Minutes of the Federal Open Market Committee

Meeting of July 1-2, 1997

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 1, 1997, at 2:30 p.m. and continued on Wednesday, July 2, 1997, at 9:00 a.m.

Present:

Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Broaddus
Mr. Guynn
Mr. Kelley
Mr. Moskow
Mr. Meyer
Mr. Parry
Ms. Phillips
Ms. Rivlin

Messrs. Hoenig, Jordan, Melzer, and Ms. Minehan, Alternate Members of the Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis 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. Beebe, Goodfriend, Hunter, Lindsey, Mishkin, Promisel, Siegman, Slifman, and Stockton, Associate Economists

Mr. Fisher, Manager, System Open Market Account

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors

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

Ms. Johnson, Assistant Director, Division of International Finance, Board of Governors

Messrs. Reifschneider[1] and Small, [1] Section Chiefs, Divisions of Research and Statistics and Monetary Affairs respectively, Board of Governors

Mr. Sichel, [1] Senior Economist, Division of Research and Statistics, Board of Governors

Mr. Elmendorf, [1] and Ms. Garrett, Economists, Division of Monetary Affairs, Board of Governors

Mr. Lebow, [2] and Ms. Lindner, [2] Economists, Division of Research and Statistics, 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

Ms. Browne, Messrs. Dewald, Hakkio, Kos, Lang, Rolnick, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of Boston, St. Louis, Kansas City, New York, Philadelphia, Minneapolis, Dallas, and Cleveland respectively

Ms. Rosenbaum, Vice President, Federal Reserve Bank of Atlanta

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By unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 20, 1997, were approved.

The Manager of the System Open Market Account reported on developments in foreign exchange markets since the meeting on May 20, 1997. There were no System open market transactions in foreign currencies during this period, and thus no vote was required of the Committee.

The Manager also reported on developments in domestic financial markets and on System open market transactions in government securities and federal agency obligations during the period May 20, 1997, through June 30, 1997. By unanimous vote, the Committee ratified these transactions.

The Committee then turned to a discussion of the economic outlook, the ranges for the growth of money and debt in 1997 and 1998, 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 the economic expansion slowed substantially in the second quarter after having surged in late 1996 and earlier this year. Consumer spending decelerated considerably, but business spending on durable equipment increased substantially further and housing demand appeared to have been well maintained. Employment growth moderated recently, while industrial production continued to rise appreciably. Price inflation remained subdued despite high rates of resource utilization, notably that of labor.

Private nonfarm payroll employment rose at a reduced pace in May after having registered sizable advances over the first four months of the year. Job growth remained brisk in the services sector despite a further drop in employment at temporary help agencies that might have reflected constraints on the availability of workers for hire. Although employment in construction recovered in May from the weather-depressed level in April, the underlying growth in such jobs seemed to have slowed. Employment in manufacturing changed little over April and May after having increased moderately in the first quarter. The average workweek for production or nonsupervisory workers was unchanged in May but was slightly below the average for the first quarter. The civilian unemployment rate fell slightly further to 4.8 percent in May.

Industrial production continued to grow briskly in May. Manufacturing output recorded a substantial gain and mining production rose considerably; however, cooler-than-average weather led to a drop in utility output. Much of the rise in manufacturing reflected a rebound in the production of motor vehicles and parts from strike-depressed levels in April and strength in the output of business equipment, construction supplies, and materials. With output generally keeping pace with the rapid expansion of factory capacity, the rate of utilization of manufacturing capacity remained at a relatively high level.

Personal consumption expenditures, in real terms, rose substantially in May after having changed little on balance over the preceding three months. Spending on services remained on a solid uptrend in May, while aggregate purchases of goods turned up after three months of lackluster spending on nondurable goods and motor vehicles. The unusual weather patterns of late winter and early spring apparently had a depressing effect on consumer expenditures, especially for seasonal items; however, the combination of strong job gains, buoyant sentiment, and increased household net worth pointed to a possible resumption of more robust spending by consumers.

