FEDERAL RESERVE press release

For Use at 4:30 p.m. May 22, 1987

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 March 31, 1987. This record also includes policy actions taken during the period between the meeting on March 31, 1987, and the next regularly scheduled meeting held on May 19, 1987.

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 March 31, 1987

1. Domestic policy directive

The information reviewed at this meeting suggested that economic activity has risen at a faster pace so far this year than in the fourth quarter of 1986, while the rate of price increase has accelerated slightly. The expansion in output apparently has reflected a rebuilding of inventories and some improvement in the external sector. Important components of domestic final demands seem to have eased off in the early months of 1987 after a surge late in 1986. The pickup in inflation primarily has reflected a rebound in crude oil prices; wage pressures have remained subdued.

Data on employment and production suggested a sizable advance in output in early 1987. Total nonfarm payroll employment rose more than 300,000 per month over the first two months of the year, appreciably faster than in 1986; large gains were reported in construction, trade, and services. In addition, the average workweek has lengthened, and total hours worked by production and nonsupervisory personnel have risen sharply from the fourth quarter. The civilian unemployment rate was 6.7 percent in February for the third consecutive month as increases in the labor force matched the strong expansion in employment.

The index of industrial production rose 0.5 percent in February to a level about 1 percent above its fourth-quarter 1986 average. Increased production of motor vehicles accounted for most of the gain, but output of defense and space equipment, construction supplies, and nondurable materials also posted further appreciable increases. Reflecting the recent strengthening in the industrial sector, the capacity utilization rate increased 0.2 percentage point in February to 79.8 percent.

On the demand side, both consumption and business fixed investment have been relatively weak. Purchases of automobiles, after a sharp drop in January, have recovered somewhat over the past two months, but are still well below the fourth-quarter pace. Automakers have trimmed assembly schedules and have renewed sales incentive programs, but dealer inventories have been building up. Consumer spending on goods other than autos has advanced at a moderate rate. Business investment spending appears to have weakened in recent months. Shipments of nondefense capital goods fell on balance over the first two months of the year after the tax-related surge in equipment outlays late last year. New orders also have moved lower and outlays for nonresidential construction fell further in January, maintaining the downtrend that began early last year.

The large fluctuations in final sales that occurred around the turn of the year have been mirrored in changes in inventories. Stocks rose sharply in January, after being drawn down late last year. Notable swings in inventories occurred for autos and machinery, where tax incentives may have had a greater effect on the timing of purchases than on production. In addition, some stockbuilding was evident in manufacturing industries in which production has been relatively strong.

Activity in the housing sector remained vigorous in January and February, with starts averaging more than 1.8 million units at an annual rate in both months. The strength in starts appeared to reflect unusually good weather in the Midwest. Single-family starts have been particularly robust. Multifamily starts, by contrast, have remained weak because of high vacancy rates and a less favorable tax environment for construction of rental units.

Inflation picked up early this year, largely reflecting the pass-through of higher crude oil prices into prices of final energy products. The CPI rose 0.4 percent in February, after a 0.7 percent increase a month earlier. Prices of gasoline and fuel oil posted further sizable increases last month. Consumer food prices in February continued to rise at the pace that has prevailed since last September. Excluding food and energy, increases in consumer prices slowed a bit in February. Spot prices for industrial materials have essentially leveled off in recent weeks after rising late last year. Wage increases have remained moderate so far this year.

Economic activity in major foreign industrial countries remained generally weak in the fourth quarter of 1986 and early 1987, except in the United Kingdom. Debt-servicing problems beset several important developing countries but progress was made in the negotiations of a number of such countries with commercial banks.

The trade-weighted value of the dollar against other G-10 currencies changed little in the period following the February 10-11 meeting of the Committee until mid-March. The stability apparently was fostered to a considerable extent by the announcement that the major industrial countries at a meeting in Paris on February 22 had agreed to support the prevailing structure of exchange rates. Since mid-March, however, the dollar has come under strong downward pressure, particularly against the Japanese yen, apparently triggered in part by intensified trade frictions between the United States and Japan. An improved fiscal picture for the United Kingdom contributed to a sharp rise in sterling. As a result, the Bank of England cut its lending rates around mid-March; several other European countries also lowered official lending rates as their currencies strengthened against the German mark.

