially in light of uncertainties about the economic outlook and continuing efforts by businesses to improve competitiveness.

In the Committee's discussion, members emphasized that the economic outlook was subject to a great deal of uncertainty under prevailing circumstances. They noted that it was especially difficult to evaluate the outlook for an economy that appeared to be in transition from a consumer-driven to an export-driven expansion. Another area of uncertainty related to the decline



in equity prices. The latter did not appear to have had a substantial impact on consumer or business spending to date, judging from currently available data, but more repercussions might be felt later. In addition, financial markets, including the foreign exchanges, were still relatively sensitive, and many financial institutions had been weakened by serious debt repayment difficulties among their domestic and foreign borrowers. Several members commented that the staff projection remained a reasonable expectation but that the risks of a different outcome were substantial. Others saw somewhat greater or somewhat lesser economic growth as more likely for the year ahead. The members generally agreed, however, that the major risks to the economy over the longer run appeared to be in the direction of more inflation.

In conformance with the usual practice at meetings when the Committee considers its long-run objectives for monetary growth, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members had prepared specific projections of economic activity, the rate of unemployment, and the overall level of prices. For the period from the fourth quarter of 1987 to the fourth quarter of 1988, the forecasts for growth of real GNP had a central tendency of 2 to 2-1/2 percent and a full range of 1/2 to 3 percent. Forecasts of nominal GNP centered on growth rates of 5-1/4 to 6 percent and ranged from 4 to 6-1/2 percent. Estimates of the civilian rate of unemployment in the fourth quarter of 1988 were concentrated in a range of 5-3/4 to 6 percent with a full range of 5-1/2 to 6-3/4 percent. With regard to the rate of inflation, as indexed by the GNP deflator, the projections centered on rates of 3-1/4 to 3-3/4 percent and had an overall range of 2-1/2 to 4 percent for the year. In making these forecasts, the

members took account of the Committee's objectives for monetary growth in 1988. They also assumed that future fluctuations in the foreign exchange value of the dollar would not be of sufficient magnitude to have any significant effect on the projections.

In their assessment of specific developments bearing on the economic outlook, members gave considerable attention to the recent buildup of inventories and the related possibility of some correction that would tend to depress overall growth in business activity during the first half of the year. Several believed that the adjustment in inventories might be relatively limited and economic growth in the first half somewhat stronger than projected by the staff, especially in light of the strength of orders for capital goods on the books of manufacturing firms. Others anticipated a sharper inventory correction but one that would probably be over by mid-year. The outlook for the second half was particularly uncertain, and views differed regarding the likelihood and potential strength of a rebound. Conditions in financial markets would have an important influence on business conditions and any major new disturbances in those markets could have a negative effect on both consumer and business spending. Some members could see few signs in the domestic economy that pointed to a resurgence in business activity later in the year. Other members viewed the prospects as more promising and some did not rule out the possibility that the expansion might in fact tend to be more vigorous than was desirable in a period when increasing domestic production needed to be diverted to export markets. All of the members agreed that the rate of economic expansion over the next several quarters would depend to a substantial extent on the rate of improvement in the nation's balance of trade.

In the discussion of the outlook for trade, a number of members observed that sizable further gains in exports were a reasonable expectation, but the rate of increase would probably diminish from the very rapid pace in recent quarters. Among the factors tending to inhibit export growth, they cited the possibility that expansion in major industrial nations, as a group, might be relatively limited. On balance, while the extent of the improvement in trade was uncertain and might well prove to be relatively slow and uneven, most members saw favorable prospects for continuing gains of appreciable magnitude over the year ahead.

Turning to the outlook for inflation, the members generally agreed that the risks over time were in the direction of greater inflation. They emphasized that relatively rapid growth in overall demands, including that for exports, could trigger inflationary pressures in a period when the utilization of productive resources was already relatively high and comparatively little leeway appeared to exist for growth in excess of the moderate pace projected by most members. The recent behavior of broad price indexes did not suggest any acceleration in the overall rate of inflation, but several members saw evidence in local economies that price pressures might be intensifying. Business contacts were reporting that some firms were successful in selective efforts to pass through rising costs by raising product prices. And, in one view, the behavior of key commodity prices raised concern about more inflation. Some members also indicated that rising import prices were tending to put upward pressure on competing products that were manufactured domestically. In general, increases in wages remained moderate, but members expressed concern that,

given the reduced level of unemployment, rising prices would tend to be translated into higher wages at some point. It was noted that the key to avoiding both more inflation or a recession in a period of major adjustments in the trade balance would be the difficult task of maintaining restrained growth in domestic demands over an extended period.