Housing activity appeared to have been generally well maintained in recent months. Although housing starts were down somewhat in May from the relatively elevated average rate for the first four months of the year, this slowing might have been, at least in part, the result of unusually mild winter weather that enabled an early start on spring building activity. The latest information on home sales suggested continued firm demand for single-family housing: Sales of existing homes rose in May and were among the highest monthly totals on record, and sales of new homes in April (latest data available) were down only a little from the brisk pace of earlier months in the year.

Available information suggested further sizable gains in business fixed investment. Shipments of nondefense capital goods edged higher in May after posting large increases in earlier months of the year. Shipments of computers had been particularly strong this year in conjunction with rapidly falling prices, but shipments of other categories of capital goods also had been robust on balance. Recent data on orders pointed to further brisk growth in coming months. Nonresidential construction activity appeared to have eased recently, with construction-put-in-place slipping in March and April from the elevated pace of the first two months of the year. However, other information suggested that the downturn might be shortlived: Vacancy rates for office space had been declining, prices for commercial real estate had been edging up, and recent data on contracts suggested that building activity would improve in coming months.

Business inventory investment picked up sharply in April from the slow pace in March but, overall, stocks remained at a low level in relation to sales. In manufacturing, much of the increase in stocks occurred in capital goods industries in which production was expanding briskly. In the wholesale sector, a substantial decline in stocks in April more than offset a sizable increase in March, and the aggregate stock-sales ratio for the sector fell further over the March-April period. Retail inventories rose considerably in April, with notable increases in stocks of apparel and general merchandise. In a departure from the general downtrend of recent months, inventory-sales ratios for most types of retail establishments were up appreciably in April.

The nominal deficit on U.S. trade in goods and services narrowed somewhat in April from a downward-revised average rate in the first quarter. The value of exports in April rose substantially from the first-quarter level, led by increases in exports of machinery and aircraft. The value of imports also rose but by less than that of exports; imports were up in most trade categories except petroleum products. Recent information suggested that, on average, economic activity in the major foreign industrial countries continued to grow at a moderate rate in the second quarter. Growth remained robust in Canada and the United Kingdom and was improving in Germany, France, and Italy. Economic activity appeared to have flattened temporarily in Japan following an increase in the consumption tax in April.

Price inflation remained subdued. For a third straight month, consumer prices recorded only a slight increase in May. Favorable developments in food and energy continued to hold down the overall rise and accounted for a much smaller advance in the index of prices of all consumer items over the twelve months ended in May than over the previous twelve months. The decline in core CPI inflation over the same time period was much less, though this measure of inflation also remained relatively restrained. At the producer level, prices of finished goods other than food and energy fell further in May and were little changed over the year ended that month. At earlier stages of processing, producer prices for intermediate materials other than food and energy changed little over the year ended in May, and producer prices at the crude level advanced only slightly. The tight conditions prevailing in labor markets were associated with a somewhat larger increase in average hourly earnings in the twelve months ended in May than in the year-earlier period.

At its meeting on May 20, 1997, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. Because the members saw the potential need for some tightening in monetary policy to counter rising inflationary pressures, perhaps in the relatively near term, the directive included a bias toward the possible firming of reserve conditions during the intermeeting period. The reserve conditions associated with this directive were expected to be consistent with moderate growth of M2 and M3 over coming months.

Open market operations were directed throughout the intermeeting period toward maintaining the existing degree of pressure on reserve positions, and the federal funds rate averaged close to the intended level of 5-1/2 percent. Most other market interest rates declined somewhat on balance during the period. Market participants apparently concluded that the likelihood of further policy tightening had decreased substantially in light of incoming data that suggested slowing growth of final demand and continued subdued inflation. Share prices in equity markets rose considerably further.

In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was up on balance over the intermeeting period; the advance occurred despite a smaller decline on average in long-term interest rates abroad than in the United States. The dollar rose appreciably against the German mark and most other continental European currencies amid growing market concerns that there would be broad participation in the European Monetary Union despite the fact that the major European countries would not be able to comply strictly with the Maastricht fiscal standards and related expectations that the euro would be a weak currency. In contrast, the dollar fell against the Japanese yen and the British pound; the yen moved up as markets focused more closely on recent and prospective increases in Japan's current account surplus, and the pound strengthened in anticipation of further policy tightening by the Bank of England.

