TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

May 18, 1976

Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcript was not fully edited for accuracy at the time it was produced because it was intended only as an aid to the Secretariat in preparing the record of the Committee's policy actions. The edited transcript has not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Staff Statements Appended to the Transcript

Mr. Sternlight, Deputy Manager for Domestic Operations

Content last modified 01/11/2011.

Meeting of Federal Open Market Committee

May 18, 1976

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 18, 1976, at 9:00 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Gardner
Mr. Jackson
Mr. Kimbrel
Mr. Partee
Mr. Wallich
Mr. Winn

Messrs. Baughman, Guffey, Mayo, and Morris, Alternate Members of the Federal Open Market Committee

Messrs. MacLaury and Roos, Presidents of the Federal Reserve Banks of Minneapolis and St. Louis, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard,1/ Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist (Domestic Finance)
Mr. Gramley,1/ Economist (Domestic Business)
Messrs. Brandt,1/ Hocter,1/ Keran,1/ Kichline,1/ Parthemos,1/ Reynolds,1/ and Zeisel,1/ Associate Economists

1/ Entered meeting at point indicated.

Mr. Holmes, Manager, System Open Market Account
Mr. Pardee,1/ Deputy Manager for Foreign Operations
Mr. Sternlight,1/ Deputy Manager for Domestic Operations

Mr. Coyne, Assistant to the Board of Governors
Mr. Keir,1/ Adviser, Division of Research and Statistics, Board of Governors
Mr. Gemmill,1/ Adviser, Division of International Finance, Board of Governors
Mrs. Farar,1/ Economist, Open Market Secretariat, Board of Governors
Mrs. Deck,1/ Staff Assistant, Open Market Secretariat, Board of Governors

Mr. Willes,1/ First Vice President of the Federal Reserve Bank of Philadelphia
Messrs. Boehne1/ and Doll,1/ Senior Vice Presidents, Federal Reserve Banks of Philadelphia and Kansas City, respectively
Messrs. Balbach,1/ Burns,1/ and Davis,1/ Vice Presidents, Federal Reserve Banks of St. Louis, Dallas, and New York, respectively
Mrs. Nichols1/ and Mr. Kareken,1/ Economic Advisers, Federal Reserve Banks of Chicago and Minneapolis, respectively
Mr. McNees,1/ Assistant Vice President, Federal Reserve Bank of Boston
Mr. Hill,1/ Senior Economist, Federal Reserve Bank of New York

1/ Entered meeting at point indicated.

Transcript of Federal Open Market Committee Meeting of
May 18, 1976

CHAIRMAN BURNS. Gentlemen, we'll get our meeting under way. During the past two or three meetings, we have deliberated on the desirability of continuing the Memorandum of Discussion or discontinuing it, and also the desirability of changing the character of the Record of Policy Actions and of reducing the lag in its release.

Now, at our [March 29] intermeeting [meeting], the Committee agreed in principle with the following: (1) the Memorandum of Discussion should be discontinued, (2) the Record of Policy Actions should be expanded to include more information on the factors or considerations underlying the Committee's policy decision, and (3) the lag in the release of the Record of Policy Actions should be reduced by some 10 or 15 days from the present lag of approximately 45 days.

This was an agreement in principle, and the Committee did not act formally at the intermeeting. The Committee did not act formally in part in order to enable the staff to consult with the Justice Department about these actions in the light of the lawsuit that the Committee is presently involved in. And Mr. Broida informs me that members of the Committee have been advised that a representative of the Justice Department has concurred in the reasonableness of our proposals--in other words, he sees no objection or difficulty from the viewpoint of the lawsuit. Is that correct?

MR. BROIDA. That's correct.

CHAIRMAN BURNS. To go on with the review of where we were and what has taken place since the meeting, at the April meeting the Committee also left open the questions of the specific duration of the lag in releasing the Record of Policy Actions. Our staff, [which] has studied various possible schedules, has concluded, and I'm inclined to agree, that the best procedure, all things considered, would be to release the record for each meeting on the Friday following the next meeting. In other words, we hold the meeting--this is the May meeting--and some four or five weeks from now we'd be meeting in June; the Record of Policy Actions for the May meeting would be released on the Friday following our June meeting, held on a Tuesday.

Now, to [give] you, the Committee, some insight into the new procedure, if we choose to adopt it, the Committee drafted a preliminary version of an expanded Record of Policy Actions covering the meeting. And this was done in order to test the feasibility of the new procedure if we finally decide to take that road. And I understand from Mr. Broida that the process of getting comments from members of the Committee went well, and Mr. Broida may want to say something about that a little later on.

Now, we've privately agreed to [take] formal and final action today. And if the Committee decides to adopt the new procedures, namely, to drop the Memorandum of Discussion, to have an expanded Record of Policy Actions, and to release it some 30 or 35 days after our meeting, I think it would be desirable to hold a press conference to explain these procedures at the time when the first policy record is released on the new schedule. Regrettably, I will be out of the city on Friday, and such a press conference, if we proceed in this way, would have to be delayed until next Monday. But the plan would be to make the release, henceforth, on a Friday following the Tuesday meeting.

Now two elements of the proposal of this new approach were left open at the time of our April meeting. One was the suggestion that the Secretary place in the files memoranda that would summarize informal Committee decisions and understandings; and the second item that was left open was that the minutes of the Committee's deliberations be expanded to include explanations of procedural actions. Now we could hold a long debate on these outstanding items; I would suggest that we not do so. I would suggest that occasions may arise when such procedures would be appropriate, and that a committee or a subcommittee--special subcommittee--be appointed to deal with these unresolved technical issues. That subcommittee might have a great deal to do, and again that subcommittee might have literally nothing to do.

Now that is a summary of where we are or where we might want to go, and before we proceed to an informal voting, we might want to address specific questions that members of the Committee may have. The questions may be directed to Mr. Broida, to Mr. O'Connell, or to me. Are there any questions?

CHAIRMAN BURNS. Yes, Mr. MacLaury.

MR. MACLAURY. Thank you, Mr. Chairman. I've been thinking about the Sunshine in Government [bill] today, and in that context, my wonder is that, were the bill to pass as it presently is being proposed, am I correct in thinking that we would be required to keep a verbatim transcript? And if so, wouldn't that make moot this question of whether we drop the Memorandum of Discussion? That's my question.

CHAIRMAN BURNS. I'm going to turn this over to Mr. O'Connell.

MR. O'CONNELL. Mr. Chairman, in the present wording of the bill, we hope to be able, by liberal interpretation of that language--if it isn't changed from present wording of both Senate and House version of the Sunshine bill, President MacLaury--to assert that the Sunshine legislation is not applicable to the FOMC.

CHAIRMAN BURNS. Let me just interrupt. I think this is a statement that literally should be kept to ourselves. We should not--no member of the Committee should discuss that with any of his aides or anyone else at any time because we run the risk of amendment that might make life a good deal more difficult for us.

MR. O'CONNELL. Yes, sir. At this time, it has not been discussed by anyone. There had been many allusions, I think perhaps loosely used, Mr. MacLaury, to applicability to the FOMC. Some in defense of our position, that it should not be covered. We haven't asserted applicability to the FOMC. Our position has always been [that of] the Board's trouble with this bill. Others have converted that to use of the term FOMC.

Assume for a moment, though, that it is held to be applicable, either by an amendment in the language, if that occurs, or by court decision, and thus this Committee is subjected to the provisions of the Sunshine bill as finally passed. If it in any form parallels its present language, [then] meetings the Committee would be subject to the transcript requirements of verbatim transcript. The requirement [would be] that the portion that is not exempt under one of the ten exemptions now in the bill would be made immediately available to the public. The balance, if it fits any of the exemptions, can be deleted and withheld by the Committee, but the verbatim transcript would be required.

MR. BROIDA. May I add, the Memorandum of Discussion, of course, is a rather different document from a verbatim transcript. It's condensed and written in the third person and is presumably a more efficient record of the meeting. But also, as I understand it, the parts of the verbatim transcript that are not made public need be held only for two years and need never be made public, whereas the Memorandum of Discussion, under present practices, is made public after five years. But if there is a verbatim transcript under the Government in the Sunshine Act that is made public in part or in whole, I think the Committee would certainly not want to have a competitive report of the meeting in [existence] at the same time.

MR. O'CONNELL. May I add, Mr. Chairman, too, in reference to Art's point that a certain portion need not be published in the two year [period]: we question the certitude with which that could be asserted. We anticipate lawsuits being filed [against] many agencies [arguing that] a certain closed meeting was improperly closed and that the transcript should not have been withheld. And thus, they will ask that the court examine and make public even withheld portions of the transcript. I think this is a reasonable anticipation.

CHAIRMAN BURNS. All right, any other question or comment?

MR. WALLICH. I have a question with regard to the general style of the expanded Record of Policy Actions. I don't know whether it's appropriate at this time to bring that up.

CHAIRMAN BURNS. Yes, yes, it certainly is.

MR. WALLICH. I think what we saw was an extremely well-done piece, and what I'm going to say is in no way critical of the fine work that's gone into it. It does seem to me that it kind of aims [at] a great deal of material that is familiar to every reader of the newspapers, who know GNP was such, employment was such, and so forth. Now, it's interesting to somebody who studies these matters carefully to know what information the Committee had, [but] that could easily be accomplished by saying information was available up to such and such a date, in particular.

CHAIRMAN BURNS. That wouldn't help a historian very much. It would make his task much more difficult.

MR. WALLICH. Yes, but the general reader of this [unintelligible], such a reader is really very familiar with all the data that are in that record, besides their release with a delay of 30 days or whatever, so that they are not even a useful way for him to recapitulate this information. The interesting information for the reader, I think, is what the projections were of the staff [unintelligible]. That's new information. My suggestion is that we emphasize the latter and deemphasize the former.

CHAIRMAN BURNS. I follow the trend of thinking and I don't think I wholly agree, for two reasons. One is purely formal. We are describing this document as an expanded policy record. We're providing more information than in the past. And that is partly the justification for eliminating the Memorandum of Discussion. Now, on the basis of this concept, the document should be longer, you see, must be longer, and this is a formal consideration that cannot be neglected, and we need some additional pages.

Now, as for the information that is contained about the economy, well, I think you credit individuals who follow the Federal Reserve with more knowledge than I think many of them really have. I think it is a useful summary. Those who feel that it merely repeats that which they already know will have no difficulty skipping paragraphs or pages. Those on the other hand, who may find such a recapitulation useful, or find that they derive new knowledge, will have an opportunity to be instructed fully.

And therefore, while I understand these criticisms, I think that if anything, this document may be criticized on the grounds, coming back to my first formal point, that it is not long enough. Now, when this document was first shown to me, it was hardly longer, or just about a page or two longer--two pages longer than a policy record was in the past. And I told members of the staff, "Well, that will not do. I'm not going to tell you how to add additional pages, and I'm certainly not going to say that we should do anything that remotely resembles padding, but produce several additional pages."

