FEDERAL RESERVE press release

For Use at 4:30 p.m. August 21, 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 July 7, 1987.

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 7, 1987

Domestic policy directive

The information reviewed at this meeting suggested that economic activity expanded at a moderate pace in the second quarter, as consumer expenditures grew at a relatively modest pace, business capital spending experienced some recovery, and the trade deficit apparently continued to narrow in volume terms. Producer and consumer prices slowed in May, after sizable increases earlier in the year that reflected, to a considerable extent, higher energy prices. Rising import prices also contributed to higher consumer prices. Wage increases have remained relatively limited in recent months.

Payroll employment rose modestly further in May and June, following substantial increases in the first four months of the year, with the gains again concentrated in the service-producing sector. Employment advances in the goods-producing sector were lackluster as manufacturing employment rose minimally. In June, the household survey indicated a small drop in employment, but the labor force fell noticeably. As a result, the unemployment rate fell 0.2 percentage point to 6.1 percent; most of the drop in employment was attributed to fewer young people than normal entering the labor force as of the early June survey week.

The index of industrial production rose 0.5 percent in May; and following upward revisions to the three preceding months, the index was 2-1/2 percent (annual rate) above the first-quarter average. The recent growth reflects in part the increased production of business equipment, especially high-technology capital goods, and of a wide variety of consumer goods. In the motor vehicles sector, however, auto assemblies have slowed in recent months due to relatively depressed sales and large dealer stocks.

Partly because of the lagging auto sales, consumer spending in real terms has been sluggish in recent months, though above its first-quarter pace. Outlays for services have continued to advance steadily, but total auto sales dropped back noticeably in May to the slow pace experienced in the first quarter. Excluding autos, outlays for durables have been flat on balance since the end of 1986, while spending on nondurable goods has edged down.

Housing activity has dropped back from its elevated pace early this year. Total starts fell to an annual rate of 1.62 million units in May. Single-family starts were down appreciably, apparently reflecting the upturn in mortgage interest rates after March. Multifamily starts increased somewhat from an extremely low level in April but remained below the first-quarter average.

Business fixed investment has rebounded after a tax-related decline at the beginning of the year. Shipments of nondefense capital goods were about flat in April and May but on average were above the first-quarter level. Outlays for nonresidential structures turned up in May, with the gains fairly widespread; and petroleum-drilling activity has continued to recover. In addition, new orders for nondefense capital goods, excluding aircraft, picked up in the spring and new commitments for nonresidential construction have moved up slightly.

Inventory investment apparently slowed in the second quarter from its rapid first-quarter pace. Production cutbacks trimmed auto inventories, but the level of dealer stocks still was relatively high. Outside of autos, inventory changes have been relatively small in recent months and inventory-sales ratios have remained low.

The U.S. merchandise trade deficit in nominal terms was about unchanged in the first quarter from its value in the final quarter of 1986. Preliminary data suggest that the deficit declined in April as exports rose and imports fell from their first-quarter rate. Economic activity has remained sluggish in most major foreign industrial nations so far this year. Real GNP and industrial production declined sharply in Germany in the first quarter, although industrial production picked up in April and May. Japan has shown the reverse pattern with declines in industrial production registered in both April and May.

Inflation rates slowed in May. The consumer price index (CPI) rose 0.3 percent, after more rapid increases earlier this year. Increases in retail energy prices, which had boosted prices during the first quarter, were smaller in April and May and accounted for much of the slower rise in consumer prices. However, the price of crude oil has advanced further since mid-April, which suggests upward pressure on retail energy prices in the period ahead. Excluding food and energy, the CPI has risen about 1 percentage point faster so far this year than in 1986 partly because of more rapid increases in consumer goods that have high import proportions. Wage inflation, in contrast, has remained relatively low for the year to date.