Expansion of M2 and M3 slowed sharply in May in association with a swing in household balances related to large tax payments; growth of M2 rebounded in June, but M3 accelerated by less. For the year through June, M2 increased at a rate near the upper bound of its range for the year. Rapid growth of M3 over the first half of the year, partly in conjunction with robust expansion of bank credit, placed growth of this aggregate somewhat above the upper bound of its range. The rate of increase in total domestic nonfinancial debt had been a little higher in recent months; for the year to date, this aggregate had grown at a rate near the middle of its range.

The staff forecast prepared for this meeting suggested that the economy would expand at a pace somewhat above that of its estimated potential in the second half of the year but would slow to a rate of increase more in line with that of potential in 1998. Growth of consumer spending, supported by high levels of household wealth and further projected gains in employment and income, was expected to be relatively brisk for some time. Business spending on equipment and structures was anticipated to continue outpacing the overall expansion of the economy, though the differential would tend to narrow in association with the gradual diminution of increases in sales and profits that was expected to occur in the context of moderating economic growth. Housing construction was projected to drift lower over the forecast period. The staff anticipated that fiscal policy and the external sector would exert mild restraint on the expansion of economic activity. With labor compensation gradually accelerating in the context of high resource utilization, core consumer price inflation was forecast to drift slightly higher.

In the Committee's discussion of current and prospective economic developments, members commented on the continuing exceptional performance of the economy, including widespread indications of strength in business activity and subdued inflation. Following a surge in late 1996 and earlier this year, the rate of expansion had moderated considerably in recent months, and the members generally expected economic activity to settle into a pattern of growth over the next six quarters that would approximate the economy's estimated output potential. A major factor in that outlook was their expectation of some deceleration in demands for consumer durables and business plant and equipment in light of the substantial buildup of such assets that already had taken place in recent years. However, given the underlying strength of the expansion, favorable financial conditions, and the absence of major imbalances in the economy, the risks of a different outcome were judged to be in the direction of somewhat faster growth than currently projected. The outlook for inflation was subject to particular uncertainty. Despite an economy that had been operating for a considerable period at rates of resource utilization that were very close to, and by some estimates somewhat above, sustainable levels, inflation had remained relatively low and indeed had declined on the basis of some broad measures of prices. Such an outcome was very much welcome, but the reasons for it were not completely understood and appeared to include some factors that might exert only temporary restraint on price increases. Consequently, continuing pressures on resources associated with economic growth in line with the members' current forecasts could well be reflected in rising inflation over time.

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 1997 and 1998. The forecasts of the rate of expansion in real GDP for 1997 as a whole had a central tendency of 3 to 3-1/4 percent and for 1998 were centered on a range of 2 to 2-1/2 percent. With regard to the growth of nominal GDP, most of the forecasts were in ranges of 5 to 5-1/2 percent for 1997 and 4-1/2 to 5 percent for 1998. The civilian rate of unemployment associated with these forecasts had a central tendency of 4-3/4 to 5 percent in the fourth quarters of both years. Projections of the rate of inflation, as measured by the consumer price index, pointed to a sizable moderation this year from the rate in 1996 and a partially offsetting rise in 1998, with prices of food and energy accounting for much of the swing. Specifically, the projections converged on CPI inflation rates of 2-1/4 to 2-1/2 percent in 1997 and 2-1/2 to 3 percent in 1998.

