FEDERAL RESERVE press release

For Use at 4:30 p.m. August 22, 1986

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 8-9, 1986.

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 8-9, 1986

Domestic policy directive

The information reviewed at this meeting indicates that economic activity has expanded at a relatively slow pace recently. Consumer spending and housing activity have been strong, reflecting large gains in real income and lower interest rates. However, business investment has remained sluggish, and the trade balance has continued to deteriorate. At the same time, wage and price increases have been moderate.

Total nonfarm payroll employment grew slowly again in June, rising about 80,000 after adjusting for strike activity. Employment continued falling in manufacturing, particularly in the metals and machinery industries, and more jobs were lost in oil and gas extraction. Hiring in construction, which had surged in April, levelled off in May and fell in June. Service industries continued to post large gains in employment in June; however, hiring at retail establishments was markedly slower than earlier in the year. The civilian unemployment rate declined to 7.1 percent from 7.3 percent in May.

The index of industrial production fell 0.6 percent in May and has declined 1-3/4 percent since December, erasing the gains that occurred at the end of 1985. The decrease in output in May was related in part to a further contraction in oil and gas drilling and to a decline in auto assemblies. Output elsewhere generally was lower with notable weakness in the production of business equipment and selected materials for durable goods. Available indicators of industrial activity in June are mixed; auto assemblies are expected to have increased, but the output of steel decreased and strike activity hampered production in the lumber, aluminum, and communication equipment industries. Capacity utilization in manufacturing was 78.6 percent in May, off 0.6 percentage point from April and more than 2 percentage points from January.

Total retail sales were about unchanged in May; however, sales at the retail control group of stores, which excludes outlets for autos, gasoline, and building materials, rose somewhat and were stronger in the previous two months than originally reported. Total car sales in May were at an annual rate of 11-1/4 million units, up from the 10-3/4 million unit pace registered in the first quarter. Sales of domestic automobiles have held at around a rate of 8-1/4 million units since the expansion of incentive financing programs in late April, up from the 7-3/4 million unit pace earlier in the year.

Housing activity generally has been brisk. Starts fell a little in May but still were at a 1.9 million unit annual rate. Single-family starts held steady at a level that was fractionally above the first-quarter average, while the pace of house sales, although down in May, has remained relatively robust. At the same time, home prices have risen sharply. Multifamily starts fell sharply in May, owing in part to the depletion of tax-exempt funds raised by huge issues of mortgage revenue bonds in late 1985 and to overbuilding in a number of major markets.

Business investment probably declined again in the second quarter, reflecting weakness in the energy sector, the availability of unutilized capacity, and concerns about tax reform. Shipments of nondefense capital goods have been sluggish in recent months. In the construction area, drilling activity has fallen sharply further, and spending for office and other commercial projects also has weakened. Moreover, advance indicators of investment spending have been weak. New commitments for nonresidential building have fallen since late last year, and new orders for nondefense capital goods were flat in May after two months of declines. In addition, according to the latest surveys, businesses are planning little, if any, increase in nominal spending for 1986 as a whole.

The producer and consumer price indexes turned up in May, as the steep decline in energy prices ended. Producer prices rose 0.6 percent, after declining in the previous four months. Consumer prices were up 0.2 percent; retail gasoline prices rose 2-1/2 percent, after falling around 25 percent from January to April. Excluding food and energy, the CPI has risen at an annual rate of about 3-1/2 percent so far this year, somewhat less than in 1985. Prices of goods have been essentially flat, while some types of services have registered large increases.

The trade-weighted value of the dollar against major foreign currencies has declined almost 2-1/2 percent on balance since the FOMC meeting on May 20; the largest decline was registered against the yen. In the first two weeks of the intermeeting period, the dollar appreciated somewhat in response to data indicating a possible strengthening of U.S. economic activity. This rise was subsequently reversed when additional information on the economic performance in the United States disappointed market expectations. The differential between U.S. interest rates and a weighted average of foreign short-term interest rates changed little on balance over the period. Preliminary data for the U.S. merchandise trade deficit showed a somewhat larger deficit in April than the average for the first quarter, because a decline in the value of oil imports was more than offset by an increase in imports of other goods; exports in April-May combined seem to have been no higher than the first-quarter rate.