At its meeting on May 19, the Committee adopted a directive that called for increasing somewhat the degree of reserve pressure from that sought in the weeks just before the meeting, taking into account the possibility of a change in the discount rate. The members agreed that somewhat greater reserve restraint would, or somewhat lesser reserve restraint might, be acceptable depending on developments relating to inflation and the dollar in foreign exchange markets, as well as the behavior of the monetary aggregates and the strength of the business expansion. M2 and M3 were expected to grow at annual rates of around 6 percent or less from March through June, while growth in M1 was expected to be well below its pace in 1986. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

Adjustment plus seasonal borrowing at the discount window averaged $580 million for the three complete maintenance periods since the May meeting, close to its average level around the time of that meeting. Borrowing during the first full maintenance period after the May meeting was heavy, particularly over the long Memorial Day weekend when an imminent increase in the discount rate was expected by market participants. Total reserves decreased at an annual rate of about 2 percent between April and June, reflecting a falloff in required reserves associated with a net contraction in M1.

M2 grew only a little on balance in May and June, bringing its growth rate for the March to June period to 2-3/4 percent, and its M1 component declined over the two months. While some of the weakness in May reflected the unwinding of the previous tax-related buildup, more generally these aggregates appear to have been substantially affected by the increase in market interest rates among other factors this year. Expansion in M3 was better maintained as banks and thrift institutions continued to fund a moderate pace of credit extension, and for the March to June period this aggregate increased at an annual rate of 5-1/2 percent. The growth of M2 in 1987 through June left this aggregate below the lower end of the growth "cone" representing the Committee's 5-1/2 to 8-1/2 percent range for the year, and growth of M3 around the lower end of its 5-1/2 to 8-1/2 percent growth cone.

Early in the intermeeting period interest rates remained near the higher levels reached in the weeks before the May meeting, as markets continued to reflect concerns about the course of inflation and the dollar. However, rates subsequently declined in response to a sharp drop in some commodity prices, a firmer dollar, and an abatement of inflation fears. The federal funds rate continued to average around 6-3/4 percent during the intermeeting period, but other short-term interest rates were down 10 to 55 basis points on balance. Longer-term Treasury yields were about 60 basis points lower and corporate bond rates declined about half that much. The commitment rate for fixed-rate mortgages fell slightly since the May FOMC meeting, but still was well above the low established earlier in the year. Stock price indexes increased strongly over most of the period to record levels.

The dollar strengthened somewhat during the intermeeting period, boosted in part by the announcement of an economic stimulus package in Japan as well as better than expected economic and price news for the United States. On balance, the weighted-average foreign exchange value of the dollar against other G-10 currencies moved up by about 3-3/4 percent since the May meeting, including increases of nearly 7-3/4 percent against the yen and 3-3/4 percent against the mark. Over the same period, bond rates rose substantially in Germany and Japan and with U.S. long-term rates declining somewhat, the rate differentials narrowed.

The staff projections suggested that real GNP would grow at a moderate rate through the end of 1987 and perhaps slow slightly from this pace in 1988. Improvement in the external sector was expected to be a major factor contributing to growth in overall output. Growth in domestic demand was anticipated to be sluggish over the forecast horizon. In particular, the rise in import prices associated with the fall in the dollar was expected to hold down real income gains and thus consumer expenditures. Construction spending was anticipated to be damped by high vacancy rates for office structures and rental housing and recent increases in mortgage rates, while the expansion of government expenditures would likely be held down by budgetary limitations. Business equipment spending, however, should rise moderately in coming quarters, reflecting continued modernization efforts and expanding domestic production. Inflation rates were forecast to edge down over the second half of this year but then to move up again in 1988, primarily due to increases in non-petroleum import prices. Moreover, with the civilian unemployment rate projected to remain close to 6-1/4 percent, labor market slack would have a reduced influence in damping inflationary pressures.

In the Committee's discussion of the economic situation and outlook, the members generally agreed that business activity was likely to expand at a moderate pace over the balance of the year. Greater uncertainty surrounded the outlook for 1988, but most of the members felt that further moderate growth also was a reasonable expectation for next year. In general, the members anticipated relatively sluggish expansion in domestic demands over the projection horizon, and as at earlier meetings they believed that sustained growth in overall activity would depend to an important extent on the achievement of significant improvement in the nation's balance of trade. Most of the members anticipated a marginally higher rate of price increase in 1988.

