Minutes of the Federal Open Market Committee

Meeting of July 2-3, 1996

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, July 2, 1996, at 1:00 p.m. and continued on Wednesday, July 3, 1996, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman	Mr. McTeer
Mr. McDonough, Vice Chairman	Mr. Meyer
Mr. Boehne	Ms. Phillips
Mr. Jordan	Ms. Rivlin
Mr. Kelley	Mr. Stern
Mr. Lindsey	Ms. Yellen

Messrs. Broaddus, Guynn, Moskow, and Parry, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig and Melzer, and Ms. Minehan, Presidents of the Federal Reserve Banks of Kansas City, St. Louis, and Boston respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. D. Lindsey, Mishkin, Promisel, Rolnick, Rosenblum, Siegman, Simpson, Sniderman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Winn, [1] Assistant to the Board, Office of Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

Messrs. Madigan and Slifman, Associate Directors, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors

Mr. Brayton, [2] Ms. Johnson, [2] Messrs. Reinhart and Smith, [3] Assistant Directors, Divisions of Research and Statistics, International Finance, Monetary Affairs, and International Finance respectively, Board of Governors

Ms. Kusko [2] and Mr. Wilcox, [2] Senior Economists, Divisions of Research and Statistics and Monetary Affairs respectively, Board of Governors

Ms. Garrett, Economist, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Ms. Holcomb, First Vice President, Federal Reserve Bank of Dallas

Mr. Beebe, Ms. Browne, Messrs. Davis, Dewald, Eisenbeis, Goodfriend, and Hunter, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Boston, Kansas City, St. Louis, Atlanta, Richmond, and Chicago respectively

Messrs. Kos and Meyer, Vice Presidents, Federal Reserve Banks of New York and Philadelphia respectively

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By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 21, 1996, were approved.

The Manager of the System Open Market Account reported on recent developments in foreign exchange markets. There were no open market transactions in foreign currencies for System account during the period since the meeting on May 21, 1996, and thus no vote was required of the Committee.

The Manager also reported on recent developments in domestic financial markets and on System open market transactions in U.S. government securities and federal agency obligations during the period May 21, 1996, through July 2, 1996. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic and financial outlook, the ranges for the growth of money and debt in 1996 and 1997, and the implementation of monetary policy over the intermeeting period ahead. A summary of the economic and financial information available at the time of the meeting and of the Committee's discussion is provided below, followed by the domestic policy directive that was approved by the Committee and issued to the Federal Reserve Bank of New York.

The information reviewed at this meeting suggested that economic activity advanced considerably further in the second quarter, although growth in aggregate final demand showed some signs of slowing. Consumer spending continued to post sizable gains, but business investment in equipment and structures apparently was rising less vigorously, and higher mortgage rates evidently were starting to exert some restraint on housing construction activity. Business inventories had been brought into better balance with sales, and production and employment had risen appreciably. Upward pressures on food and energy prices had led to somewhat larger increases in the consumer price index over recent months.

Nonfarm payroll employment continued to expand briskly over April and May. Job gains were concentrated in the service-producing and construction industries, while employment in manufacturing was stable on balance over the April-May period after having declined somewhat in 1995 and the first quarter of 1996. The civilian unemployment rate rose in May to 5.6 percent, which was the average rate for the year to date.

Industrial production increased appreciably further in May. In contrast to April's advance, much of which had resulted from the resumption of operations at a major motor vehicle manufacturer after the settlement of a strike, the May rise largely reflected gains in a wide range of non-auto-related manufacturing industries as well as a weather-related jump in electricity generation. The surge in overall output lifted total utilization of industrial capacity somewhat above the average rate recorded during the previous two quarters.

Total nominal retail sales surged in May after having changed little in April; the increase in sales, coupled with available information on prices, suggested that real consumer spending on goods had risen substantially on balance since the first quarter. Recent data (available through April) indicated that spending on services had increased moderately on balance in recent months. Single-family housing starts fell considerably in May from the relatively high April level. The decline suggested that the rise in mortgage rates in recent months had begun to damp construction activity, but indicators of housing demand, such as sales of new and existing homes, remained relatively robust.

Growth in business expenditures on durable equipment and nonresidential structures appeared to be slowing following a surge in outlays in the first quarter. In May, shipments of nondefense capital goods rebounded from the substantial decline in April; however, excluding movements in the volatile aircraft category, shipments were down on balance over the two months. Among the major components, shipments of both computing and communications equipment fell sharply in April and retraced only part of that decline in May. Recent data on new orders pointed to more modest increases in spending on business equipment over the months ahead. Nonresidential building activity increased considerably further in April (latest data available), but incoming information on contracts suggested that growth in nonresidential construction would weaken somewhat in coming months.