In their review of the outlook for economic activity in major sectors of the economy, members referred to the generally sluggish pace of retail sales in recent months. It was noted, however, that the slowdown was perhaps in part an adjustment to very strong growth of sales in previous months, and some members commented on anecdotal indications of some pickup in recent weeks. More importantly, underlying trends and fundamentals pointed to prospective growth in consumer expenditures at a pace that was likely to continue to provide key support for further moderate expansion in overall economic activity. In particular, jobs and incomes had continued to post sizable gains; further large increases in stock market prices had raised wealth-to-income ratios sharply; and consumer optimism had risen to new highs. On the other hand, the accumulation of consumer durables that had occurred over the course of the current cyclical advance was likely to exert a retarding influence on the rise in consumer spending. Other somewhat restraining factors included the prospect of some softening in housing demand and related purchases of household goods and the already heavy debt repayment burdens of many consumers. Some members also noted that a possible correction from the currently elevated levels of stock market prices could have adverse effects on consumer sentiment and purchasing power. On balance, growth in personal consumer expenditures was seen as likely to approximate the moderate rate of increase projected in overall domestic demand.

The members viewed the prospects for further growth in business fixed investment as another important supportive factor in the outlook for sustained economic expansion. Current indicators pointed to the continuation of very rapid growth in such spending over the near term, but some moderation was likely over the course of coming quarters in conjunction with the projected slowing in the increase of overall demand and the very large buildup in the stock of capital that already had occurred in recent years. Even so, investment spending was likely to be relatively robust over the projection horizon in the context of continuing incentives to hold down production costs in highly competitive markets and to take advantage of falling prices and wider applications for certain types of new equipment, notably computer-related equipment. The ready availability of both debt and equity finance on favorable terms, an upbeat outlook for sales in many industries, and generally high profit levels were other positive factors. The outlook for nonresidential construction activity also seemed to be relatively favorable. Members referred to declining vacancy rates and rising rents for commercial structures in many parts of the country and noted that construction contracts for new office buildings and hotels recently had turned up on a nationwide basis after a pause earlier this year. In sum, the growth in business fixed investment seemed likely to continue to outpace that of overall demand in coming quarters.

Some restraint on aggregate demand would come from other sectors of the economy--notably government spending, net exports, housing, and perhaps business inventories. None of these factors seemed likely to exert a substantially negative effect, but in total they were expected to help keep the pace of the expansion close to the estimated rate of increase in the economy's potential over coming quarters.

During the course of the Committee's discussion, many of the members commented on the persistence of an impressively benign inflation performance despite widespread indications of very high, and by some measures increasing, levels of capacity use. Indeed, most broad measures of prices pointed to subdued or even declining inflation, and it was difficult to find evidence of rising inflation pressures in "pipeline" price data or the wage structure. The members anticipated that inflation as measured by the consumer price index would decline appreciably over 1997 as a result of favorable developments in the food and especially the energy sectors of the economy and declining import prices associated with the previous appreciation of the dollar. These positive influences would wane over time, however, and consumer prices were likely to rise at a somewhat faster pace in 1998.

The members agreed that the risks to their price forecasts were in the direction of higher inflation, given already high levels of capacity use and their expectations of appreciable further economic growth. Nonetheless, the relatively low inflation experienced despite a lengthy period of fully employed resources suggested that the timing of a potential upturn in inflation--indeed whether inflation would in fact pick up--could not be predicted with any degree of confidence on the basis of past historical patterns. The reasons for the persistence of a relatively benign inflation performance in the current expansion were not fully understood. They included some temporary factors such as the effect of the rise in the dollar on import prices and the restraint on health care costs. More fundamentally, they presumably also involved the favorable effects on production costs of widespread business restructurings and the large volume of investment in more productive technology in recent years, the impact of both factors on the job security concerns of workers and their willingness to accept reduced increases in compensation, and the effects of an intense degree of competition among domestic and foreign producers in U.S. markets. With regard to the possibility that more robust productivity increases would be holding down production costs, it was noted that a surge in economic activity, such as had occurred in late 1996 and early 1997, tended to be accompanied by above-trend gains in productivity. A slower pace of economic growth in the second quarter and beyond might provide an opportunity to assess whether productivity increases were on a clear uptrend and could help to explain the favorable behavior of prices over an extended period. In any event, it was too early to reach any firm conclusion on this issue or the broader question of whether or when a rise in inflation might materialize under anticipated economic conditions.

