FEDERAL RESERVE press release

For Use at 4:30 p.m. November 6, 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 September 22, 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 September 22, 1987

Domestic policy directive

The information reviewed at this meeting suggested that economic activity was expanding in the current quarter at a pace similar to that in the first half of the year. Output and employment appeared to have registered solid gains in the third quarter, with particular strength in the industrial sector of the economy. On the spending side, outlays for consumption and business equipment have risen noticeably this quarter, but construction has been weak. Price advances have eased in recent months after a sharp rise earlier in the year, and wage increases have remained subdued.

Industrial production rose further in August after large gains in other recent months; the August level was more than 7 percent (annual rate) above the second-quarter average. Business equipment and materials have been the strongest components of industrial output in recent months, but advances have been widespread among major market groupings.

Nonfarm payroll employment increased again in August; although the gain was half the size of the July increase, the average change in the two months was close to the pace of the first half of the year. The average workweek also rose in August and, coupled with the employment gains, pushed up aggregate hours of production and nonsupervisory workers significantly. Hiring remained strong in services, but employment leveled off in manufacturing after a large gain in July. The unemployment rate was unchanged at 6.0 percent in August, about three quarters of a percentage point lower than at the beginning of the year.

Retail sales have increased considerably in recent months. Auto sales have been boosted by end-of-model-year discounts and financing incentives. However, a considerable decrease in domestic car sales in the first ten days of September suggested that the effectiveness of the incentive programs might be waning. Retail spending on consumer goods excluding autos and gasoline continued to advance at a moderate pace in July and August to a level slightly above the second-quarter average.

Housing starts edged down to an annual rate of 1.58 million units, as a decline in single-family starts more than offset some increase in multifamily construction. The run-up in mortgage interest rates during April and May has damped housing demand, as reflected in the reduced pace of housing starts and sales in recent months. Multifamily starts have remained close to the average rate in the second quarter but substantially below that recorded during the first three months of the year.

Business fixed investment appeared to be strengthening, particularly for equipment. In July, shipments of nondefense capital goods were 2-1/2 percent above the second-quarter average, and orders for these goods rose substantially in recent months. Spending for nonresidential structures has continued to trend lower, albeit at a slower rate than over the past couple of years, partly because of renewed strength in petroleum drilling.

Inventories in midsummer appeared to be moderate in most segments of the nonfarm business sector. At auto dealers, the quickened selling pace in August, combined with scaled-back production, reduced inventories to more comfortable levels. For retailers other than auto dealers, stocks increased at a relatively slow rate, and the inventory-sales ratio edged down in August. As a result of the apparently conservative inventory stance in manufacturing, factory stocks have remained generally lean, with the July inventory-shipments ratio near its lowest point in the current cycle.

Preliminary data suggested that the nominal U.S. merchandise trade deficit was essentially unchanged in July from its June level despite substantial increases in the quantity and prices of oil imports. However, the July deficit was larger than the second-quarter average. In real terms, the second-quarter deficit on goods in the GNP accounts narrowed only slightly further because a rebound in the quantity of oil and non-oil imports largely offset a substantial rise in the quantity of exports. The surplus on services in the GNP accounts narrowed in real terms. The average pace of economic growth in the major foreign industrial economies increased in the second quarter after a very weak first quarter. A rebound in German GNP in the second quarter reversed a first-quarter decline but left GNP no higher than its third-quarter 1986 level. Real GNP also resumed growing in the second quarter in France and Italy, while real GNP in Canada and the United Kingdom showed continued strength. In Japan, real GNP did not grow in the second quarter on average as a more rapid rise in domestic demand was offset by the negative contribution of the external sector; however, industrial production picked up in June and July. While cumulative surpluses in the trade and current accounts of Japan and Germany for the year to date remained at or near a record rate, data for recent months indicate some adjustment, especially for Japan.

Price increases have eased in recent months; the CPI and PPI for finished goods both rose 0.2 percent in July, and the August PPI was unchanged. The deceleration in these price measures from the pace in the first half of the year largely reflected a downturn in food prices and smaller energy price increases. Producer prices for finished foods fell sharply in August, and although the effect of rising oil prices continued to be evident, declines in both spot and contract prices were likely to damp retail energy prices by early autumn. Excluding food and energy, the CPI rose in July at around the reduced pace of the second quarter and the comparable PPI increased moderately over the first two months of the current quarter.

At its meeting on August 18, the Committee adopted a directive that called for maintaining the existing degree of pressure on reserve positions. The members decided that somewhat greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange markets, as well as the behavior of the monetary aggregates. M2 and M3 were expected to grow at annual rates of around 5 percent from June through September, while growth in M1 was expected to pick up from the much reduced pace of recent months. The intermeeting range for federal funds was left unchanged at 4 to 8 percent.