Businesses had made considerable progress in recent months in bringing their inventories into better alignment with sales. In manufacturing, stocks rose moderately in April after a decline in March. The stock-to-shipments ratio dropped further in April and was at a low level. At the wholesale trade level, inventory accumulation was appreciable in April after several months of modest growth. The inventory-to-sales ratio for this sector edged up in April but remained well below the elevated levels of last fall. Retail inventories increased slightly in April after a large decline in March associated with a substantial liquidation of motor vehicle stocks. The aggregate ratio of inventories to sales for retail establishments was around the lower end of its range in recent years.

The nominal deficit on U.S. trade in goods and services widened in April from its rate in the first quarter, reflecting a slightly larger increase in the value of imports than in that of exports. The expansion in imports was concentrated in oil as U.S. refiners sought to meet growing domestic demand and rebuild their inventories. The rise in exports was broadly based, although exports of computers, semiconductors, and automotive products edged off. Economic activity in the major foreign industrial countries appeared to have expanded moderately on balance since the beginning of the year. In the first quarter, economic performance ranged from unexpectedly robust in Japan to further weakness in Germany; the limited data available for the second quarter suggested a slowdown in Japan, a bounceback in Germany, and moderate growth in other major trading partners.

Although upward pressures on energy prices continued to boost overall consumer prices in April and May, price increases for nonfood, non-energy items remained small. Over the twelve months ended in May, the increase in core consumer prices was appreciably smaller than in the previous twelve-month period; much of the deceleration reflected swings in automobile finance charges. At the producer level, higher prices for finished energy goods over April and May were partially offset by slightly lower prices for finished foods; prices for nonfood, non-energy finished goods were little changed over the two-month period and rose less over the twelve months ended in May than in the comparable year-earlier period. Data on average hourly earnings of production and nonsupervisory workers indicated that this measure of labor costs had increased by a somewhat larger amount in the year ended in May than in the comparable year-earlier period.

At its meeting on May 21, 1996, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions and that did not include a presumption about the likely direction of any adjustments to policy during the intermeeting period. The directive stated that in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint or slightly lesser reserve restraint would be acceptable during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth in M2 and M3 over coming months.

Open market operations were directed toward maintaining the existing degree of pressure on reserve positions throughout the intermeeting period. The federal funds rate averaged near 5-1/4 percent, the level expected to be associated with the unchanged policy stance. Because the Committee's decision had been largely anticipated in financial markets, other market interest rates also were little changed during the early part of the period. However, market rates increased appreciably following the release of a strong employment report in early June, though most of that rise was later retraced as expectations of near-term tightening of monetary policy diminished. On balance, most market rates were up a little over the intermeeting period. Major indexes of stock prices were down on balance over the period.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies depreciated slightly over the intermeeting period. The dollar declined against the German mark and other European currencies as growing indications of a recent pickup in economic activity in Germany damped market expectations of any further easing of monetary policy by the Bundesbank. By contrast, the dollar rose against the yen in apparent response to a series of statements by Japanese officials suggesting that there would be no near-term firming of Japanese monetary policy.

The broad monetary aggregates were weak in May: M2 declined, and M3 expanded relatively sluggishly. The weakness in M2 and M3 was associated in part with the adverse effects of the earlier rise in market interest rates on the opportunity costs of holding deposits. Deposit balances also may have been drawn down to meet unusually large individual tax liabilities on the April 15 tax date. Partial data for June pointed to a rebound in both aggregates. For the year through June, these aggregates were estimated to have grown at rates around the upper bounds of their respective annual ranges. Expansion of total domestic nonfinancial debt had slowed somewhat in recent months, but the debt aggregate had remained in the middle portion of its annual range.

The staff forecast prepared for this meeting suggested that, after a sizable advance in economic activity in the second quarter, growth would moderate and the economy would expand around or perhaps a little above its estimated potential. Consumer spending was projected to expand at a more moderate pace, in line with disposable income; the favorable effect of higher equity prices on household wealth and the still-ample availability of credit were expected to balance persisting consumer concerns about job and retirement security and the restraining effect of high household debt burdens. Homebuilding was forecast to slow somewhat in response to the back-up in residential mortgage rates but was expected to remain at a relatively high level in the context of sustained income growth and the still-favorable cash-flow affordability of home ownership. Business spending on equipment and structures was projected to grow less rapidly in light of the anticipated moderate growth of sales and profits and the reduced rate of utilization of production capacity now prevailing. The external sector was expected to exert a small restraining influence on economic activity over the projection period, even though an anticipated firming of economic activity abroad would bolster demand for U.S. exports. Little further fiscal contraction was forecast over the projection period. Inflation recently had been lifted by adverse developments in energy markets and was projected to remain above the levels of recent years, given the still-high level of resource utilization and the effects of tight grain supplies on food prices.

