FEDERAL RESERVE press release

For Use at 4:30 p.m. August 23, 1985

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 July 9-10, 1985.

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 July 9-10, 1985

Domestic policy directive

The information reviewed at this meeting indicated that expansion of economic activity had picked up in recent months, following virtually no growth in the first quarter of the year. Rates of increase in prices and wages had slowed a bit recently after indications of some acceleration early in the year, and for the year to date inflation appeared to be running at about the same pace as in 1984.

The nominal value of retail sales fell in May after an extraordinary rise in April, but the average level of sales for the April-May period was about 2-1/4 percent above the average for the first quarter. Over the two-month period, sales of durable goods were especially strong, fostered by a surge in sales at automotive outlets in April and a sharp rebound in sales at furniture and appliance stores in May. In the automotive sector, financing incentives on many domestic models and increased availability of imported cars boosted total automobile sales to an annual rate of 11.3 million units in May, the highest monthly pace in six years. Many of the special financing programs were phased out by the end of May, however, and sales of domestic cars slowed substantially in June.

Activity in the housing sector appeared to be holding earlier gains. Total private housing starts averaged 1.8 million units at an annual rate in the April-May period, the same as the advanced first-quarter pace, and newly issued permits for residential building rose in May to their highest level in nearly a year. Combined sales of new and existing homes remained strong, as the general decline in mortgage credit costs apparently continued to bolster demand.

Information on business capital spending suggested further growth in that sector, though at a much less rapid pace than earlier in the economic expansion. Most of the recent strength in business fixed investment has been concentrated in expenditures for nonresidential construction. Imports apparently have continued to account for a sizable share of outlays for equipment; new orders for nondefense capital goods and shipments by domestic producers have changed little on balance since last fall. The Commerce Department's survey of business spending plans, conducted in late April and May, suggested that nominal outlays for plant and equipment would be roughly 9 percent above their 1984 average.

The index of industrial production edged down in April and May, after rising little over the first quarter. Production of defense and space equipment continued to advance and output of construction supplies also increased. Production of other products and materials generally remained sluggish: output of consumer goods had changed little from the level prevailing a year earlier, and production of business equipment -- a source of strength throughout 1984 -- had declined thus far in 1985. The rate of capacity utilization for total industry fell 0.4 percentage point further in May to 80.3 percent, a cumulative drop of nearly 2-1/2 percentage points since July 1984.

Nonfarm payroll employment rose 80,000 in June, after an advance in May that equaled the average monthly increase of 260,000 recorded in the first four months of the year. Manufacturing employment continued to fall in both May and June, however, bringing the cumulative loss in factory jobs to 220,000 so far this year. The civilian unemployment rate remained at 7.3 percent in June, unchanged since February.

The producer price index for finished goods and the consumer price index rose 0.2 percent in May. Over the first five months of the year, producer and consumer prices have risen at annual rates of about 1-3/4 percent and 4 percent respectively, the same as in 1984. The index of average hourly earnings also has continued to increase at its 1984 pace, rising at an annual rate of about 3 percent for the year through May.

Over the period since the Committee's meeting in May, the trade-weighted value of the dollar had generally moved within a relatively narrow range. But in the days immediately preceding this meeting the value of the dollar declined about 2 percent, to a level below its recent low in April, bringing its decline over the intermeeting interval to around 3-1/2 percent. The U. S. merchandise trade deficit widened in the April-May period from the rate in the first quarter, as both agricultural and non-agricultural exports fell while imports remained close to their high first-quarter rate.

At its meeting on May 21, 1985, the Committee had adopted a directive that, against the background of the reduction in the discount rate announced a few days before the meeting, called for maintaining the existing degree of pressure on reserve positions. The members expected that action to be consistent with growth in M1 at an annual rate of around 6 percent or a little higher during the period from March to June. Given the weakness in M2 and M3 in April, growth in these broader aggregates over the three-month period was expected to be slower than the respective annual rates of 7 and 8 percent anticipated at the time of the previous meeting in late March. The members agreed that somewhat lesser restraint would be acceptable in the event of substantially slower growth in the monetary aggregates while somewhat greater restraint might be acceptable in the event of substantially faster growth. It was understood that the need for lesser or greater restraint would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

In May and June, M1 expanded very rapidly, and its growth over the March-to-June interval was at an annual rate of about 13-1/4 percent, well above the rate expected at the time of the May meeting. The strength in M1 was evident in all its major components, particularly in demand deposits. That strength, coupled with an acceleration in the nontransaction component of M2 in June, brought growth in the broader aggregates to rates somewhat higher than expected in May for the three-month period. Nevertheless, for the period from the fourth quarter of 1984 through the second quarter of 1985, M2 and M3 expanded at rates within their long-term ranges, while M1 grew at a rate well above its range. Expansion in total domestic nonfinancial debt slowed a little in the second quarter, but remained high relative to the Committee's monitoring range for the year.