Total and nonborrowed reserves resumed expansion in August, primarily because of higher levels of excess reserves. In the maintenance period after the August meeting, federal funds generally traded in a 6-1/2 to 6-3/4 percent range, though the rate moved a bit higher around the end of August when markets began to expect that the System would tighten policy. In light of the potential for greater inflation, associated in part with weakness in the dollar, a decision was made in early September to reduce marginally the availability of reserves through open market operations. On September 4 the discount rate was raised from 5-1/2 percent to 6 percent. After the discount rate increase, federal funds traded mainly in the 7 to 7-1/4 percent area. In the two maintenance periods completed since the August meeting, adjustment plus seasonal borrowings averaged about $530 million.

Other interest rates rose substantially over the intermeeting period. Market interest rates moved up early in the period amid pressures on the dollar, concerns about inflation, and expectations of policy-firming actions by the Federal Reserve. Rates rose further after the increase in the discount rate, particularly short-term rates; also, commercial banks raised the prime rate by 1/2 percentage point. On balance, market rates were up 1/2 to 3/4 percentage point over the intermeeting period. Most stock price indexes reached new highs in late August but subsequently retreated to levels 2-1/2 to 6 percent below those at the time of the August meeting.

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies declined about 2-1/2 percent in the weeks immediately following the August meeting. The main factor in the dollar's depreciation appeared to be greater pessimism about the pace of adjustment of external imbalances, following the release of U.S. merchandise trade data that were worse than market participants had expected. Moreover, prospects for growth abroad relative to that in the United States suggested only a limited contribution from this source to external adjustment. The dollar rose somewhat later in the period after the increase in the discount rate, reducing its net decline over the intermeeting period to about 1-1/2 percent.

Growth in the monetary aggregates increased in August from the sluggish pace of previous months. The acceleration of M2 in August partly reflected faster growth in its M1 component as the run off in demand deposits ended and the growth of other checkable deposits accelerated slightly. The strongest growth among nontransactions components of M2 occurred in RP liabilities at banks, which rose sharply in association with a surge in acquisitions of Treasury securities for trading accounts, and in money market mutual funds. Bolstered by the expansion in M2 and by faster growth in managed liabilities, M3 expanded at a 7-1/2 percent annual rate in August. Over July and August the broader monetary aggregates increased at annual rates of 4 to 5 percent, and for the year through August their cumulative growth remained below the low ends of their target ranges for 1987, with M2 substantially below its range.

The staff economic projections had changed only marginally since the August FOMC meeting. Somewhat stronger growth was anticipated over the near term, but real GNP still was expected to expand at a moderate rate through the end of 1988. Improvement in the external sector was projected to provide substantial impetus for real growth as changes in the foreign exchange value of the dollar boosted U.S. exports and damped import growth. In contrast, growth in domestic spending would probably be relatively subdued. Rising import prices associated with the fall in the value of the dollar were likely to limit increases in real income and consumer spending; budgetary pressures probably would constrain government purchases; and rising mortgage rates and high vacancy rates were expected to damp construction activity. As in previous forecasts, inflation was projected to moderate in the second half of 1987, but to move back up in 1988, reflecting pressures from rising import prices. Moreover, with the civilian unemployment rate projected to edge lower, the pickup in prices was expected to push up labor costs and compensation gains next year.

In the Committee's discussion of the economic situation and outlook, members commented that current indicators of business activity were generally favorable and pointed on balance to continuing expansion at a moderate pace. A number of members believed that any deviation from current expectations was likely to be in the direction of faster growth. However, some saw factors in the outlook that would be likely to restrain any potential for a substantially stronger expansion, and one view stressed the vulnerability of the expansion to a slowdown. With regard to the outlook for inflation, members noted that developments in financial markets suggested some buildup in inflationary expectations, but they also stressed that there was no current evidence of an upturn in broad measures of inflation. Nonetheless, several expressed concern about the risks of some intensification in price and wage pressures. Others saw greater prospects that the rate of inflation might hold around current levels or possibly decline.

In their discussion of specific developments bearing on the outlook for domestic business activity, members observed that key economic indicators provided evidence of appreciable momentum in the business expansion. Individual members also reported that local business conditions appeared to be strengthening in many parts of the country, although recovery in some previously depressed areas or sectors of the economy was still quite modest or tentative, with current activity still well below earlier peaks. It was suggested that the expansion could be characterized currently as better balanced than earlier, with favorable implications for its sustainability. At the same time, some members believed that the risks of appreciably more rapid expansion were relatively limited in the context of considerable progress in reducing the federal budget deficit, restrained monetary expansion, and an increased level of interest rates. Some members also noted that increasing domestic demands and the prospects for improvement in the foreign trade balance had greatly reduced the odds of a shortfall in the expansion from current expectations.