In the Committee's discussion of current and prospective economic developments, members commented on the stronger-than-expected expansion in overall economic activity in recent months, but for a variety of reasons they anticipated that growth would slow appreciably over the second half of the year to a pace more in line with the growth in the economy's potential. Key factors bearing on this outlook included the prospective effects of the rise in interest rates and the dollar that had occurred since earlier in the year and the waning influence of transitory factors that had stimulated economic activity in the second quarter. The members generally agreed, however, that, apart from evidence of some moderation in the growth of business investment expenditures from a very rapid pace, there were few hard indications of a slowing in the expansion and the risks were clearly to the upside of their current forecasts. Against that background, they were concerned that inflation could begin to rise. Cost and price pressures had been surprisingly well contained at high levels of resource utilization, but this unusually favorable performance might not be sustained, and in any event even greater resource utilization, as would occur if growth did not moderate appreciably, carried substantial inflation risk. There were some scattered indications in statistical and anecdotal reports that tended to suggest that wage inflation might be trending higher, although key measures of price inflation, excluding their food and energy components, continued to display a flat or even a declining trend.

In keeping with the practice at meetings when the Committee sets its long-run ranges for the money and debt aggregates, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members provided individual projections of the growth in real and nominal GDP, the rate of unemployment, and the rate of inflation for the years 1996 and 1997. (The ranges in this paragraph take into account minor revisions made by a few members subsequent to the meeting.) The forecasts of the rate of expansion in real GDP for 1996 as a whole had a central tendency of 2-1/2 to 2-3/4 percent, reflecting expectations of considerable moderation in the rate of economic growth over the second half of the year; for 1997, the projections centered on continued moderate growth of GDP in a range of 1-3/4 to 2-1/4 percent. With regard to the expansion of nominal GDP, the forecasts were concentrated in growth ranges of 5 to 5-1/2 percent for 1996 and 4-1/4 to 5 percent for 1997. The civilian rate of unemployment associated with these forecasts was expected by most members to remain around 5-1/2 percent this year and to be in a range of 5-1/2 to 5-3/4 percent in 1997. This level of resource utilization was expected to be associated with a slightly higher rate of inflation in 1996, as measured by the consumer price index, than that recorded in 1995 owing to developments in the food and energy sectors, but a decline was anticipated in 1997. Specifically, the projections converged on rates of 3 to 3-1/4 percent in 1996 and 2-3/4 to 3 percent in 1997. The projections for both 1996 and 1997 were based on individual views concerning what would be an appropriate monetary policy over the projection horizon.

In their assessment of factors bearing on the outlook for final demand, members commented that growth in consumer spending was likely to moderate in coming quarters from its pace thus far this year. This moderation would reflect the projected slowing in income growth. While overall employment conditions, the buildup of household net worth, and access to financing would bolster consumer expendi- tures, members also cited a number of limiting factors. The latter included the increase in consumer indebtedness, satisfaction of earlier pent-up demand for consumer durable goods, and continuing concern about job security. Higher interest rates also were expected to exert an inhibiting effect on purchases of consumer durables, including those related to housing. Some members observed that while slower growth in consumer spending was the most probable forecast, they saw an upside risk from the wealth effects of the large rise that had occurred in the value of stock market holdings.

Business expenditures for plant and equipment were expected to grow at a slower though still appreciable pace. Indeed, such spending already appeared to be moderating. Contract data suggested that nonresidential construction activity was on a slowing growth trajectory and expansion of outlays for producers' durable equipment also appeared to have softened. Given the outlook for slower growth in final demand, many businesses would not have to add significantly to capacity. However, spending for computing equipment, while perhaps moderating from the exceptional pace of recent quarters, was thought likely to remain buoyant as continuing innovations and declining prices stimulated further solid gains in this segment of business spending.

Housing was seen as another important sector of the economy that was likely to exert a retarding effect on the expansion as the rise that had occurred in mortgage interest rates was felt increasingly in housing markets. The anecdotal information from around the nation and the available statistics suggested, however, that those markets generally had remained surprisingly ebullient thus far, and there were only limited indications of some softening in home construction activity.