At its meeting in February, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. M2 and M3 were expected to grow at annual rates of about 6 to 7 percent from January through March, while growth in M1 was expected to slow substantially from the high rates of previous months. The members decided that somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on the behavior of the aggregates, taking into account developments in the economy and in foreign exchange and domestic credit markets. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

Growth of the monetary aggregates slowed sharply in February and March, and over the two months expansion in M2 and M3 was somewhat below the Committee's expectations. In March, these aggregates appeared to be around the lower bounds of the 5-1/2 to 8-1/2 percent ranges established by the Committee for the year. Some of the slower growth in the aggregates so far this year appears to be related to a reversal of the bulge in deposits and bank lending associated with the surge in transactions before year-end, but a more general moderation in the expansion of money balances also might be associated with completion of portfolio adjustments to earlier declines in interest rates. Total and nonborrowed reserves fell slightly over the past two months, as required reserves leveled off after the year-end bulge in transactions deposits and excess reserves edged lower in line with their usual seasonal pattern. In the three complete reserve maintenance periods after the February FOMC meeting, adjustment plus seasonal borrowing averaged about $280 million. At the same time, the federal funds rate edged off from 6-1/4 percent to around 6 percent or a bit higher.

Other interest rates changed little over most of the intermeeting period before firming somewhat recently. Over the past few days concern about the dollar contributed to some pressure on rates, particularly in long-term markets where Treasury bond yields have risen about 20 basis points. On balance, private short-term rates rose about 15 basis points over the intermeeting period, while Treasury bill rates were about unchanged to 20 basis points lower; the differential probably reflected heightened concerns about credit quality relating to debt-servicing problems of developing countries and a paydown of bills by the Treasury. Equity prices rose markedly over the period.

As at other recent meetings the staff projections suggested that real GNP would grow at a moderate rate through the end of 1987. The rise in net exports remained critical to sustaining growth. In response to the increased competitiveness of U.S. goods, growth in exports was expected to continue to boost demands on domestic production and growth of imports was anticipated to slow. Gross domestic purchases were expected to be sluggish, reflecting in part the effects of a less expansive fiscal policy and the influence of rising import prices on real income growth and consumption. Business equipment spending was projected to resume a moderate uptrend; however, construction of single-family homes was expected to edge down from the current pace, and activity in office-building and multifamily housing could weaken substantially in response to overbuilding of such structures in many areas and the effects of the new tax law. Inflation was likely to pick up reflecting the effects of the recent rebound of crude oil prices as well as the projected acceleration of import prices. However, remaining margins of slack in product and labor markets were expected to limit overall inflationary pressures.

In their discussion of the economic situation and outlook, Committee members generally agreed that recent developments on the whole were consistent with continuing expansion at a moderate pace. Comments on business conditions in several parts of the country tended to support a somewhat brighter picture than had been reported at earlier meetings. Business confidence appeared to have improved in many areas, buoyed by greater success in meeting foreign competition. Overall, economic activity seemed to have picked up in early 1987, though the improvement was due importantly to a buildup of inventories. Domestic final demands were expected to grow at a relatively slow pace over the year, with business spending for equipment and nonresidential construction likely to be retarding influences. Consumer spending on automobiles was mentioned as another potentially weak area of the economy, and problems persisted in agriculture and energy. The members concluded as at previous meetings that the prospects for sustaining a moderate rate of expansion would depend to an important extent on the achievement of significant gains in net exports.

The members saw encouraging signs that the trade deficit was narrowing in real terms if not yet in current dollar terms. Business contacts in several parts of the country reported that the dollar's depreciation was fostering growing demand for their products in export markets, although that experience was not shared by businesses in all areas. On the import side, many domestic producers indicated an increased ability to compete with foreign goods. Nonetheless, the outlook for foreign trade remained subject to a great deal of uncertainty. Generally weak economic growth abroad was cited as a negative factor. Members acknowledged that the dollar's depreciation might help U.S. producers, but substantial further weakness in the dollar carried considerable risks. A large additional decline would tend to damp demands and economic growth abroad, especially in the absence of stimulative policy actions in other major industrial countries. It could lead to substantially greater inflationary pressures in the United States, with adverse impacts on credit markets. While a few members were of the view that the dollar sooner or later might need to decline somewhat further to correct the nation's trade imbalance -- and such a decline should be accepted if it occurred -- most expressed concern about the implications of continuing dollar depreciation under prevailing circumstances.

Members already were anticipating that the earlier depreciation of the dollar along with the rebound in energy prices would be reflected in a somewhat higher rate of inflation this year. Tending to support that view were indications in some parts of the country that prices of a number of products and services were rising somewhat more rapidly than earlier.

Nevertheless, the still ample availability of production resources in most industries and continuing competition from abroad were viewed as likely to limit price increases, assuming the absence of a substantial further drop in the dollar. It also was noted that recent labor contract settlements were generally favorable in terms of their impact on business costs.