The members continued to view the very large deficits in the federal budget and in the foreign trade balance as issues of fundamental concern. Although a great deal of progess had been made in reducing the federal deficit in the current fiscal year, the outlook for needed further progress was uncertain. The trade deficit also had improved in real terms, though not in nominal terms, over the course of recent quarters. The members generally expected at least some progress to be made on the latter basis as foreign trade patterns and prices were adjusted over time to the reduced value of the dollar in foreign exchange markets. However, the timing and extent of such improvement remained subject to considerable uncertainty and differing views were expressed regarding the most likely prospects for net exports and the underlying pressures on the dollar. The members agreed that the vigor of the domestic expansion would depend to a substantial extent on foreign trade developments. Some members noted that with shrinking margins of excess capacity in labor markets, overall domestic demands would need to remain relatively moderate to provide room for growth in export production; in that regard continuing progress in reducing the federal budget deficit was essential.

Turning to the outlook for inflation, members commented that the sharp decline in unemployment this year together with anecdotal evidence of labor shortages in many areas of the country had not triggered any general increases in wage rates thus far. Additionally, the members did not see in recent indicators any evidence of an upturn in the general level of prices. However, several expressed concern that the economy might have reached the point where employment and production levels would tend to be associated with stronger pressures on wages and prices, particularly if the business expansion proved to be more vigorous than was generally anticipated. Of particular concern was the prospect that rising prices of internationally traded goods could foster a more general increase in domestic prices and lead to higher wages. Because such developments would reflect broader and more permanent cost factors, the inflation problem would become much more difficult for policymakers. A number of other members saw a lesser risk that inflation would intensify over the period ahead. Highly competitive conditions continued to characterize many markets, both domestic and international, and businessmen were persisting in their efforts to curb their costs of production. It also was noted that a portion of the gains in output and employment was occurring in previously depressed industries where the availability of labor and other production resources was concentrated.

In this view monetary policy had been sufficiently tight, with relatively low monetary growth, and in the context of a less expansionary fiscal policy, the economy was not seen as likely to generate excessive demand pressures over the next several quarters.

At its meeting in July the Committee reviewed the basic policy objectives that it had set in February for growth of the monetary and debt aggregates in 1987 and established tentative objectives for expansion of those aggregates in 1988. For the period from the fourth quarter of 1986 to the fourth quarter of 1987, the Committee reaffirmed the ranges established in February involving growth of 5-1/2 to 8-1/2 percent for both M2 and M3. Given developments through mid-year, the Committee agreed that growth in these aggregates around the lower ends of their ranges might be appropriate, depending on the circumstances. The monitoring range for expansion in total domestic nonfinancial debt also was left unchanged at 8 to 11 percent for 1987. For 1988 the Committee agreed on tentative reductions of 1/2 percentage point to growth ranges of 5 to 8 percent for both M2 and M3. The Committee also reduced the associated range for growth in total domestic nonfinancial debt by 1/2 percentage point to 7-1/2 to 10-1/2 percent for 1988. With respect to M1, the Committee decided at the July meeting not to set a specific target for the remainder of 1987 or to establish a tentative range for 1988. It was understood that all the ranges for 1988 were provisional and that they would be reviewed early next year in the light of intervening developments. The issues involved with establishing a target for M1 would be carefully reappraised at the beginning of 1988.

In the Committee's discussion of policy implementation for the weeks immediately ahead, most of the members indicated that they were in favor of directing open market operations, at least initially, toward achieving the increased degree of reserve pressure that had been sought in recent weeks. No change in policy would be involved, given the decision in early September to reduce the availability of reserves; however, because implementation of that decision had not yet been reflected in actual pressures on reserves or in money markets, an unchanged policy at this meeting would imply some slight firming from the actual reserve conditions that had prevailed recently. A few members expressed a preference for maintaining the existing degree of reserve pressure. The members agreed that the differences in question were slight and that, against the background of earlier policy firming actions, significant further changes in policy were not desirable at this time. In the latter connection, some members urged that particular caution be exercised in implementing policy following today's meeting in order not to convey a misleading impression of the System's policy intentions.

In reaching their decisions the members took account of a staff analysis that suggested that even without any increase in reserve pressures money growth was likely to remain fairly subdued over the months ahead. This outlook reflected in large measure the expected effects on money demand of the increase in market interest rates associated in part with the decisions in early September to achieve slightly firmer reserve conditions and to raise the discount rate. In the circumstances growth of M2 might continue at about its average pace of recent months and on a cumulative basis remain appreciably below the Committee's range for the year. Growth in M3 might pick up marginally from its recent pace, ending the year around the lower limit of its range for 1987. Given its particular sensitivity to interest rates, growth in M1 for the balance of the year was expected to slow further from its considerably reduced pace thus far in 1987. The members recognized that projections of monetary growth necessarily involved a wide range of uncertainty. In particular, developments in the months ahead would depend importantly on the unknown extent to which holders of money assets would respond to the higher market interest rates that had emerged and also on the extent to which depository institutions would adjust their offering rates on interest-bearing deposits. In light of the uncertainties that were involved, judgments about appropriate rates of monetary growth would need to rely on accompanying economic and financial developments.