MR. MAYO. Mr. Chairman, I might say, too, that, to elaborate on your point, even the more sophisticated readers of our document, three or four weeks later, may be hard put to remember whether our directive came out the day before or the day after the appearance of new GNP figures, and this sort of thing. The timing can be sensitive, and I think it does make for more complete background information, quite apart from the formal requirement here to have the facts as we knew them on that day and not have people wondering, "Sure, but did this new figure come out before or after that date?"

MR. MACLAURY. But perhaps Henry's point could be put a different way that would serve both of your principles, and that is that the interpretation of the existing facts by the staff and by the members is what is new information to anyone outside of this group, and the question is whether that information should be supplemented, not to say padded.

CHAIRMAN BURNS. I think that's a good comment, and I think our staff should strive toward somewhat fuller statements in the future. Now, they will vary from time to time.

MR. COLDWELL. May I raise a question, Mr. Chairman? I'm not going to reiterate all my reasons for objecting to this [unintelligible] last time, so I'm not going to reiterate. I would--

SPEAKER(?). Phil, we can't hear you down here.

MR. COLDWELL. I would like to know whether the informal understanding memo was planned to be released at any time?

CHAIRMAN BURNS. Now to [unintelligible], on the basis of discussions that I've held with the staff thus far, and on the basis of the discussion that we've had at this table last month, I would say that the present answer probably is no. Now, that may not be a good answer, and therefore we might well want to minimize the occasions where they are simply informal understandings and [instead] seek a maximum of formal explicit understandings which would be included in the Record of Policy Actions. Now, Mr. Broida, you have thought more about these questions than I have, and you, Mr. O'Connell, have, and would each of you try to answer Mr. Coldwell's question?

MR. BROIDA. I would say I agree with you, Mr. Chairman, that there's no present plan to release them, but this is fully within the domain of the Committee, and the Committee at any time could decide to make any package of these public. The occasions may well arise in the form of requests under the Freedom of Information Act; presumably the response would be on an ad hoc basis.

CHAIRMAN BURNS. I think that it might be beneficial to indicate explicitly just what it is that we are talking about when we discuss informal understandings. If we just talk about informal understanding in the abstract, we may create a conspiratorial mood within this Committee or convey a suggestion. Now, you're the author of the concept of informal understandings, Mr. Broida; would you be good enough to enlighten us as to just what it is that we might have informal understandings about.

MR. BROIDA. There is a category of matters with respect to which the Committee reaches conclusions that do not constitute formal policy actions or formal procedural action. A case in point is the agreement in principle reached at the last meeting with respect to the matters under discussion now. This was deliberately not a formal action, but it seemed to the staff worthwhile that some record be made of that discussion, and we would simply propose to note it in a memorandum to files.

Now, at the March 29 meeting, a special meeting, there was an understanding that RPDs would be dropped from the specifications. The specifications themselves, for reasons that have been discussed earlier, are not formal actions, and so a change in the variables for which the Committee makes specifications could not be a formal action. But in the staff's view, [there] should be some internal record of considerations underlying that action.

CHAIRMAN BURNS. Let me ask you a question. You have a technical reason here, but suppose we had decided to have a sentence in the Record of Policy Actions that we're dropping the RPDs, suppose we had decided--

MR. BROIDA. We do.

CHAIRMAN BURNS. We do what?

MR. PARTEE. Have such a sentence.

MR. BROIDA. In this draft Record of Policy Actions for April, there is such a sentence.

CHAIRMAN BURNS. Then I missed the point that you just made.

MR. BROIDA. The point is that there is simply a sentence stating that the Committee decided to drop RPDs without any record whatsoever of the discussion.

CHAIRMAN BURNS. All right, suppose that we not only decided to do that--well, suppose that the Record of Policy Actions reported not only the decision but some of the major considerations that led to that decision. Would we be violating some statute that should concern us?

MR. BROIDA. No sir.

CHAIRMAN BURNS. All right, therefore, I'd say this is something that [unintelligible].

MR. COLDWELL. Unless you can [unintelligible] upward the level of the policy record.

CHAIRMAN BURNS. Yeah, have an extra paragraph, and another half page.

MR. COLDWELL. How about the zone of indifference, is that another point which you put as an informal understanding?

MR. BROIDA. I would recommend that the Committee not have any record of a decision with respect to the policy. I take it the zone of indifference is part of the policy decision beyond what's in the Record of Policy Actions. I think it might be dangerous and inappropriate to have it--a secret record of a policy decision that goes beyond the public record of policy decision. So anything having to do with the Committee's policy decision, I think the full account should be in the Record of Policy Actions and no other record maintained.

MR. COLDWELL. I may have missed it, but is it in this one?

CHAIRMAN BURNS. You see, our difficulty--

MR. BROIDA. There was no decision on that point.

CHAIRMAN BURNS, --our difficulty is that Mr. Broida and Mr. O'Connell have a very clear concept of what is a policy decision and what is not a policy decision. I've never shared that knowledge of that understanding, you see. Now, I'm willing to be guided by them, and when they explain their reasons, [then] at [that] moment I do understand them or have the illusion of understanding them, then I forget immediately.

MR. BALLES. I share that problem.

CHAIRMAN BURNS. Let me say just one word. I think that--responding not to the precise question, but I think to the thought that was at the basis of Mr. Coldwell's question--what we ought to do, really, is to seek to minimize [in]formal understandings, and the examples that you've cited I think, are matters that could very well--I see no reason why, myself, [they] should not be included in the Record of Policy Actions. And, therefore, the problem of informal understandings in these instances wouldn't arise. Now and then, something may arise, but the Committee could then determine whether or not that specific item should be omitted from the policy record, and if so, whether a minute should not be retained within our files.

So we handle this, I think, on an ad hoc basis, but I would like to think we'd handle it with the understanding now that we would maximize inclusion of items in the Record of Policy Actions and thereby largely eliminate the need for so-called informal understandings.

MR. COLDWELL. I would certainly hope we would, Mr. Chairman, because I think that what we are doing is actually reducing the amount of information to venture into the public's domain. If we do this informal--

CHAIRMAN BURNS. No, I don't think that's true because the items that Mr. Broida is referring to are items that have not gotten into the Memorandum of Discussion. Is that correct?

MR. BROIDA. It has not gotten into the Record of Policy Actions.

MR. COLDWELL. Well, they've been in the Memorandum of Discussion.

MR. O'CONNELL. But the term "openly" is the further point. In five years, they would be made available.

CHAIRMAN BURNS. But I think that the question that Mr. Coldwell has raised is a good one and I think the proper answer is let's proceed on the principle that there will rarely be informal understandings. Now and then there may be and that's something we will act on, on the ad hoc basis. Mr. Balles?

MR. BALLES. Excuse the interruption, Mr. Chairman--

CHAIRMAN BURNS. Not at all.

MR. BALLES. --but I was going to say that I shared your lack of understanding of certain issues. In my case, I must say I fully support the proposal you made, but I just am mystified by why the specifications are not a part of the policy decision. I know that was explained once--I didn't understand it then, and I'd like to be educated.

CHAIRMAN BURNS. Do you really want to be educated on this distinction now?

MR. BALLES. Well, I'd like an executive summary education in two minutes.

CHAIRMAN BURNS. All right.

MR. BALLES. This is not an idle question. It seems to me with respect to the specs, the specs are such an integral part of what we have talked about here, I am in doubt as to why it shouldn't be in the Record of Policy Actions.

MR. BROIDA. They are in the Record of Policy Actions, President Balles. The situation briefly is this: If a matter is agreed by the Committee to be a policy decision or part of a policy decision, certain consequences follow. In particular, the information must be published in the *Federal Register*, it must be made available in the Record of Policy Actions.

CHAIRMAN BURNS. It must be made--

MR. BROIDA. It must be included in the Record of Policy Actions. Now, subject to the lags, and if the court rules, if the appellate court upholds the District Court , the facts will have to be made available on the day of the meeting. The Committee, in the past, has not been willing to publish the full specs on the same basis as it has published the directive. For a long time, it was disinclined to publish the long-run or the short-run [monetary aggregate] targets, but then it agreed to publish the short-run but [not] the long-run.

It now has agreed to publish [in] full, but not immediately--to defer publication of the long-run [targets] until the Chairman testifies in one of the quarterly hearings. So long as the Committee is not willing to accept the consequences of having the specs as part of the policy decision, it cannot appropriately treat them as part of the policy decision. If the Committee [can't] accept all of the consequences, then it can't treat them as part of the policy decision.

MR. BALLES. Art, what are those consequences--immediately reached--is that the problem?

MR. BROIDA. At present, since the District Court order has been stayed, they would be released in the Record of Policy Actions on whatever schedule that might [unintelligible] is released, whatever the lag that is [determined for] release. If the District Court is upheld, then it would be immediate release.

MR. BALLES. Okay, thank you. I'll try to remember that.

CHAIRMAN BURNS. All right, any--yes, Mr. Willes?

MR. WILLES. Some time ago I spent many hours in the library at Columbia going through in detail the Memorandum of Discussion, but on prior [unintelligible] to this Committee. And contrary to my expectations, they were very happy hours, because I found the memorandum rich in detail and insight into the workings of monetary policy in the Federal Open Market Committee. Recognizing that I'm just a guest here today, I have just a note on that basis--some sadness in seeing these particular documents--

CHAIRMAN BURNS. Well, I think you would find that a good many members of this Committee carry your sentiments. It's the recent turn of events, within the Congress, within the courts, within the environment in which we dwell that has moved members of this Committee towards the kind of decision that we may be taking today. But it will be done with a feeling of sadness by me and by a good many members of this Committee.

Any other question or comment? Well, if not, I think we are ready for a formal vote. There are three steps that we need to go through or [unintelligible], that is to say, if we decide to move in the directions that we have been going, I would proceed systematically. First, we need a motion that the Memorandum of Discussion be discontinued after the memorandum of the March meeting.

SPEAKER(?). So moved.

SPEAKER(?). Seconded.

CHAIRMAN BURNS. Motion has been made and seconded. Any further discussion of the motion? If not we'll take a formal vote now.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Mr. Balles	Yes
Mr. Black	Yes
Mr. Coldwell	No
Mr. Gardner	Yes
Mr. Jackson	Yes
Mr. Kimbrel	Yes
Mr. Partee	Yes
Mr. Wallich	Yes
Mr. Winn	Yes

Ten to one, Mr. Chairman.

CHAIRMAN BURNS. All right. Now, next we need a motion that the Record of Policy Actions for each meeting of the Committee is to be released to the public shortly after the next regularly scheduled meeting of the Committee--meaning by that, normally on the Friday following the Tuesday meetings.

SPEAKER(?). Mr. Chairman, clarification, I'm assuming you mean Friday afternoon after the markets are closed?

CHAIRMAN BURNS. Yes, that is correct.

MR. PARTEE. I have a question, too. What would be the treatment of interim votes of the Committee, or of interim telephone meetings of the Committee? Would they be included in that release?

CHAIRMAN BURNS. I would interpret it, if I may. Let's take today's meeting. The release would be three days after our June meeting, and if there are any decisions taken between now and the June meeting by way of telegram or telephone conversation or a special, physical meeting of the Committee, all that would be included in the Record of Policy Actions. Now that's my interpretation, is that correct?

