FEDERAL RESERVE press release

For Use at 4:30 p.m. May 23, 1986

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on April 1, 1986.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS OF THE
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on April 1, 1986

Domestic policy directive

The information reviewed at this meeting indicated a mixed pattern of developments. On balance it appeared that economic activity had picked up from the reduced fourth-quarter pace, although spending remained sluggish in some key sectors. Price developments thus far in 1986 had been dominated by sharp declines in oil prices. Energy prices fell substantially over the first two months of the year and food prices also declined somewhat, while prices of most other goods and services rose at a moderate pace.

Total nonfarm payroll employment, which had increased substantially in January, rose further in February, but employment in manufacturing fell after four months of gains. The average monthly rise in employment for the two months was about 325,000, somewhat higher than the average in the fourth quarter of 1985. Hiring was exceptionally brisk at retail trade and service establishments in both months. In contrast to the employment gains reported in the payroll survey, employment as measured by the household survey fell almost 400,000 in February, about offsetting the increase in January, and the civilian unemployment rate rose 0.6 percentage point to 7.3 percent. A sharp drop in agricultural employment, not measured by the payroll survey, accounted for about half of the decline; job losses in energy-related industries apparently also contributed to the decline.

The index of industrial production fell an estimated 0.6 percent in February after edging up only slightly in January. Although output of automotive goods was higher in February, production cutbacks were widespread for most other categories of goods. In particular, petroleum drilling activity was curtailed sharply in response to the dramatic declines in oil prices. Limited information available for March, including reported cutbacks in motor vehicle assemblies and steel production, and a further decline in drilling activity, suggested continued sluggishness in production. The index of capacity utilization for total industry declined 0.6 percent to 80.0 percent; over the past year the index generally had fluctuated in a range of 80 to 81 percent.

Although retail sales changed little in January and February, they remained about 1.0 percent above the average in the fourth quarter, owing to a spurt in December. The rise relative to the level of the fourth quarter was attributable to gains in outlays for durable goods, particularly automobiles and furniture and appliances. Sales of domestic automobiles, boosted by additional financing incentive programs, rose to an average annual rate of 8.3 million units over the January-February period, about 1-1/2 million units above the depressed fourth-quarter rate. However, sales slipped during the first 20 days of March to a rate of 7 million units.

Total private housing starts surged in the January-February period to an annual rate of more than 2 million units, compared with an average of about 1-3/4 million units for the fourth quarter and for the year 1985. The increase was concentrated in the single-family sector, though construction of multifamily structures remained at a relatively brisk pace despite continued high rental vacancy rates. Sales of new homes declined somewhat in February to a level about equal to the fourth-quarter average, while sales of existing homes remained at about their January pace and a little lower than in the fourth quarter. Over the period since the FOMC meeting in February, the average rate on commitments at savings and loan associations for conventional fixed-rate home mortgage loans had declined nearly 1 percentage point to about 10 percent, the lowest level since 1978.

Business capital spending apparently weakened somewhat in early 1986 after a surge around the end of last year. Shipments of nondefense capital goods from domestic producers rose 5 percent in February but remained well below the average in the fourth quarter. New orders for nondefense capital goods, after having been essentially flat in the fourth quarter, declined sharply in January but turned up in February. Outlays for nonresidential structures probably fell in early 1986, as spending on petroleum drilling activity reportedly plummeted.

Largely reflecting declines in energy prices, the producer price index for finished goods fell substantially in January and February, dropping 0.7 percent and 1.6 percent respectively. Producer prices for consumer foods and for crude food materials also declined appreciably over the two months. The consumer price index declined 0.4 percent in February--its first decline in more than three years--more than offsetting a rise in January. A sharp drop in prices for gasoline and fuel oil accounted for most of the February decline, but food prices also fell. Prices of other goods and services generally rose moderately. The index of average hourly earnings edged up on balance over the first two months of the year.

The trade-weighted value of the dollar against major foreign currencies continued to fall through about mid-March but recently rose somewhat; on balance the dollar had declined about 1-3/4 percent over the period since the February meeting. Disappointment among market participants about data released on U.S. economic activity and concerns about potential adverse effects of the sharp declines in oil prices on U.S. banks holding sizable loans to energy-related businesses and to oil-producing developing countries exerted downward pressure on the dollar, offset to some extent by views that foreign authorities, especially the Japanese, were reluctant to see further appreciation of their currencies. The merchandise trade deficit in January appeared to have been only slightly smaller than in December; preliminary data for February suggested that exports increased and that the price and quantity of oil imports declined.