At its meeting on May 20, 1986, the Committee had adopted a directive that called for maintaining the existing degree of pressure on reserve positions. The members expected such an approach to policy to be consistent with a deceleration in money growth over the balance of the quarter. However, because such growth had been rapid in April and early May, the Committee anticipated faster growth for the quarter as a whole, particularly for M1, than was expected at the time of the April meeting. M2 and M3 were expected to expand over the period from March to June at annual rates of 8 to 10 percent. Over the same period, M1 was anticipated to grow at an annual rate of 12 to 14 percent, although the members acknowledged that the behavior of M1 continues to be subject to unusual uncertainty. The Committee agreed that if money growth did not slow as anticipated, somewhat greater reserve restraint would be acceptable in the context of a pickup in the economic expansion, while also taking account of conditions in domestic and international financial markets and the behavior of the dollar on foreign exchange markets. On the other hand, they agreed that somewhat lesser restraint might be acceptable if the expansion weakened noticeably in conjunction with a marked slowing in monetary growth. The intermeeting range for the federal funds rate was reduced to 5 to 9 percent.

In the circumstances, M1 continued to expand rapidly over the past two months, with growth surging to an annual rate of around 23 percent in May before decelerating to a rate of about a 15 percent in June. Consequently, growth in M1 from March to June, at an annual rate of almost 18 percent, substantially exceeded the Committee's short-run expectations and so far this year has been well above the Committee's 3 to 8 percent range for 1986. Growth in M2 slowed in both May and June but was still somewhat above earlier expectations for the quarter and brought this aggregate up to around the midpoint of its range for the year. M3 continued to increase at rates around the middle of its long-run range in May and June.

However, in the light of the clear indications that business activity, rather than picking up momentum, was growing at a slower pace, open market operations during the intermeeting period continued to be directed at maintaining the prevailing degree of pressure on reserve positions. In the three complete maintenance periods since the May meeting, adjustment plus seasonal borrowing at the discount window averaged $285 million. Excess reserves averaged around $830 million in the first two maintenance periods after the meeting, but then rose to $1.3 billion in the most recent period, which included the quarter-end statement date.

Federal funds generally traded in a narrow range around 6-7/8 percent over the intermeeting period, aside from some firming around the quarter end. Other interest rates rose early in the period but then retreated amid signs of weakness in the economies of the United States and some of its major trading partners, renewing expectations of a discount rate cut in the near future. Since the May meeting short-term market rates had declined 10 to 40 basis points on balance. In long-term markets, yields on Treasury securities were down about 35 to 45 basis points, while rates on corporate and municipal bonds were about unchanged and those on fixed-rate mortgages were up around 1/2 of a percentage point. The widening spread between rates on long-term private securities and Treasury issues appeared to reflect strong foreign demand for recently issued long-term Treasuries, large supplies of private securities, and increased focus on the value of the greater call protection for Treasury issues.

The staff projections presented at this meeting continued to suggest that growth in real GNP, though relatively slow in the second quarter, was likely to strengthen somewhat in the second half of the year. However, growth over the next two quarters probably would be at a slower pace than had been expected earlier in part because news on business investment and foreign trade was disappointing. Growth was projected to continue at a moderate pace in 1987. The civilian unemployment rate was forecast to decline somewhat over the projection horizon. Inflation was expected to pick up a bit over the next six quarters, as the favorable effects of declining energy prices diminished while upward pressure on prices from the effects of the dollar's depreciation tended to intensify.

In their discussion of the economic situation and outlook, Committee members generally agreed that some strengthening in the economic expansion was a reasonable expectation for the second half of the year and that, on the whole, the prospects were favorable for continuing growth at a moderate pace in 1987. At the same time, members emphasized the uncertainties that surrounded the economic outlook and a number commented that the improvement in economic activity might well be more delayed or less pronounced than they had anticipated earlier. In this connection, some members expressed concern about the lack of firm evidence to date of a prospective pickup in the rate of economic growth and, in particular, the absence thus far of any apparent improvement in the balance of trade which many members saw as the key to stronger economic expansion. The members continued to view the outlook for inflation as relatively favorable, although they anticipated that, in the context of a growing economy, the lagged impact of the dollar's depreciation was likely to boost prices somewhat.