Business inventory investment was viewed as a key upside risk in the economic outlook for coming quarters. An inventory overhang at the end of last year had been corrected in the first quarter, and inventory investment was indicated to have turned positive again in the second quarter. However, current inventory-to-sales ratios appeared to be relatively lean, and final sales that exceeded current expectations might well induce a sharp upward adjustment in inventory accumulation, especially if lead times were to lengthen and producers perceived shortfalls in their safety stocks.

Members viewed the outlook for inflation as a source of substantial uncertainty in their forecasts, though many saw reasonable prospects that a rate of economic expansion in line with their forecasts and associated levels of capacity utilization would prove to be consistent with little change in the core rate of inflation. Some important measures of price inflation, after adjustment to exclude their volatile food and energy components, had shown a flat or even a declining trend in recent quarters. The outlook for overall price increases would remain contingent in part on food and energy price developments, but more importantly on underlying cost pressures in the economy.

Several members commented that the levels of utilization of capital and labor resources that had prevailed over the past couple of years would have been expected, on the basis of past historical patterns, to foster rising cost pressures and greater inflation. However, labor compensation gains had been subdued in relation to earlier cyclical experience, likely as a consequence of increased worker concerns about job security and job opportunities. Despite the continued low rate of unemployment and widespread anecdotal reports of tight labor markets across the country, there were only limited indications in national data that wage inflation might be increasing. Whether greater labor cost pressures would emerge in the context of the members' consensus forecast for economic activity was a critical issue in the outlook for prices, though it was noted that at least some of the rising costs were likely to be absorbed in shrinking profit margins. Even if greater price inflation were averted under that scenario, the members saw a substantial risk that if economic growth did not slow in line with their current forecasts, the resulting added pressures on resources would at some point translate into higher price inflation. Accordingly, the factors bearing on the outlook for resource use and inflation needed to be monitored with special care in this period.

With regard to inflation over the long run, the members agreed that it was essential for the Committee to continue to focus on reducing inflation over time because the achievement of an even less inflationary economic environment would foster a more productive economy and maximum sustainable economic expansion. The members acknowledged that as inflation diminished to very low levels, questions about the measurement of the overall price level presented difficult problems for assessing progress toward price stability. Some also observed that the precise level of average price inflation that might be compatible with the optimal functioning of the economy was an unsettled issue owing, for example, to potential rigidities in labor markets. Thus far, such rigidities had not impeded the economy from functioning at a very high level as inflation came down, and continued adaptation to even lower inflation rates was very likely. However, the Committee would need to pay careful attention to these potential problems as inflation fell further. For now, the members agreed that some additional progress in reducing inflation was very likely to improve the ultimate performance of the economy, and that it was particularly important at this juncture to resist firmly any tendency for inflation to worsen.

In keeping with the requirements of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee at this meeting reviewed the ranges for growth of the monetary and debt aggregates that it had established in January for 1996 and it decided on tentative ranges for those aggregates for 1997. The current ranges set in January for the period from the fourth quarter of 1995 to the fourth quarter of 1996 were unchanged from the ranges for 1995 and included expansion of 1 to 5 percent for M2 and 2 to 6 percent for M3. An unchanged monitoring range of 3 to 7 percent was set in January for growth of total domestic nonfinancial debt in 1996.

A majority of the members favored retaining the current ranges for this year and extending them on a provisional basis to 1997. They anticipated that growth of M2 and M3 probably would continue at rates close to the upper limit of their respective ranges in both years, given the Committee's expectations for the performance of the economy and prices. However, despite a degree of concern about setting ranges that did not more comfortably encompass expected growth, these members preferred not to change the ranges for a variety of reasons. The current ranges for the broad monetary aggregates could be viewed as anchors or benchmarks for money growth that would be associated with approximate price stability and sustained economic growth, assuming behavior of velocity in line with historical experience. Accordingly, a reaffirmation of those ranges would underscore the Committee's commitment to a policy of achieving price stability over time; and in the view of some members, higher ranges could raise questions in this regard. Moreover, a change in the ranges might be misinterpreted as a signal of greater reliance on the broad monetary aggregates in the formulation and conduct of monetary policy. In this connection, the members noted that the behavior of M2 in relation to nominal GDP and interest rates had displayed a pattern over the past two years or so that was in line with historical norms prior to the 1990s. However, in light of difficulties in the early 1990s and changes in financial markets, the prospective growth of M2 and its velocity remained subject to considerable uncertainty and the members felt that it would be premature for the Committee to place increased reliance on M2 at this point.