At its meeting on February 11-12, 1986, the Committee had adopted a directive that called for maintaining unchanged conditions of reserve availability. The members expected such an approach to policy implementation to be consistent with growth in M2 and M3 at annual rates of about 6 percent and 7 percent respectively for the period from November to March. Over the same period they expected M1 to expand at an annual rate of around 7 percent, though the behavior of M1 was viewed as still subject to unusual uncertainty. The Committee agreed that somewhat greater or somewhat lesser reserve restraint might be acceptable over the intermeeting period, depending on the behavior of the aggregates, the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

After growing little in January, M1 expanded at an annual rate of about 7-1/4 percent in February and was expected to grow at a rate of about 14 percent in March -- leaving this aggregate at a level somewhat above the upper end of the Committee's range for the year. On the other hand, growth of M2 was generally sluggish over the first three months of the year, and expansion in M3 remained moderate. As a result, M2 was running below its long-run range while M3 was near the midpoint of its range for 1986. The expansion in total domestic nonfinancial debt appeared to have slowed appreciably over the first quarter, after extraordinarily rapid growth around the end of last year.

Open market operations during the intermeeting period were directed at maintaining about the prevailing degree of pressure on reserve positions. Seasonal plus adjustment borrowing from the discount window averaged about $350 million during the three full reserve maintenance periods after the February FOMC meeting. That level was inflated a bit by technical problems associated with wire transfers early in the interval; more recently, borrowing was running in the area of $225 million to $250 million.

Federal funds generally traded in the 7-3/4 to 8 percent area during the first half of the intermeeting period. After the announcement by the Federal Reserve on March 7 of a reduction in the discount rate from 7-1/2 to 7 percent, the federal funds rate fell to around 7-3/8 percent and generally fluctated around that level throughout the remainder of the period. Other short-term interest rates declined about 1/2 to 7/8 percentage point over the intermeeting interval. Long-term rates dropped more sharply, falling by 1 to nearly 1-3/4 percentage points, against a background of further weakness in oil prices, mixed economic news, and declines in some aggregate measures of prices.

During the Committee's discussion of the economic situation and outlook, several members commented on the contrast between current indications of some sluggishness in economic activity and a number of underlying developments that pointed to stronger expansion later in the year and perhaps in 1987 as well. The incoming information on business activity was mixed, but it was thought that on balance such information suggested a pickup in economic growth in the first half of this year from the very slow pace in the fourth quarter. Several members observed, though, that the near-term outlook remained relatively weak, particularly taking account of substantial cutbacks in oil company investments associated with declining oil prices. At the same time a combination of developments--including reduced interest rates, higher stock prices, lower oil prices, and a decline in the dollar on exchange markets--was likely to exert an increasingly stimulative impact on the economy as the year progressed. The staff projection presented at this meeting had suggested that the expansion in real GNP would strengthen by the second half of the year, after relatively modest growth in the first half.

In evaluating the economic outlook, some members referred to the apparent improvement in business confidence over the course of recent weeks as the cost of capital declined and international competitiveness improved. It was thought that substantial declines in interest rates would have a stimulative impact on interest-sensitive sectors of the economy; indeed, that impact was already being felt in the housing sector. Members also reported that lower interest rates were leading to a large volume of mortgage debt refinancings. The latter would reduce monthly servicing costs and would therefore tend to support consumer spending over time. The rise in stock market prices and the decline in oil prices also were viewed as favorable for consumer spending. Taking account of these various factors, a few members commented that potential deviations from the staff projection were likely to be in the direction of more rapid growth.

Other members, while seeing some improvement as a likely prospect for the second half of the year, nonetheless emphasized the uncertainties--both domestic and international--that continued to trouble the business outlook and that could portend more restrained expansion than was currently anticipated. Consumer debt burdens remained large and one member observed that sales of new automobiles currently appeared to be inhibited to some extent by a reduced willingness or capacity of some consumers to borrow. In the business sector, while investment spending was likely to benefit considerably from the reduced cost of capital, its overall growth might well be restrained by weak demands for business equipment in important sectors of the economy such as agriculture and energy, and by the impact over time of apparent overbuilding, notably of office structures, in some parts of the country. One member also noted that uncertainties relating to tax reform legislation were continuing to inhibit business investment spending. Members also indicated that the improved conditions in financial markets stemmed to a large extent from expectations of future reductions in federal budget deficits and a failure to implement such reductions could have highly adverse consequences for financial markets and the economy.

