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July 5, 1985

Strictly Confidential (FR) Class I FOMC

MONETARY POLICY ALTERNATIVES

Prepared for the Federal Open Market Committee

By the staff Board of Governors of the Federal Reserve System

STRICTLY CONFIDENTIAL (FR)
CLASS I - FOMC

July 5, 1985

MONETARY POLICY ALTERNATIVES

Recent Developments

(1) With growth very rapid in May and June, M1 expanded at about a 13-1/4 percent annual rate over the March-to-June interval, well above the path for that period of a little over 6 percent adopted at the last FOMC meeting and bringing the aggregate far above the upper edge of the parallel band associated with its 1985 growth range. The overall strength in demand for M1, even as income growth remained moderate, probably has reflected in some degree the effects of recent interest rate declines. The velocity of M1 has declined by about 5 percent at an annual rate in both the first and second quarters, in association with growth in M1 averaging 10-1/2 percent over the two quarters.

(2) The extent of M1 growth over the past two months has been much greater than monthly models predict. Strength has been evident during that period in all major components of M1 and is widespread across Reserve Districts. However, demand deposits have been particularly strong for several weeks now. Examination of the data and contacts with banks do not suggest any clear special factor at work--such as a change in cash management techniques in response to the E.F. Hutton development or a much larger rise in compensating balances than would be expected in response to recent interest rate declines. It may be noted, though, that the total Treasury balance dropped very sharply from mid-May to mid-June, perhaps providing some temporary stimulus to demand deposits at the time.

(3) Growth in M2 and M3 picked up further in June to 13-3/4 and 10-3/4 percent annual rates, respectively. The nontransactions component of M2 strengthened considerably in June as flows into MMDAs and money funds

KEY MONETARY AGGREGATES
(Seasonally adjusted annual rates of growth)

	April	May	June^p	March to June^p	QIV to QII^p	QIV to June^p
Money and Credit Aggregates						
M1	5.9	14.0	19.4	13.2	10.5	11.6
M2	-0.8	8.4	13.8	7.2	8.7	9.3
M3	0.2	7.1	10.7	6.0	7.9	8.2
Domestic nonfinancial debt	12.0	11.9	11.9	11.9	12.7	12.7
Bank credit	4.7	13.3	10.0	9.4	9.9	10.1
Reserve Measures[1]						
Nonborrowed reserves[2]	9.6	7.9	33.1	17.0	16.3	17.7
Total reserves	7.1	18.1	24.9	16.9	15.1	16.4
Monetary base	3.7	10.6	14.8	9.8	8.0	8.9
Memo: (Millions of dollars)						
Adjustment and seasonal borrowing						
Total	455	800	540	—	—	—
Excluding special situation borrowing	362	607	506	—	—	—
Excess reserves	738	804	939	—	—	—

p—preliminary.

NOTE: Monthly reserve measures, including excess reserves and borrowing, are calculated by prorating averages for 2-week reserve maintenance periods that overlap months.

1. Growth rates of reserve measures are adjusted to remove the effects of discontinuities resulting from phased changes in reserve ratios under the Monetary Control Act.
2. Includes "other extended credit" from the Federal Reserve, but not special situation borrowing by thrifts that was part of adjustment plus seasonal borrowing until reclassified as extended credit.

were sizable in response to relatively favorable yields on these instruments, whose offering rates, as usual, lagged behind the recent decline in market rates. Over the three-month period ending in June, M2 and M3 expanded at annual rates of 7-1/4 and 6 percent--somewhat stronger than anticipated at the time of the last meeting, and in the case of M2 in line with earlier expectations at the time of the March meeting. By June, M2 was slightly above the upper end of its long-run target growth cone and M3 was still well within its range.

(4) Growth in total domestic nonfinancial debt has slowed from its first-quarter pace, though second-quarter expansion remains relatively high at around an 11-3/4 percent annual rate. Both federal and private sectors contributed to the recent deceleration in debt. Business borrowing has continued to be boosted by unusually large debt-financed retirements of corporate equity, which are estimated to account for around one percentage point of total credit growth thus far this year. Issuance of debt by state and local governments has been quite heavy as refunding issues have surged.

(5) Total reserves grew at about a 22 percent annual rate over May and June, on average, reflecting strength in required reserves against transaction accounts. The nonborrowed reserve path over the entire intermeeting period was constructed assuming $350 million of adjustment plus seasonal borrowing, abstracting from any borrowing still in the adjustment category by thrifts in special situations. Excluding special situations, adjustment plus seasonal borrowing averaged around $510 million over the past six weeks--fluctuating on a weekly basis between $240 million and $850 million. Throughout the period, excess reserves ran higher than expected, particularly during the last maintenance period containing the mid-year

statement date, and averaged around $940 million. By mid-June virtually all special situation borrowing had been reclassified as extended credit, and total borrowing by privately-insured thrift institutions has dropped to $330 million most recently from $463 million at the time of the May FOMC meeting.

(6) Federal funds since the last FOMC meeting have traded mainly in the 7-1/2 to 7-3/4 percent range reached following the discount rate cut, although around mid-June the funds rate fell to around 7 percent and below. Very recently, the funds rate moved above 8 percent for a time with the approach of the July 4 holiday and an unusually sharp reserve drain as Treasury balances at Federal Reserve Banks soared on the settlement date of two new Treasury issues. Other market rates generally varied within a wide range over the intermeeting period, in response to the ebb and flow of expectations about the proximity of further cuts in the discount rate, incoming economic information, and at times unanticipated money supply developments. On balance, Treasury bill rates are currently around 60 basis points below their levels at the time of the last FOMC meeting, while commercial paper and CD rates have declined less, as risk premiums widened somewhat in response to concerns about the health of some financial institutions. The prime rate was reduced from 10 to 9-1/2 percent. In the capital markets, Treasury and corporate bond yields are down a little more than 1/2 percentage point, and some broad stock price indices reached record levels; mortgage rates have fallen by about 80 basis points in lagged response to earlier market gains.

(7) Foreign exchange market conditions have generally been less volatile since the last FOMC meeting than in earlier periods of the year. The dollar has declined by about 2-1/2 percent on a weighted average basis, with trading in a relatively narrow range. Interest differentials among

major currencies have shown little change since the last Committee meeting.

Long-run targets

(8) Two alternative long-run targets for the monetary and debt aggregates for 1985, plus the currently established targets, are shown below. Alternative I differs only with respect to M1. Alternative II suggests a larger revision for M1, together with small increases in the upper limits of the M2 and debt ranges. At mid-year, M2 was around its upper bound and debt was running strong, so that some adjustments of the ranges for those aggregates might be considered.

	Growth Ranges for 1985		
	Current	Alt. I	Alt. II
M1	4 to 7	4 to 8	5 to 9
M2	6 to 9	6 to 9	6 to 9-1/2
M3	6 to 9-1/2	6 to 9-1/2	6 to 9-1/2
Debt	9 to 12	9 to 12	9 to 12-1/2

(9) The table below focuses on the arithmetic of achieving the upper bounds of the current and proposed M1 long-run growth ranges for the year 1985, given growth of 10-1/2 percent annual rate over the first half of 1985 (QIV '84 to QII '85). A particular problem arises because M1 was so strong in the latter part of the second quarter. This high jumping off point means that attainment of, say, the 7 percent upper limit of the current long-run range would entail virtually no month-by-month growth on average over the balance of the year--as can be seen from the table, one-half of one percent at an annual rate. However, implied growth over the second half measured from QII '85 to QIV '85 would be higher--about 3-1/4 percent annual rate--owing to the carry-over effect of the acceleration of M1 late in the second quarter. The upper limit of the alternative II range could be achieved with 5 percent, annual rate,

month-by-month growth, which would yield substantial quarterly average growth.