MR. O'CONNELL. That's correct, Mr. Chairman. You recall that was one of the factors you mentioned in arriving at times of our [unintelligible] interval. You would include those.

MR. JACKSON. If you didn't, you might distort the information that you give to the public, which would mislead them rather than inform them.

MR. WINN. Supposing we'd had a phone meeting last Friday, then would that be included this Friday in your release?

CHAIRMAN BURNS. It would.

VICE CHAIRMAN VOLCKER. Well, the information in any sense is distorted anyway. You would have always had another meeting before this is released. That's the object of delaying.

MR. PARTEE. Suppose the subject at the Friday telephone conference call had been the bankruptcy of New York--then the discussion on that would be reported very promptly.

CHAIRMAN BURNS. Now, there is a question there in my own mind. When members of this Committee have held telephone meetings or conversations via telegram, we announce the decision. We would not have gone beyond that. And I would assume that if members of this Committee chose to talk about something and no decision was reached, then there would be no clear reason for including that in the Record of Policy Actions. And I would leave that to our lawyers.

MR. BROIDA. I might add, Mr. Chairman, that we do not make a policy record for every meeting, only those for which there are policy actions, and if, as the Chairman suggests, there is a discussion with no formal policy action that it need not be--

MR. PARTEE. --reflected in the policy record.

CHAIRMAN BURNS. But I would say, again, that this is a procedural question that members of the Committee may choose to decide one way or another in the future. What I've described, and what Messrs. Broida and O'Connell have described, is the procedure that we have worked with or under up to the present time. This Committee makes its own procedures--to change any time that we as a Committee decide to do so.

VICE CHAIRMAN VOLCKER. The fact that there is a meeting is always reported? And if we had a telephone meeting and we have reached [no] decision in your terms, you just note that there's been a meeting with no discussion at all?

MR. BROIDA. We have in the past included in the following Record of Policy Actions an indication that there had been an intermeeting [meeting] and the subject is--there's a case in point in this draft of April records, there's a footnote with respect to the March 29 meeting.

MR. COLDWELL. But by your lights, no decision may actually be a decision, would be an action.

MR. JACKSON. How would you say no decision is a decision?

CHAIRMAN BURNS. I don't think this is a matter that should really trouble us because it's only a matter that we should be sensitive to--we should be alert to our own thinking. If we have a meeting and no decision is reached, and if we want that recorded, I see no difficulty with recording it. Why not? On the other hand, I might see a difficulty if we held a meeting to discuss a specific, sensitive issue, then we've reached no decision. Then I would seriously doubt the wisdom of disclosing the sensitive issue on which we met and [on which we] decided to take no action.

MR. COLDWELL. My point is, [when] you decide to take no action, that, in effect, is a decision. Suppose we had a situation in which we were discussing New York, and they had applied to us for a loan, and we took no action, we neither approve nor disapprove. Will that be--

CHAIRMAN BURNS. That's different, because then an action would be taken, you see. Here is an application that we are [unintelligible]. We would assemble for the purpose of acting on [unintelligible]. But I see no difficulty, really.

MR. JACKSON. It strikes me, Mr. Chairman, that we could well establish the custom, to the extent that those meetings were held, that the public record would show that the Committee had either a [unintelligible] or other type of meeting for the purpose of a discussion of recent events which have transpired since the last meeting. I [unintelligible] just, a comment, and that no policy actions were taken. And if you establish this custom, then the nature of the discussion--I've never seen one of these yet where we didn't discuss more than [we planned for on] the day [on which] we convened. So I think that would be an accurate statement.

MR. PARTEE. Well, ordinarily there would be some action, that is, in the hypothetical case.

CHAIRMAN BURNS. I can't think of a case where we did not have--

MR. PARTEE. It would be a decision to constrain the [federal] funds limit, or something like that. And I take it, then, the entry would be that the Committee had a telephone conference or call to discuss the emerging problems of financial markets, particularly with regard to New York, and had decided for the time being to constrain the funds rate. That is, without any discussion of the ins and outs of the thing. It would be a simple reference to the thing. Well, I don't see that that does much damage, because of the public--something the public would know, I guess, and it would even come out in three, or four, or five days, or after the [unintelligible].

MR. BLACK. Point of clarification, question to Art and Tom. Isn't it true that, if we get the Government in the Sunshine Act, we will have to publish the fact that we had a meeting, and secondly the general nature of that meeting?

CHAIRMAN BURNS. Tom has indicated something that we are to keep in our own bosoms and not communicate to anyone that the present best legal interpretation--of Tom and our other attorneys--is that this Committee will not be subject to Sunshine legislation. And to keep this--never to discuss this in these sensitive days. I cannot emphasize the importance of that too much because it would be so easy to amend the Sunshine legislation to make sure that we are covered. Any other question? Yes?

VICE CHAIRMAN VOLCKER. Just to return to the same question of the intermeeting. It seems to me the general choice one has is, one either reports the interim meetings before the next full meeting in the policy record--is that the right term?--which comes out immediately after the next full meeting or almost immediately after, or you wait a month and report it with the second meeting. We can go one way or the other.

I feel a little bit uncomfortable, although I think it would arise very rarely if we did have an intermeeting just before our regular meeting. What's the point of delaying the report on the regular meeting--since it probably pretty much validated what you did at the intermeeting--why delay that a whole month? It seems a little inconsistent if we feel that there is some point in delaying the report basically a month. I suppose you could split the difference by saying you're going to report on any intermeeting that takes place 20 days before the release, or something like that. So, once it got near the next meeting [it] would be [in] the following report then--

CHAIRMAN BURNS. May I say a word? We have had interim meetings during the past several years, and we have reported those within the interval of 45 days.

MR. BROIDA. Ninety.

CHAIRMAN BURNS. Oh well, yes, 90 days, and then...

MR. BROIDA. The lag period.

CHAIRMAN BURNS. And, I'm not aware of any difficulty that has arisen as a result of reporting these special meetings, and all that is involved now is shortening the period from 45 to some 30 or 35 days.

MR. ROOS. Mr. Chairman, in announcing this change and its [unintelligible] publicly, will the rationale behind the change be explained or what will that rationale be--I mean in other words, why does the public think we are doing this?

CHAIRMAN BURNS. Well, that's the purpose of--instead of having a mere press release, it seemed wise to hold a press conference to explain the reasons for these changes, and to give newspaper men, financial writers, an opportunity to ask such a question.

MR. COLDWELL. Why are we reducing from 45 to 30?

CHAIRMAN BURNS. We want to provide the public with maximum information in the shortest possible time. Yes, Mr. Broida wants to comment on Mr. Volcker's--

MR. BROIDA. Mr. Chairman, most of the intermeeting consultations that we have had, they have generally been by telegram rather than telephone, have involved modifications of the instructions issued at the previous meeting, and apply to the remaining period until the next meeting. If they were not reported at the same time as the decision which they modify, the public might well conclude that the Manager [of the System Open Market Account] is violating his instructions, whereas in fact he's been acting under modified instructions.

CHAIRMAN BURNS. Well, not only that but by that time the market will have validated the Committee's special decision.

MR. JACKSON. This is really a [moot] discussion because the procedural issues are subject to change by the Committee at any time. I think we haven't had any occurrence [where] delay of release of information would be appropriate, [but] all we do is change our procedures.

VICE CHAIRMAN VOLCKER. I think that's right, it would arise very rarely.

MR. JACKSON. [Unintelligible] but if that [unintelligible], then we have got that alternative open to us so we really don't have any problems.

CHAIRMAN BURNS. That's true, but I want to modify a statement I made previously. I think that if we do have a special meeting, telephonically or otherwise, and if no decision, no policy decision is reached, the fact that such a meeting had occurred I think should be made a part of the record even though no action was reached. I think it's a better [unintelligible] and I think I spoke hastily at the outset.

VICE CHAIRMAN VOLCKER. I'll make the motion if that's what you're waiting on.

CHAIRMAN BURNS. All right, the motion has been made. Should the motion be repeated? The motion is simply that the Record of Policy Actions for each meeting of the Committee be released to the public shortly after the next regularly scheduled meeting of the Committee. Now the reason for saying shortly after is, there may be special circumstances for making the release not on the Friday following the meeting of the Committee but a day or two later and it's to take care of contingencies of that sort. One such contingency is arising immediately. That is, we want to make this release at the time of the press conference, and the press conference cannot be held on Friday. Well, we are ready for the vote.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Mr. Balles	Yes
Mr. Black	Yes
Mr. Coldwell	Abstained
Mr. Gardner	Yes
Mr. Jackson	Yes
Mr. Kimbrel	Yes
Mr. Partee	Yes
Mr. Wallich	Yes
Mr. Winn	Yes

Ten for, and one abstention.

CHAIRMAN BURNS. All right, now, we have a third item that we have to vote on, and this is an item that I'm going to ask Mr. Broida to explain. I shall vote for it, then I hope I shall understand it.

MR. BROIDA. Mr. Chairman, in the Committee's rules regarding the availability of information--as noted in the memorandum from Mr. O'Connell and myself to the Committee--section 271.5(a) cites, as an example of the policy of deferred availability of information, the Committee's release of its directive and information pertaining thereto 45 days after the meeting. We recommend simply that the Committee amend the rules to delete that language. As an example, it is not essential to an understanding or the thrust--it does not modify the thrust of the rules and it would obviously be in conflict with the action the Committee has just taken to release the record shortly after the next meeting.

CHAIRMAN BURNS. Any question or discussion? Well, we are ready for a vote.

MR. PARTEE. You are not substituting anything, you're just deleting it.

MR. O'CONNELL. Just today.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Mr. Balles	Yes
Mr. Black	Yes
Mr. Coldwell	Yes
Mr. Gardner	Yes
Mr. Jackson	Yes
Mr. Kimbrel	Yes
Mr. Partee	Yes
Mr. Wallich	Yes
Mr. Winn	Yes

Unanimous, Mr. Chairman.

CHAIRMAN BURNS. Well, I think we've disposed of the--oh, I'm terribly sorry, Mr. Broida is calling my attention to a note that he prepared in my behalf. I'm not sure that it is necessary to take this up, but I also see no harm in doing so, and therefore I will read the note that Mr. Broida prepared for me. The suggestion is that we arrive at an informal consensus--we may already be in trouble--that it would be desirable to expand the Record of Policy Actions to include more detailed information on members' views concerning longer-run and current policy. I think we've decided all that. We ought to have an expanded policy record. Do you have anything else in mind?

MR. BROIDA. No.

CHAIRMAN BURNS. Well, let's leave this quickly then. Now there is a fifth item. I am advised that it need not be covered because it already had been covered. Let's leave this quickly. All right? Are we legal?

MR. O'CONNELL. Yes, sir, I think you've, in substance, covered both of these points and subsequent questions.