Total reserves grew rapidly in May and June, reflecting increases in required reserves associated with the growth in transaction accounts. The level of adjustment plus seasonal borrowing averaged around $550 million in the three complete maintenance periods between meetings and was running over $1.2 billion in the week before this meeting, as seasonal strains associated with the midyear statement date and the holiday period, together with massive swings in Treasury balances, complicated reserve management at depository institutions and the Federal Reserve. Throughout the intermeeting interval, borrowing was boosted by occasional surges for a day or two near the end of a reserve maintenance period, apparently reflecting higher-than-expected demands for excess reserves, particularly around the midyear statement date.

The federal funds rate centered on a trading range of 7-1/2 to 7-3/4 percent during much of the intermeeting interval. The rate fell below 7 percent briefly in mid-June and rose above 8 percent for a time around the quarter-end statement date and July 4 holiday, when seasonal influences and sharply rising Treasury balances temporarily increased pressures on reserves. Other market rates fluctuated over relatively wide ranges in response to incoming economic data, changing expectations about the likelihood of a further cut in the discount rate, and at times, unanticipated money supply developments. On balance, rates on most Treasury securities fell about 35 to 60 basis points, while rates on commercial paper and certificates of deposits declined about 15 to 25 basis points, apparently reflecting emergence of slightly higher risk premiums in response to some concerns about the health of some financial institutions. Most commercial banks reduced their "prime" rate 1/2 percentage point to 9-1/2 percent. Corporate bond yields fell about 60 to 70 basis points and most broad stock price indexes reached record levels. The average rate on new commitments for fixed-rate conventional home mortgage loans declined about 80 basis points over the intermeeting period.

The staff projections presented at this meeting suggested that growth in real GNP would pick up somewhat in the second half of the year from the sluggish pace in the first half, and would continue at a modest pace through 1986. The unemployment rate was expected to fall only slightly over the projection period and the rate of increase in prices was projected to remain close to that experienced in recent years.

In the Committee's discussion of current and prospective economic developments, the members agreed that some pickup in the rate of economic expansion from the slow growth of the first half of the year was a reasonable expectation for the second half. The outlook for 1986 was more uncertain, but the members generally saw continuing expansion, though possibly at a moderating pace, as the most likely prospect for the year. As they had at previous meetings, the members expressed concern about the uneven participation of various industries in the economic expansion, including the continuing and serious problems in the agricultural sector. They also remained concerned about the underlying imbalances in the economy, notably the massive deficits in the federal budget and in the balance of trade, that along with persisting strains in domestic and international financial markets threatened the sustainability of the expansion. In these circumstances the members recognized that their forecasts were subject to a great deal of uncertainty and several commented that the risks of any deviation appeared to be on the downside. Other members were more optimistic, at least with respect to the next few quarters, and in one view the rapid growth of M1 since the latter part of 1984 could presage significantly faster expansion than generally was anticipated currently.

In keeping with the usual practice for meetings when the Committee considers its longer-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 average prices. With regard to growth in real GNP, the projections had a central tendency of 2-3/4 to 3 percent for 1985 as a whole and 2-1/2 to 3-1/4 percent for 1986. The central tendency for the rate of unemployment was an average rate of 7 to 7-1/4 percent for the fourth quarter of 1985 and about the same or a bit lower for the fourth quarter of 1986. The projections for the implicit GNP deflator centered on a rise of 3-3/4 to 4 percent for the year 1985 and 3-3/4 to 4-3/4 for the year 1986. These projections were considered to be consistent with the Committee's objectives for growth in money and credit established at this meeting. The projections also assumed that Congress and the Administration would achieve deficit reductions in the range of those contained in recent House and Senate budget actions. The projections were based on an assumption that the exchange value of the dollar would not deviate substantially from its recent trading range.