M1 Growth rate from QIV '84 to QIV '85	Implied M1 Growth QII '85-QIV '85	Implied M1 Growth June-December
7	3.3	.5
8	5.3	2.8
9	7.1	5.0

(10) The staff GNP projection for 1985 assumes, given recent developments, M1 growth above the upper limit of the current range--increasing 8 to 9 percent for the year--with interest rates showing little net change over the balance of the year. Growth of M2 and M3 for the year is expected to be within their current long-run ranges, though well into the upper part for M2, while debt growth may be just above the upper limit of the range.

(11) The alternatives presented in paragraph (8) above assume the Committee retains the QIV '84 base for M1. However, as in mid-1983, the FOMC may wish to contemplate shifting the base to the second quarter of 1985; relevant economic considerations are discussed in the next paragraph. Because of the very rapid growth of M1 toward the end of the spring quarter, the aggregate would still be starting off high relative to a rebased long-run path. If the Committee chose to retain the existing 4 to 7 percent range, but to shift the base to the second quarter (so that the range applied to the QII '85-QIV '85 period), the upper limit could be attained with growth from June-to-December at a 4-3/4 percent, annual rate, while growth around the mid-point of the range would be consistent with month-by-month growth averaging 3 percent at an annual rate. If an 8 percent upper limit were employed in a rebased range,

June-to-December growth of 6 percent, annual rate, would be consistent with the upper limit.

(12) The economic argument for shifting the base is similar to the consideration that prompted the base shift in mid-1983—the likelihood that the rapid growth of M1 above target was needed to accommodate to a "permanent" downward shift in the level of velocity and thus did not entail the need to offset rapid growth by commensurately lower growth subsequently.[1/] Assuming the recent decline in velocity represents a "permanent" adjustment, it could be appropriate to rebase, with the new M1 target range designed to be more consistent with the longer-run trend of velocity (abstracting from interest rate movements) allowing for a reasonable range of actual velocity variation in light of emerging economic and financial conditions. The target would also need to take account of the speed with which the FOMC wishes to move to decelerate price inflation further and assessment of the prospective strength of the economy. It would not seem appropriate to rebase, however, if the Committee felt that the recent burst of M1 growth would contribute in the period ahead to undesirably strong demand pressures and to accelerating inflation or felt that rebasing would be perceived as signaling less determination to resist inflation. In those circumstances, it would be desirable to aim at a greater slowdown of M1 growth than is implied by rebasing, although one might still wish to consider raising the current M1 range so as to avoid a deceleration that is unduly abrupt, given the

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1/ Factors behind the recent behavior of M1, in comparison with 1982-83, and implications for monetary targeting are discussed in some detail in the memorandum circulated to the Committee under date of July 2, 1985.

remaining lagged effects on M1 demand that can be expected from the recent declines in interest rates.

(13) Regarding tentative money and credit targets to be set for 1986, three alternatives are presented below. Alternative I encompasses a 4 to 7 percent range for M1, the same as that currently in place, and also an unchanged range for M2. The growth range for M3 has an upper limit that is one-half percent lower than the current one and the credit range is lower by a full percentage point. Nominal GNP is projected by the staff to grow about 1/2 percentage point more than this year, but with no further worsening in the current account deficit expected, spending and the credit needed to finance it would tend to grow less than this year. In addition, debt growth should be damped by an abatement of mergers and other activities associated with greater leveraging by businesses. Alternative II widens the M1 and M2 ranges to provide added flexibility in the face of uncertainties such as those described in paragraphs (14) to (17) below. Alternative III represents a stronger move in the direction of attaining reasonable price stability.

	Growth ranges for 1986		
	Alt. I	Alt. II	Alt. III
M1	4 to 7	4 to 8	3-1/2 to 6-1/2
M2	6 to 9	6 to 9-1/2	5-1/2 to 8-1/2
M3	6 to 9	6 to 9	5-1/2 to 8-1/2
Debt	8 to 11	8-1/2 to 11-1/2	7-1/2 to 10-1/2

(14) The staff's GNP projection for next year assumes M1 growth on the order of 5-1/2 percent and little change in the level of market interest rates from recent levels. That assumption is encompassed by

all of the alternatives, with alternative II representing a looser and alternative III a tighter fit. The Committee's choice of monetary targets would depend on, among other things, the extent to which it finds the projected growth of GNP acceptable, the pace at which it wishes to move toward price stability, and the extent to which it wishes to allow for uncertainties such as the sustainability of real growth under current credit and exchange market conditions, the course of fiscal policy, the behavior of the dollar, and effects of institutional change.

(15) In general, money growth on the high side would likely be needed if nominal interest rates were, contrary to our expectation, to notch down further next year. Indeed, even the upper limit of alternative II may not encompass developments in the event of a substantial downward adjustment of interest rates, as the experience of 1982-1983 and from late last year through the first half of this year tends to suggest. Nominal interest rates could drop if the present level of real interest rates turns out to be too high, as the expansion matures further, to sustain real growth at a satisfactory pace (assuming the level of real rates is not reduced by acceleration of inflation). Nominal rates could also drop in the event of a further decline of inflation expectations. The evolution of fiscal policy could also affect interest rates, though perhaps not substantially given the range of probable fiscal outcomes. In principle, a move toward greater fiscal restraint than the $50 billion federal deficit cut in the fiscal year 1986 assumed by the staff should exert greater downward presure on interest rates, with potential one-time feedback effects on money demand. On the other hand, a failure to act on the deficit would exert some upward impact on interest rates and possibly also inflation expectations.

(16) The behavior of the dollar on exchange markets is another area of uncertainty. The GNP outlook assumes a moderate decline, but a very sharp decline would entail certain fundamental changes in the underlying economic situation. Upward price pressures would be stronger, there would be a greater stimulus to domestic output from the declining dollar, and there would be a risk of worsening inflationary expectations. Desirable behavior of money under these conditions would depend in part on other surrounding circumstances. But, in general, keeping money growth at rates earlier contemplated would involve upward pressure on interest rates, with real GNP growth sustained over time by the positive impact on domestic production of the dollar depreciation. The continued restraint on money growth would work to check tendencies for inflationary expectations to rise. An increase in money growth might relieve potential strains in financial markets, and help ensure that economic growth was not unduly depressed by behavior of interest-sensitive domestic sectors, but probably at the cost of worsening the long-run inflationary consequences of a sharp dollar decline. A lessening of money growth would do most to restrain any inflationary impact of a sharp dollar decline, but would tend to exacerbate financial strains as added upward pressures were placed on interest rates and would most risk a weakening, at least in the short run, of real growth.

(17) The institutional changes known to be in prospect for next year are the lifting of ceiling rates on regular NOW accounts and savings deposits on March 31, 1986, and the removal of the present $1,000 minimum balance restriction on super NOWs and MMDAs on January 1 of that year. There will undoubtedly be some resulting deposit shifts. However, we do not at this point expect any significant impact on growth of M1 or M2,

taking into account experience with reductions in the minimum balance earlier this year, the availability of ceiling-free checking and savings accounts in any event for some time now, and the observation that most banks currently impose minimum balance requirements above $1,000 on regular NOW accounts (if fees are to be avoided) and on super NOWs.

Near-term policy alternatives

(18) The table below gives three alternative specifications for the monetary aggregates over the June-to-September period along with associated federal funds rate ranges. (More detailed data, including growth implied under each alternative for the fourth quarter to September, can be found on the table and charts on the following pages.)