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 presented 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 1987 as a whole and the same central tendency for 1988, though with a slightly wider range of individual forecasts for next year. Projections of growth in nominal GNP centered on ranges of 6-1/4 to 7 percent for 1987 and 5-3/4 to 7 percent for 1988. The rate of unemployment was not expected to deviate significantly from current levels; the central tendency of the forecasts was 6.2 to 6.4 percent for the fourth quarter of 1987 and 6.0 to 6.5 percent for the fourth quarter of 1988. With respect to the rate of inflation, as indexed by the GNP deflator, the projections centered on rates of 3-3/4 percent for 1987 and 4 percent for 1988. In making these forecasts, the members took account of the Committee's objectives for monetary growth established at this meeting. The members also assumed that fluctuations in the exchange value of the dollar would not be of sufficient magnitude to affect the projections significantly.

While the central tendency of the members' forecasts suggested some moderation in the rate of expansion from the pace currently indicated for the first half of this year, business activity was thought likely to be better balanced in that a number of previously depressed industries, notably in manufacturing, would benefit from further growth in net exports. Some members commented that relatively moderate expansion in line with that forecast by most of the members would represent a satisfactory economic performance under foreseeable circumstances. In this view appreciably faster growth would incur a considerable risk of increased inflationary pressures and the resulting distortions would threaten the sustainability of the expansion itself. Relatively rapid growth in domestic demands, in particular, would be inconsistent with needed external adjustment.

In the Committee's discussion of various factors bearing on the business outlook, some members commented that the growth in consumer demands seemed likely to be reasonably well maintained, especially in the services area, based on current trends and on prior cyclical experience. Others gave more weight to recent indications of softness in overall consumer spending and, in the context of increased consumer debt burdens and a relatively low saving rate, they saw relatively weak growth as a more likely prospect for the next several quarters. The members generally expected further improvement in net exports as both importers and exporters continued to adjust to a lower value of the dollar, but the extent of such improvement remained subject to considerable uncertainty. The possibility of relatively limited economic expansion in key foreign industrial countries was again cited as a negative factor. With regard to the federal budget deficit, the members emphasized that further reductions were essential to assure satisfactory economic performance over time. The outlook for continuing progress in lowering the deficit was uncertain, but any reduction in the deficit would tend to relieve pressures on financial markets, particularly in the context of diminished inflows of funds from abroad as the balance of trade improved, and would enhance the ability of the domestic economy to fund needed private capital formation.

The members differed to some extent in their assessments of the outlook for inflation, although most expected higher import prices to contribute to slightly greater price pressures in the period through 1988. In one view, there was a considerable risk that rising import prices would have a sizable impact on domestic pricing decisions as well. That risk might be augmented by efforts to raise wages in line with increasing inflation, particularly with reduced levels of unemployment and possible pressures on capacity in some industries experiencing strong export demand. Other members commented, however, that most industries were still operating appreciably below capacity, including in many cases industries that had been depressed earlier by the effects of the dollar's appreciation; some members also noted that most commodities remained in ample supply on world markets. A key factor tending to limit inflationary pressures was the continuing moderation in overall wage increases, but the members recognized that a substantial upturn, if it were to occur, would deal a major setback to the effort to restore price stability. The members also observed that potential developments in world oil prices were a major uncertainty in the inflation outlook.

At this meeting the Committee reviewed its ranges for growth of monetary and debt aggregates in 1987 and established tentative ranges for

1988 within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act).[1/] At its meeting on February 10-11, 1987 the Committee had adopted growth ranges of 5-1/2 to 8-1/2 percent for both M2 and M3 for the period 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. The Committee had anticipated that growth in M1 would slow in 1987 from its very rapid pace in 1986, but the members had 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 potential inflationary pressures.

In the course of the Committee's review of the ranges for 1987, most of the members indicated a preference for not changing the existing ranges set in February, but some sentiment also was expressed in favor of a slightly lower range for M2. The members took account of the sharp deceleration in the growth of the broader aggregates thus far in 1987, especially in M2. However, with the advance in business activity evidencing reasonable momentum and velocity showing signs of increasing in the context of rising interest rates associated with a pickup in inflation and a weaker dollar, the members viewed such a development as acceptable.