CHAIRMAN BURNS. Let me appoint a subcommittee, but the intention would be to give this subcommittee nothing to do. We talked about informal understandings to be recorded in our files. I think we have reached a decision, a consensus, that we will minimize such occasions and try to proceed in such a fashion that there will be no need for informal understandings. And yet we have to be pragmatic and recognize that such a need may arise. To help our Secretary discharge his duties, and to take care of troubles that may arise, and which I hope will not arise, let me appoint a committee consisting of Mr. Gardner as chairman, Mr. Volcker, and Mr. Partee, who are to be consulted by the Secretary.

But now let me ask you, you know I've been away, and since getting back I've had to prepare a speech and cover a lot of ground, and I'm less well prepared for this meeting than I'd like to be or ought to be. But I seem to recall that we felt a need for a committee, not only for this purpose but for a wider purpose. The Secretary may need assistance and some guidance. There will be comments from committee members that he may find difficult to resolve. Didn't we discuss that? Or is it my imagination?

MR. BROIDA. I don't recall the discussion.

CHAIRMAN BURNS. Well, can we not do this, consider this a committee that the Secretary may find it useful to consult in connection with difficult questions that arise in the preparation of the policy record? All right? Well, I think we are ready for our regular meeting. Let's take a recess for two or three minutes. To stretch our legs.

CHAIRMAN BURNS. Well, we are ready to proceed with our meeting now, gentlemen. And may we have a motion to act on the minutes of the April meeting.

SPEAKER(?). So moved.

CHAIRMAN BURNS. Motion to approve the minutes is before us. I discern that there might be a second. I hear no objection. I take it the minutes are approved and we are ready now, Mr. Holmes, for your report on foreign currency operations.

MR. HOLMES. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN BURNS. Thank you, Mr. Holmes. Any questions? Any comment on the foreign exchange market?

MR. COLDWELL. I have a question, Mr. Chairman. I wonder if any progress has been made with the Treasury on our Swiss debt.

MR. HOLMES. A committee was established at the last meeting to look into this, and it has not yet had a chance to--

CHAIRMAN BURNS. Has not yet had a chance to meet, or the committee has not yet met?

MR. HOLMES. The Committee has not yet met.

CHAIRMAN BURNS. All right, any other comment or question? Very well, a motion to approve or confirm transactions that have been conducted by Mr. Holmes at the Foreign [Exchange Trading] Desk is now in order.

SPEAKER(?). So moved.

CHAIRMAN BURNS. The motion has been made and probably seconded, hear no objections. And Mr. Holmes, do you have any recommendations?

MR. HOLMES. Well, Mr. Chairman, I noted that we had paid off our remaining deutsche mark debt, and we've continued to build up some balances--we have about $28 million. Last September, the Committee agreed that a buildup of foreign exchange balances of about $150 million would be desirable. That amount appears to be perfectly adequate for our needs right now, and we would like to proceed and continue to build up balances as market conditions permit.

Finally, I should make some note of the Italian situation. Their drawings on us still amount to $500 million of the $750 million we agreed to make available to them. They have since taken down the medium[-term] EC oil facility loan and have arranged another $1.1 billion of short term swaps with other EC central banks and the BIS. They also had a swap of $250 million maturing on June 22, the date of the next FOMC meeting and the day after their elections. And in view of the continuing uncertainty and the nearness of that swap maturity to the elections, I would recommend that we be prepared to roll over that $250 million if they so request for another three-month period.

CHAIRMAN BURNS. Any questions on that? I think taking things all in all, this is to my mind clearly the right thing to do. Is there any difference of opinion on that?

MR. PARTEE. This would be the first renewal?

MR. HOLMES. The first renewal was rolled over for three months.

CHAIRMAN BURNS. Well, I hear no objections. Any other recommendations?

MR. HOLMES. That's all I had, Mr. Chairman.

CHAIRMAN BURNS. Thank you, Mr. Holmes. We are ready now for your report, Mr. Gramley.

MR. GRAMLEY. Thank you, Mr. Chairman.

CHAIRMAN BURNS. I'm sorry, I'm sorry--Mr. Broida insists that everything be done properly and legally, and we are all grateful to him. The Manager's recommendation has not been formally approved by the Committee. May we infer that the Committee has formally approved? I hear no objections. Yes, Mr. Gramley.

MR. GRAMLEY. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN BURNS. Thank you, Mr. Gramley. I believe that the report on housing starts and building permits will be released--

MR. GRAMLEY. It should be out this afternoon.

CHAIRMAN BURNS. This afternoon. I've gotten a preliminary reading on that report, and I think members of the Committee should know that the reported figure on housing starts for the month of April is somewhat lower than for the month of March.

All right, Mr. Morris, let's, for our economic discussion--ah, but we want to concentrate on any differences of views from the approach or interpretation presented by Mr. Gramley and also on any supplementary information that members of the Committee think should be brought to the attention of the Committee. Mr. Morris.

MR. MORRIS. Mr. Chairman, I have two points to make. One is that I've sensed that the economy is really moving ahead more rapidly than our projections indicate. I think one factor that ought to be given some attention is this whole business of retail sales. The April figure, particularly, shows a slight decline--it seems to me that this could very well be another case of a seasonal adjustment problem because, if you applied the 1975 seasonal factors, instead of getting a decline in April, you would get an increase of 4.4 percent.

CHAIRMAN BURNS. Really?

MR. MORRIS. Yes.

SPEAKER(?). Say that again, Frank.

MR. MORRIS. That if the 1975 factor was used, it would translate that slight decline to an increase of 4.4 percent.

CHAIRMAN BURNS. Yeah, but Mr. Partee inquires whether correction for the difference of Easter dates is being respected in this calculation.

MR. PARTEE. You'd have much more effect on March and less in April last year, in 1975 compared to 1976.

MR. MORRIS. Well, I think, looking at these numbers, the last three months taken as a whole are stronger than with the new factors.

CHAIRMAN BURNS. Using last year's seasonal factors.

MR. MORRIS. That's right.

CHAIRMAN BURNS. Well, that takes care of that Easter problem.

MR. MORRIS. The other point I'd like to make, Mr. Chairman, is this. I'm concerned about whether we are going to be prepared in this Committee to properly assess, particularly as we go into 1977, the capacity limits of the economy. Back in 1972, this Committee made a misjudgment. I think, fundamentally, looking back on those days, we misjudged the capacity level of the economy. We ran into widespread shortages of materials at a much higher level of unemployment than we had anticipated. My question is, I'm worried about whether in this next expansion we are going to be in a substantially better position to make judgments than we were in 1972.

It seems to me we ought to, as a System, give a high priority in our research work to really getting a grasp on what the capacity limits really are in the various major materials, and perhaps this is a job that could be split up between the Reserve Banks and the Board's staff. But it seems to me, that--I would hate to see us make the same mistake that we made then. And I think I'm particularly concerned that we're again moving in sync with the other major industrial countries in an expansion phase, so that the chance of misjudging the situation, it seems to me, is still very high. Would you want to comment on that Lyle?

CHAIRMAN BURNS. Lyle, first of all, would you comment on the historical point, that is, how we judged the rate of utilization of capacity or misjudged, or whichever it may be, during the preceding boom.

MR. GRAMLEY. I think we underestimated in 1972--

CHAIRMAN BURNS. Well, now, Lyle, let me try to stimulate your recollection. We put out a new index on the rate of utilization of capacity of major raw materials industries, and when we did that new index.....

MR. GRAMLEY. That was put out only after we recognized the fact that our overall index of capacity utilization in manufacturing was seriously misleading us. I was building up to that. I think there were three elements in the picture. I think we tended to underestimate the strength of domestic expansive forces in 1972-73. I think we underestimated seriously the significance of the worldwide boom in economic activity in our own economy. And I think, third, that we were not at all aware of the serious deficiencies in our index of capacity utilization in manufacturing. We were led, as a consequence of the resulting shortages that developed and our failure to perceive them, to [revise] our index--

CHAIRMAN BURNS. When did the new index appear? When did we first have it? Do you remember the date?

MR. PARTEE. March or April 1973.

CHAIRMAN BURNS. April 1973?

MR. PARTEE. March or April 1973.

CHAIRMAN BURNS. Well, now, that was not too late was it?

MR. GRAMLEY. Well, things were beginning to--

MR. MORRIS. If we had had it in March 1972--

CHAIRMAN BURNS. It would have been better to have had it in 1972. I just want to ask-- Yes.

MR. GRAMLEY. The overall index reached its peak rate of utilization in the second and third quarter. In the second quarter, for major materials the index was at 93.4 percent, for the third quarter about the same, 93.5. So we were moving into that area looking for signs of shortages at a time when the index was very close to its peak.

CHAIRMAN BURNS. Yeah, alright, that's helpful. Now, Mr. Morris has asked a very important question. How can we equip ourselves so that we would not make a similar mistake?

MR. GRAMLEY. I [and] the research staff here would be very happy for any assistance we could get from the Reserve Banks. We do have a paper in process which is designed to assess what is likely to happen to rates of capacity utilization in the major materials industries if roughly the consensus forecast is realized. I'm aware also that studies for other countries are being undertaken under the auspices of the OECD, so we may get some better information from that source.

One thing I would point out, President Morris, is that the expansion that we are forecasting as a staff, and our forecast is reasonably close to the consensus, is a lot weaker than the expansion we had in 1972. In 1972 we had the strongest expansion for the second year of recovery of any postwar upswing. Real GNP in the four quarters ending in the fourth quarter of 1972 rose by 7.3 percent. That's an extraordinarily strong expansion. Of course, it did occur after a relatively weak first year.

What we are forecasting now is an increase in the second four quarters--that is, the four quarters beginning with the second quarter of this year, ending with the second quarter of 1977--of around 5-1/4 percent. If in fact, our forecast underestimates significantly the expansive forces in the economy, and we get up into the 7 percent range, then I think we are going to have to reassess the meaning of the capacity constraint problem that we may face.

CHAIRMAN BURNS. Lyle, let me follow up on Mr. Morris's question. Our index of capacity utilization apart from the raw materials group is unsatisfactory.

MR. GRAMLEY. Quite.

CHAIRMAN BURNS. All right. Now, some work has been under way for some time to give us a significantly improved overall index. What is the status of that?

MR. GRAMLEY. That's right. Well, we would hope that within a few months we will be able to put out an expanded index of capacity utilization in the materials industry so we will not only have measures of capacity utilization for major materials but for all materials.

CHAIRMAN BURNS. I see.

MR. GRAMLEY. We are working and we hope to have, in the not too distant future, a new and completely overhauled index through all of manufacturing. I think whether that index is useful in telling us about problems of capacity utilization, I'll [wait for] some experience with it. Mr. Chairman, I--

CHAIRMAN BURNS. Well, I would think it would be very useful. And you think it would be available within, say, six months?

MR. GRAMLEY. I would hope so.

MR. PARTEE. On the materials?

MR. GRAMLEY. No, on the materials within a few months. Within six months, possibly, we may have a--

MR. PARTEE. Whole index?

MR. GRAMLEY. Well, it's quite possible.

CHAIRMAN BURNS. Well, now, next let me ask this. You know I've been impressed over the years with the reports, Mr. Mayo, we get from Chicago--your meetings with economists--

MR. MAYO. Yes.