	Alt. A	Alt. B	Alt. C
Growth from June to Sept.			
M1	7	5-1/2	4
M2	8-1/2	7-1/2	6-1/2
M3	8	7-1/4	6-1/2
Associated federal funds rate range	5 to 9	6 to 10	7 to 11

(19) Alternative B contemplates a slowing of M1 growth to a 5-1/2 percent annual rate over the June-to-September period, consistent with seasonal and adjustment borrowing at the discount window at around the $350 million level used in constructing reserve paths since the last FOMC meeting. Federal funds would generally trade in a 7-1/2 to 7-3/4 percent area. Growth in total and nonborrowed reserves would slow to 3-1/2 and 5-1/2 percent annual rates respectively over the June-to-September period as the expansion of transaction deposits moderates.

(20) In part, the slowing of M1 growth under alternative B is expected to result from a substantial weakening in the demand deposit component, working off a portion of its recent unusually large bulge. The rapid growth of M1 late last quarter has brought money balances to a point where they might be considered to be sufficiently high to finance at least some significant GNP growth in the third quarter without further

Alternative Levels and Growth Rates for Key Monetary Aggregates

	M1			M2			M3		
	Alt. A	Alt. B	Alt. C	Alt. A	Alt. B	Alt. C	Alt. A	Alt. B	Alt. C
1985--April	574.9	574.9	574.9	2427.5	2427.5	2427.5	3055.9	3055.9	3055.9
May	581.6	581.6	581.6	2444.5	2444.5	2444.5	3074.1	3074.1	3074.1
June	591.0	591.0	591.0	2472.7	2472.7	2472.7	3101.4	3101.4	3101.4
July	594.6	594.4	594.2	2490.1	2489.2	2488.3	3114.4	3113.4	3112.4
August	598.0	597.1	596.2	2508.0	2504.2	2500.4	3137.8	3133.7	3129.6
September	601.3	599.1	596.9	2524.7	2518.5	2512.4	3162.8	3157.0	3151.3
Growth Rates Monthly									
1985--April	5.9	5.9	5.9	-0.8	-0.8	-0.8	0.2	0.2	0.2
May	14.0	14.0	14.0	8.4	8.4	8.4	7.1	7.1	7.1
June	19.4	19.4	19.4	13.8	13.8	13.8	10.7	10.7	10.7
July	7.4	6.9	6.4	8.5	8.0	7.5	5.0	4.6	4.2
August	6.9	5.5	4.1	8.6	7.2	5.8	9.0	7.8	6.6
September	6.6	4.0	1.4	8.0	6.9	5.8	9.6	8.9	8.3
Growth Rates									
1985--Q1	10.6	10.6	10.6	12.0	12.0	12.0	10.7	10.7	10.7
Q2	10.1	10.1	10.1	5.3	5.3	5.3	5.0	5.0	5.0
Q3	10.6	9.9	9.1	9.7	9.1	8.5	8.0	7.5	7.0
Q4 84 to June 85	11.6	11.6	11.6	9.3	9.3	9.3	8.2	8.2	8.2
Q4 84 to Sept. 85	10.4	9.9	9.4	9.2	8.8	8.5	8.2	8.0	7.8
1985 Mar. to June	13.2	13.2	13.2	7.2	7.2	7.2	6.0	6.0	6.0
1985 June to Sept.	7.0	5.5	4.0	8.4	7.4	6.4	7.9	7.2	6.4