A few members preferred somewhat higher growth ranges for M2 and M3 because such ranges would more comfortably surround the Committee's expectations for monetary growth. The higher ranges would be more informative for the Congress and the public as to the money growth likely to be associated with the Committee's expected economic outcomes for the period covered by the ranges. They believed that the reasons for establishing the higher ranges could readily be explained and understood as appropriate technical adjustments that did not imply any lessened commitment to the Committee's price stability goal. For example, such an explanation appeared to have been accepted with little or no comment by the public when the range for M3 was increased in July 1995.

The Committee members were unanimously in favor of retaining the current monitoring range of 3 to 7 percent for growth of total domestic nonfinancial debt in 1996 and extending that range on a provisional basis to 1997. They took account of a staff projection indicating that growth of the debt aggregate was likely to slow somewhat from its pace earlier this year in line with some moderation in the expansion of nominal income. According to the staff projection, growth in the debt measure would be near the midpoint of the existing range over the period through 1997.

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At the conclusion of this discussion, the Committee voted to reaffirm the ranges for growth of M2 and M3 and the monitoring range for expansion of total domestic nonfinancial debt that it had established in January for 1996. For the year 1997, the Committee approved provisional ranges for M2 and M3 and a provisional monitoring range for total domestic nonfinancial debt that were unchanged from the 1996 ranges. In keeping with its usual procedure under the Humphrey-Hawkins Act, the Committee would review its preliminary ranges for 1997 early next year, or sooner if interim conditions warranted, in light of their growth and velocity behavior and ongoing economic and financial developments. Accordingly, the Committee voted to incorporate the following statement regarding the 1996 and 1997 ranges in its domestic policy directive:

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1996 to the fourth quarter of 1997, of 1 to 5 percent for M2 and 2 to 6 percent for M3. The Committee provisionally set the associated monitoring range for growth of total domestic nonfinancial debt at 3 to 7 percent for 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

Votes for this action: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, McTeer, Meyer, Mses. Phillips and Rivlin, and Mr. Stern.

Votes against this action: Mr. Lindsey and Ms. Yellen.

Mr. Lindsey and Ms. Yellen dissented because they preferred somewhat higher ranges for M2 and M3 growth in 1996 and 1997. The central tendencies of the members' forecasts of nominal GDP for the two years were likely to be associated with growth of the broad monetary aggregates at rates around the top of the current ranges. Somewhat higher ranges would more comfortably encompass the anticipated growth of the monetary aggregates and in their view would conform more closely with the provisions and intent of the Federal Reserve Act that require the System to communicate its objectives and plans for monetary growth to the Congress. They believed the reasons for raising the ranges could easily be explained and understood as a technical adjustment that did not represent a reduced commitment to the goal of price stability or an increased emphasis on the monetary aggregates in policy formulation.

In the Committee's discussion of policy for the intermeeting period ahead, all but one of the members supported a proposal to maintain an unchanged policy stance. These members also indicated that they preferred or could accept an asymmetric directive that was biased toward restraint. In their view, the most likely outcome was a slowing of the expansion to a more sustainable pace and a continuation of subdued inflation. Nevertheless, they were concerned that the risks to that outcome were tilted toward higher inflation, While a strong economy generally was a welcome development, at current levels of resource use a continuation of rapid growth was not likely to be sustainable because it would have the potential for adding significantly to inflation pressures. However, inflation had remained relatively damped thus far and the rise in interest rates among other factors was expected to curb demand. Moreover, any tendency for price pressures to mount was likely to emerge only gradually and be reversible through a relatively limited policy adjustment. The current stance of monetary policy could not be described in this view as clearly accommodative. While the federal funds rate had been reduced appreciably in nominal terms over the past year, its current level on an inflation-adjusted basis seemed to be only marginally below its peak prior to mid-1995. In the circumstances, the Committee could afford to wait for more evidence to see whether additional inflation pressures were likely to develop. A number of key economic data would become available over the next several weeks that would provide a much better basis for assessing the economy's momentum over the second half of the year and the outlook for inflation.

A differing view gave more emphasis to prospects for rising inflation and the need for immediate action to forestall a buildup of cost and price pressures before they undermined the expansion. There was little firm evidence that economic growth was slowing and reports of appreciable wage pressures were increasing. Inflation expectations persisted in financial markets, and probably in product and labor markets as well; if they were allowed to worsen, the Committee's long-run goal of price stability would become much more difficult to achieve. Delaying action risked the need for a greater adjustment in policy at a later date with possible disruption to the economy.