In keeping with the usual practice at meetings when the Committee considers its long-run objectives for monetary growth, the members of the Committee and the Federal Reserve Bank presidents not currently serving as members prepared specific projections of economic growth, the rate of unemployment, and changes in the overall price level. With regard to the rate of expansion in real GNP, the projections had a central tendency of 2-1/2 to 3 percent for 1986 as a whole and 3 to 3-1/2 percent for 1987. Forecasts of growth in nominal GNP centered on ranges of 4-3/4 to 5-3/4 percent for 1986 and 6 to 7-1/2 percent for 1987. The central tendency for the rate of unemployment was an average of 7 percent in the fourth quarter of 1986 and around 6-3/4 percent in the fourth quarter of 1987. With respect to the rate of inflation, as indexed by the GNP deflator, the projections centered on rates of 2-1/4 to 2-3/4 percent for 1986 and 3 to 4 percent for 1987. In making these forecasts, the members took account of the Committee's objectives for monetary growth that were established at this meeting. The projections were based on the assumption that fluctuations over the projection period in the foreign exchange value of the dollar would not be of sufficient magnitude to have a significant effect on economic activity or prices during the period. The members also assumed that the Congress would seek to achieve the deficit reductions contemplated by the Gramm-Rudman-Hollings legislation. In the members' views, significant progress in reducing the federal deficit was essential in order to maintain financial conditions that were conducive to sustained economic expansion and an improved pattern of international transactions.

In their assessment of the factors pointing to somewhat faster economic growth over the balance of the year and in 1987, members referred as they had at earlier meetings to a number of favorable underlying developments including reduced interest rates, higher stock market prices, lower energy costs, and the positive impact of the dollar's depreciation on the competitive position of U.S. businesses. Members also made reference to the stimulative impact of a broadly accommodative monetary policy, as evidenced by rapid growth in money and credit and several decreases in the discount rate. One member suggested that stimulative financial conditions probably helped to account for the relative longevity of the current business expansion in the face of a variety of unfavorable factors. The latter included the negative impact that the decline in oil prices and the uncertainties associated with pending tax reform legislation were currently exerting on investment activity; some members commented that both of these factors were likely to have a less inhibiting impact on the economy over the course of the next several quarters. On the other hand, the overbuilding of various commercial facilities, notably of office structures, in several parts of the country and severe problems in agriculture were deemed likely to have retarding influences on economic activity that could persist.

Such developments were reflected in sharp contrasts in the economic performance of different sectors and regions of the country and in strains on financial institutions that serviced the depressed industries. Moreover, members expressed concern about the continuing rapid growth in total debt and its negative implications for sustained business expansion.

The members gave particular emphasis during the discussion to the key role of foreign trade developments which were seen as a major source of uncertainty in shaping the economic outlook. The substantial depreciation of the dollar against the currencies of several large industrial countries had strengthened the international competitiveness of U.S. businesses, notably in the industrial sector, and pointed to eventual improvement in the U.S. trade balance. Unfortunately, evidence of such improvement had proved elusive to date and several members commented that significant progress in reducing the nation's trade deficit was unlikely in the absence of faster economic growth in key industrial nations abroad. Indications of such growth were mixed, with several countries having experienced relative weakness earlier in the year. The absence of more robust growth abroad--and an improvement in the U.S. trade balance--would constitute a major risk to the realization of stronger domestic economic expansion.

At this meeting the Committee reviewed its ranges for growth of the monetary and debt aggregates in 1986 and established tentative ranges for 1987 within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act).[1/] At its meeting on February 11-12, 1986 the Committee had adopted monetary growth ranges of 3 to 8 percent for

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1/ The midyear Monetary Policy Report prepared pursuant to this legislation was transmitted to Congress on July 18, 1986.

M1 and 6 to 9 percent for both M2 and M3 for the period from the fourth quarter of 1985 to the fourth quarter of 1986. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent. With respect to M1 the Committee had recognized that, based on the experience of recent years, the behavior of that aggregate was subject to substantial uncertainties in relation to economic activity and prices. The Committee had indicated its intention to evaluate M1 behavior in the light of its consistency with the other monetary aggregates, developments in the economy and financial markets, and potential inflationary pressures.