Chart 1

ACTUAL AND TARGETED M1

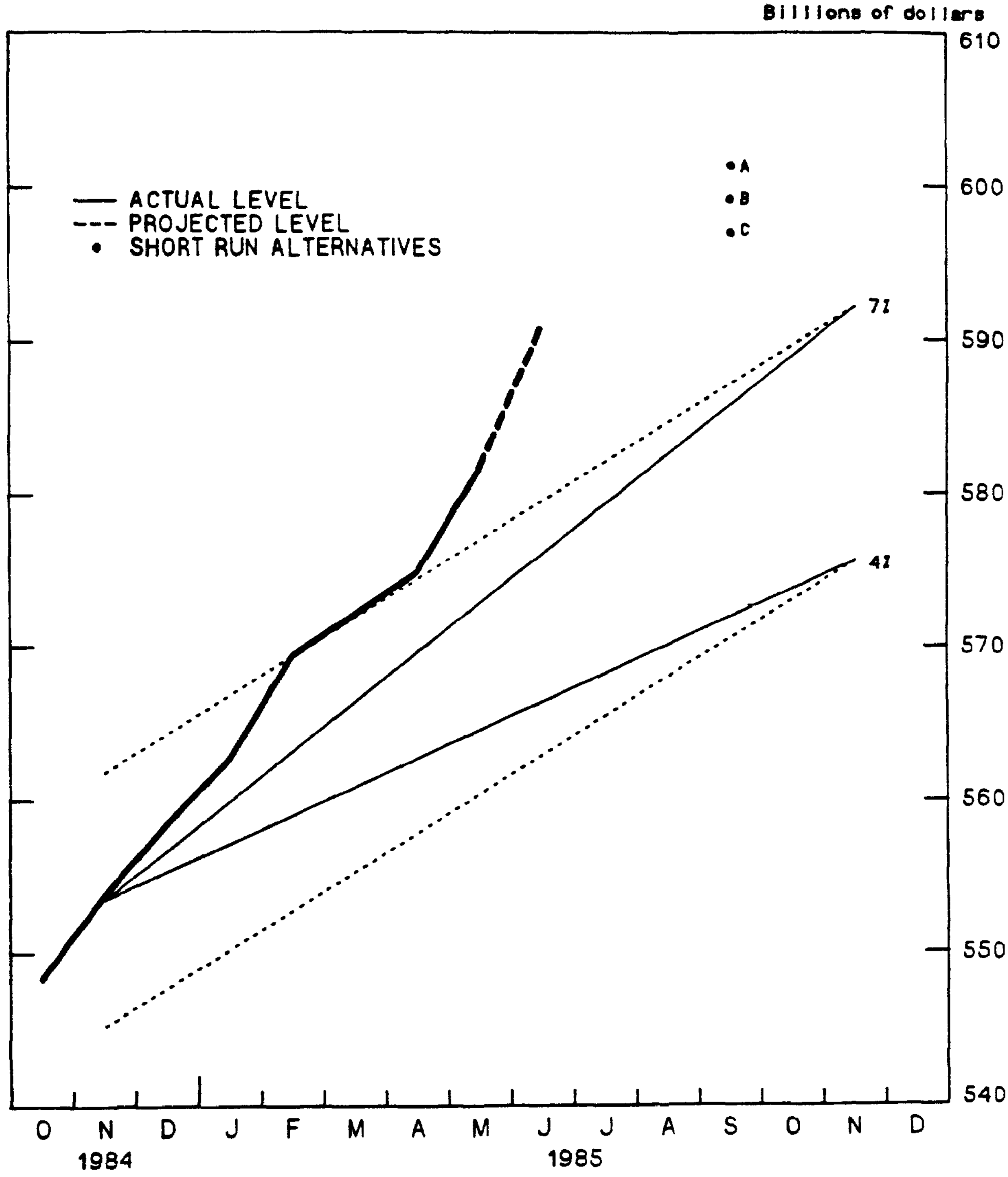


Chart 2

ACTUAL AND TARGETED M2

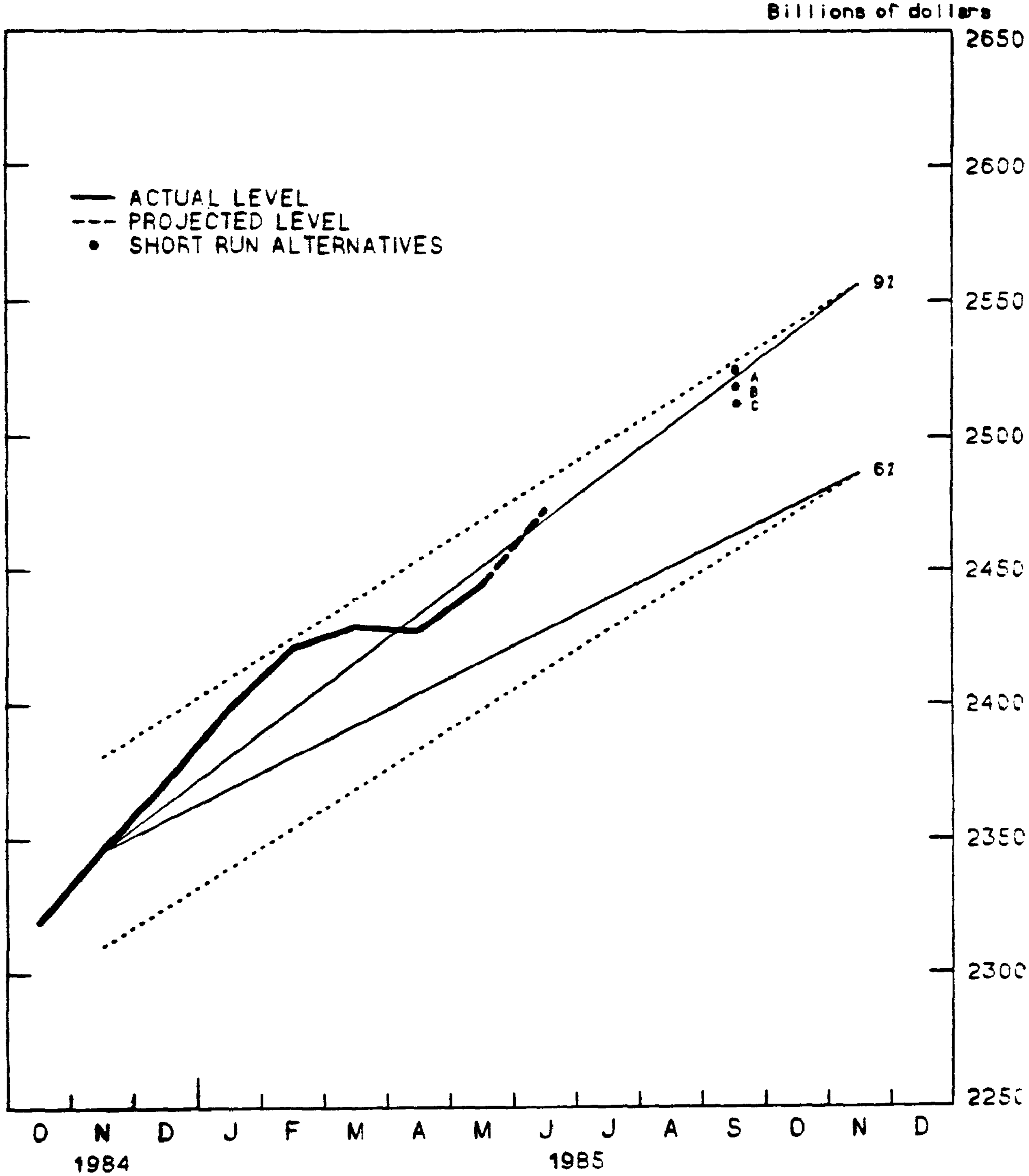


Chart 3

ACTUAL AND TARGETED M3

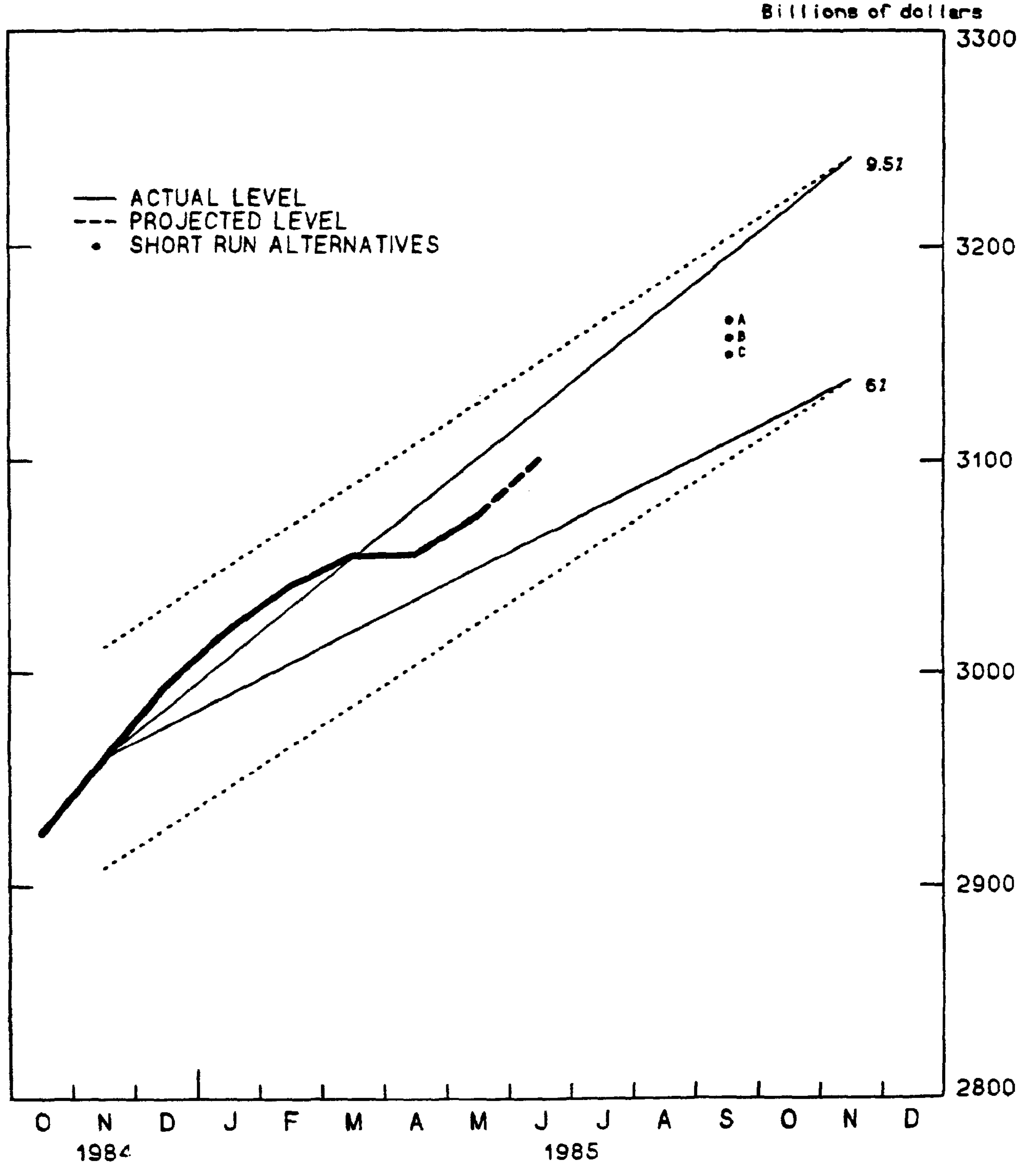
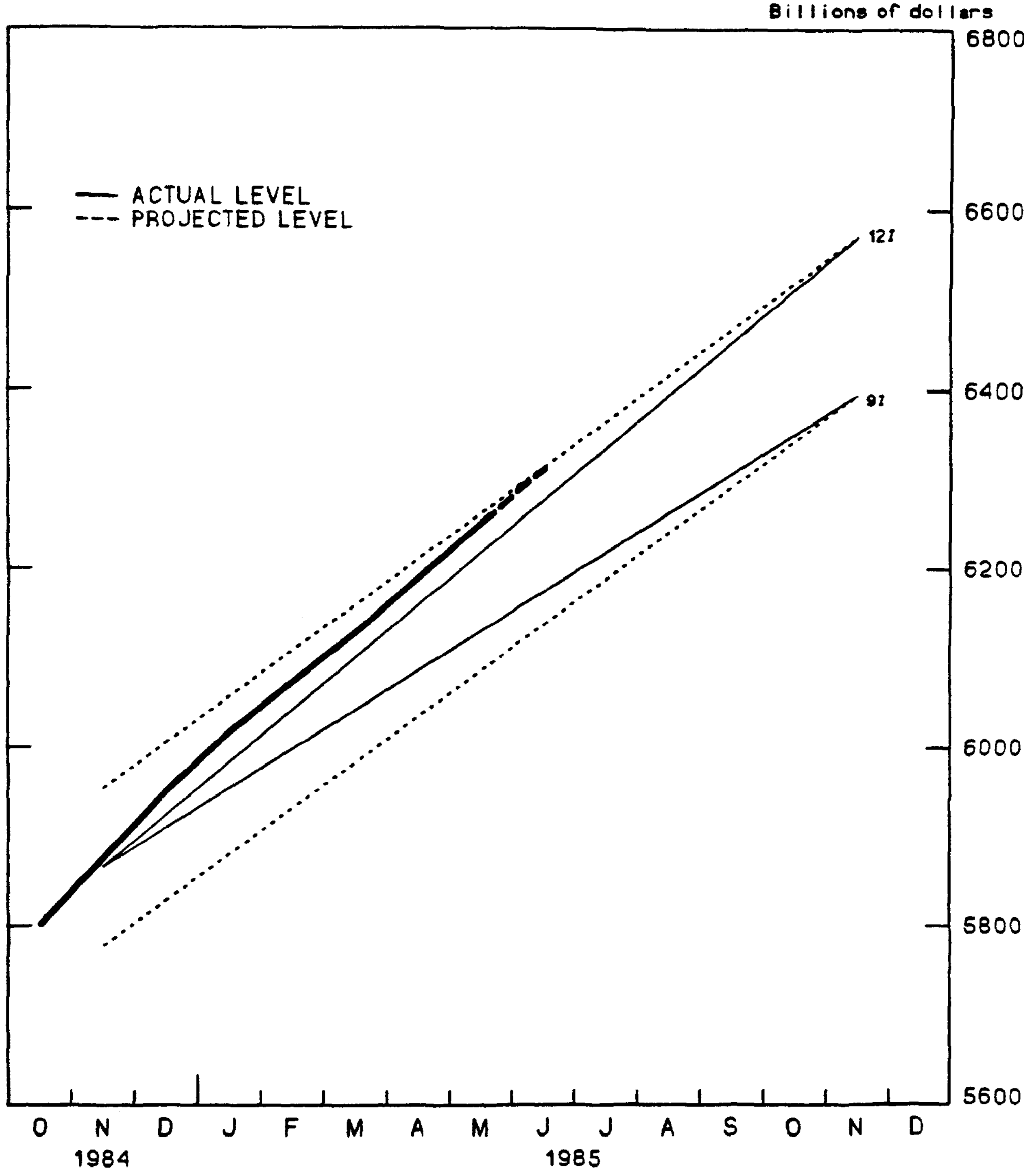


Chart 4
DEBT



Billions of dollars
ACTUAL LEVEL
PROJECTED LEVEL
12%
9%
6800
6600
6400
6200
6000
5800
5600
O
N
D
J
F
M
A
M
J
J
A
S
O
N
D
1984
1985

expansion of M1. Indeed, if M1 remained at its June level during the third quarter, average growth for the quarter would be more than 5-3/4 percent at an annual rate. While this suggests that transactions needs of the third quarter may have been in some measure already satisfied, M1 growth over the months ahead is likely to be sustained by the continuing effect on money demand of the recent declines of interest rates, if for no other reason. On a quarterly average basis, M1 would be expected to increase at around a 10 percent annual rate, implying another appreciable decline in velocity of more than 3-3/4 percent at an annual rate given the Greenbook GNP forecast.

(21) Under alternative B, M1 by September would be about 10 percent at an annual rate above the fourth-quarter 1984 long-run target base. It would of course be less high relative to a long-run target rebased to QII '85, with growth from that base to September at an 8-1/2 percent annual rate. M1 expansion would be expected to slow further on a month-by-month basis in the fourth quarter, to a 3 to 4 percent annual rate, if reserve market conditions remain essentially unchanged, as the effects on money demand of recent interest rate declines wear off and velocity returns to around its expected trend rate of growth (absent interest rate changes). As a result, M1 by the fourth quarter on average might be about 8-3/4 percent above its QIV '84 level and 7 percent, annual rate, above a QII '85 level.

(22) Growth of M2 and M3 under alternative B would also be expected to slow relative to their average pace of May and June. In addition to the moderation of M1 growth, the nontransaction components of M2 and M3 should expand less rapidly over coming months, with inflows to money market funds and MMDAs tapering off as their yields fall into more