CHAIRMAN BURNS. --and presumably meetings like that are held in our [Reserve] Banks across the country, [but] I don't see reports such as we get from Chicago. Now, keeping in touch in systematic fashion, not so much with financial economists or general economists, but industrial economists, those working for industrial firms, I think would be one way of meeting the needs that Mr. Morris has described. And this certainly can be done by the research departments of our District Banks, and perhaps we ought to be looking to the future and be sensitive to the problem that Mr. Morris has described so well and Mr. Gramley elaborated on.

Perhaps we ought to strive for a collation of such reports over the next year, not committing ourselves to a "Purple Book," you know. But over the next year, [collect] such reports from the research departments of individual Banks--these reports to be based on conversations with industrial economists and being compiled for the System. Now, Mr. Morris, what is your own reaction to that suggestion?

MR. MORRIS. Well, I feel intuitively that, even if we aggregate an index that you're working on, and even though that total index may look not too bad, we may run into shortages in particular areas that could be very troublesome.

CHAIRMAN BURNS. Yeah, but look, first of all, the index that Mr. Gramley described will show numerous industrial components, it does now, and he's planning an expanded index, and therefore there will be broader industrial representation--

MR. GRAMLEY. We have a good bit more industrial detail, too, than what is in the published index that we look at--

CHAIRMAN BURNS. Now then, second, these surveys that I am thinking about--well, talking to industrial economists, they are going to talk about their industry, their firm, you see, and that's what we want, and therefore the reports will be on a disaggregated or specific industrial basis.

MR. ROOS. Mr. Chairman, we in St. Louis are conducting a regularly scheduled series of meetings, not only with industrial economists from various industries but chief executive officers of the largest industrial firms in the area, and their economists attend these meetings. We find that they are most enthusiastic about participating. And as a result of their participation, not only do we receive valuable information, but I think from the point of view of the image of the System--these people are very flattered to be invited, and we found this to be very productive both in terms of gathering information and in terms of further identifying the importance and seriousness of our activities.

CHAIRMAN BURNS. That's very helpful. Mr. MacLaury?

MR. MACLAURY. My question was on the conceptual framework of this capacity index. The public gets it, and the way we talk about it, not in detail, is as a percentage of capacity utilization overall, and then by industry--which implies what is of course not true, that there is some sort of absolute level of capacity in each industry. And I think that that way of thinking about it gives rise to a feeling that until one reaches 100 percent, then price pressures are relatively easy, and then after 100 percent it becomes a skyrocket. And we get a lot of uninformed comment based upon that kind of a concept.

CHAIRMAN BURNS. Well, we are not going to make mistakes like that.

MR. MACLAURY. No, we don't, but my question really is whether there is any practical or feasible way of constructing the index or an index based upon increasingly less efficient plant utilization so that one gets an immediate index, if you will, of the price pressures that would result from the use of increasingly inefficient plant.

CHAIRMAN BURNS. Well, this is a very basic question, a very difficult question. I worked on that 40 years ago, and I knew more about it then than I know now. Oh, more than 40 years ago. I don't think we can do anything in this area now. I think we've got to somehow use the rough, raw material that we can gather, while our staff continues working on the basic conceptual question that you've so rightly called attention to. Does my suggestion meet with any--it doesn't seem to meet with any enthusiasm. I still think it's a good suggestion.

SPEAKER(?). Sure.

MR. GRAMLEY. I would certainly support it wholeheartedly, Mr. Chairman. I think qualitative input of the sort that you're talking about is very valuable, and I would encourage the Reserve Banks to submit to us whatever they can obtain by way of information from their contacts.

CHAIRMAN BURNS. Well, I think this would have to be, if it's going to be done, you know we need more than encouragement. We don't need too much system, but we need to organize ourselves for the purpose, and--

MR. GRAMLEY. I think an appropriate place for that to be taken up might be in the System Research Advisory Committee. We are not meeting today, but we will a month from now, and perhaps we can get some thinking stimulated between now and then so that--

CHAIRMAN BURNS. I'd like to get started sooner. Mr. Mayo, would you be willing to assume responsibility for getting the Banks, you see, to compile reports of this sort to be made available? These could be brief reports, gathered from conversations with industrialists and their economists?

MR. MAYO. Be glad to, certainly.

MR. MORRIS. My thought, Bob, was that particular commodities could be assigned to particular Reserve Banks such as steel in Cleveland, paper to Boston, something like that, so that we'd have continuing responsibility to the Committee from a particular bank organizing--

MR. MAYO. Well, we'll see what we can do, Mr. Chairman. I would like to work with Lyle and his people.

MR. JACKSON. Mr. Chairman, for the next meeting, why don't we try to encourage each Reserve Bank to make a special comment about industrial capacity in their Redbook comment?

CHAIRMAN BURNS. Now, I think that's a splendid suggestion.

MR. ROOS. Mr. Chairman, couldn't these contacts with industry not only [cover] the subject of industrial capacity but inventory accumulation and capital spending plans, things like that. I mean we get a lot of valuable information covering a broad spectrum from these regular meetings that we have. I don't think we have to limit it.

CHAIRMAN BURNS. Well, I think that's a very useful comment. You know, that's another area where we all went wrong in our judgment of the inventory situation during 1974 in particular. But that was traceable to our faulty statistics, and our statistics were so faulty because our statisticians could not take adequate account of inflation; the inflation was distorting the meaning of our inventory figures. Is that a correct statement, Lyle?

MR. GRAMLEY. Indeed it is. We had major revisions of the inventory statistics coming out in July 1974.

CHAIRMAN BURNS. And we were surprised by the magnitude of the accumulation, by the magnitude of the inventory boom that apparently had occurred.

MR. WALLICH. Mr. Chairman, I just want to put out a warning. Capacity data derived from particular industries, and particularly locally derived, of course, can be extremely helpful. There's some danger in putting them together unless one bears in mind [that industry sources] very often talk about what they can do provided they get the labor, provided they get the materials. They may not be thinking of the national effect of an expansion [in which] not only they but their competitors are expanding, so the Reserve Banks, in evaluating this, would have to be cognizant of that limitation of estimates on single firms.

CHAIRMAN BURNS. I think that all that we can really do in this fashion is to gather impressions in a more systematic way than we otherwise might, but I think that in the absence of authentic statistical data, it's very important that we try to form impressions of what is going on as fully and as promptly as we can. Mr. Partee?

MR. PARTEE. I might just note that the only source of indicated pressure that was available in Washington in late 1972 came from the Redbooks.

MR. MAYO. Came from what?

MR. PARTEE. The Redbooks.

CHAIRMAN BURNS. Now, isn't that interesting.

MR. PARTEE. There was no other government source or no other government agency that had that information, so I think what we are talking about is very good, Frank. It's a sort of an attempt to develop a little further in the Banks a system for spotting this as it goes along. And I would myself put much more confidence on it than I did at the end of 1972, when it seemed all by itself out there as an interesting observation.

CHAIRMAN BURNS. I like very much Mr. Jackson's suggestion about improving in this respect the Redbook. And my own idea as to a possible ["Purple Book"] and so on, I withdraw. Your idea is much better, and that can develop. And we can do something next month already, you see, and the fact that individual Banks will go about this task in different ways, there's no harm in that. This Redbook has been useful, even though each Bank approaches the matter in a somewhat different way. Well, I want to thank you, Mr. Morris, for your alertness and your suggestion. Let's hear from Mr. Balles now.

MR. BALLES. Well, I'd like to turn for a minute to the price outlook--this disturbing rise in April of the wholesale price index. Even though a good part of it was in farm and food, there was a broad-based increase, as you know, in food materials, manufactured products, sensitive commodities, the whole bit. The immediate indication I see is that it's going to slow down, but what's the staff view here on that outlook?

MR. GRAMLEY. What we are concerned about, as I indicated in my briefing, President Balles, is that price pressures will begin to develop a little more strongly than we had anticipated. I don't look for the serious problem to come from the agricultural side. I think the run-up in farm and food prices is a rebound from very low levels in agricultural prices. That's not likely to continue unless we get very unfavorable weather. The crop situation looks quite favorable, generally speaking, and we think that, at the retail level, the trend of food prices is more likely to be determined this year by wage costs than by what happens to the prices of raw agricultural commodities.

On the industrial side, the increase in wholesale commodity prices in April still looks reasonably moderate. And we're worried about the announced increases we've seen in the metals area, particularly recently, but we think that if wage costs continue to rise at a rate which boosts the unit cost of labor--it's somewhere around the 5-1/2 percent annual rate--then an increase in the general price level much above that would not be particularly likely. You will see [greater increases in] individual commodities, but probably not in the overall indexes. So something in the range of 5-1/2 to 6 percent still looks to us like the reasonable estimate of the general rate of inflation between now and mid-1977.

MR. BALLES. Well, I hope you are right. I've been hearing for months now from my [Reserve Bank] directors--in [response to] the briefings we give to them, where our price outlook is pretty close to the one that you cited here--that they think we are far too optimistic. They see pressures developing across a broad front that are going to lead to higher prices in the industrial sector and they say several things: wage settlements that go considerably beyond what the staff view seems to be within the System, efforts to reestablish profit margins that were run down during the recession period, and what have you. There's quite a divergence of opinion between the gut feeling of our directors on one hand and the research work that's done by our staff on the other hand. That remains an unresolved question in my own mind.

CHAIRMAN BURNS. Well, that's an interesting point. Are other Bank presidents getting similar impressions from their fellow directors?

PRESIDENTS. Yes, yes, yes, yes [etc.].

CHAIRMAN BURNS. Generally true?

SPEAKER(?). Mr. Chairman, since our last meeting, we conducted a series of meetings around the District with industrial leaders, major retailers, key businessmen, and with our own directors, both Branch and head office. We are getting a very strong feeling that the recovery is proceeding much faster; business thrust is considerably stronger than these numbers would indicate. There is a definite feeling that prices are generally going to rise faster, that inflation thrust is much stronger than we project. They are making decisions based on that and are proceeding on that. I think we get a very strong feeling of that in our District.

So I guess the only other question I would like [to ask] Lyle [is], what industries might be calculated to be the strongest capital spenders in your projections.

MR. GRAMLEY. What we are assuming is a strong pickup [unintelligible] in manufacturers. The projection we have at this point is for an increase, year over year, of 10-1/2 percent in spending for 1976. And by the middle of 1976, we figure that total business fixed investment would be rising in a general range of 12 to 15 percent at annual rates in real terms. [We see a] quite widespread increase in plant and equipment spending, and a particularly large [increase] in manufacturing.

VICE CHAIRMAN VOLCKER. You said 12 to 15 percent in real terms.

MR. GRAMLEY. At annual rates, yes. That's not an unprecedented kind of expansion in business fixed investment.

VICE CHAIRMAN VOLCKER. No, it's not unprecedented, but it just doesn't seem to be in line with these surveys and so forth.

MR. PARTEE. Did you say in mid-'77 or '76?

MR. GRAMLEY. By mid-'77. By mid-'77.

VICE CHAIRMAN VOLCKER. Oh, mid-'77. Okay.