With respect to exchange market developments, the decline in the dollar was viewed as implying upward pressures on domestic prices over time, but also as likely to stimulate business activity. While there were few actual indications to date of directly induced increases in export sales, contacts with business suggested that export markets were improving. The members continued to differ in their assessment of when and to what extent a lower dollar would exert its favorable effects on overall domestic economic activity or begin to show through significantly in prices. One emphasized that efforts by foreign firms to retain market shares, especially in the absence of strong economic growth abroad, would tend to reduce the expansionary and price effects of the dollar's depreciation.

Some members commented that the strength of the expansion in the U.S. economy over the next few quarters would depend to an important extent on the rate of economic growth in key industrial nations abroad and the resulting increase in their demands for U.S. exports. It was noted, however, that stronger expansion in some major foreign countries might well be contingent on their pursuit of more stimulative economic policies, and there was question about the willingness of some key countries to undertake such policies at this time. A member also commented on the importance of world commodity prices in maintaining the international purchasing power of many developing countries, in addition to those that exported oil, and the potentially adverse repercussions of lower commodity prices on world trade and U.S. export industries.

In their comments about the outlook for inflation the members gave considerable emphasis to the favorable impact of declining oil prices, but it was also noted that those prices remained vulnerable to a reversal. In the staff's economic projections, the rate of increase in prices was projected to slow over the near term, largely because of the favorable, one-time effects of lower oil prices. Members noted that the current downward pressures on prices provided an opportunity for the more effective pursuit of policies designed to foster a continuing reduction in the rate of inflation. It was observed in this connection that while considerable progress had been made in curbing inflation in key industries such as manufacturing and construction, the services industries appeared to be particularly resistant to further anti-inflationary progress. Partly for that reason but also in light of the recent weakness in productivity, the depreciation of the dollar, federal budget uncertainties, and the possibility of a reversal in oil prices, some members expressed concern about the underlying inflationary potential in the economy. They also cited recent price increases by a major automobile manufacturer as a worrisome development in terms of its broader implications for inflationary attitudes and future inflation.

At its meeting in February the Committee had agreed on policy objectives for monetary growth for the period from the fourth quarter of 1985 to the fourth quarter of 1986 that included ranges of 3 to 8 percent for M1 and 6 to 9 percent for both M2 and M3. The associated range for total domestic nonfinancial debt was set at 8 to 11 percent. In keeping with the Committee's usual procedures under the Humphrey-Hawkins Act, these ranges would be reviewed at the July meeting or sooner if warranted by unanticipated developments.

In the Committee's discussion of policy implementation for the weeks immediately ahead, all of the members favored directing open market operations at least initially toward maintaining essentially unchanged conditions of reserve availability. However, some shadings of opinion were expressed. A few preferred to tilt the provision of reserves toward slightly easier reserve conditions or at least to retain flexibility in that direction, depending on emerging market conditions. Others expressed the view that current reserve pressures should be well maintained, recognizing the possibility that such an approach to policy implementation might involve some little tightening of market conditions since market participants might be anticipating some easing. More generally, a number of members commented that policy implementation needed to take account of the already accommodative posture of monetary policy and the favorable, though somewhat uncertain, prospects for stronger expansion over the intermediate term, if not in the period immediately ahead.

The members anticipated that, with little or no change in reserve conditions, the monetary aggregates would tend to grow at rates that were broadly consistent with the Committee's target ranges for the year. M1 might remain on the high side in the weeks ahead, but it was emphasized that the behavior of M1 remained subject to considerable uncertainty. According to an analysis prepared for this meeting, M1 growth over the next three months might be close to that experienced over the December-to-March period, assuming unchanged conditions of reserve availability, somewhat slower expansion in nominal GNP, and no further declines in short-term market rates. However, demands for M1 balances were likely to be boosted, possibly substantially, if interest rates should decline further during the period ahead. Some members also stressed the desirability of focusing on the tendency for the velocity of M1 to remain relatively weak and the associated possibility that relatively rapid growth in M1 and in reserves might be needed to help sustain the expansion. In general, the members agreed that the behavior of M1 should continue to be evaluated in light of its consistency with M2 and M3 and also in the context of broader economic and financial developments, the potential for inflationary pressures, and exchange market conditions. Over the next three months M2 was expected to strengthen from its reduced pace in the first quarter, while M3 was likely to continue to expand at a moderate rate.