In support of their expectation that the rate of economic expansion would improve from the very sluggish pace experienced in the first half of the year, members referred to the favorable impact of reduced interest rates on interest-sensitive sectors of the economy, such as the construction and automobile industries, and they also noted the build up of liquidity in the economy. Some members commented that consumer spending was likely to remain relatively robust, at least over the quarters immediately ahead, given generally favorable consumer attitudes and the sizable gains expected in employment and earnings. A number of members also referred to favorable prospects for continuing growth in business capital spending against the background of reduced borrowing costs and strong competitive pressures -- both domestic and foreign -- on business firms to enhance their productivity. In the latter connection one member reported on the expectation of some businessmen that the lull in demands for high-technology equipment might prove to be temporary.

On the negative side, apart from the underlying imbalances that constituted an ongoing threat to the economy, the members cited a number of factors that would tend to limit, if not arrest, the expansion. The growth of private debt and rising delinquency rates could have an increasingly negative effect on consumer spending and perhaps on housing demand. In the investment area, the demand for high-technology equipment might not revive as some businessmen expected, and the high vacancy rates in many parts of the country for multi-family housing and office space suggested a marked slowdown in that type of construction. More generally, relatively low rates of capacity utilization would limit the need for investments in many industries. Several members referred to the continuing drag on domestic production stemming from the high value of the dollar and the associated intense foreign competition in both domestic and export markets.

With regard to the outlook for inflation, the members noted that wage and price pressures were relatively subdued in domestic labor and product markets. Inflationary pressures were greater in some of the service industries, but against the background of generally low capacity utilization rates and relatively high unemployment the members did not expect much change in the overall rate of inflation during the year ahead, at least in the absence of any sizable decline in the foreign exchange value of the dollar. Indeed, one member observed that the performance of prices might well prove to be better than was generally expected unless the exchange value of the dollar were to fall substantially. A number of members commented that a limited decline in the dollar might have little, if any, effect on domestic prices or in the extent of import penetration. Many foreign suppliers who enjoyed sizable profit margins would probably tend to absorb such a decline by maintaining current dollar prices in order to preserve their market shares. On the other hand, a substantial decline in the value of the dollar, if it were to occur, would pose a considerable risk of being reflected in higher domestic prices.

At this meeting the Committee reviewed its ranges for growth of the monetary and credit aggregates in 1985 and established tentative ranges for 1986 within the framework of the Full Employment and Balanced

Growth Act of 1978 (the Humphrey-Hawkins Act).[1/] At its meeting on February 12-13, 1985, the Committee had adopted monetary growth ranges of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9-1/2 percent for M3 for the period from the fourth quarter of 1984 to the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent. The Committee had agreed that growth in the monetary aggregates in the upper part of their ranges might be appropriate for the year, depending on developments with respect to velocity and provided that inflationary pressures remained subdued.

The Committee's review of its ranges for 1985 focused on the rapid growth of M1 during the first half of the year, the factors that may have influenced the demand for money, and the implications of M1 growth for the future course of economic activity and the rate of inflation. In their discussion the members took account of an analysis which suggested that the strength of M1 relative to the Committee's target range appeared to reflect in part a one-time response on a lagged basis to the sizable declines in interest rates that had occurred over the past year. The available evidence suggested, not only on the basis of the recent experience but also that of earlier periods such as in 1982-1983, that in periods characterized by large interest rate declines individuals and businesses tended to shift into transaction-type

---

1/ The Midyear Monetary Policy Report pursuant to this legislation was transmitted to the Congress on July 16, 1985.

balances from other assets because they sacrificed less interest income in doing so. Moreover, it was possible that the availability of interest on certain types of checking accounts in recent years, together with the fact that the rates of interest on such accounts have tended to change more sluggishly than competing market-oriented rates, has increased the interest sensitivity of M1, particularly in the short run. It was also noted, however, that a part of the rapid growth of M1, notably in the past two months, did not appear to be related to interest rate adjustments or to ongoing transaction demands, raising questions about whether there were special factors, such as changes in corporate cash management practices or transitory responses to sharp declines in Treasury balances, that also may have been influencing the demand for money.

While acknowledging that both the explanation and the implications of the bulge in M1 growth were subject to a great deal of uncertainty, the members generally concluded that faster than targeted expansion in M1 could be accepted for the first half of the year in light of the sluggish growth in economic activity, relatively well contained price pressures, and a high value of the dollar on foreign exchange markets. Moreover, growth in the broader aggregates for the year to date had been consistent with the Committee's earlier expectations.