MR. GRAMLEY. It's going to take some time to generate a head of steam. So that the year-over-year increase we're projecting--

VICE CHAIRMAN VOLCKER. I think you said mid-'76. Could I fall [back] from this pace just a second, Mr. Chairman? In reconciling these various views, [we] certainly have some of the same instincts and hear some of the same reports that John Balles does. You just asked Lyle, he states a kind of basic forced pressure from the wage side, of 5-1/2 percent or so. And [he] concluded that the overall price performance ought to be at about that [rate], and I'm trying to explore for a minute how you get to that conclusion. I mean assume for a moment the 5-1/2 percent is [correct] on the wage side.

CHAIRMAN BURNS. Now wait, 5-1/2 percent is the unit labor cost?

VICE CHAIRMAN VOLCKER. The unit labor cost, not the wages themselves, although even there I tend to think it may be higher than that, but we are talking in a fairly narrow range. But you do see materials prices rising. The fuel thing, partly [depends] upon OPEC, I suppose, but it's not going to be as good as it's been, presumably.

CHAIRMAN BURNS. Even if OPEC did nothing.

VICE CHAIRMAN VOLCKER. Even if OPEC did nothing. You do, I think, see some evidence of this desire to expand profit margins in an economic environment where that will become possible. All these modifications to the basic unit labor cost kind of calculation would seem to [give] a plus to the [unit labor cost] numbers. We're just wondering why you didn't arrive at that conclusion.

MR. GRAMLEY. Well, I think there are two things in our mind that will keep the rate of general price advance relatively close to the increase in unit labor cost. One is the fact that we think the outlook for food prices at the retail level is such that, on balance, retail food prices will increase a little less than the rate of increase in prices generally. The other thing is that profit margins already have improved rather substantially. And this is a stage of the cycle where we often see profit margins begin to be trimmed. And what we have worked out in terms of a projection of corporate profits for the next four quarters, given an increase of overall prices only a little above the rate of increase in unit labor cost, is a further increase in corporate profits. It's something like 20 to 25 percent. So it seems to fit as a consistent overall package, and we are led to believe therefore, that this is a reasonable price projection.

Now, I would say that, in looking at the staff's record of price projections in the past, if I were to make a claim that we are fairly accurate in this area, everybody in the room would know it's pure fantasy. But I would also remind you that the business community has been saying since early last year that, as soon as the economy gets back into recovery, we're very likely to get right back into double-digit inflation. I don't think the business community is a particularly good forecaster of prices either.

MR. MACLAURY. I am with Lyle on that. I think our directors probably would share the same sentiments that have been expressed by other directors, but I think they're just wrong.

VICE CHAIRMAN VOLCKER. Where are you putting it?

SPEAKER(?). [Unintelligible].

VICE CHAIRMAN VOLCKER. One other question on the unit labor cost itself. How do you appraise what's going on in wages now? Are they tending to rise with a more rapid rate?

MR. GRAMLEY. So far this year the performance on the wage side has been far better than our expectations. And I'm a little hesitant to cite any numbers now, at the moment, because the Teamsters settlement hasn't got into the index yet. In March and April, the rate of increase of average hourly earnings was only 4 percent at annual rates. Now that's way, way under what I think is a likely expectation for the rest of the year. What we've been forecasting for the year as a whole is an increase in average hourly earnings of around 7-3/4 percent. The experience so far is much lower than that, but we think it will bounce back up again once the Teamsters settlement--and the rubber settlement and the others to come in--get into the averages.

VICE CHAIRMAN VOLCKER. Well, I'd like to make just one more comment on this price matter. Irrespective of whether most of the directors around the system are right or wrong--they may be wrong, I'm not sure--but even if they are [wrong], the fact that they believe that there is going to be a resurgence of inflation could be an important element in how they behave both with regard to inventory policy and capital expenditure policy. And that kind of business psychology is something that perhaps you ought to take into account in terms of the outlook.

MR. GRAMLEY. I think that's a fair comment. However, it's difficult to tell exactly how to take it into account when businesses thus far have given almost no evidence that, with regard to either inventory policy or commitments in the fixed investment area, they're acting in line with an expectation of wildly increasing prices. All the reports we get are that businesses are still playing their inventory policy very, very close to their chest, very cautiously.

VICE CHAIRMAN VOLCKER. But capital expenditure plans have picked up strongly this year, as you know.

MR. GRAMLEY. I know, but they picked up strongly in an environment of large increases in consumer spending, and they've done so much later than they do in a cyclical recovery.

CHAIRMAN BURNS. You know, I'd say capital expenditures are still [unintelligible].

VICE CHAIRMAN VOLCKER. But I don't feel that a businessman would react to a firm expectation of prices accelerating by expanding inventory and capital spending. I think they may react by saying this will bring in another recession.

CHAIRMAN BURNS. Well, but I think that's precisely what Mr. Balles had in mind. He said take it into account, he didn't tell us how.

MR. MORRIS. Mr. Chairman, one little bit of intelligence on these lines. One of my directors recently returned from a business council meeting. He reported to me a dramatic change in the confidence of the business community represented there from three months ago.

The confidence in the sustained expansion of the economy. He was surprised at the degree of improvement in confidence.

CHAIRMAN BURNS. I don't think there is any doubt about that.

MR. PARTEE. To supplement that, I think that there is typically a lag in business reactions to an improving situation. That is, in the case of economists, there is a dramatic improvement in attitudes in January and February, and as the sales figures came in, and the better order [figures] came in, that spread to the business [unintelligible]. So I don't think there's anything unusual about this coming in by the dozen.

MR. MORRIS. No, it's not unusual, but I think it does suggest that we are going to see a change in the conservative inventory policies and plant expansion policies.

MR. PARTEE. But I would point out to you, Frank, as Lyle said, he's got a rising [rate] of capital spending in real terms. And a 15 percent annual rate by the middle of 1977 in [real] terms, which is a pretty good recovery. If that had been months ago, I don't think the Committee would have accepted [it]. The inventory accumulation is what, 20, 20 plus [unintelligible].

MR. GRAMLEY. We've got the [unintelligible] of inventory accumulation.

MR. PARTEE. And that could also be related to stimulation, not astounding in either case, but it certainly does depend on relatively strong business attitudes to get [that].

MR. MORRIS. But I think we do have to face the prospect that our forecast could still be conservative given this major change that's [unintelligible].

CHAIRMAN BURNS. Well, I think that's fair. All right, Mr. Black, please.

MR. BLACK. Mr. Chairman, I had two observations on this matter of capacity utilization which we kind of left behind, but one is in regard to the suggestion you made that we collect what information we can on this. I would caution that we ought to also take into consideration the existence of excess capacity abroad and our ability to import. I [raise] this since there seems to be more excess capacity abroad than there is here. And the second observation is that there are contained in the Redbook, this time, three references I remember to industries that may be approaching capacity: steel, paper products, and some chemicals.

CHAIRMAN BURNS. What about textiles?

MR. BLACK. Yeah, I think that's true there, too. And this may have implications for imports and inventories and plant and equipment expenditures that we may not have taken into consideration adequately yet.

CHAIRMAN BURNS. Thank you, Mr. Black. Mr. Winn, please.

MR. WINN. Two observations, Mr. Chairman. First, if you look at the oil import figures and look at what's happening in the Middle East, plus informed guesses, and they are only guesses, of the 10 percent increase in oil prices with the summer coming on, you [become] troubled in the price area on that score. Second, with respect to automobiles and their importance in the recovery, we get reports of all kinds of 60-month credit terms being given. Sixty-month credit terms. Now, that's showing up always [in terms of] the other fellow [giving 60 months], of course, but the frequency with which we run into this disturbs me--that it will alter your cyclical behavior in terms of replacements here down the road.

CHAIRMAN BURNS. Have you heard about that?

MR. GRAMLEY. We have heard nothing here about 60-month terms; we've heard a good bit about the move from 36 to 48 [months].

MR. WINN. That's right. That's the problem.

MR. GRAMLEY. The proportion of over-36-month maturities is rising. There's no question about that.

MR. WINN. But they all talk about the other fellow giving 60 months, and the frequency with which we run into this--they who [claim that it is happening], of course, never [give 60 months], it's the other fellow--but the frequency with which we run into it makes me realize that this has happened.

MR. PARTEE. This is banks or--

MR. WINN. Well, they say it's always the finance companies. But I'm suspicious even in terms of some of our banks of [unintelligible] competitive relationships.

CHAIRMAN BURNS. Who's in charge of our data on this area?

MR. GRAMLEY. That's Mr. Fisher's section.

CHAIRMAN BURNS. Be sure to call--

MR. GRAMLEY. Oh yes, we'll get this under way.

CHAIRMAN BURNS. All right, thank you very much, Mr. Winn. Mr. Wallich, please.

MR. WALLICH. I have a comment on capacity. Since 1973, '74, we've had very moderate plant and equipment spending. We've had a good rise in labor force. So overall, one would guess that the relationship of plant capacity to labor force capacity has deteriorated, and we would be suffering from shortages and higher levels of unemployment. This might have been offset if the area in which there were shortages had experienced a higher rate of investment in the midst of generally lower investment. Is there any indication that that might have happened? [Can] one, for instance, match up our major materials index categories to McGraw-Hill categories?

MR. GRAMLEY. Right, we did have two years of very strong increases in capacity in the major materials industries relative to expansion of capacity elsewhere. These were in both '73 and '74. The projections for '76 don't show any unusual increase in [capacity in] the major materials area relative to other industries, except a fairly broad-based kind of thing. So I think that has alleviated the problem. But I think a greater factor tending to alleviate that problem of shortages of industrial materials is the fact that we do not have the synchronous, tremendous worldwide boom that we had then. If that should develop again, there is, I think, a serious question relative to the adequacy of capacity--

CHAIRMAN BURNS. It could develop in 1977.

MR. GRAMLEY. It could, yes.

CHAIRMAN BURNS. I'd go further and say that that is, as of today, a reasonable expectation.

MR. GRAMLEY. I'm not a student of the economies of other countries, but I have the feeling, from what I have generally understood, that economic policies being pursued by most of the major industrial countries are much more conservative now than they were [earlier]. And that I think would tend to constitute--

CHAIRMAN BURNS. You don't need stimulative policies. There's been so much stimulation around the world that momentum has been built up within the private economy. That's certainly our condition, and it's the position of Germany at the present time. I think France is close to it. And before too long, I think others will join that procession. So I've had my eye on the possibility of a worldwide economic expansion in 1977. I think that's exactly the direction in which we are moving. Mr. Partee?

MR. PARTEE. Well, I was just going to comment that, earlier we were talking about 1973, and it is true that the world boom will have a considerable effect on the rate of inflation. But I think we also ought to remember that there had been two prior devaluations of the dollar, so that the effect was to shift demand [to] the U.S. markets, particularly for finished materials used in [unintelligible] manufacture, like chemicals and steel and things of that kind, where the product is exactly the same regardless of the country it came from. Now we are not thinking in terms of further substantial devaluations of the dollar [unintelligible], but that is one difference now compared to [unintelligible].