With regard to possible intermeeting adjustments in policy implementation, the members could foresee potential developments that might call for either some easing or some tightening, given the uncertainties about prospective economic and financial developments and the behavior of the monetary aggregates. In these circumstances, most of the members felt that there should be no presumptions about the likely direction of any intermeeting adjustments. However, some members believed that policy implementation should remain especially alert to developments that might call for some easing of reserve conditions, given the risks that the expansion might prove to be significantly weaker than expected over the period immediately ahead. It was noted that a further reduction in the discount rate, should market conditions here and policy developments abroad make such an action desirable, could have implications for monetary policy implementation and, depending on the circumstances, might require a consultation of the Committee prior to the next scheduled meeting on May 20.

At the conclusion of the Committee's discussion, all of the members indicated their acceptance of a directive that called for maintaining about the existing degree of pressure on reserve conditions. The members expected such an approach to policy implementation to be consistent with growth of both M2 and M3 at an annual rate of about 7 percent for the period from March to June. Over the same period, M1 was expected to expand at an annual rate of about 7 to 8 percent, but the members recognized that the behavior of M1 remained subject to unusual uncertainty. The Committee indicated that it might find somewhat lesser or somewhat greater reserve availability acceptable over the intermeeting period depending on the growth of the monetary aggregates, the strength of the business expansion, the performance of the dollar on foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Committee agreed that the current intermeeting range of 6 to 10 percent for the federal funds rate should be retained, although some members suggested that the current range might be lowered as a technical adjustment that would bring the present trading level of the federal funds rate closer to the midpoint of the range.

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 indicates a mixed pattern of developments with evidence of a pickup in economic activity from the reduced fourth-quarter pace but with spending sluggish in some key sectors. Total nonfarm payroll employment increased appreciably further in February following a large rise in January, but employment in manufacturing fell after four months of gains and industrial production declined. The civilian unemployment rate rose sharply to 7.3 percent. Retail sales were little changed in January and February after rising over the previous two months, while housing starts were well above their pace in late 1985. Business capital spending apparently weakened somewhat in early 1986. The merchandise trade deficit

for January appears to have been only slightly smaller than in December; preliminary data for February suggest that exports increased and that the price and quantity of oil imports declined. Largely reflecting declines in energy prices, consumer prices edged down on balance over the first two months of 1986 and producer prices fell substantially.

Growth in M1 picked up considerably over the course of the first quarter, leaving this aggregate by March somewhat above the upper end of its range for the year. On the other hand, growth of M2 was generally sluggish over the past 3 months and was running below its long-run range. Expansion of M3 was moderate during the winter months, with growth around the midpoint of its range for 1986. Interest rates have declined considerably since the February meeting of the Committee. On March 6, the Federal Reserve Board approved a reduction in the discount rate from 7-1/2 to 7 percent. The trade-weighted value of the dollar against major foreign currencies continued to decline through mid-March but has risen somewhat more recently; on balance the dollar has declined slightly since the February 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 its February meeting to establish the following ranges for monetary growth, 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 was subject to substantial uncertainties in relationship to economic activity and prices, depending among other things on its responsiveness to changes in interest rates. It agreed that an appropriate target range under existing circumstances would be 3 to 8 percent, but it intends to evaluate movements in M1 in the light of its consistency with the other monetary aggregates, developments in the economy and financial markets, and potential inflationary pressures. It adopted a range of 6 to 9 percent for M2 and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent for the year 1986.

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 March to June at annual rates of about 7 percent; while the behavior of M1 continues to be subject to unusual uncertainty, growth at an annual rate of about 7 to 8 percent over the period is anticipated. Somewhat lesser reserve restraint or somewhat greater reserve restraint might be acceptable depending on behavior of the aggregates, the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

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

On April 21, the Committee held a conference by telephone after the announcement of a reduction in the discount rate from 7 to 6-1/2 percent effective on that date. The members reviewed recent economic and financial developments, including the behavior of the monetary aggregates and technical factors affecting the provision of reserves. At the conclusion of the discussion the members agreed that no changes were needed in the current directive adopted at the meeting on April 1. It was understood that in carrying out open market operations within the framework of that directive, and recognizing that partial data suggested a strengthening in all the monetary aggregates in recent weeks, a degree of caution should be exercised to avoid an impression that a further change in the discount rate was sought over the period immediately ahead.