normal alignment with market interest rates. Moreover, issuance of managed liabilities in the broader aggregates is unlikely to strengthen greatly, given expectations of some weakening in bank credit growth and continuing constraints on thrift asset expansion from capital requirements and market concerns about the thrifts' financial condition. Under alternative B, M2 in September would be just below the upper end of its current long-run range, while M3 would be expected to be a little above the midpoint of its range.

(23) Growth in the debt of nonfinancial sectors is expected to slow slightly further in the third quarter, but expansion through September might be around the upper end of the Committee's 9 to 12 percent long-run range. Some of the moderation in overall debt growth is attributable to less rapid expansion of federal government debt on a seasonally adjusted basis. In addition, state and local governments' advance refunding of existing debt is expected to taper off. Consumer credit growth also should slow along with the growth of consumption expenditures--including those for durable goods. Mortgage credit expansion is expected to edge higher, however, as housing activity responds to the previous declines in interest rates. Underlying needs for funds by businesses may increase, with capital spending expanding in the face of relatively flat profits, but borrowing to finance mergers, buyouts and stock retirements is projected to moderate a little. In the fourth quarter, growth of debt of private nonfinancial sectors is expected to remain close to the third-quarter pace, assuming interest rates stay around current levels. However, federal government borrowing is likely to pick up, seasonally adjusted, and credit growth for the year probably would be just above the upper end of the Committee's long-run range.

(24) Unchanged reserve and money market conditions, as under alternative B, are likely to be associated with a modest back-up in short-term interest rates as the summer progresses, given fairly widespread expectations of some easing of Federal Reserve policy over coming months. The 3-month Treasury bill rate might rise to around 7-1/4 percent. Bond yields, although increasing a bit initially in sympathy with short-term rates, might change relatively little on balance, since long-term rates are high in real terms and relative to short-term rates. Some upward movement in long-term rates may develop, however, should there be substantial disappointment with Congressional action on federal deficits. In foreign exchange markets, the dollar is expected to remain within the trading range prevailing in the last few months.