The members also discussed a staff study of the relative performance of various prices indices as measures of inflation. Members noted that most broad measures of inflation moved together over extended periods of time, but they did not always do so over short intervals. Differences in construction, coverage, and other factors meant that none of the individual measures was clearly superior in assessing general inflation trends, and several members commented that all measures needed to be monitored.

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 February for 1997 and it decided on tentative ranges for those aggregates for 1998. The current ranges set in February for the period from the fourth quarter of 1996 to the fourth quarter of 1997 were unchanged from the ranges for 1996 and included expansion of 1 to 5 percent for M2 and 2 to 6 percent for M3. An unchanged range of 3 to 7 percent also was set in January for growth of total domestic nonfinancial debt in 1997.

All the members favored retaining the current ranges for this year and extending them on a provisional basis to 1998. They anticipated that growth of M2 probably would continue at rates in the upper part of its current range in both years and that of M3 at rates approximating or even slightly above the upper bound of its range, given the Committee's expectations for the performance of the economy and prices. The current ranges were not expected to be guides to money growth under anticipated conditions in the period ahead, but instead 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 at least some members, higher ranges could raise questions in this regard.

Over the last few years, in contrast to earlier in the 1990s, the behavior of the broad aggregates, especially that of M2, in relation to nominal GDP and short-term interest rates had displayed a pattern that was in line with historical norms prior to the 1990s. The members viewed this as an encouraging development in that it raised the possibility of giving more weight at some point to the performance of these aggregates as useful indicators in formulating monetary policy. However, the period of more predictable M2 and M3 behavior was still relatively brief and such behavior had occurred at a time of generally settled conditions in financial markets and the overall economy. The prospective performance of these aggregates in periods of rapid changes in financial and economic conditions was still an open question, and in light of the uncertainties that were involved the members concluded that it would be premature to place increased reliance on them in the conduct of policy. Accordingly, the Committee decided that despite projected growth of M2 and M3 at rates in the vicinity of the upper limits of the current ranges, prevailing uncertainties made it desirable to retain those ranges as benchmarks for the achievement of price stability rather than to establish higher ranges that seemed more likely to capture expected outcomes. In the circumstances, any tendency for growth of the monetary aggregates to move outside the Committee's ranges would not in itself call for a policy adjustment but would continue to be interpreted in the context of a broad range of business and financial developments bearing on the prospective performance of the overall economy.

The Committee members were unanimously in favor of retaining the current range of 3 to 7 percent for growth of total domestic nonfinancial debt in 1997 and extending that range on a provisional basis to 1998. They took account of a staff projection indicating that growth of the debt aggregate was likely to slow somewhat from its pace in 1995 and 1996, reflecting a small reduction in the expansion of federal government debt. According to the staff projection, growth in the debt measure would be near the midpoint of the existing range over the period through 1998.

At the conclusion of this discussion, the Committee voted to reaffirm the ranges for growth of M2, M3 and total domestic nonfinancial debt that it had established in February for 1997. For the year 1998, the Committee approved provisional ranges for the three aggregates that were unchanged from the 1997 ranges. In keeping with its usual procedure under the Humphrey-Hawkins Act, the Committee would review its preliminary ranges for 1998 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 1997 and 1998 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 February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1998, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1997 to the fourth quarter of 1998, of 1 to 5 percent for M2 and 2 to 6 percent for M3. The Committee provisionally set the associated range for growth of total domestic nonfinancial debt at 3 to 7 percent for 1998. 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, Broaddus, Guynn, Kelley, Meyer, Moskow, Parry, Mses. Phillips and Rivlin.

Votes against this action: None.