In the Committee's discussion of its long-run ranges at this meeting, all of the members supported a proposal to retain the range of 6 to 9 percent for growth in M2 and in M3 for the year 1986. Both aggregates had expanded at rates that left them close to the midpoint of their ranges at midyear. Growth within these ranges for the year as a whole was still deemed to be consistent with the Committee's overall policy objectives. A majority of the members preferred a slightly lower range for 1987. In their view, a modest reduction would be consistent with the Committee's long-term objective of achieving a rate of monetary growth compatible with price stability. They also believed that the lower range was likely to prove fully consistent with somewhat faster economic growth in 1987 and, in that context, with some decline in velocity should that develop. Some members suggested maintaining the 6 to 9 percent range for 1987 because it would provide a little extra leeway that might prove useful in support of continuing growth in nominal GNP, given the possibility of some further decline in the velocity of the broader aggregates. However, the slightly lower range favored by the majority was considered acceptable by most members.

In the discussion of appropriate ranges for M1 growth in 1986 and 1987, the members gave considerable emphasis to the exceptional uncertainties that continued to affect M1 velocity. Over the course of recent years, the relationship of M1 to income appeared to have been significantly altered by changes in the composition of the aggregate, resulting in part from the deregulation of interest rate ceilings and the relatively rapid growth of its interest-bearing components. In the process, the demand for M1 balances has become much more sensitive to movements in interest rates. Given the evolving nature of that demand, it had become very difficult to assess or predict the implications of M1 growth for the future course of economic activity and the rate of inflation. As a consequence, a number of members questioned the usefulness of M1 as a guide for the conduct of monetary policy under present circumstances. A few proposed dropping the M1 range, at least pending the reestablishment of a more predictable relationship with overall measures of economic performance. A majority, however, preferred to retain an M1 range even though they believed its operational significance could only be judged in the perspective of concurrent economic and financial developments, including the behavior of M2 and M3. It was noted in this discussion that even under current circumstances M1 continued to have some information value for policy and that retention of some range for M1, even if used only as a benchmark for measuring deviations, might well assist judgments about monetary policy. Moreover, the importance of M1 could again become greater in the future.

After reviewing the available evidence, the members concluded that much of the rapid growth of M1 in recent months probably reflected shifts in holdings of liquid assets in response to declining interest rates and subsiding inflationary expectations rather than excessive money creation with potentially inflationary consequences. Tending to reinforce that judgment was the moderate growth in overall economic activity, the behavior of broad measures of inflation, and the expansion of M2 and M3 at rates well within their ranges for the year. As events unfolded, relatively rapid growth in M1 had been needed to accommodate continuing economic expansion. Given developments for the year to date, growth in excess of the 3 to 8 percent range established in February appeared likely for 1986 as a whole, but most of the members did not want to raise or to rebase the existing range; such an adjustment might imply greater certainty about future performance than in fact existed. Since they believed that the significance of changes in M1 could only be evaluated in the context of the behavior of the broader aggregates and against the background of economic and financial developments, including trends in interest rates, they agreed that after taking account of those factors M1 growth above the existing range would be acceptable for the year.

With regard to 1987, some members argued that the uncertainties precluded setting a meaningful range for M1 so far in advance, but a majority preferred to retain this year's range of 3 to 8 percent. The members noted that this range should be considered even more tentative than usual. Such a range assumed that the velocity of M1 would not change as much as in the recent period under conditions of greater economic, price, and interest rate stability. In any event the members agreed that developments over the balance of this year would provide a better basis for judging the prospects for M1 behavior in 1987 and that careful appraisal of the range -- including the weight that M1 should receive as a guide to policy -- would be required at the start of next year.

Turning to the Committee's monitoring range for total domestic nonfinancial debt, most of the members indicated that they were in favor of retaining the 8 to 11 percent range adopted in February for 1986 even though growth in excess of that range now appeared likely for the year. Members expressed concern about the persistence of rapid growth of total debt in the context of already large debt burdens. As in the past, they felt that raising the Committee's range for debt would create an inappropriate benchmark for evaluating long-term trends in debt expansion. One member proposed dropping the range for total debt and substituting a measure for total liquid assets which, at least in the past year or two, had had a closer relationship to developments in nominal GNP. Other members preferred to continue to monitor debt trends explicitly in light of their concerns about the implications of overall debt levels. For 1987, the members generally felt that a range of 8 to 11 percent for total debt growth would remain appropriate, though that range would need to be reviewed early next year.