At its meeting in February the Committee had agreed on policy objectives that called for monetary growth ranges for the period from the fourth quarter of 1986 to the fourth quarter of 1987 of 5-1/2 to 8-1/2 percent for both M2 and M3. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent. The Committee anticipated that growth in M1 would slow in 1987 from its very rapid pace in 1986 but the members decided not to establish a numerical target for the year; instead, the appropriateness of M1 changes would be evaluated during the year in the light of the behavior of M1 velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In their discussion at this meeting, Committee members agreed that domestic business and financial conditions and growth of the monetary aggregates did not call for any change in the current degree of pressure on reserve positions, at least at the start of the intermeeting period. With regard to the weeks ahead, a number of members noted that, while other developments in the economy and financial markets would need to be taken into account, continuing weakness in the dollar would suggest the possibility that some limited adjustment in policy implementation in a firming direction would be appropriate.

In the course of the Committee's discussion, a good deal of attention was devoted to the implications for policy of the currently strong downward pressure on the dollar in foreign exchange markets. Members agreed that the conduct of open market operations needed to be especially sensitive to any tendency for the dollar to weaken significantly further. Some commented that, within the framework of basically unchanged conditions of reserve availability, open market operations should be conducted with special caution to minimize unintended market impacts at times when the dollar was under particular downward pressure. Several also indicated that if pressures increased enough so that intervention in the foreign exchange markets was not effective in stabilizing the dollar, policy implementation might need to be adjusted to reduce reserve availability somewhat during the intermeeting period. In appraising the need for some firming, the Committee would be mindful of the adverse effects that a further slide in the dollar could have on domestic interest rates, on inflation expectations, and on the economy more generally over the longer run. The members also recognized that the problem was multilateral in nature and that the effectiveness of any policy steps in the United States would be greatly enhanced by complementary actions abroad.

There was some divergence of views regarding the circumstances under which any tendency for the dollar to fall appreciably further should be resisted through a reduced availability of reserves. Some members emphasized the desirability of relatively prompt, if limited, action to enhance the prospects for more stable exchange rates and also to reduce the need for stronger measures in the future. If successful, that approach would minimize the rise in domestic inflation and interest rates over time and perhaps facilitate a reversal of interest rates. One member noted that the success of such an approach in stabilizing the dollar might be realized more promptly and certainly if the markets were alerted to any firming action the Federal Reserve might undertake. Some other members preferred to move with relative caution, if at all, in countering any further weakening in the dollar. These members acknowledged that failure to arrest a considerable further decline in the dollar might result in substantial upward pressures on longer-term domestic interest rates, especially given current market anxieties. At the same time, they stressed the uncertainties surrounding the relationship between U.S. interest rates and the behavior of the dollar and also the negative impact that a firmer policy could have on a possibly fragile economic expansion, not only in the United States but around the world.

With regard to the monetary aggregates, the members generally viewed the recent slowdown in monetary growth as a welcome development in light of the previously rapid expansion over an extended period. In their assessment of the outlook for the months immediately ahead, the members took account of an analysis which suggested some acceleration in the growth of M2 and M3 to rates approximating the expansion in nominal income, if interest rates remained around current levels. Most of the members felt that more restrained monetary growth would be acceptable, especially if it occurred against the background of further downward pressures on the dollar. While continued slow money growth that held the broad aggregates below the lower ends of their long-run ranges could be a basis for concern, some shortfall in the growth of M2 and M3 would not seem to call for a more generous provision of reserves in the period immediately ahead, given the earlier monetary expansion, continuing moderate growth of the economy, and weakness of the dollar in foreign exchange markets. On the other hand, the members would not welcome a resumption of relatively rapid growth under current conditions. Some members suggested that the Committee specify rates of acceptable growth of around 6 percent for M2 and M3 from March to June. Other members, reflecting the Committee's discussion that some shortfall in monetary growth would be of less concern than an overshoot under current circumstances, suggested various ranges of growth for the broader aggregates, with the ranges extending further below than above 6 percent. All the members were able to accept a specification of 6 percent or less on the understanding that the Committee would need to reconsider its stance should monetary growth be extremely weak, especially in the context of a more sluggish economy than was currently anticipated.

At the conclusion of the Committee's discussion, all of the members indicated that they favored or could accept a directive that called for no change in the degree of pressure on reserve positions in the immediate future. There was a consensus in favor of allowing for possible limited adjustments during the intermeeting period toward some firming of reserve conditions, with excessive weakness in the dollar recognized as the potential development most likely to make such an adjustment appropriate. In particular, the members agreed that somewhat greater reserve restraint might be acceptable depending on the performance of the dollar in foreign exchange markets, but also taking into account the behavior of the monetary aggregates, the strength of the business expansion, progress against inflation, and conditions in credit markets.

This approach to policy implementation was expected to be consistent with growth in M2 and M3 at annual rates of around 6 percent or less over the three month period from March to June. Over the same period growth in M1 was expected to remain substantially below its pace in 1986. Because the behavior of M1 remained subject to unusual uncertainty, the Committee decided to continue its practice of not specifying a numerical expectation for its growth. The members agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be left unchanged at 4 to 8 percent.