Against that background the Committee at this meeting completed the review, begun at the meeting in December, of the ranges for growth in the monetary and debt aggregates in 1988; those ranges had been established on a tentative basis in July 1987 in keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act). The tentative ranges included growth of 5 to 8 percent for both M2 and M3 for the period from the fourth quarter of 1987 to the fourth quarter of 1988. A monitoring range of 8 to 11 percent had been set on a provisional basis for growth of total domestic nonfinancial debt in 1988. With regard to M1, the Committee had decided in July not to set a tentative range for 1988 but to reappraise at this meeting the issues relating to the establishment and use of such a target.

All of the members favored some reduction in the ranges for growth of M2 and M3 in 1988. Such a reduction would help to focus attention on the need for relatively restrained expansion in domestic demand to accommodate the adjustment in the nation's external accounts and would underscore the Committee's commitment to achieving reasonable price stability over time. However, given their differing assessments of the risks to the business expansion and of the prospective relationship of monetary growth to satisfactory economic performance, members expressed some divergence of views with

regard to how much the ranges should be reduced. Several indicated a preference for confirming the ranges for 1988 that the Committee had established on a tentative basis in July. Those ranges involved reductions of 1/2 percentage point from 1987. Others favored lower ranges with midpoints that were reduced by a full percentage point. The latter included a proposal, which received considerable support, for wider ranges of 4 to 8 percent for both M2 and M3. The members noted that monetary expansion in 1988 at rates around the midpoints of the ranges under consideration, which they generally viewed as a reasonable expectation, would represent some acceleration from the relatively modest expansion in 1987, especially in the case of M2.

Further discussion focused on the desirability of widening the ranges for growth of the broader aggregates to 4 to 8 percent. Such a range was deemed to be warranted by the experience of recent years when more marked variability had emerged in the relationship between monetary expansion and ultimate policy objectives such as prices and output. That variability stemmed from a number of sources, but prominent among them was the course of interest rates; a level of rates consistent with satisfactory economic performance would depend on the underlying strength of demands in the economy and on emerging price pressures. In that context, an uncertain outlook for the economy and inflation suggested to several members the need for somewhat wider ranges than had been used in the past. A range of 4 percentage points would provide more room for appropriate policy responses to unanticipated economic and financial developments and would encompass more fully the possible outcomes for monetary growth that might prove consistent with acceptable economic performance in 1988. Some members

expressed reservations about the desirability of wider ranges. They acknowledged that ranges of 4 percentage points might reflect more adequately the various uncertainties that were involved, but they were concerned that widening the ranges could be viewed as a further retreat from effective monetary targeting. Moreover, the narrower ranges imposed a desirable discipline by requiring a more prompt reappraisal of policy as their limits were approached or exceeded.

The members also considered proposals for using a different base than the actual fourth-quarter level of the aggregates as the starting point for the 1988 ranges. In support of this view, some members argued that the depressed levels of the aggregates in late 1987, which may have reflected in part some special factors, together with the reduced ranges under consideration implied a quite substantial lowering of the Committee's objectives for monetary growth. Several members were opposed to a change in the Committee's procedures, especially on an ad hoc basis. A number expressed their willingness to consider at a later time proposals for a regularized procedure that would take account of overshoots or of shortfalls in the previous year. Others believed that it would be preferable to adjust the new ranges themselves each year, rather than the base, if the Committee concluded that it was desirable to compensate for excessive or inadequate monetary growth in the previous year.

No member supported the reestablishment of a target range for M1 in 1988, but a few favored the use of a monitoring range for this aggregate. The behavior of M1 had become highly sensitive to changes in interest rates, among other factors, in recent years, as reflected in sharp swings in its

velocity. It remained particularly difficult to interpret the relationship between growth in M1 and the performance of the economy. In light of its unpredictable behavior, a narrow range for M1 could easily trigger an inappropriate response of monetary policy to unexpected developments in the economy. On the other hand, a range wide enough to reasonably encompass possible acceptable growth in M1 over the year would be of little use in guiding the conduct of monetary policy or in communicating the Committee's policy intentions to the public.

The members anticipated some further slowing in the growth of non-financial debt in 1988, following a marked slowdown in 1987, but the rate of growth this year appeared likely to remain well above that of nominal GNP. A key factor bearing on the outlook for debt expansion was the expectation of some reduction in government borrowing. However, as in the case of the monetary aggregates, considerable uncertainty surrounded the prospects for debt growth in 1988 and Committee members endorsed a proposal to widen the monitoring range for total domestic nonfinancial debt to 7 to 11 percent, a reduction of 1 percentage point from the lower limit of the 1987 range.