At the conclusion of the Committee's review, all of the members indicated that they favored, or could accept, a proposal to reaffirm the ranges for monetary and debt growth that had been established in February for the year 1986. The behavior of all of the monetary aggregates would continue to be judged against the background of developments in the economy and financial markets and potential price pressures. Growth of M1 in excess of its range would be acceptable and would be evaluated in the light of the behavior of the broader aggregates. The Committee recognized that expansion in total debt also might exceed its range for the year.

The following paragraph relating to the long-run ranges for 1986 was approved for the domestic policy directive:

> The Committee agreed at this 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 nonfinancial 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.
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> Votes for this action: Messrs. Volcker, Corrigan, Angell, Guffey, Mrs. Horn, Messrs. Johnson, Melzer, Morris, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: None. Absent and not voting: None.

With respect to the tentative ranges for 1987, most of the Committee members supported a reduction of 1/2 percentage point in the ranges for M2 and M3. For M1 and total debt the members agreed that with the reservations noted above, the 1986 ranges should be retained for 1987; those ranges implied considerable reductions from the rates of growth that now seemed likely for 1986. It was understood that all the ranges were provisional and that, notably in the case of M1, they would be reviewed in early 1987 in the light of intervening developments.

The following paragraph relating to the ranges for 1987 was approved for inclusion in the domestic policy directive:

> 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.

> Votes this action: Messrs. Volcker, Corrigan, Angell, Guffey, Mrs. Horn, Messrs. Johnson, Melzer, Morris, Rice, and Wallich.
> Vote against this action: Ms. Seger.
> Absent and not voting: None.

Ms. Seger dissented because she preferred to retain--at least for now--this year's range of 6 to 9 percent for growth in both M2 and M3 in 1987. In her view, the higher range might be needed to accommodate an acceptable rate of economic expansion, especially in light of the possibility that the velocity of these aggregates might remain weak next year. At the same time she did not want to rule out the possibility that interim developments might justify reductions in the M2 and M3 ranges when the latter were reconsidered early next year. She also preferred not to specify a tentative range for M1 at this time because of the substantial uncertainties currently surrounding the relationship between M1 growth and broad measures of economic activity.

In their discussion of policy implementation for the weeks immediately ahead, Committee members took account of the likelihood that the discount rate would be reduced within a few days after the meeting. Against the background of sluggish expansion in economic activity and a subdued rate of inflation, most of the members believed that some easing was desirable and they indicated a preference for implementing the easing, at least initially, through a lower discount rate rather than through open market operations. Some members commented that further easing could have a favorable impact on interest-sensitive sectors of the economy, particularly in light of what could be viewed as still relatively high real interest rates. It was also suggested that a reduction in the discount rate might encourage over time similar actions by a number of major countries abroad, although such actions were not expected over the near term, at least in the case of some of the key industrial nations.

While nearly all the members indicated their acceptance of the policy approach in question, a few referred to the risks of easing under present circumstances, particularly the risk under current conditions of sharp further depreciation of the dollar in foreign exchange markets. Concern also was expressed about the absence of clearer indications of a reduction in federal budgetary deficits. In one view, a cut in the discount rate might need to be accompanied by some increase in the degree of pressure on reserve positions, pending evaluation of further economic and financial developments.

With respect to the outlook for monetary growth, the members expected that M2 and M3 might continue to expand at rates around their 1986 ranges over coming months, even assuming some pickup in the rate of business activity and some easing in overall conditions of reserve availability. In their evaluation of the outlook for growth in M1, the members took account of an analysis which indicated that appreciably slower growth might be expected over the months ahead even if interest rates were to fall somewhat further. However, the members recognized that the timing and extent of any slowing in M1 growth continued to be subject to unusual uncertainty. In the circumstances and taking account of their willingness to accept M1 growth in excess of the 3 to 8 percent range, especially if growth of the broader aggregates remained within their ranges, a majority of the members expressed a preference for not indicating a specific rate of expected growth for M1 in the short-run operational paragraph of the Committee's directive.