Members observed that an asymmetric directive would represent a shift from the symmetric directives that had been adopted over the past year but would be in keeping with their assessments of the risks of higher inflation. Several commented that an asymmetric directive did not imply a commitment to tighten monetary policy at some point, whether during the intermeeting period or at a future meeting, but it did imply the need for special vigilance. Some noted that a policy tightening action could tend to have a more pronounced effect than usual because it would indicate a shift in the direction of policy and might generate expectations of further tightening. Under the circumstances, the Committee would consult in some way before any policy tightening was undertaken.

At the conclusion of the Committee's discussion, all but one member indicated that they supported a directive that called for maintaining the existing degree of pressure on reserve positions and that included a bias toward the possible firming of reserve conditions during the intermeeting period. Accordingly, in the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, the Committee decided that somewhat greater reserve restraint would be acceptable and slightly lesser reserve restraint might be acceptable during the intermeeting period. The reserve conditions contemplated at this meeting were expected to be consistent with moderate growth of M2 and M3 over coming months.

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At the conclusion of the meeting, the Federal Reserve Bank of New York was authorized and directed, until instructed otherwise 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 that economic activity advanced considerably further in the second quarter, but increases in final demand showed some signs of moderation. Nonfarm payroll employment was up substantially in April and May; the civilian unemployment rate rose to 5.6 percent in May. Industrial production increased appreciably further in May, reflecting gains across a wide range of industries. Real consumer spending rose substantially on balance over April and May. Single-family housing starts fell considerably in May from a relatively high level in April. Orders and contracts point to some deceleration in spending on business equipment and nonresidential

structures after a very rapid expansion earlier in the year. The nominal deficit on U.S. trade in goods and services widened in April from its rate in the first quarter. Upward pressures on food and energy prices have led to somewhat larger increases in the consumer price index over recent months.

Most market interest rates have edged higher since the Committee meeting on May 21. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated slightly over the intermeeting period.

M2 declined in May, though partial data for June pointed to a rebound. Growth of M3 was relatively sluggish in May but also appears to have turned up in June. For the year through June, both aggregates are estimated to have grown at rates around the upper bounds of their respective ranges for the year. Expansion in total domestic nonfinancial debt has been moderate on balance over recent months and has remained in the middle portion of its range.

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in January for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1995 to the fourth quarter of 1996. The monitoring range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1997 the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1996 to the fourth quarter of 1997, of 1 to 5 percent for M2 and 2 to 6 percent for M3. The Committee provisionally set the associated monitoring range for growth of total domestic nonfinancial debt at 3 to 7 percent for 1997. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, somewhat greater reserve restraint would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with moderate growth in M2 and M3 over coming months.

Votes for short-run policy: Messrs. Greenspan, McDonough, Boehne, Jordan, Kelley, Lindsey, McTeer, Meyer, Mses. Phillips, Rivlin, and Yellen.

Vote against this action: Mr. Stern.

Mr. Stern dissented because he was convinced that a modestly more restrictive policy was warranted. In his view, the momentum of the economy and strains on capacity in labor and some other markets raised the possibility of an acceleration of inflation that would jeopardize the economic expansion. This concern aside, Mr. Stern also believed that current circumstances were favorable for policy action to reduce inflation further and thereby help to sustain the ongoing improvement in the economy.

As a prelude to its formal review later in the year, the Committee at this meeting considered its existing network of swap arrangements with a number of foreign central banks and the Bank for International Settlements. From time to time in recent years, the Committee had discussed a variety of issues relating to its foreign exchange activities and its financial arrangements with other central banks. In this discusssion, the Committee considered in particular whether the swap arrangements, all of which had been put in place in the 1960s, remained an appropriate approach to international financial cooperation among central banks in light of the evolution of the international financial system in recent decades, and whether other approaches should be considered. The Committee made no decisions relating to these matters, though it was understood that these issues would be explored further.

It was agreed that the next meeting of the Committee would be held
on Tuesday, August 20, 1996.

The meeting adjourned at 12:50 p.m.

Donald L. Kohn
Secretary

Footnotes

1 Attended portion of meeting concerning issues relating to the long-run price objective for monetary policy.

2 Attended portion of the meeting relating to the Committee's discussion of the economic outlook and its longer-run growth ranges for the monetary and debt aggregates.

3 Attended portion of the meeting relating to the Committee's review of its swap line agreements.

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