(25) Alternative A contemplates an easing in money market conditions consistent with somewhat more rapid money growth over the June-to-September period. Borrowing at the discount window would drop to minimal levels of around $150-200 million, or a more modest reduction in borrowing might be accompanied by a cut in the discount rate to 7 percent. The federal funds rate under this alternative would be expected to decline toward 7 percent. Total and nonborrowed reserves would increase at 5-1/2 and 9-1/4 percent annual rates, respectively, over the summer. Other market interest rates would fall relatively little under this alternative from most recent levels--levels that appear to reflect anticipations of some easing by the Federal Reserve over the near-term. The three-month bill would probably trade in a 6-1/2 to 6-3/4 percent area. Private short-term rates might decline more than bill rates as the lower overall level of rates was seen as helping those financial institutions currently under some stress. The dollar would decline in foreign exchange markets.

(26) Alternative A incorporates M1 growth at a 7 percent annual rate over the third quarter, and at a 10-1/2 percent annual rate from its fourth-quarter 1984 base. Growth of M2, and to a lesser extent M3, would be bolstered under this alternative, as lower interest rates boosted flows into MMDAs and MMFs. The lower interest rates likely to develop, if maintained over the balance of the year, would also tend, along with stronger growth in income, to raise money demand into the fourth quarter. Under those conditions, growth of M1, M2 and debt for the QIV 1984 to QIV 1985 period could be around the upper ends of the specifications of alternative II.

(27) Alternative C contemplates a more marked slowing of money growth over the months ahead than alternative B, with M1 specified to grow at a 4 percent annual rate. Adjustment plus seasonal credit at the discount window would be expected to increase to around $600 million, with growth in nonborrowed reserves slowing to a one percent annual rate over the coming three months. The federal funds rate would be expected to rise to around the 8-1/4 to 8-1/2 percent area, and other interest rates, as well as the foreign exchange value of the dollar, would increase substantially in response to the unexpected tightening in money markets. This greater slowing of money growth and tightening of credit conditions would increase the odds that M1 might approach its current long-run upper limit by late this year, although growth at the upper bound of or within the current range would probably require a further tightening of reserve conditions.

Directive language

(28) Given below is draft directive language, with variants, relating to the Committee's decisions on the longer-run ranges. (Draft language for the operating paragraph is shown in paragraph (29) beginning on p. 22.) To improve readability, the language adopted at the previous meeting is intially shown below in crossed-out form and proposed language is shown thereafter without the usual format of strike-throughs and capital letters. For simplicity, the proposed language does not repeat the first sentence containing the general statement of the Committee's policy objectives nor the ensuing standard paragraph on policy implementation. The first proposal is structured to allow for consideration of raising the base of the M1 range for 1985, or, as shown in brackets, for shifting the base; the possibility of adjusting the upper limits of certain other ranges is also provided for. The second proposal assumes all current ranges for 1985 are retained but allows for accepting growth in M1 above the range. After the two proposals, a proposed paragraph for 1986 ranges is shown.

Current language

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. ~~In furtherance of these objectives the Committee agreed at its meeting in February to establish ranges for monetary growth of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9-1/2 percent for M3 for the period from the fourth quarter of 1984 to the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was set at 9 to 12 percent for the year 1985. The Committee agreed that~~

~~growth in the monetary aggregates in the upper part of their ranges for 1985 may be appropriate, depending on developments with respect to velocity and provided that inflationary pressures remain subdued.~~

The Committee understood that policy implementation would require continuing appraisal of the relationships not only among the various measures of money and credit but also between those aggregates and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

Proposal 1

...In furtherance of these objectives the Committee at this meeting established a range of ___ to ___ percent for M1 for the period from the fourth quarter of 1984 to the fourth quarter of 1985 [for the period from the second quarter of 1985 to the fourth quarter of 1985] and reaffirmed [established] ranges for the year of ___ to ___ percent for M2 and ___ to ___ percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed [established] at ___ to ___ percent. Although growth in M1 was expected to slow in the second half of 1985, the range for the year was raised from that established in February to allow for the possibility that the velocity of M1 may decline for the year as a whole, given the substantial drop in the first half of the year. [The base for the M1 range was moved forward to the second quarter of 1985 to be consistent with a gradual return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year.] [The upper limit(s) of the range(s) for (M2 and/or debt) was (were) also raised in light of the decline(s) in its (their) velocity on average over the first half of the year.] The Committee agreed that growth in the aggregates generally may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.

Proposal 2

...In furtherance of these objectives the Committee at this meeting reaffirmed the ranges of money growth established in February of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9-1/2 percent for M3 for the period from the fourth quarter of 1984 to the fourth quarter of 1985. The associated range for total domestic nonfinancial debt was retained at 9 to 12 percent. In reaffirming these ranges, the Committee recognized, with respect to M1, that the velocity of M1 for the year may decline, given the substantial drop in the first half. In that context, although growth in M1 was expected to slow from the first-half pace in the second half of the year, growth for the year as a whole above the range would be acceptable provided that inflationary pressures remain subdued. Growth of other aggregates in the upper part of their ranges would also be acceptable depending in part on velocity developments.

Proposal for 1986 ranges

For 1986 the Committee agreed on tentative ranges of monetary quarter of 1986, of ___ to ___ percent for M1, ___ to ___ percent for M2, and ___ to ___ percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at

___ to ___ percent for 1986. However, in establishing ranges for next year, the Committee recognized that account would need to be taken of experience with institutional and depositor behavior in response to the completion of deposit rate deregulation early in the year.

(29) An operating paragraph structured along the lines of the Committee's usual approach of recent months is proposed below.

Proposed operating paragraph

In the implementation of policy for the immediate future, ~~and against the background of the recent reduction in the discount rate,~~ the Committee seeks to DECREASE SLIGHTLY (ALT. A)/maintain (ALT. B)/INCREASE SLIGHTLY (ALT. C) ~~about~~ the ~~same~~ EXISTING degree of pressure on ~~bank~~ reserve positions. This action is expected to be consistent with growth in M1, M2, AND M3 at ~~an~~ annual ~~rate~~ RATES of around 6 ___, ___, AND ___ percent ~~or a little higher~~ during the period from ~~March to~~ June TO SEPTEMBER~~, while M2 and M3, in the light of their weakness in April, are expected to grow more slowly over the quarter than the 7 and 8 percent annual rates, respectively, anticipated earlier~~. Somewhat lesser reserve restraint would (MIGHT) be acceptable in the event of substantially slower growth of the monetary aggregates while somewhat greater restraint might (WOULD) be acceptable in the event of substantially higher growth. In either case such a change would be considered in the context of appraisals of the strength of the business expansion, progress against inflation, and conditions in domestic credit and foreign exchange markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of ~~6-to-10~~ ___ TO ___ percent.