CHAIRMAN BURNS. Well, and hopefully it will be a little more responsible, etc., but I think the distinctive viewpoint to keep our eye on is price developments. Not be too [unintelligible]. My instinct tells me that the businessmen are more likely to be right than economists on this issue, but all we can do is to be as alert as we can to the developments and not have closed minds, and I don't think anyone around this table has a closed mind. Any other comment? Yes, Mr. Winn.

MR. WINN. Just one more comment. As you look at the capacity expansion efforts, you want to keep in mind the energy bottlenecks, with gas and some of these other things not being as expandable as [other] plants in certain of these areas.

CHAIRMAN BURNS. You notice it takes so much longer to expand capacity [unintelligible]. Mr. Jackson?

MR. JACKSON. I was just going to ask Lyle. We know that the cost pressures for price increases have been there all along, it's just [that] they have not been able to be validated by the results coming in. And it looks to me like your projections will indicate, if anything, that that aspect to demand is not going to continue to grow as rapidly as it has. Is it therefore possible that even if these cost pressures exist, they will not be validated as well as businessmen might hope or expect? As a consequence of the lack of growth in prices?

MR. GRAMLEY. Well, I think product markets are improving quite nicely, now, and [if] our projection is realized, products are going to continue to improve. We are projecting a continuing strong increase in consumer expenditures, around 5 percent, which is historically a very good rate of increase in consumer spending. We are forecasting a substantial rise in business fixed investment. A movement of inventory investment up to something like 1-1/4 percent of gross national product. If those kinds of markets materialize, I would think it would be relatively easy for businesses to pass on their cost increases.

CHAIRMAN BURNS. Well, they've managed to do not too badly even during the severe recession that we've gone through.

MR. BALLES. Mr. Chairman?

CHAIRMAN BURNS. Yes, Mr. Balles.

MR. BALLES. Just to follow on a comment made at the last meeting, there seems to have been quite a firming up of views with respect to drilling activity, that, while it's still at a reduced level, it's definitely going to pick up at possibly [a] fairly substantial [rate] in the second half of the year. We hear this both from the people in the oil business and from the bankers that they are talking to with respect to financing.

CHAIRMAN BURNS. Now what is the reason for that--expectation [of a] price rise?

MR. BALLES. There seem to be a number of reasons involved. As near as I can determine, the most important one is increasing confidence that the government is going to exercise what elbow room is provided in the recent legislation with respect to authorizing limited price increases from time to time. There also is developing some expectation that, when the legislation expires, they may in fact be relieved of price control. There are a couple of other things; one is that--

CHAIRMAN BURNS. When will the legislation expire? Wasn't it [to last] around four years or so?

SPEAKER(?). I think about 3-1/2, something like that. But there is a fairly long gestation period between drilling and getting the product in the market. And there is also the interpretation that some current weakness in product prices is viewed as temporary and that demand will soon turn that around. Drilling costs are down in some respects, that is, rigs are available at lower rentals, and pipe is available at a lesser cost than it was a number of months ago, when there were shortages.

And apparently also some fields which were uneconomical now are becoming economic because of some changes in technology. Apparently they have techniques available now which enable them to fracture the rock down in the oil-bearing strata and thereby get a greater release of the product than had been previously the case. This is showing up in specific terms at the present time in the so-called Pearsall-Devine area. Those two little towns are now boom towns, primarily because they feel [unintelligible] which is long known to exist [unintelligible] there, but just on economic [terms] is now seeing quite a strong play in development.

I would just record, without any attempt to evaluate, that the retailers on our board of directors were much less optimistic at our last meeting than at the preceding meeting--well, I said [I wouldn't evaluate]--but my own interpretation is that it's because they are not looking through the effects of the [recent] pattern. But they're knowledgeable, experienced people in this business, so I may be doing them an injustice in that respect. These are general merchandise retailers. There was a tendency on their part to explain what they judge as less vigorous retail activity on the grounds that the automobile dealers are getting [more business]. And they are inclined to feel that, with automobile sales real strong, it's harder for them to capture the portion of the consumer dollar that normally would come their way. But in terms of the staff's general forecast, we see the general picture essentially as has been described in their documents.

CHAIRMAN BURNS. Thank you, Mr. [unintelligible]. Mr. Wallich, please.

MR. WALLICH. I wonder if I could make a general comment on two ways of looking at the outlook. So, look at our projections--we have a very strong business spending outlook and yet a tapering off of GNP to the middle of '77 [that] results from the expectation that almost nothing else is going to [grow quickly]. Government is going to go slow, consumption is going to take off a little, housing will taper off strongly, then exports are flat. So we've got the picture of just [business spending] being very powerful and pulling the economy along--everything else moderate.

Somehow this strikes me as an implausible picture. Either, it would seem to me, other things will be pulled up, with the exception of housing, if the impact of investment is as strong as indicated here, or else maybe investment spending itself will suffer from this. But I see a sectoral divergence here in the configuration of the expansion that strikes me as somehow a little unusual.

CHAIRMAN BURNS. Mr. Gramley, you've already commented on that.

MR. GRAMLEY. I guess I would not interpret our projections quite the same way you do Governor Wallich. I think if one looks back one finds historical precedent for the sort of projection we're making, that is, in the second year of recovery, normally speaking, the rate of real GNP expansion slows substantially. A typical postwar recovery has something like a 7 percent [rise] in the first year--using very broad numbers--and drops back to the 3 to 4 percent range in the second. Yet the second year is the year in which you have the biggest thrust from business fixed investment.

What we're looking at now is a projection in which true business fixed investment is a strong element, but we still have a very large expansion of personal consumption expenditures going on. A rise of around 4-3/4 to 5 percent in real terms, the decline in the saving rate to around 6-3/4 percent by the end of the projection period, and we have a good rate of inventory investment continuing. The rate of inventory accumulation rises further, up to about 1-1/4 percent of GNP, as I mentioned earlier.

The only sectors from which we are not getting a significant thrust are government, which you mentioned; and we may still be underestimating state and local expenditures; we may have misjudged fiscal policy; the housing sector, where I think a strong case can be made that the further rise is likely to be moderate; and the net export picture. In this latter connection, I would note that we have quite a strong increase in real exports plugged into our projections. I remember that the real increase is on the order of something like 8 to 9 percent. But an expanding economy also generates rising imports and that takes away the expansive thrust [unintelligible]. I think this is a fairly typical--

CHAIRMAN BURNS. I would second what Mr. Gramley has said, but I would call attention to a growth phenomenon which I have not studied during the past 20 years, but which I did study very intensely in earlier times. What I found in our studies of business cycles at the National Bureau [of Economic Research] was that if you take all [of the] some 10 business cycle expansions prior to the 1940s or 1950s, you find that in about 8 out of 10 instances you had what we at the National Bureau called a mid-expansion retardation. That is, your GNP, if you like, expands and then there is retardation and then a re-acceleration in the second half or last third of the expansion. You’ve got 8 instances out of 10.

Now I don’t know the record for the past 20 or 30 years, which is much more relevant to judging the future. I don’t know it nearly as well and I don’t know in [unintelligible] precise terms. But I would keep in mind that this phenomenon was very prominent in the business cycle history of this country in earlier times. Any other questions or comments? If not, the hour for the coffee break has come, so--

[Coffee break]

MR. STERNLIGHT. [Statement--See Appendix.]

CHAIRMAN BURNS. Thank you, Mr. Sternlight. We are ready for discussion of Mr. Sternlight’s report. Any questions or comments?

MR. COLDWELL. As the Desk was proceeding through this gradual tightening, were you giving weight, in [your] evaluation of the [monetary] aggregates’ change, to the impact that might have developed from the Treasury balance, currency, and shifts in corporate savings?

MR. STERNLIGHT. We were trying to weigh the impact of a number of factors on the aggregates as we went through the period--developments in Treasury balances, the introduction of this $2 bill, all these things were evaluated. We were uncertain about the impact of a number of these factors midway through the period, and that was one factor causing us to be quite cautious in responding to the evidence in the aggregates. As we went further along in the period, some of these doubts were resolved on the side of indicating that substantial growth was being sustained. And we continued to react in a modestly but steadily firming direction.

MR. COLDWELL. As you look back over the period, with the large rise in April, what proportion of that would you assess would be a fundamental shift in demand for balances?

MR. STERNLIGHT. I don't think that [I] could put [a figure on that].

MR. AXILROD. I am going to be discussing that at some length.

MR. COLDWELL. I'll withdraw the question and wait for your discussion.

CHAIRMAN BURNS. Well, Mr. Axilrod is apparently a little bolder than Mr. Sternlight.

MR. AXILROD. Sir, I'm not going to be putting a precise magnitude on that.

MR. PARTEE. Peter, in talking about the period, some of the language you used reminded me of the language we used to use about "even-keel" during the Treasury financing. Would you regard yourself as being subject to even-keel considerations during this unusually heavy period of long-term financing?

CHAIRMAN BURNS. Semi-even-keel.

MR. PARTEE. Semi-even-keel?

MR. STERNLIGHT. That does just about sum it up. I would say that even without precise language in the directive alluding to even-keel, we feel that considerations relating to a major Treasury financing are part of that background of domestic financial developments, so we do want to pay attention.

MR. PARTEE. I don't have a figure in mind precisely, but given the projected size of the federal deficit, I would assume that there is going to be a continuing, very large volume of financing on a very frequent calendar.

MR. STERNLIGHT. I think that's been true through this whole--

MR. PARTEE. I just suggest to you that I think we need to be careful that we not constrain ourselves too much by consideration of those Treasury financings, or we may find ourselves quite unable to react to developments in the credit markets. I hesitate, having been on the receiving end of these, to ask for a review of what our policy ought to be with regard to Treasury financing and even-keel, but I really think maybe there ought to be a new look at it, given the changes in practice and the frequency of financing.

CHAIRMAN BURNS. We've done that. We've had a new look for some time--in practice.

MR. PARTEE. In practice, but I mean--

CHAIRMAN BURNS. Just not to leave the matter in doubt, we are paying much less attention to even-keel, and the Treasury understands this thoroughly and is not raising any questions or expressing any doubt.

MR. PARTEE. The point is, gentlemen, I think we have paid more attention over the last several weeks.

VICE CHAIRMAN VOLCKER. No--from the viewpoint of an ex-Treasury official, I think your comment is well-justified--even going back a few years. But I find Mr. Partee's comments may be subject to a little different interpretation, anyway as I read the record here.

We did discuss this a bit at the meeting last week. And what was interesting about this past month, it seems to me, is, in part, that action was taken almost on the eve of a Treasury financing and very shortly thereafter. I think the Committee did suggest that some account be taken of the Treasury financing itself, with the implication that one doesn't act very vigorously right during the very days that this rather complex operation is going forward. Unusual in that sense, but looked at in a broader prospective, it seems to me that this operation went on during the month with the minimal necessary consideration for the actual financing operation during the particular days when it took place.

CHAIRMAN BURNS. The term that I just coined, semi-even-keeling, doesn't correspond precisely to the thought I had in mind. I think we've moved away from even-keeling by something more than 50 percent.