At the conclusion of the Committee's consideration of the ranges for 1988, all of the members indicated that they could support ranges of 4 to 8 percent for growth in both M2 and M3 for the year. No range was established for M1 for the year, while the monitoring range for growth in total domestic nonfinancial debt was set at 7 to 11 percent. In keeping with the Committee's usual procedures under the Humphrey-Hawkins Act, the ranges would be reviewed at midyear, or sooner if deemed necessary. It was understood that in carrying out policy the Committee would continue to judge

the behavior of the monetary aggregates against the background of developments in the economy and financial markets, including attention to the sources and extent of price pressures in the economy, the performance of the dollar in foreign exchange markets, and other indicators of the impact of monetary policy.

The following paragraphs relating to the 1988 ranges were approved for the domestic policy directive:

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 this meeting established growth ranges of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic non-financial debt was set at 7 to 11 percent for the year.

With respect to M1, the Committee again decided not to establish a specific target for 1988. The behavior of this aggregate in relation to economic activity and prices has become very sensitive to changes in interest rates, among other factors, as evidenced by sharp swings in its velocity in recent years. Consequently, 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.

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

In the Committee's discussion of policy implementation for the period immediately ahead, all of the members indicated that they favored or could accept a directive that called for maintaining the slightly reduced degree of pressure on reserve positions that had been sought recently. While some



members expressed reservations about that easing, a few indicated a preference for easing marginally further. Members commented during the discussion that policy implementation faced the special challenge of balancing the risks of a potentially softer economy over the nearer term while also remaining positioned to achieve the Committee's anti-inflationary objectives over the longer run. Accordingly, despite shadings of opinion, the members were in broad agreement that any substantial change in policy, in either direction, was not warranted under prevailing economic and financial conditions. A tightening move would not be appropriate at a time when the expansion was showing some signs of slackening, and against this background such a policy course might well have a disruptive impact on financial markets, which remained somewhat fragile. On the other side, policy should not overreact to recent indications of a more sluggish business expansion because any policy easing now would tend to have its major impact later in the year when, in the view of many members, a stronger economic expansion was likely to emerge. Moreover, while the dollar had tended to stabilize recently in the foreign exchange markets, members were concerned that appreciable further easing, especially if it was seen as leading to a lower discount rate, could have highly adverse repercussions on the dollar. It might also have unsettling effects on financial markets more generally if it was not viewed by market participants as warranted by substantial new evidence of a weaker economy. The slight easing that had already been undertaken did not appear to put significant downward pressure on the dollar and it provided greater assurance that the expected strengthening of the business expansion would in fact materialize later in the year.

In the course of the Committee's discussion, members referred to the rebound in the growth of M2 and M3 in January, but they noted that the stronger growth needed to be viewed in relation to the weakness in late 1987. According to a staff analysis prepared for this meeting, expansion in M2 and M3 could be expected to strengthen a little over the balance of the first quarter from the average pace in December and January, assuming unchanged conditions of reserve availability. More generally, somewhat faster growth was projected in the current quarter than had occurred in the second half of 1987, as increased demands for money balances in response to the decline in interest rates since mid-October more than offset the expected effects of slower income growth. The growth in M1 might also strengthen over the first quarter, but the near-term behavior of this aggregate remained subject to a high degree of uncertainty.

During this meeting further consideration was given to the Committee's operating procedures. In keeping with the Committee's decision in early January, continuing progress had been made toward restoring the Committee's previous focus on reserve positions in the day-to-day implementation of policy. At this meeting the members expressed differing views about whether that process should now be completed. Several felt that the approach originally adopted at a time of crisis in financial markets was no longer warranted, even in attenuated form, and that the previous approach to reserve management provided a better basis for guiding the conduct of monetary policy because it allowed greater scope for changes in supply and demand forces to be reflected in the money market. On the other hand, a majority of the members preferred to retain for now a directive that called for some flexibility in the approach

to open market operations. These members emphasized that financial market conditions still exhibited some degree of fragility and, against the background of substantial uncertainty in the economic outlook, unanticipated developments might well continue to warrant occasional departures from the focus on reserve objectives for the purpose of moderating temporary fluctuations in money market conditions. A number of these members also commented on the need for flexibility because a relatively normal or predictable relationship between the provision of reserves and money market conditions had not yet emerged.