In the Committee's discussion of possible intermeeting adjustments in policy implementation, the members generally agreed that there should be no presumptions about the likely direction of any such adjustments, given the current uncertainties about prospective economic and financial developments and the behavior of the monetary aggregates. A majority of the members also indicated a preference for reducing the existing intermeeting range for the federal funds rate by 1 percentage point to 4 to 8 percent. The reduction was viewed as a technical adjustment that would provide a more symmetrical range around a lower federal funds rate that could be expected to emerge following the anticipated reduction in the discount rate. The Committee regards the federal funds range as a mechanism for initiating Committee consultation when its boundaries are persistently exceeded.

At the conclusion of the Committee's discussion, all but one member indicated their acceptance of an operational paragraph for the directive that called for some decrease in the existing degree of reserve pressure, recognizing that that relaxation could be accomplished in the first instance by a reduction in the discount rate. The members expected such an approach to policy implementation to be consistent with growth in M2 and M3 at annual rates of about 7 to 9 percent over the three-month period from June to September. Over the same period growth in M1 was expected to moderate from the exceptionally large increase during the second quarter. The specific rate of M1 growth remained subject to unusual uncertainty and the Committee agreed that this aggregate should continue to be judged in the light of the behavior of the broader aggregates and other factors. The Committee indicated that it might find somewhat greater or somewhat lesser reserve restraint acceptable over the intermeeting period depending on the growth of the monetary aggregates, the strength of the business expansion, the performance of the dollar on foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets.

At the conclusion of the meeting, the following domestic policy directive, embodying the Committee's long-run ranges and its short-run operating instructions, was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting indicates a mixed pattern of developments but suggests on balance that economic activity expanded slowly in the second quarter. In June total nonfarm payroll employment grew little after accounting for striking workers, with continued weakness in the industrial sector reflected in further declines in employment in manufacturing and mining. The civilian unemployment rate moved down to 7.1 percent from 7.3 percent in May. Industrial production declined in May. Total retail sales were about unchanged during the month, although consumer spending rose considerably for the second quarter as a whole. Housing starts fell somewhat in May from a relatively high level. Weakness in the energy sector has contributed to a slowing of business capital spending. Preliminary data for the U.S. merchandise trade balance in April show a somewhat larger deficit than the rate recorded in the first quarter. Both consumer and producer prices turned up in May but have fallen on balance since late 1985, largely reflecting declines in energy prices.

M1 growth in June, though less than in May, was still rapid; through June, M1 grew at a rate well above the Committee's range for 1986. Growth of M2 slowed somewhat and expansion of M3 remained relatively moderate in June, keeping these two aggregates close to the middle of their respective ranges for the year. Expansion in total domestic nonfinancial debt remains appreciably above the monitoring range for 1986. Most short-term interest rates have declined on balance since the May 20 meeting of the Committee. Rates on Treasury bonds also have moved lower while rates on private long-term obligations are about unchanged to somewhat higher. The trade-weighted value of the dollar against major foreign currencies has declined somewhat on balance since the May meeting.

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 this 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 nonfinancial 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.

In the implementation of policy for the immediate future, the Committee seeks to decrease somewhat 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.

Votes for the short-run operational paragraph: Messrs. Volcker, Corrigan, Angell, Guffey, Mrs. Horn, Messrs. Johnson, Morris, Rice, Ms. Seger, and Mr. Wallich. Vote against this action: Mr. Melzer. Absent and not voting: None.

Mr. Melzer preferred to direct open market operations toward maintaining the existing degree of pressure on reserve conditions. He was concerned that easing under current circumstances could foster inflationary expectations, especially in light of the uncertain outlook for reductions in the federal deficit, and have adverse repercussions on the dollar in foreign exchange markets. In addition, he noted that the outlook for the balance of 1986 and 1987 appeared to be in line with the economy's long-run potential and, in any event, he believed that further accommodation would have little positive impact on real output in the short run and would be accompanied by greater price pressures in the long run.