According to a staff analysis prepared for this meeting, the relatively weak growth in the monetary aggregates in the first half of the year appeared to reflect a number of developments whose impact might be greatly diminished over coming quarters. To some extent, special factors

1/ The midyear Monetary Policy Report prepared pursuant to this legislation was transmitted to Congress on July 21, 1987.

related to the tax reform legislation may have helped to depress the growth in M2, while growth in M3 also was restrained by some unusual patterns in funding asset expansion at depository institutions. However, the available evidence suggested that a substantial portion of the slowing in monetary growth could be attributed to relatively slow adjustments in deposit interest rates to rising market rates. Opportunity costs of holding money balances had increased over the spring after an extended period of declines. By the time of the meeting, rates on many components of the broad aggregates had adjusted to the higher market rates and the impact of wider opportunity costs on overall M2 and M3 growth appeared to be abating. The analysis concluded that growth in M2 could be expected to pick up over the balance of the year to a rate closer to the expansion in nominal GNP, assuming steady reserve conditions and market interest rates near current levels, and for the year as a whole M2 might expand at a rate around the lower end of the Committee's existing range. Growth in M3 also might strengthen somewhat over the balance of the year, leaving this aggregate well within its range.

In further discussion a number of members took the view that the existing M2 range should not be "fined tuned" at this time despite the outlook for actual growth near the bottom of the range for 1987 as a whole. The members recognized that in light of the weakness during the first half of the year and the uncertainties that were involved, growth in this aggregate might in fact be somewhat below the lower end of the range for 1987. The latter development, if it occurred, would be acceptable provided it was associated with some strengthening in M2 velocity and satisfactory economic performance; in particular, a very limited pickup in M2 growth might be appropriate should the dollar tend to weaken or inflation concerns intensify. A number of members expressed concern that a reduction in the M2 range at this point might be misread as an indication of intended firming in monetary policy. On the other hand, several members observed that they would not endorse an easier policy posture solely for the purpose of assuring M2 growth within the Committee's existing range without regard for ongoing economic and financial developments, including the behavior of the dollar in foreign exchange markets.

The members anticipated that growth in the debt of nonfinancial sectors would remain well within its monitoring range for the year, reflecting a marked reduction from the expansion in other recent years. The reduced rate of expansion was in large measure the consequence of a lower federal deficit and some slowing in state and local government borrowing. However, with growth in private debt remaining relatively strong and that in federal debt still on the high side, expansion in total nonfinancial debt appeared likely to continue to exceed that in nominal GNP and average close to its pace of recent months over the balance of the year.

Turning to M1, the members considered whether or not a specific numerical range should be reestablished for its growth over the balance of this year or tentatively for 1988. The sharp slowing of M1 growth thus far in 1987 following a long period of rapid expansion, while appropriate in the circumstances of the first half of the year, provided further evidence that this aggregate had become highly sensitive to movements in interest rates and other factors. The members concluded that the prospective behavior of M1 remained subject to exceptional uncertainties, and no member favored establishing a specific target range at this time. However, the behavior of this aggregate, evaluated in the light of other economic and financial developments, would be taken into account in implementing policy over the second half of the year. The Committee also discussed M1A--a narrower measure of aggregate transactions accounts that includes demand deposits plus currency in circulation but excludes other checkable deposits from M1. The members noted that the characteristics of this aggregate probably also had changed in recent years as households shifted transactions deposits from demand to NOW accounts and more businesses adopted sophisticated techniques for managing their cash balances. The velocity of this aggregate had varied less than that of M1, but given the uncertainties in its relationship to the economy and prices, the members saw no advantage at this time in introducing M1A as a formal guide to policy.

At the conclusion of the Committee's review, all of the members indicated that they favored, or could accept, a proposal not to change the ranges for growth in the broader aggregates or the monitoring range for nonfinancial debt that had been established in February for the year 1987. Growth in both M2 and M3 around the lower ends of their ranges might be acceptable depending on developments relating to their velocities and attendant economic and financial conditions, notably the strength of inflationary pressures. No numerical range would be established for M1 growth in 1987, or tentatively for 1988, but M1 developments, weighed in the context of emerging economic and financial conditions, would be taken into account in reaching operational decisions over the balance of 1987, and the desirability of a numerical range for 1988 would be reassessed early next year in the light of circumstances at that time.