Selected Interest Rates

Percent

July 8, 1985

Period	Short-Term								Long-Term							
	federal funds	Treasury bills secondary market			CDs secondary market	comm. paper	money market mutual fund	bank prime loan	U.S. government constant maturity yields			corporate A utility recently offered	municipal Bond Buyer	home mortgages		
		3-month	6-month	1-year	3-month	1-month			3-year	10-year	30-year			conventional at S&Ls	FHA/VA ceiling	S&L 1-year ARM
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1984--High	11.77	10.65	10.76	11.09	11.71	11.35	10.72	13.00	13.44	13.84	13.81	15.30	11.44	14.68	14.00	12.31
Low	7.95	7.71	8.01	8.39	8.24	8.04	8.38	11.00	10.39	11.30	11.36	12.70	9.86	13.14	12.50	10.81
1985--High	8.75	8.65	9.03	9.21	9.13	8.83	8.31	10.75	11.19	11.95	11.89	13.23	10.31	13.29	13.00	11.14
Low	7.13	6.77	6.92	7.10	7.34	7.22	7.01	9.50	8.86	10.02	10.34	11.50	9.19	12.05	11.50	9.83
1984--Apr.	10.29	9.69	9.84	9.95	10.41	10.17	9.29	11.93	11.98	12.63	12.65	13.96	10.26	13.65	13.00	11.16
May	10.32	9.83	10.31	10.57	11.11	10.38	9.52	12.39	12.75	13.41	13.43	14.79	10.88	13.94	13.94	11.35
June	11.06	9.87	10.51	10.93	11.34	10.82	9.92	12.60	13.18	13.56	13.44	15.00	11.07	14.42	14.00	11.67
July	11.23	10.12	10.52	10.89	11.56	11.06	10.30	13.00	13.08	13.36	13.21	14.93	10.84	14.67	14.00	12.20
Aug.	11.64	10.47	10.61	10.71	11.47	11.19	10.58	13.00	12.50	12.72	12.54	14.12	10.40	14.47	13.70	12.14
Sept.	11.30	10.37	10.47	10.51	11.29	11.11	10.62	12.97	12.34	12.52	12.29	13.86	10.54	14.35	13.50	12.00
Oct.	9.99	9.74	9.87	9.93	10.38	10.05	10.16	12.58	11.85	12.16	11.98	13.52	10.77	14.13	13.38	11.96
Nov.	9.43	8.61	8.81	9.01	9.18	9.01	9.34	11.77	10.90	11.57	11.56	12.98	10.69	13.64	12.75	11.54
Dec.	8.38	8.06	8.28	8.60	8.60	8.39	8.55	11.06	10.56	11.50	11.52	12.88	10.40	13.18	12.50	11.01
1985--Jan.	8.35	7.76	8.00	8.33	8.14	7.99	8.00	10.61	10.43	11.38	11.45	12.78	9.96	13.08	12.50	10.84
Feb.	8.50	8.27	8.39	8.56	8.69	8.46	7.80	10.50	10.55	11.51	11.47	12.76	10.07	12.92	12.50	10.63
Mar.	8.58	8.52	8.90	9.06	9.02	8.74	7.97	10.50	11.05	11.86	11.81	13.17	10.23	13.17	12.63	10.92
Apr.	8.27	7.95	8.23	8.44	8.49	8.31	7.97	10.50	10.49	11.43	11.47	12.75	9.85	13.20	12.75	10.83
May	7.97	7.48	7.65	7.85	7.92	7.80	7.71	10.31	9.75	10.85	11.05	12.25	9.46	12.91	12.30	10.56
June	7.53	6.95	7.09	7.27	7.44	7.34	7.26p	9.78	9.05	10.16	10.45	11.60	9.18	12.21	11.50	9.89
1985--Apr. 10	8.45	8.11	8.53	8.73	8.75	8.57	8.03	10.50	10.79	11.69	11.67	12.71	9.83	13.23	13.00	10.83
17	8.46	7.98	8.20	8.39	8.55	8.40	8.08	10.50	10.42	11.35	11.36	12.53	9.64	13.16	12.50	10.80
24	7.69	7.74	7.95	8.17	8.20	7.99	7.92	10.50	10.21	11.18	11.28	12.65	9.82	13.12	12.50	10.72
May 1	8.35	7.82	8.07	8.29	8.27	8.11	7.83	10.50	10.37	11.37	11.45	12.56	9.73	13.07	12.50	10.66
8	8.19	7.76	7.94	8.13	8.19	8.06	7.82	10.50	10.16	11.22	11.33	12.49	9.56	13.02	12.50	10.61
15	8.14	7.64	7.81	8.00	8.11	7.98	7.77	10.50	9.89	11.01	11.18	12.24	9.34	12.94	12.50	10.59
22	7.91	7.32	7.48	7.70	7.77	7.67	7.74	10.29	9.49	10.69	10.93	12.01	9.39	12.83	12.00	10.52
29	7.60	7.22	7.38	7.61	7.60	7.49	7.55	10.00	9.44	10.53	10.80	11.78	9.27	12.71	12.00	10.40
June 5	7.75	7.04	7.15	7.32	7.45	7.40	7.47	10.00	9.10	10.12	10.46	11.57	9.10	12.39	11.50	10.05
12	7.62	7.12	7.21	7.37	7.46	7.40	7.29	10.00	9.09	10.10	10.43	11.50	9.18	12.27	11.50	9.90
19	7.13	6.77	6.92	7.10	7.34	7.22	7.26	9.86	8.86	10.02	10.34	11.71	9.19	12.05	11.50	9.83
26	7.46	7.00	7.19	7.38	7.52	7.34	7.01	9.50	9.22	10.39	10.60	11.62	9.24	12.15	11.50	9.77
July 3	8.06	6.91	7.04	7.22	7.55	7.49	7.12	9.50	9.11	10.25	10.47	11.37	9.25	N.A.	11.50	N.A.
Daily--June 28	7.95	6.83	6.97	7.19	7.55	7.49	--	9.50	9.08	10.25	10.47	--	--	--	--	--
July 5	7.98p	6.77	6.79	6.93	7.41	7.47	--	9.50	8.77p	9.94P	10.26P	--	--	--	--	--

NOTE: Weekly data for columns 1 through 11 are statement week averages. Data in column 7 are taken from Donoghue's Money Fund Report. Columns 12 and 13 are 1-day quotes for Friday and Thursday, respectively, following the end of the statement week. Column 13 is the *Bond Buyer* revenue index. Column 14 is an average of contract interest rates on new commitments for conventional first mortgages with 80 percent loan-to-value ratios at a sample of savings and loan associations on the Friday following the end of the statement week. After November 30, 1983, column 15 refers only to VA-guaranteed loans. Column 16 is the average initial contract rate on new commitments for one-year ARMs at those institutions offering both fixed- and adjustable-rate mortgages with the same number of discount points.

FR 1367 (4/85)

