

Meeting of the Federal Open Market Committee

May 20, 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, May 20, 1986, at 9:15 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Guffey
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
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield, 1/ General Counsel
Mr. Oltman, Deputy General Counsel
Mr. Kichline, Economist
Mr. Truman, Economist (International)

Messrs. J. Davis, T. Davis, Kohn, Lindsey, 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

1/ Entered meeting after action to approve minutes for meeting of April 1, 1986.

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Mr. Coyne, 1/ Assistant to the Board, Board of Governors
Mr. Roberts, Assistant to the Chairman, Board of Governors
Mr. Gemmill, Staff Adviser, Division of International
Finance, Board of Governors
Mrs. Low, Open Market Secretariat Assistant,
Board of Governors

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

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

Messrs. Burger, Cook, and Fieleke, Vice Presidents,
Federal Reserve Banks of St. Louis, Richmond,
and Boston, respectively

By unanimous vote, the minutes of actions taken at the meeting of
the Federal Open Market Committee held on April 1, 1986, were approved.

By unanimous vote, System open market transactions in Government
securities and Federal agency obligations during the period April 1, 1986,
through May 19, 1986, were ratified.

Without objection, the Committee agreed to a suggestion by the
Manager for Domestic Operations, System Open Market Account, that, given
changes in recent years in reserve requirement reporting periods, the Manager's
weekly "Report of Open Market Operations and Money Market Conditions" should
be replaced by a report covering operations and money market developments
for each 2-week reserve maintenance period.

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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 indicates a mixed pattern of developments but suggests on balance that economic activity is expanding at a relatively modest pace in the current quarter. Total nonfarm payroll employment increased moderately further in April following a considerable rise in the first quarter, but employment in manufacturing fell for the third consecutive month. The civilian unemployment rate edged down to 7.1 percent. Industrial production and total retail sales turned up in April following earlier declines, while housing starts rose somewhat further from a relatively high level. Weakness in the energy sector has contributed to a slowing of business capital spending. The merchandise trade deficit appears to have decreased somewhat in the first quarter, as the volume and average price of oil imports fell. Largely reflecting declines in energy prices, consumer prices have declined somewhat since late 1985 and producer prices have fallen substantially.

In April M1 continued to grow at a rapid pace, leaving this aggregate above the upper end of its range for the year. Growth of the broader aggregates, especially of M2, strengthened considerably in April, bringing M2 into the lower part of its long-run range and M3 slightly above the midpoint of its range for 1986. Most short-term interest rates have declined on balance since the April 1 meeting of the Committee, while long-term rates are somewhat higher. On April 18, the Federal Reserve Board approved a reduction in the discount rate from 7 to 6-1/2 percent. The trade-weighted value of the dollar against major foreign currencies has risen somewhat recently but on balance the dollar has declined further since the April meeting, particularly against the Japanese yen.

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 a deceleration in money growth over the balance of the quarter. However, in view of the rapid money growth thus far in the quarter and the apparent weakness in velocity, the Committee anticipates faster growth for the monetary aggregates, particularly M1, than expected at the last meeting. M2 and M3 are expected to expand over the period from March to June at annual rates of about 8 to 10 percent. While the behavior of M1 continues to be subject to unusual uncertainty, growth at an annual rate of about 12 to 14 percent over the period is now anticipated. If the anticipated slowing in monetary growth does not develop, somewhat greater reserve restraint would be acceptable in the context of a pickup in growth of the economy, taking account of conditions in domestic and international financial markets and the behavior of the dollar in foreign

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exchange markets. Somewhat lesser reserve restraint might be acceptable in the context of a marked slowing in money growth and pronounced sluggishness in economic performance. 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.

It was agreed that the next meeting of the Committee would be held on July 8-9, 1986.

The meeting adjourned.

Secretary