Looking ahead to the balance of the year, the members differed to some extent on an appropriate M1 target, but they generally concluded that it would not be desirable in the current economic and financial environment to offset the recent spurt in M1 by a slowing in the second half sufficient to bring M1 into the existing 4 to 7 percent long-run range. That would imply almost no growth month-by-month on average over the balance of the year. While the prospective behavior of M1 would remain subject to continuing uncertainties, the members believed that M1 velocity would probably move gradually toward a more usual or predictable pattern and that maintenance of the current degree of reserve pressure would be associated with a reduction in M1 growth during the second half of the year to a moderate pace. Such growth was likely to be consistent with a pickup in the rate of economic expansion and continued containment of inflationary pressures. Accordingly, most of the members favored either raising the M1 range that had been established in February for the year or rebasing the range from the fourth quarter of 1984 to the second quarter of 1985, with a smaller increase or no change in the actual numerical range.

Members who expressed a preference for a higher range over rebasing emphasized that the degree of uncertainty surrounding the future behavior of M1 remained considerable and a higher range would not carry an implication that the velocity adjustment in M1 was concluded. Moreover, to the extent that changes in the composition of M1 toward interest-bearing accounts, shifts in cash management practices, and generally lower interest rates implied a more slowly rising trend in M1 velocity, M1 growth relative to GNP would be higher over time than the Committee had anticipated earlier and, in one view, should begin to be reflected in the Committee's M1 ranges. However, a majority of the members preferred to rebase M1 on the second quarter. While they did not disagree that there were considerable uncertainties about the prospective relationship between M1 and economic performance, these members felt that a rebased range would better reflect the current thrust of the Committee's policy and would be more consistent with a movement toward lower growth ranges over time, as needed to attain the long-run objective of sustained, noninflationary economic growth.

Because of the uncertainties surrounding the behavior of M1, one member proposed placing much less weight than usual on movements in that aggregate, possibly by relegating it to a monitoring status for some period of time. Other members opposed such a course because they felt that M1, together with the other monetary aggregates, would continue to provide a useful focus for the conduct of monetary policy even as their behavior had to be evaluated in the context of ongoing economic, financial, and exchange market developments.

With regard to the members' preferences for a specific M1 range, a majority supported a proposal to establish a range of 3 to 8 percent, rebased on the second quarter. Such a range implied a substantial slowing in growth from the pace in the first half. Other members indicated a preference for a rebased range of 4 to 7 percent which they believed was likely to prove more consistent with the Committee's longer-run objectives. Given the uncertainties surrounding the behavior of M1, most of the members supported a relatively wide range for the second half, even though the prospects for expansion at the low end of the range were viewed as somewhat remote. It was recognized that because M1 growth had been strong during the latter part of the second quarter, its level was currently high in relation to the rebased range and it was not likely to fall within that range until some time had elapsed. Relatively low growth within the range, should it occur, would be acceptable if the recent decline in M1 velocity were substantially reversed and economic performance proved to be satisfactory. In summary, the rebased range was based on expectations of a return of velocity growth over time toward more usual patterns, but because of the many uncertainties that were involved the members agreed on the desirability of continuing to judge M1 developments against the background of the other aggregates and evidence on the behavior of the economy, prices, and financial markets, both domestic and international.

With regard to M2, M3, and debt all of the members supported a proposal to reaffirm the current ranges for 1985, subject to the understanding that actual growth, as had been contemplated previously at the February meeting, might appropriately be high within the ranges depending on developments with respect to velocity and provided that inflationary pressures remained subdued.

At the conclusion of its review of the ranges for 1985, the Committee voted as follows to establish a rebased range for M1 and to reaffirm the ranges that were set at the February meeting for the broader aggregates and for total domestic nonfinancial debt:

> The Committee at this meeting reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9-1/2 percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth rate of 3 to 8 percent. The range takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.
>
> > Votes for this action: Messrs. Volcker, Corrigan, Balles, Forrestal, Keehn, Partee, Martin, Rice, Ms. Seger, and Mr. Wallich. Vote against this action: Mr. Black. (Absent and not voting: Mr. Gramley.)

Mr. Black dissented because he preferred a rebased range of 4 to 7 percent for M1, which he thought was more likely to be consistent with both sustained economic expansion and progress towards price stability. In particular, he was concerned that the higher 8 percent top of the rebased range adopted by the Committee might tend to prolong the process of reducing M1 growth to a noninflationary rate.