The members expressed some shadings of opinion with regard to possible adjustments in policy during the intermeeting period. A majority felt that there should be no presumptions about the likely direction of any such adjustments, especially in light of the consensus at this meeting for maintaining reserve conditions that were consistent with the slight easing that had been sought since late January. Some members believed, however, that policy implementation should be especially alert to developments that might point to somewhat easier reserve conditions, particularly because of the risks that they saw of a weaker economy than was currently projected. In the view of some members, further easing might also be appropriate if monetary growth fell appreciably short of current expectations. Several members cautioned that any decision to ease should take careful account of the potential impact on the dollar in foreign exchange markets. While the dollar had tended to stabilize recently, it could be vulnerable to a further decline.

At the conclusion of the Committee's discussion, all of the members indicated their acceptance of a directive that called for maintaining the slightly easier degree of reserve pressure that had been sought recently. With regard to the Committee's operating procedures, a majority endorsed the view that some flexibility might continue to be needed in the conduct of open market operations in light of the still somewhat unsettled conditions in financial markets, the uncertainties in the relationship between reserve and money market conditions, and the substantial risks of unanticipated economic and financial developments. Taking account of conditions in financial markets, the members indicated that somewhat less or somewhat more reserve restraint would be acceptable, depending on the strength of the business expansion, indications of inflation, the performance of the dollar in foreign exchange markets, with consideration also given to the behavior of the monetary aggregates. The reserve conditions contemplated by the Committee were expected to be consistent with growth in both M2 and M3 over the 4-month period from November through March at annual rates of about 6 to 7 percent. Because of the unusual uncertainty relating to the behavior of M1 and in keeping with the decision not to set a longer-run target for this aggregate, the Committee decided not to indicate any expectation regarding its growth over the months ahead. The members agreed that the intermeeting range for the federal funds rate, which provides one 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 indicated that economic activity continued to expand rapidly in the fourth quarter but that the advance reflected a build-up in inventories as domestic final demands weakened. The growth in output appeared to have slowed around year-end. Total nonfarm payroll employment rose much less in January than on average over the previous three months; the manufacturing sector also recorded reduced employment growth in January. The civilian unemployment rate, at 5.8 percent in January, was unchanged from December. Growth in industrial production moderated further in December. Retail sales picked up in December, buoyed by improved auto sales, but remained below levels reached during the summer. Indicators of business capital spending were mixed late in the year. Housing starts fell markedly in December, and were down somewhat on balance in the fourth quarter from the average pace in the second and third quarters. The nominal U.S. merchandise trade deficit declined substantially in November. For October and November combined, the deficit rose slightly from the average rate in the third quarter, but in real terms the deficit was estimated to have narrowed further. The rise in consumer prices slowed and producer prices fell in late 1987, reflecting declines in energy prices; wage trends have shown little change in recent months.

Most interest rates were down substantially on balance since the Committee's meeting in mid-December. In the Treasury securities market, long-term yields fell considerably more than short-term rates. Broad indexes of stock prices rose somewhat on balance over the intermeeting period in still relatively volatile trading. The trade-weighted foreign exchange value of the dollar in terms of the other G-10 currencies declined further in the second half of December but recovered after the turn of the year and has increased moderately on balance since the December meeting.

Growth of M2 and M3 strengthened substantially in January after slowing over November and December. For 1987 as a whole, expansion of M2 fell considerably below the lower end of the range established by the Committee for the year, while growth of M3 was at the lower end of its range. Growth of M1 surged in January following two months of declines. For the year 1987, M1 growth was marginally below that of nominal GNP, and expansion in total domestic nonfinancial debt was at the midpoint of the Committee's monitoring range for the year.

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 this meeting established growth ranges of 4 to 8 percent for both M2 and M3, measured from the fourth quarter of 1987 to the fourth quarter of 1988. The monitoring range for growth in total domestic non-financial debt was set at 7 to 11 percent for the year.

With respect to M1, the Committee again decided not to establish a specific target for 1988. The behavior of this aggregate in relation to economic activity and prices has become very sensitive to changes in interest rates, among other factors, as evidenced by sharp swings in its velocity in recent years. Consequently, 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.

In the implementation of policy for the immediate future, the Committee seeks to maintain the slightly reduced degree of pressure on reserve positions sought in recent days. The Committee agrees that the current more normal approach to open market operations remains appropriate; still sensitive conditions in financial markets and uncertainties in the economic outlook may continue to call for some flexibility in operations. Taking account of conditions in financial markets, somewhat lesser reserve restraint or somewhat greater reserve restraint would be acceptable depending on the strength of the business expansion, indications of inflationary pressures, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. The contemplated reserve conditions are expected to be consistent with growth in both M2 and M3 over the period from November through March at annual rates of about 6 to 7 percent. 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.