Thereupon, the Committee approved the following paragraphs relating to its objectives for the broader aggregates and nonfinancial debt in 1987 and the role of M1:

> The Committee agreed at this meeting to reaffirm the ranges established in February for growth 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 Committee agreed that growth in these aggregates around the lower ends of their ranges may be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity is expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the year was left unchanged at 8 to 11 percent.
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> 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. Because of this sensitivity, which has been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range has been set for 1988. The appropriateness of changes in M1 this year will continue to 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. The Committee welcomes substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee in reaching operational decisions over the balance of the year will take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully reappraised at the beginning of 1988.

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

With regard to the tentative ranges for 1988, all but one member of the Committee felt that some reduction in the broader aggregates from their 1987 ranges would be consistent with the Committee's longer-run objective of fostering progress toward price stability while also encouraging sustained expansion in business activity. A majority indicated a preference for reducing the M2 range by 1/2 percentage point. Of these, a number commented that, should economic and financial conditions warrant, they would be prepared to support a further reduction of 1/2 percentage point when the tentative ranges were reviewed in February 1988. Some sentiment was expressed for lowering the M2 range by a full percentage point at this time on the ground that such a reduction appeared fully consistent with satisfactory economic growth and with the reduced rate of inflation that was anticipated and desired over the longer run; in this view a smaller reduction might not appear sufficiently decisive with respect to restraining inflation. However, one member expressed concern that a reduction of more than 1/2 percentage point would establish a lower limit that might not be consistent with adequate economic growth, at least insofar as could be foreseen at this time. In light of the uncertainties that were involved some members also indicated that they could support a proposal to widen the tentative range for M2 in the expectation that it might be narrowed later. Others objected to a wider range on the ground that, because of the Committee's focus on the broader aggregates, such a range might be viewed as weakening the importance of the Committee's monetary targets.

At the conclusion of the Committee's discussion, all but one of the members indicated that they could accept a reduction of 1/2 percentage point in the tentative ranges for M2 and M3 and in the monitoring range for nonfinancial debt in 1988. It was understood that all these ranges were provisional and that they, along with the possibility of establishing a numerical range for M1, would be reviewed in early 1988 in the light of intervening developments.

The following paragraph relating to the ranges for 1988 was approved for inclusion in the domestic policy directive:

> For 1988, the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7-1/2 to 10-1/2 percent.

> Votes for this action: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, and Stern. Vote against this action: Ms. Seger.

Ms. Seger dissented because she did not want to reduce at this time the tentative M2 and M3 ranges for 1988 below those established for this year In her view the performance of key sectors of the domestic economy implied a relatively weak business expansion, and she did not anticipate enough offsetting support from gains in foreign trade. In the circumstances inflationary pressures seemed likely to remain subdued, and she concluded that a policy consistent with monetary growth within this year's ranges would probably be needed to sustain the expansion in 1988. She recognized that the economic outlook was surrounded by a great deal of uncertainty, and she would be prepared to lower the M2 and M3 ranges early next year if intervening developments seemed to warrant such a reduction.

In the Committee's discussion of policy implementation for the weeks immediately ahead, all of the members indicated that they were in favor of continuing to direct open market operations toward maintaining the existing degree of reserve availability. Recent financial developments, including indications of some easing in inflationary sentiment and the emergence of a more stable dollar in foreign exchange markets, along with evidence of continued moderate expansion in business activity did not point to the need for any change in reserve conditions at this time. The outlook for monetary expansion also seemed consistent with such a stance since unchanged reserve conditions and relatively stable market rates were thought likely to be associated with some strengthening in money growth over the third quarter. Even so, the cumulative expansion of M2 through September might still be somewhat below the Committee's target range for the year; growth in M3 might move this aggregate closer to the middle of the Committee's 1987 range by September. The outlook for growth in M1 remained uncertain, but a relatively moderate rate of expansion in this aggregate over the third quarter appeared consistent with stable reserve conditions and the Committee's expectations for the broader aggregates.

Most members felt that there should be no presumption about the likely direction of any intermeeting adjustment in policy implementation. The market concerns about inflation and downward pressures on the dollar that had argued for a relatively prompt firming of reserve conditions at the time of the May meeting had eased somewhat, and growth in the monetary aggregates had been quite restrained in recent months. One member felt that policy implementation should be especially alert to developments that might call for some easing, given the risks in this view that indicators of business activity might prove to be weaker than expected and a related belief that the risks of greater inflation were limited. The members generally indicated that attention should continue to be given to developments bearing on the outlook for inflation and the performance of the dollar in foreign exchange markets, but in keeping with the Committee's usual approach to policy implementation, any decision to alter reserve objectives during the intermeeting period would take account of the behavior of the monetary aggregates and the overall performance of the economy.