Turning to the establishment of tentative ranges for 1986, several members emphasized the desirability of taking further action, in line with previously stated Committee intentions, to reduce growth in money and credit over time to rates that would be consistent with sustainable economic expansion and reasonable price stability. In that context, a majority of the members favored an M1 range of 4 to 7 percent for 1986. However, with varying degrees of emphasis, a number of members questioned whether such a range would prove adequate to sustain the economic expansion, particularly in light of the possibility that the trend in M1 velocity might be shifting lower. Reference was also made to the uncertainties associated with the lifting of remaining Regulation Q interest rate ceilings early in 1986, as provided for in current legislation. One member commented that the elimination of rate ceilings on savings accounts could result in rate adjustments that favored such accounts over M1-type deposits, thereby tending to restrain M1 growth in relation to that of M2. However, the removal of ceilings on regular NOW accounts would work in the other direction.

With regard to the broader aggregates, the members favored no change in the tentative range for M2 and a 1/2 percentage point reduction in the upper limit of the M3 range compared with the 1985 ranges for those aggregates. There was general agreement on the desirability of reducing the monitoring range for total domestic nonfinancial debt by one percentage point, partly reflecting an expectation that its expansion would be tempered by a drop-off in the net redemption of equity shares that had boosted corporate debt substantially over the past several quarters. Moreover, credit needs to finance the expansion would tend to grow less than in 1985 if, as a number of members anticipated, the current account deficit did not worsen further and the gap between the growth in domestic spending and domestic production narrowed or disappeared. All of these ranges were believed to be consistent with sustained growth in the economy so long as inflationary pressures remained subdued. However, the Committee recognized that uncertainties about interest rates and other factors that could affect the velocity of the various aggregates would require careful reappraisal of the ranges at the beginning of 1986. In addition, actual experience with institutional and depositor behavior after the completion of deposit rate deregulation would need to be taken into account in judging the ongoing appropriateness of the ranges.

At the conclusion of its discussion, the Committee took the following action to establish the tentative ranges for 1986:

> For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for next year, the Committee also recognized that account would need to be taken of experience with institutional and depositor behavior in response to the completion of deposit rate deregulation early in the year.

> Votes for this action: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Keehn, Partee, Rice, and Wallich. Votes against this action: Mr. Martin and Ms. Seger. (Absent and not voting: Mr. Gramley.)

Mr. Martin dissented because he preferred a somewhat higher growth range for M1 to provide for greater flexibility if needed to accommodate sustained economic expansion, should velocity continue to decline or increase very sluggishly. Ms. Seger dissented because she believed that higher growth ranges were desirable to foster an acceptable rate of economic expansion and help reduce financial strains in the economy. Both Mr. Martin and Ms. Seger saw little risk under current conditions that inflation would intensify.

In the Committee's discussion of policy implementation, some divergence of views was expressed with regard to the appropriate operational approach for the weeks immediately ahead. A majority of the members were in favor of directing operations, at least initially, toward maintaining the existing degree of pressure on reserve positions, but others indicated preferences for somewhat firmer or somewhat easier reserve conditions. The members agreed that current reserve conditions were likely to be associated with a marked slowing in the growth of M1 during the third quarter, partly because the recent unusual surge in demand deposits would appear to have satisfied transaction needs for some period ahead. Growth in the broader aggregates would also be expected to slow from the pace in May and June, partly because of the prospect of some moderation in the inflow of funds to money market mutual funds and to money market deposit accounts as the interest paid on such accounts was brought into better alignment with short-term market rates.

Despite the outlook for more moderate growth in the monetary aggregates, notably M1, compared with the second quarter, some members were concerned that such growth might not slow sufficiently, and they proposed some modest firming of reserve conditions to help assure that the expansion of M1 would moderate to within the Committee's range for the second half of the year. A differing view, which placed less emphasis on the behavior of M1 because of the uncertainties that were involved, stressed the desirability of some easing of reserve conditions against the background of ongoing financial strains in some sectors and the sluggish performance of the economy.

In keeping with the Committee's usual practice, the members considered the question of possible intermeeting adjustments in the degree of reserve restraint. They agreed as they had previously that such adjustments should not be made automatically in response to the behavior of the monetary aggregates alone, but should take account of the strength of economic activity and inflationary pressures, domestic credit conditions, and the foreign exchange value of the dollar. In particular, the members agreed that some shortfall in the growth of M1 from expectations, should it occur for a month or two, should not be resisted and might indeed be desirable in the context of acceptable economic performance. Conversely, a tendency for M1 growth to exceed expectations should be countered more promptly, at least in the view of some members, in light of the rapid earlier growth in transaction balances. The members also felt that the behavior of the dollar in foreign exchange markets might well impose a significant constraint -- potentially in either direction -- with regard to possible adjustments in the degree of reserve restraint over the weeks ahead.