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

> The information reviewed at this meeting suggests on balance that economic activity has been expanding at a faster pace than in the fourth quarter, with output apparently strengthened by a rebuilding of business inventories and some improvement in foreign trade. Total nonfarm payroll employment rose strongly again in February. The civilian unemployment rate remained at 6.7 percent for the third consecutive month. Industrial production also increased appreciably further in February. Total retail sales have continued to fluctuate substantially from month to month, largely reflecting the uneven pattern of automobile sales, but on balance overall consumer spending has been relatively flat over the past several months. Housing starts strengthened further in February after rising in December and January to their highest level since late spring. Business capital spending appears to have weakened in early 1987. Consumer and producer prices rose more rapidly in early 1987, primarily reflecting sizable increases in energy prices. Labor cost increases have remained relatively moderate in recent months.

Growth of M2 and M3 has slowed substantially from the pace in December and January, and for 1987 to date expansion of these two aggregates appears to have been around the lower ends of their respective ranges established by the Committee for the year. Growth of M1, after moderating in January from an exceptionally rapid pace in late 1986, also has slowed markedly further. Expansion in total domestic nonfinancial debt appears to have moderated appreciably since year-end. Interest rates generally have fluctuated in a relatively narrow range since the February 10-11 meeting of the Committee, although they have firmed somewhat recently. At a meeting in the latter part of February, the Finance Ministers and Central Bank Governors of major industrial countries agreed to cooperate closely to foster stability of exchange rates around then-current levels. However, after mid-March, the trade-weighted value of the dollar against the other G-10 currencies declined further on balance, including a sizable decline against the yen.

The Federal Open Market Committee seeks monetary and financial conditions that will foster reasonable price stability over time, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee at its February meeting established growth ranges of 5-1/2 to 8-1/2 percent for both M2 and M3, measured from the fourth quarter of 1986 to the fourth quarter of 1987. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for 1987.

With respect to M1, the Committee recognized that, based on experience, the behavior of that aggregate must be judged in the light of other evidence relating to economic activity and prices; fluctuations in M1 have become much more sensitive in recent years to changes in interest rates, among other factors. During 1987, the Committee anticipates that growth in M1 should slow. However, in the light of its sensitivity to a variety of influences, the Committee decided at the February meeting not to establish a precise target for its growth over the year as a whole. Instead, the appropriateness of changes in M1 during the course of the year will be evaluated in the light of the behavior of its velocity, developments in the economy and financial markets, and the nature of emerging price pressures.

In that connection, the Committee believes that, particularly in the light of the extraordinary expansion of this aggregate in recent years, much slower monetary growth would be appropriate in the context of continuing economic expansion accompanied by signs of intensifying price pressures, perhaps related to significant weakness of the dollar in exchange markets, and relatively strong growth in the broad monetary aggregates. Conversely, continuing sizable increases in M1 could be accommodated in circumstances characterized by sluggish business activity, maintenance of progress toward underlying price stability, and progress toward international equilibrium. As this implies, the Committee in reaching operational decisions during the year, might target appropriate growth in M1 from time to time in the light of circumstances then prevailing, including the rate of growth of the broader aggregates.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. Somewhat greater reserve restraint might be acceptable depending on developments in foreign exchange markets, taking into account the behavior of the aggregates, the strength of the business expansion, progress against inflation, and conditions in credit markets. This approach is expected to be consistent with growth in M2 and M3 over the period from March through June at annual rates of around 6 percent or less. Growth in M1 is expected to remain substantially below its pace in 1986. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 4 to 8 percent.

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

2. Authorization for Domestic Open Market Operations

Effective April 22, 1987, the Committee approved a temporary increase of $3 billion, to $9 billion, in the limit between Committee meetings on changes in System Account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the Authorization for Domestic Open Market Operations. Subsequently, effective May 6, 1987, the Committee approved a further increase of $2 billion, to $11 billion, in the intermeeting limit. These increases were effective for the remainder of the intermeeting period ending with the close of business on May 19, 1987.

> Votes for the April 22 action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Ms. Seger, and Mr. Stern. Votes against this action: None.

> Votes for the May 6 action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, and Ms. Seger. Votes against this action: None. Absent and not voting: Mr. Stern.

The increases were approved on the recommendation of the Manager for Domestic Operations. The Manager had advised on April 22 that outright purchases of securities in the intermeeting interval through April 21 had reduced the leeway under the usual $6 billion limit to about $1-1/4 billion. On May 6, the Manager advised that the leeway had been reduced under the April 22 ceiling to a little over $100 million. Additional purchases of securities in excess of these leeways were necessary chiefly because of unusually steep increases in Treasury balances at the Federal Reserve Banks.