At the conclusion of the Committee's discussion, all of the members agreed on the desirability of a directive that called for no change in the degree of pressure on reserve positions. Some firming or some easing of reserve conditions would be acceptable depending especially on developments relating to inflation and the performance of the dollar in foreign exchange markets, while also taking account of the behavior of the monetary aggregates and the strength of the business expansion. This approach to policy implementation was expected to be consistent with growth of M2 and M3 at annual rates of around 5 percent and 7-1/2 percent, respectively, over the three-month period from June to September. Over the same period, growth in M1 was expected to resume after declining on balance in May and June but to remain well below its pace in 1986. Because the behavior of M1 was still subject to unusual uncertainty and in keeping with its decision regarding the longer-run target, the Committee decided to continue its practice of not specifying a numerical expectation for its short-run 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 expanded at a moderate pace in the second quarter. In May and June, total nonfarm payroll employment rose modestly further, with most of the gains continuing to be in the service-producing sectors. The civilian unemployment rate fell to 6.1 percent in June and was down appreciably from its average level in the first quarter. Industrial production increased substantially in May after rising moderately on balance in earlier months of the year. Consumer spending appears to have increased in the second quarter, but housing starts were down somewhat further in May to a level considerably below their first-quarter average. Recent indicators of business capital spending point to some recovery, particularly in equipment outlays, from a depressed level in the first quarter. In April the merchandise trade deficit was smaller than in March and below the monthly average for the first quarter. The rise in consumer and producer prices moderated in May but for the year to date prices have risen more rapidly than in 1986, primarily reflecting sizable increases in prices of energy and non-oil imports. Wage increases have remained relatively moderate in recent months.
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> M2 increased slightly in May and June while growth of M3 remained moderate. For 1987 through June, expansion of M2 has been below the lower end of the range established by the Committee for the year, and growth of M3 around the lower end of its range. Following a surge in April, M1 contracted on balance in May and June. Expansion in total domestic nonfinancial debt has moderated this year.

Most interest rates have declined somewhat on balance since the May 19 meeting of the Committee. In foreign exchange markets, the trade-weighted value of the dollar against the other G-10 currencies has risen 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 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 Committee agreed that growth in these aggregates around the lower ends of their ranges may be appropriate in light of developments with respect to velocity and signs of the potential for some strengthening in underlying inflationary pressures, provided that economic activity is expanding at an acceptable pace. The monitoring range for growth in total domestic nonfinancial debt set in February for the year was left unchanged at 8 to 11 percent.

For 1988, the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1987 to the fourth quarter of 1988, of 5 to 8 percent for both M2 and M3. The Committee provisionally set the associated range for growth in total domestic nonfinancial debt at 7-1/2 to 10-1/2 percent.

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. Because of this sensitivity, which has been reflected in a sharp slowing of the decline in M1 velocity over the first half of the year, the Committee again decided not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range has been set for 1988. The appropriateness of changes in M1 this year will continue to 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. The Committee welcomes substantially slower growth of M1 in 1987 than in 1986 in the context of continuing economic expansion and some evidence of greater inflationary pressures. The Committee in reaching operational decisions over the balance of the year will take account of growth in M1 in the light of circumstances then prevailing. The issues involved with establishing a target for M1 will be carefully reappraised at the beginning of 1988.

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 or somewhat lesser reserve restraint would be acceptable depending on indications of inflationary pressures and on developments in foreign exchange markets, as well as the behavior of the aggregates and the strength of the business expansion. This approach is expected to be consistent with growth in M2 and M3 over the period from June through September at annual rates of around 5 and 7-1/2 percent, respectively. Growth in M1, while picking up from recent levels, is expected to remain well below its pace during 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 the short-run operational paragraph: Messrs. Volcker, Corrigan, Angell, Boehne, Boykin, Heller, Johnson, Keehn, Kelley, Ms. Seger, and Mr. Stern. Votes against this action: None.