With regard to possible adjustments in policy implementation during the intermeeting period, the members generally felt that there should be no presumptions about the likely direction of such adjustments, if any. A number of members commented that, taking account of earlier policy firming decisions, monetary policy was now appropriately positioned under the circumstances that were most likely to prevail. While a few members felt that the Committee should remain especially alert to developments that might call for somewhat firmer reserve conditions, others did not want the directive to lean in the direction of still further firming, given the slight initial firming that was already contemplated. The members generally agreed that in addition to developments relating to the outlook for inflation, any reserve adjustments during the intermeeting period should give weight to ongoing business developments and the performance of the dollar in foreign exchange markets. In keeping with the Committee's usual approach, it also was understood that any decision to alter reserve objectives during the intermeeting period would take account of the behavior of monetary aggregates.

The members generally supported a proposal to raise the existing intermeeting range for the federal funds rate by one percentage point to 5 to 9 percent. One member expressed concern that the higher range might be misinterpreted as signaling future firming action. Others pointed out, however, that the increase was a technical adjustment intended to take account of the rise in the federal funds rate over the course of recent weeks and to provide a more symmetrical range around the current rate. By itself the increase would have no significance for policy. The federal funds range provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded.

At the conclusion of the Committee's discussion, all of the members indicated that they preferred or could accept a directive that called for maintaining the slightly firmer degree of reserve pressure that had been sought in recent weeks. With regard to possible adjustments during the intermeeting period, the members indicated that somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable depending on developments relating to inflation, the strength of the business expansion, the performance of the dollar in foreign exchange markets, while also taking account of the behavior of the monetary aggregates. The contemplated provision of reserves was expected to be consistent with growth in M2 and M3 at annual rates of around 4 percent and around 6 percent, respectively, for the four-month period from August to December. Growth in M1 was expected to remain relatively slow over the same period. Because of the unusual uncertainty relating to the behavior of M1 and in keeping with the decision not to set a longer-run target for this aggregate, the Committee decided to continue the practice of not specifying a numerical expectation for its short-run growth. The members agreed that the intermeeting range for the federal funds rate should be raised from 4 to 8 percent to 5 to 9 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 is expanding in the current quarter at a pace similar to that in the first half of the year. Total nonfarm payroll employment rose further in August after a large increase in July. The civilian unemployment rate remained at 6.0 percent, well below its level at the start of the year. Industrial production increased further in August following large gains in other recent months. Consumer spending, bolstered by a rise in auto sales, posted a large increase in August. Recent indicators of business capital spending point to some strength, particularly in equipment outlays. Housing starts fell in August to a level a little below their average in other recent months. Preliminary data suggest that the nominal U.S. merchandise trade deficit was unchanged in July from its June level but larger than the second-quarter average. The rise in consumer and producer prices has slowed in recent months, reflecting favorable price developments in food and energy.
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> Growth of the monetary aggregates strengthened in August, but for 1987 through August, expansion of both M2 and M3 remained below the lower ends of the ranges established by the Committee for the year; growth in M1 has been at a much reduced pace in 1987. Expansion in total domestic nonfinancial debt has moderated this year. Interest rates have risen considerably since the meeting on August 18. On September 4, the Federal Reserve Board approved an increase in the discount rate from 5-1/2 to 6 percent. In foreign exchange markets, the trade-weighted value of the dollar in terms of the other G-10 currencies has depreciated on balance since the latest meeting; some of the decline in the dollar early in the intermeeting period was later reversed.

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 its meeting in July 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 at the July meeting not to establish a specific target for growth in M1 over the remainder of 1987 and no tentative range was 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 degree of pressure on reserve positions sought in recent weeks. Somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable depending on indications of inflationary pressures, the strength of the business expansion, developments in foreign exchange markets, as well as the behavior of the aggregates. This approach is expected to be consistent with growth in M2 and M3 over the period from August through December at annual rates of around 4 percent and around 6 percent, respectively. M1 is expected to continue to grow relatively slowly. 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 5 to 9 percent.

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

On every business day from October 19 to 30, 1987, the Committee conferred by telephone and reviewed the extremely volatile conditions that had developed in financial markets. The members agreed on the need for special flexibility in open market operations during this period for meeting the liquidity requirements of the economic and financial system. Such an approach to policy implementation was deemed to be consistent with the directive adopted at the meeting on September 22, but it was understood that policy would have to be kept under particularly close review.