In the Committee's discussion of policy for the intermeeting period ahead, all the members favored or could support a proposal to maintain an unchanged policy stance, and they strongly supported the retention of a bias toward restraint. An unchanged policy seemed appropriate with inflation still quiescent and business activity projected to settle into a pattern of moderate growth broadly consistent with the economy's long-run output potential. While the members assessed risks surrounding such a forecast as decidedly tilted to the upside, the slowing of the expansion should keep resource utilization from rising substantially further, and this outlook together with the absence of significant early signs of rising inflationary pressures suggested the desirability of a cautious "wait and see" policy stance at this point. In the current uncertain environment, this would afford the Committee an opportunity to gauge the momentum of the expansion and the related degree of pressure on resources and prices. The risks of waiting appeared to be limited, given that the evidence at hand did not point to a step-up in inflation despite low unemployment and that the current stance of monetary policy did not seem to be overly accommodative, at least on the basis of some measures such as the level of real short-term interest rates. In these circumstances, any tendency for price pressures to mount was likely to emerge only gradually and to be reversible through a relatively limited policy adjustment. Some members commented, however, that in the absence of unanticipated weakness in the economy, some tightening of policy was likely to be needed in the relatively near future, and one expressed the view that a tightening action at this meeting seemed desirable to forestall or limit the risks of intensifying inflationary pressures. However, waiting was an acceptable alternative given the favorable economic news and the persisting uncertainties surrounding the relationship of output to prices.

In their discussion of possible adjustments to policy during the intermeeting period, all the members indicated that they wanted to retain the existing asymmetry toward restraint adopted at the May meeting. An asymmetric directive was consistent with their view that the risks clearly were in the direction of excessive demand pressures in the economy and an associated upward trend in inflation. Such a bias in the directive also would serve the purpose of signaling the Committee's ongoing commitment to curb inflation in the interest of fostering maximum sustainable economic growth and employment. The members agreed that the current environment called for careful monitoring of developments and for prompt action by the Committee if needed to counter rising inflation. Indeed, in the interest of fostering a continuation of sustainable growth of the economy, it would be desirable to tighten on the basis of early signs of potentially intensifying inflation and before higher inflation actually materialized.

At the conclusion of the Committee's discussion, all the members indicated that they could support a directive that called for maintaining the existing degree of pressure on reserve positions and that retained 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 expansion in M2 and M3 over coming months.

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 the economic expansion slowed substantially in the second quarter after surging in late 1996 and earlier this year. Private nonfarm payroll employment increased at a reduced pace in May, but the civilian unemployment rate fell slightly further to 4.8 percent. Industrial production registered another sizable gain in May. Personal consumption expenditures, in real terms, rose substantially in May after having changed little over the preceding three months. Housing activity appears to have been well maintained in recent months. Available indicators point to further sizable gains in business fixed investment. The nominal deficit on U.S. trade in goods and services narrowed somewhat in April from its downward-revised average rate in the first quarter. Price inflation has remained subdued.

Market interest rates generally have declined somewhat since the day before the Committee meeting on May 20, 1997; share prices in equity markets have risen considerably further. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies was up slightly on balance over the intermeeting period.

Growth of M2 and M3 fluctuated sharply from April to May in association with a swing in household balances related to large tax payments; on balance, both aggregates expanded at a moderate pace over the two months, and available data pointed to further moderate growth in June. For the year through June, M2 expanded at a rate near the upper bound of its range for the year and M3 at a rate somewhat above the upper bound of its range. Total domestic nonfinancial debt has continued to expand in recent months and is near the middle 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 February for growth of M2 and M3 of 1 to 5 percent and 2 to 6 percent respectively, measured from the fourth quarter of 1996 to the fourth quarter of 1997. The range for growth of total domestic nonfinancial debt was maintained at 3 to 7 percent for the year. For 1998, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1997 to the fourth quarter of 1998, of 1 to 5 percent for M2 and 2 to 6 percent for M3. The Committee provisionally set the associated range for growth of total domestic nonfinancial debt at 3 to 7 percent for 1998. 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 this action: Messrs. Greenspan, McDonough, Broaddus, Guynn, Kelley, Meyer, Moskow, Parry, Mses. Phillips and Rivlin.

Votes against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 19, 1997.

The meeting adjourned at 11:55 a.m. on July 2.

Donald L. Kohn
Secretary

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Footnotes

1 Attended portions of meeting relating to the Committee's review of the economic outlook and establishment of its monetary and debt ranges for 1998.

2 Attended portion of meeting relating to price measurement issues for monetary policy.