Security Dealer Positions

Millions of dollars

July 8, 1985

Period	Net[1] Total	Cash Positions: Treasury bills	Cash Positions: Treasury coupons under 1 year	Cash Positions: Treasury coupons over 1 year	Cash Positions: federal agency	Cash Positions: private short-term	Forward and Futures Positions: Treasury bills	Forward and Futures Positions: Treasury coupons under 1 year	Forward and Futures Positions: Treasury coupons over 1 year	Forward and Futures Positions: federal agency	Forward and Futures Positions: private short-term
1984--High	32,155	15.505	1 296	6 840	19.525	21,064	8 272	131	3 381	-7,223	-4
Low	5.107	-8,251	-1,038	-5 664	11 086	11,263	-14 456	-327	-986	-10,679	-13,053
1985--High	53,514	14,672	2.068	6 479	21 007	21.623	3 823	117	6 909	-6.190	6.988
Low	9,356	3 900	-390	-6.653	16.693	14.603	-14 946	-128	-373	-8.827	-20.453
1984--Apr.	14,408	2,929	-32	-1,643	16,649	13,065	-2 140	-13	476	-9.422	-5,462
May	14,163	-7,105	-291	-1.754	16,849	12.525	5 511	-10	347	-9.676	-2,233
June	16,483	-2,631	-596	-3,248	15 999	14,457	2 207	-21	1 448	-9 937	-1,195
July	12,355	-2,382	-604	-3,391	16,040	14,751	-2,528	-89	2,800	-9.650	-2,592
Aug.	11,499	4,542	-89	-1.184	16,098	15,556	-7.312	-240	2 504	-9.073	-9,304
Sept.	17,976	10,316	310	623	14,063	17,695	-9 771	-122	2,156	-8.334	-8,960
Oct.	21,955	11,649	116	2,649	13,168	16,285	-9,867	-72	2.154	-8 815	-5,312
Nov.	19,094	9,748	-487	5,087	16,106	17,950	-8 549	-76	533	-9,229	-11,991
Dec.	26,220	13,841	-416	4,762	18,470	19,180	-11,718	59	-389	-8,313	-9,256
1985--Jan.	24,020	11,614	-110	2,467	19,416	19,977	-13,318	-31	702	-7,033	-9,662
Feb.	32,989	12,456	851	227	19,614	19,449	-3,648	-12	2,494	-8,155	-10,287
Mar.	48,477	14,027	1,316	-4,338	19,337	16,216	848	-52	4,677	-8,353	4,799
Apr.	36,627	11,538	1,203	-4,536	18,049	17,560	-2,950	10	5.575	-7,843	-1,978
May	22,475	8,016	1,082	-3,965	19,814	19,294	-5,885	95	6,104	-7,904	-14,176
June	13,785*	4,690*	830*	-3,868*	22,729*	19,271*	-5.057*	61*	4,473*	-9,608*	-19,735*
1985--Apr. 10	34,889	10,255	705	-4,252	17,372	16,350	-3,772	-14	5,532	-8,539	1,251
17	37,578	13,109	1,019	-4,602	18,862	16,509	-2,927	3	6,177	-7,910	-2,663
24	35,760	12,110	1,648	-5,840	18,671	18,679	-2,993	10	5,650	-7,411	-4,765
May 1	37,977	9,513	1,545	-4,634	18,029	19,500	112	67	5,357	-7,346	-4,166
8	37,553	11,219	1,223	-4,912	19,243	20,019	-2,744	104	6,678	-7,393	-5,885
15	26,763	9,958	1,198	-1,091	19,515	18,410	-7,410	98	6,909	-7,905	-12,919
22	15.131	6,546	999	-5,148	19,634	18,533	-7 051	56	6,031	-8,139	-16,330
29	9,356	3,900	913	-5.221	20,720	19,349	-7 152	117	5,245	-8,062	-20,453
June 5	12,883	7,422	1,011	-2,727	22,147	21.555	-7.348	113	4,512	-8,866	-24,936
12	8,276*	7,323*	1,078*	-3,906*	23,370*	21,497*	-6,774*	114*	4.227*	-10,123*	-28,530*
19	12,256*	5.692*	709*	-3,902*	22,377*	18,123*	-6 214*	68*	4,964*	-9,632*	-19,929*
26	17,183*	1,168*	581*	-5,513*	22,694*	17,406*	-2,898*	-7*	4,414*	-9,651*	-11,011*
July 3	22,244*	550*	876*	-899*	22,333*	18,353*	-1,493*	-3*	3,657*	-9,049*	-12,082*

NOTE: Government securities dealer cash positions consist of securities already delivered, commitments to buy (sell) securities on an outright basis for immediate delivery (5 business days or less), and certain "when-issued" securities for delayed delivery (more than 5 business days). Futures and forward positions include all other commitments involving delayed delivery; futures contracts are arranged on organized exchanges.

1. Cash plus forward plus futures positions in Treasury, federal agency, and private short-term securities.

* Strictly confidential

STRICTLY CONFIDENTIAL (FR)
CLASS II-FOMC

Net Changes in System Holdings of Securities[1]

Millions of dollars, not seasonally adjusted

July 8 1985

Period	Treasury bills net change[2]	Treasury coupons net purchases[3]					Federal agencies net purchases[4]					Net change outright holdings total[5]	Net RPs[6]
		within 1-year	1-5	5-10	over 10	total	within 1-year	1-5	5-10	over 10	total		
1980	-3 052	912	2 138	703	811	4 564	217	298	29	24	668	2,035	2,462
1981	5,337	294	1 702	393	379	2 768	133	360	--	--	494	8 491	684
1982	5,698	312	1,794	388	307	2,803	--	--	--	--	--	8,312	1.461
1983	13,068	484	1 896	890	383	3 653	--	--	--	--	--	16 342	-5,445
1984	3,779	826	1,938	236	441	3,440	--	--	--	--	--	6,964	1,450
1984--QTR. I	-1,168	--	--	-300	--	-300	--	--	--	--	--	-1,555	-286
II	491	198	808	200	277	1,484	--	--	--	--	--	1,918	70
III	-424	600	--	--	--	600	--	--	--	--	--	169	1,982
IV	4,880	28	1,130	335	164	1,657	--	--	--	--	--	6,432	-316
1985--QTR. I	-2,044	961	465	-100	--	1,326	--	--	--	--	--	-735	462
II	7,183	245	846	108	96	1,295	--	--	--	--	--	8,409	-350
1985--Jan	-4,268	--	--	-100	--	-100	--	--	--	--	--	-4,368	-2,315
Feb.	2,362	--	--	--	--	--	--	--	--	--	--	2,345	3,095
Mar.	-138	961	465	--	--	1,426	--	--	--	--	--	1,289	-318
Apr.	6,026	245	846	108	96	1,295	--	--	--	--	--	7,321	6,141
May	-942	--	--	--	--	--	--	--	--	--	--	-951	-9,257
June	2,099	--	--	--	--	--	--	--	--	--	--	2,039	2,766
1985--Apr. 3	422	--	--	--	--	--	--	--	--	--	--	422	-751
10	1,883	--	--	--	--	--	--	--	--	--	--	1,883	1,684
17	2.691	245	846	108	96	1,295	--	--	--	--	--	3,985	-1,954
24	1,388	--	--	--	--	--	--	--	--	--	--	1,387	891
							--	--	--	--	--	--	10,500
May 1	--	--	--	--	--	--	--	--	--	--	--	--	-7,202
8	--	--	--	--	--	--	--	--	--	--	--	-888	-4,922
15	-880	--	--	--	--	--							
May 22	-300	--	--	--	--	--	--	--	--	--	--	-300	390
29	3	--	--	--	--	--	--	--	--	--	--	3	449
June 5	249	--	--	--	--	--	--	--	--	--	--	249	286
12	2,010	--	--	--	--	--	--	--	--	--	--	1,990	-444
19	--	--	--	--	--	--	--	--	--	--	--	--	-1,385
26	--	--	--	--	--	--	--	--	--	--	--	--	851
July 3	75	--	--	--	--	--	--	--	--	--	--	75	739
LEVEL--July 3	76.3	17.7	37.0	15.3	20.8	90.8	2.6	4.0	1.2	.4	8.3	179.1	3.7

1 Change from end-of-period to end-of-period.

2 Outright transactions in market and with foreign accounts, and redemptions (–) in bill auctions.

3 Outright transactions in market and with foreign accounts, and short-term notes acquired in exchange for maturing bills. Excludes redemptions, maturity shifts, rollovers of maturing coupon issues, and direct Treasury borrowing from the System.

4 Outright transactions in market and with foreign accounts only. Excludes redemptions and maturity shifts.

5 In addition to the net purchases of securities, also reflects changes in System holdings of bankers' acceptances, direct Treasury borrowing from the System and redemptions (–) of agency and Treasury coupon issues.

6 Includes changes in RPs (+), matched sale-purchase transactions (–), and matched purchase-sale transactions (+).