With regard to the intermeeting range for the federal funds rate, which calls for Committee consultation when its boundaries are exceeded for a period, it was suggested in the course of discussion that a rise in the average rate to around the upper end of the existing 6 to 10 percent monitoring range would imply reserve conditions that were inconsistent with the Committee's objectives for monetary growth, and that accordingly the upper end might be lowered to 9 percent. On the other hand, some members were concerned that a further decline in the average level of the federal funds rate to near the lower end of the present range might also prove inconsistent with monetary growth objectives and would therefore provide a misleading signal of policy easing. On balance, most of the members preferred to retain the current range which bracketed fairly evenly the existing federal funds rate.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored or could accept a directive that called for maintaining the current degree of pressure on reserve positions, keeping in mind the possibility of some increases in those pressures if growth of the monetary aggregates exceeded intentions. The members expected such an approach to policy implementation to be consistent with growth of both M2 and M3 at an annual rate of around 7-1/2 percent for the period from June to September. Over the same period they expected the expansion of M1 to slow substantially to an annual rate of 5 to 6 percent. The members agreed that somewhat lesser restraint on reserve positions might be acceptable in the event of substantially slower-than-expected growth in the monetary aggregates, while somewhat greater restraint would be acceptable if monetary growth were substantially faster. It was understood that the need for lesser or greater restraint would be considered against the background of developments relating to the strength of the business expansion, inflationary pressures, and conditions in domestic credit and foreign exchange markets. The members agreed that the intermeeting range for the federal funds rate should be left at 6 to 10 percent.

At the conclusion of the meeting, the following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests some pickup in the expansion of economic activity in recent months following virtually no growth in the first quarter. Total retail sales rose on balance in April and May to a level appreciably above the average for the first quarter, and housing starts held earlier gains after rising substantially in the first quarter. Information on business capital spending suggests further growth, though at a much less rapid pace than earlier in the economic expansion. Industrial production declined slightly in April and May after rising little over the first quarter. Total nonfarm payroll employment increased at a somewhat reduced pace in May and June with employment in manufacturing registering further declines. The civilian unemployment rate remained at 7.3 percent in June, unchanged since February. Broad measures of prices and wages appear to be rising at rates close to those recorded in 1984.

Since the Committee's meeting in May, the trade-weighted value of the dollar against major foreign currencies has generally moved within a relatively narrow range but recently has declined to a level below its April low. The merchandise trade deficit in April-May widened from the first-quarter rate as both agricultural and nonagricultural exports fell, while imports remained close to their high first-quarter level.

M1 expanded very rapidly in May and June after growing at a moderate pace in the preceding two months. The broader aggregates also grew more rapidly in May and June after slowing appreciably earlier. From the fourth quarter of 1984 through June, M1 grew at a rate well above the Committee's range for 1985; M2 increased at a rate around the upper end of its longer-run range; while M3 expanded at a rate in the upper half of its range. Expansion in total domestic nonfinancial debt slowed a little in the second quarter but remained high relative to the Committee's monitoring range for the year. Interest rates have declined somewhat further since the May meeting of the Committee.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, 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 reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9-1/2 percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth rate of 3 to 8 percent. The range takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the

Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.

For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for next year, the Committee also recognized that account would need to be taken of experience with institutional and depositor behavior in response to the completion of deposit rate deregulation early in the year.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. This action is expected to be consistent with growth in M2 and M3 at an annual rate of around 7-1/2 percent during the period from June to September, and with a substantial slowing of M1 growth to an annual rate of 5 to 6 percent. Somewhat lesser reserve restraint might be acceptable in the event of substantially slower growth of the monetary aggregates while somewhat greater restraint would be acceptable in the event of substantially higher growth. In either case such a change would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for the short-run operational paragraph: Messrs. Volcker, Corrigan, Balles, Forrestal, Keehn, Partee, Martin, Rice, and Wallich. Votes against this action: Mr. Black and Ms. Seger. (Absent and not voting: Mr. Gramley.)

Mr. Black dissented because he believed some increase in the degree of reserve pressure was needed to help assure an adequate slowing of M1 growth over the months ahead. Ms. Seger dissented because she favored some easing of reserve conditions to help reduce current financial strains, moderate the strength of the dollar in foreign exchange markets, and promote faster economic expansion.