

Meeting of the Federal Open Market Committee

September 23, 1986

Minutes of Actions

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, September 23, 1986, at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Guffey
Mr. Heller
Mrs. Horn
Mr. Johnson
Mr. Melzer
Mr. Morris
Mr. Rice
Ms. Seger
Mr. Wallich

Messrs. Boehne, Boykin, Keehn, and Stern, Alternate
Members of the Federal Open Market Committee

Messrs. Black, Forrestal, and Parry, Presidents of the Federal
Reserve Banks of Richmond, Atlanta, and San Francisco,
respectively

Mr. Bernard, Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Oltman, Deputy General Counsel
Mr. Kichline, Economist
Mr. Truman, Economist (International)

Messrs. Balbach, T. Davis, Kohn, Lindsey, Ms. Munnell,
Messrs. Prell and Siegman, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System
Open Market Account

Mr. Cross, Manager for Foreign Operations, System
Open Market Account

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Mr. Coyne, Assistant to the Board, Board of Governors
Mr. Gemmill, Staff Adviser, Division of International
Finance, Board of Governors
Mrs. Loney, Economist, Office of the Staff Director for
Monetary and Financial Policy, Board of Governors
Mr. Simpson, Deputy Associate Director, Division of
Research and Statistics, Board of Governors
Mrs. Low, Open Market Secretariat Assistant,
Board of Governors

Mr. Fousek, Executive Vice President, Federal Reserve
Bank of New York

Messrs. Broaddus, Lang, Rolnick, Rosenblum, Scadding,
Scheld, Thieke, and Ms. Tschinkel, Senior Vice
Presidents, Federal Reserve Banks of Richmond,
Philadelphia, Minneapolis, Dallas, San Francisco,
Chicago, New York, and Atlanta, respectively

Mr. Skaperdas, Assistant Vice President, Federal Reserve
of Cleveland

By unanimous vote, the minutes of actions taken at the meeting of
the Federal Open Market Committee held on August 19, 1986, were approved.

By unanimous vote, System open market transactions in government
securities and federal agency obligations during the period August 19, 1986,
through September 22, 1986, were ratified.

With Mr. Wallich dissenting, the Federal Reserve Bank of New York
was authorized and directed, until otherwise directed by the Committee, to
execute transactions in the System Account in accordance with the following
domestic policy directive:

The information reviewed at this meeting suggests
some pickup in the growth of economic activity from the
slow pace in the second quarter. In August total nonfarm
payroll employment grew considerably further, with
employment in manufacturing rising for the first time
since January. The civilian unemployment rate edged
down further to 6.8 percent. Industrial production rose

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slightly in July and August after declining on balance during the first half of the year. Consumer spending has remained relatively strong in recent months, with gains in retail sales in August paced by a sharp rise in auto sales. Housing starts in July and August stayed at a relatively high level. Business capital spending appears to have remained sluggish, reflecting weakness in nonresidential construction. A more moderate rate of wage increases has been sustained in recent months, while broad measures of prices have firmed somewhat due to developments in food and energy markets.

The trade-weighted value of the dollar against major foreign currencies is essentially unchanged on balance since the August 19 meeting of the Committee. Preliminary data for the U.S. merchandise trade deficit in July indicate a larger deficit than in previous months.

Growth of M2 and especially of M3 moderated in August, but expansion of these two aggregates for the year through August has been at the upper end of their respective ranges established by the Committee for 1986. In August M1 continued to grow very rapidly. Expansion in total domestic nonfinancial debt remains appreciably above the Committee's monitoring range for 1986. Short-term interest rates have declined further since the August meeting of the Committee while long-term market rates have risen on balance. On August 20, the Federal Reserve Board approved a reduction in the discount rate from 6 to 5-1/2 percent.

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 the July meeting to reaffirm the ranges established in February for growth of 6 to 9 percent for both M2 and M3, measured from the fourth quarter of 1985 to the fourth quarter of 1986. With respect to M1, the Committee recognized that, based on the experience of recent years, the behavior of that aggregate is subject to substantial uncertainties in relation to economic activity and prices, depending among other things on the responsiveness of M1 growth

to changes in interest rates. In light of these uncertainties and of the substantial decline in velocity in the first half of the year, the Committee decided that growth of M1 in excess of the previously established 3 to 8 percent range for 1986 would be acceptable. Acceptable growth of M1 over the remainder of the year will depend on the behavior of velocity, growth in the other monetary aggregates, developments in the economy and financial markets, and price pressures. Given its rapid growth in the early part of the year, the Committee recognized that the increase in total domestic nonfinancial debt in 1986 may exceed its monitoring range of 8 to 11 percent, but felt an increase in that range would provide an inappropriate benchmark for evaluating longer-term trends in that aggregate.

For 1987 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1986 to the fourth quarter of 1987, of 5-1/2 to 8-1/2 percent for M2 and M3. While a range of 3 to 8 percent for M1 in 1987 would appear appropriate in the light of most historical experience, the Committee recognized that the exceptional uncertainties surrounding the behavior of M1 velocity over the more recent period would require careful appraisal of the target range at the beginning of 1987. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1987.

In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. This action is expected to be consistent with growth in M2 and M3 over the period from August to December at annual rates of 7 to 9 percent. While growth in M1 is expected to moderate from the exceptionally large increase during the past several months, that growth will continue to be judged in the light of the behavior of M2 and M3 and other factors. Slightly greater reserve restraint would, or slightly lesser reserve restraint might, be acceptable depending on the behavior of the aggregates, taking into account the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 4 to 8 percent.

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It was agreed that the next meeting of the Committee would be held on November 5, 1986.

The meeting adjourned.

Assistant Secretary