

Meeting of the Federal Open Market Committee

August 19, 1986

Minutes of Actions

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, August 19, 1986, at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Guffey
Mr. Heller
Mrs. Horn
Mr. Johnson
Mr. Melzer
Mr. Morris
Mr. Rice
Ms. Seger
Mr. Wallich

Messrs. Boehne, Keehn, and Stern, Alternate
Members of the Federal Open Market Committee

Messrs. Black, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Mr. Bernard, Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Oltman, Deputy General Counsel
Mr. Kichline, Economist
Mr. Truman, Economist (International)

Messrs. Balbach, T. Davis, Kohn, Lindsey, and
Prell, Associate Economists

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

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

8/19/86

-2-

Mr. Coyne, Assistant to the Board, Board of Governors
Mr. Roberts, Assistant to the Chairman, Board of Governors
Mr. Promisel, Senior Associate Director, Division of
International Finance, Board of Governors
Mr. Gemmill, Staff Adviser, Division of International
Finance, Board of Governors
Mrs. Loney, Economist, Office of the Staff Director for
Monetary and Financial Policy, Board of Governors
Mrs. Low, Open Market Secretariat Assistant,
Board of Governors

Mr. Wallace, First Vice President, Federal Reserve Bank
of Dallas

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

Messrs. Broaddus, Lang, Scadding, and Scheld, Senior
Vice Presidents, Federal Reserve Banks of Richmond,
Philadelphia, San Francisco, and Chicago,
respectively

Messrs. McNees, Pearce, and Sniderman, Vice Presidents,
Federal Reserve Banks of Boston, Dallas, and
Cleveland, respectively

Ms. Meulendyke, Manager, Federal Reserve Bank of New York

Mr. Weber, Senior Economist, and Ms. Rosenbaum, Economist
Federal Reserve Banks of Minneapolis and Atlanta,
respectively

Secretary's Note: Prior to this meeting notice was
given that Mr. H. Robert Heller had executed his oath
as member of the Federal Open Market Committee.

By unanimous vote, the minutes of actions taken at the meeting of
the Federal Open Market Committee held on July 8-9, 1986, were approved.

By unanimous vote, System open market transactions in government
securities and federal agency obligations during the period July 9, 1986,
through August 18, 1986, were ratified.

8/19/86

-3-

With Messrs. Melzer and Wallich dissenting, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following domestic policy directive:

The information reviewed at this meeting indicates a mixed pattern of developments but suggests on balance that economic activity is expanding moderately in the current quarter. In July total nonfarm payroll employment grew strongly, boosted in part by the return of striking workers. However, continued weakness in the industrial sector was reflected in further declines in employment in manufacturing and mining. The civilian unemployment rate moved down to 6.9 percent from 7.1 percent in June. Industrial production declined slightly further in July. The nominal value of total retail sales was about unchanged during the month, as sales of new autos declined somewhat but spending on other consumer goods remained strong. Housing starts fell somewhat in May and June from a relatively high level earlier in the year. Business capital spending appears to have remained weak, partly reflecting continuing declines in the energy sector. While fluctuations in energy prices have caused some month-to-month volatility, on average prices and wages are rising more slowly this year than in 1985.

The trade-weighted value of the dollar against major foreign currencies has continued to decline since the July 8-9 meeting of the Committee. The U.S. merchandise trade deficit in the second quarter appears to have been about unchanged from the first quarter. The value of total exports and of total imports remained about the same in the two quarters, although the value of oil imports continued to fall in the second quarter while that of non-oil imports rose further.

Growth of M2 and especially of M3 picked up in July, lifting expansion of these two aggregates for the year through July well into the upper portion of their respective ranges established by the Committee for 1986. In July M1 continued to grow at a rate close to the very rapid pace of the second quarter. Expansion in total domestic nonfinancial debt remains appreciably above

the Committee's monitoring range for 1986. Short-term interest rates have declined somewhat since the July meeting of the Committee, while most long-term interest rates are about unchanged to slightly lower on balance. On July 10, the Federal Reserve Board approved a reduction in the discount rate from 6-1/2 to 6 percent.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at the July meeting to reaffirm the ranges established in February for growth of 6 to 9 percent for both M2 and M3, measured from the fourth quarter of 1985 to the fourth quarter of 1986. With respect to M1, the Committee recognized that, based on the experience of recent years, the behavior of that aggregate is subject to substantial uncertainties in relation to economic activity and prices, depending among other things on the responsiveness of M1 growth to changes in interest rates. In light of these uncertainties and of the substantial decline in velocity in the first half of the year, the Committee decided that growth of M1 in excess of the previously established 3 to 8 percent range for 1986 would be acceptable. Acceptable growth of M1 over the remainder of the year will depend on the behavior of velocity, growth in the other monetary aggregates, developments in the economy and financial markets, and price pressures. Given its rapid growth in the early part of the year, the Committee recognized that the increase in total domestic non-financial debt in 1986 may exceed its monitoring range of 8 to 11 percent, but felt an increase in that range would provide an inappropriate benchmark for evaluating longer-term trends in that aggregate.

For 1987 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1986 to the fourth quarter of 1987, of 5-1/2 to 8-1/2 percent for M2 and M3. While a range of 3 to 8 percent for M1 in 1987 would appear appropriate in the light of most historical experience, the Committee recognized that the exceptional uncertainties surrounding the behavior of M1 velocity over the more recent period would require careful appraisal of the target range at the beginning of 1987. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1987.

8/19/86

-5-

In the implementation of policy for the immediate future, the Committee seeks to decrease slightly the existing degree of pressure on reserve positions, taking account of the possibility of a change in the discount rate. This action is expected to be consistent with growth in M2 and M3 over the period from June to September at annual rates of about 7 to 9 percent. While growth in M1 is expected to moderate from the exceptionally large increase during the second quarter, that growth will continue to be judged in the light of the behavior of M2 and M3 and other factors. Somewhat greater or lesser reserve restraint might be acceptable depending on the behavior of the aggregates, the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 4 to 8 percent.

It was agreed that the next meeting of the Committee would be held on September 23, 1986.

The meeting adjourned.

Assistant Secretary