MR. PARTEE. I did not sit in on the calls any day of this last period. My own feeling, looking back over the period, and given the strength of the monetary aggregates, is that we moved a little more slowly than I would have liked to have seen toward the 5-1/4 top on our range.

CHAIRMAN BURNS. Might agree with that, but the difference here is so subtle. The Desk got to the 5-1/4 figure--possibly I might have gotten there a couple days sooner, but it's a difference, practically speaking, without much meaning. Mr. Holmes, you have been engaged in this activity for a long time. How would you describe the attitude of the Desk toward even-keeling in general and more specifically during the past month?

MR. HOLMES. I think that when you move the funds rate up a 1/2 percent during the period of a major Treasury financing, that sort of activity would have fit under nobody's definition of even-keel, let's say a couple of years ago. And while I think it is a real delicate operation, and we did have to keep an eye on the Treasury financing, we did try to get the [federal] funds rate up before the Treasury financing so the market could take that into [account]. We continued to push it up as we got stronger and stronger confirmation of the strength of the aggregates. So I think that moving the funds range during the period of Treasury financing was a pretty good accomplishment.

MR. WALLICH. How much did [you consider] the possibility that the aggregates might slow again during the period?

MR. STERNLIGHT. This was part of the reason for wanting to be quite cautious during the first half of the period.

CHAIRMAN BURNS. The New York [Reserve]Bank had a lower estimate than our staff had. They were revised.

MR. HOLMES. Which was wrong.

CHAIRMAN BURNS. Well, this time it was wrong, next time it will be right.

MR. WALLICH. You go by your estimates exclusively?

MR. STERNLIGHT. No. We take both into account.

MR. HOLMES. We weight one by the other, Governor Wallich.

CHAIRMAN BURNS. Any other questions or comments?

MR. BLACK. I was on the call, Mr. Chairman. I would like to commend the Desk on the way it handled itself. I think they really did an admirable job during this period and would echo Alan's observations that this wasn't even-keel by any stretch of the imagination.

CHAIRMAN BURNS. I think that's valid. I think Mr. Partee's point--that in view of the magnitude of Treasury financing, we must regard traditional even-keeling as a thing of the past--this is something that now and then deserves repetition. Let's go on to Mr. Axilrod now. And you are not going to forget Mr. Coldwell's question.

MR. AXILROD. [Secretary's note: This statement was not found in Committee records.]

MR. AXILROD. I'm afraid, Governor Coldwell, that I can't--

CHAIRMAN BURNS. No, no--I think you gave a very reasonable reply to Gov. Coldwell's question.

MR. COLDWELL. I have just one other question, Mr. Chairman. If you had looked across this valley from, I guess, late December through mid-May and had, first, washed out one change in the Treasury balance, then the other change, do we then come out with something that's reasonably balanced to the growth targets of the Committee?

MR. AXILROD. Is your question, if we had a total M1 plus U.S. government deposits?

MR. COLDWELL. Suppose you just washed out the government deposits as part of the package.

MR. AXILROD. The April rate of growth of 15-1/2 percent--my initial thought three or four weeks ago was that maybe 6 to 8 percentage points of that can be attributed to government deposits. If that were true, I believe that May would have had close to a zero growth rate. So if it's temporary it should come out [unintelligible]. Because May seems to be growing at about 8 percent--which I am beginning to believe is something like the underlying growth rate--I find it very difficult to argue that any of the increase in the April M1 had anything to do, except fortuitously, with government deposits.

It puts me in a most uncomfortable position, because I then have to believe that people who received a transfer of funds out of government deposits in April realized at that point, but not sooner, that they had drawn down their cash more than they should have over the preceding several months and are [now] just holding onto it. The analysis forces me into that direction, so I almost think that the rate of increase over the past four months in M1, which I think is on the order of something like 7 percent or more, is about the underlying rate of growth. And movements in government deposits on average had very little effect on that. It had an effect on month-to-month movements but not on average.

MR. BAUGHMAN. Can I follow on with a somewhat related question? Is there any indication that Internal Revenue has been slower this year than in most recent years in processing returns and collecting checks?

MR. AXILROD. No, I have no reason to believe that. The Treasury has not so indicated when we have talked to them.

MR. BAUGHMAN. I have had a few people indicate surprise to me that the checks mailed April 15 were not [debited in the period covered by] their April bank statement.

MR. AXILROD. I have not heard of any deliberate effort to be slow. Whether inadvertently there is any slowing, the credit for that would be quite modest.

MR. BAUGHMAN. If they were slow, that would result in private balances being significantly larger than people had planned on them being.

MR. AXILROD. They were slow in sending to Treasury or slow in sending out?

SPEAKER(?). Slow in collecting taxes.

MR. AXILROD. Slow in collecting taxes--yes, that's right. But we've come some way. We're in about the middle of May, and we should have seen a sharper decline at some other point right now.

CHAIRMAN BURNS. Any other questions or comment?

MR. MAYO. On a perhaps minor point, Steve, we have noted the experience in our District, at least, of the $2 bill that we have put into circulation. [The bills] are going into bedroom bureau drawers, etc. The few merchants that have accepted $2 [bills] from their banks have done so under pressure, and they come right [back] to those banks. That's been a typical experience, although we haven't taken a full survey on it. Currency has been expanding rapidly. I haven't any numbers in mind, though, as to whether the sort of thing I am describing has any monetary policy significance or whether it's minimal.

MR. AXILROD. I don't think the increase in the $2 bills could have affected the April rate of growth in the money supply; it was quite high, on the order of 16 or 17 percent at an annual rate. And that annual rate of growth could affect the money supply on the order of _ [unintelligible]--that part which is above normal that affected the money supply by maybe 1-1/2 percentage points at an annual rate. But I don't think that the above-normal part can be attributed to the $2 bills in terms of money supply because I assume that most of the people who took the $2 bills are probably holding $2 less in demand deposits; maybe they are not, but $2 less of some other deposits--it doesn't come, as it were, out of thin air. So I don't believe there has been a substantial or even a very significant M1 or M2 effect.

CHAIRMAN BURNS. How much did we issue?

MR. COLDWELL. About $200 million to $300 million.

CHAIRMAN BURNS. So that adds up to a major factor.

MR. COLDWELL. But you annualize it and it gets to be quite a bit of money going out over a short period of time. I think Steve's got a good point, that they had to pay for it some way. If they pay for it by writing some checks for some $2 bills, that's one thing, but if they paid for it by drawing down their savings account, that's another. But, I suspect from just the people I've heard talk about it, [they] got one and put it away. How did they get it? Well, they traded a $5 for two $2s and a $1.

VICE CHAIRMAN VOLCKER. If they needed the $5 bill to go to the grocery store, they'd replenish the $5. It doesn't come out of money in checking accounts if they are really hoarding it.

MR. AXILROD. That offsets about 5 percentage points on the currency growth rates, 1 percent on the money supply growth rate.

CHAIRMAN BURNS. Well, it's still a minor factor. Any other question or comment?

MR. MORRIS. We have been exploring the strange behavior in the demand for money in the past year and we have run into one phenomenon that I would just like to ask Steve about, whether it's something that the System ought to explore. That is the big increase in net total funds purchased by the commercial banking system, which was running in the middle of 1970 at $4-1/2 billion; in the middle of 1975 it is up to almost $18 billion. [Would] an examination of this to see whether it would help explain the demand for money be worthwhile? It's a project that we could undertake, but I think you could do it more readily here.

MR. AXILROD. I don't think that would help. Even if it were relevant, that wouldn't help explain the behavior between '74 and '75 and '76. But secondly, I personally don't believe the behavior of the volumes in the federal funds market has very much to do with the money supply--the behavior in the sense that you are talking about. I think the demand for money relates to other variables, and the behavior of the federal funds market is, as it were, a distribution mechanism for credit flows within the banking system. They're in two different worlds.

MR. MORRIS. But if you are a corporate treasurer and you are putting your money out for one day, would you consider this to be a part of your balance or not? I'd be inclined to think that I would.

MR. AXILROD. The RPs--I see what you mean. The federal funds, the bulk of the federal funds transactions, yes, that is in that figure. But not all are interbank.

MR. MORRIS. I am talking about the net purchases of the commercial banking system.

MR. AXILROD. No. I think there, on the other point, if you want the analysis of corporate RPs as an alternative to holding demand deposits for a short while--that's the sort of thing [unintelligible].

SPEAKER(?). I thought you were referring to interbank transfers.

MR. MORRIS. No, I am talking about the purchase of funds from outside the banking system.

MR. AXILROD. We have been working and will continue to work on trying to refine the demand-for-money functions by not only the aggregate but by sector, and one of the things we consider in the corporate sector as an alternative to demand deposits is clearly the RPs--the overnight funds.

MR. MORRIS. And you should also look into the volume of funds purchased from thrift institutions, as a separate factor.

MR. AXILROD. Purchased from thrift institutions?

MR. MORRRIS. Right.

MR. AXILROD. By corporations?

MR. MORRIS. By commercial banks. That's a part of this aggregate.

MR. AXILROD. Yes.

MR. COLDWELL. In fact, Frank, don't you have a number of different nonbanking groups who are buying and selling federal funds?

MR PARTEE. Selling.

MR. MORRIS. Predominantly the thrift institutions and the corporations.

MR. COLDWELL. I was thinking of some international banking groups, agencies, etc., that are also in this market.

MR. AXILROD. Most of those groups are not important holders of money supply. Of the groups, only the corporations are important holders of money supply, so for only the corporations would it be extremely important that the availability of the federal funds type of investment would be an alternative to cash. The others are very trivial in our money supply figures.

MR. MORRIS. I think the fact that this series is growing--at the end of '74 it was almost $22 billion, the growth rate of this is not [out of proportion with the] growth rate of the money supply, and it may have some explanatory value.

MR. AXILROD. We will look into it.

MR. MACLAURY. In the same kind of context, I think you have been looking at--but I don't know the status--the extent to which corporations are holding their compensating balances in the form of nonnegotiable CDs to reduce the reserve requirements for the commercial banks.

MR. AXILROD. I believe we are going to get a report on that in our next survey on noninterest-bearing time deposits. We will [not] have back-data, but we will have some sense of how they trend.

CHAIRMAN BURNS. Any other questions?

MR. BLACK. Steve, we have touched on this several times in the past, but do you have any better idea now than we have had [as to why] the monetary base has been growing so fast relative to other reserve measures?

MR. AXILROD. I believe it is because currency--

MR. BLACK. Let me rephrase--why has currency been growing? I know what you said, but why has that been happening? Do we have any better fix on that?

MR. AXILROD. I would have to check it against our normal relationships between currency and GNP, but currency is generally rather more sensitive to movements in GNP than demand deposits are. We have a special factor in April that accounts for some of it--but the underlying strength in currency on the average of the last two or three months is indicative of the strength in retail sales and GNP. I can't answer specifically whether it's out of kilter. I think it is well within the range of a reasonable estimate.

MR. BLACK. It's been going on longer than two or three months, if I'm not mistaken.

CHAIRMAN BURNS. Any other questions? If not, we are ready for our discussion of monetary policy, and I'd like to make, if I may, two or three introductory comments briefly.

I think it's entirely clear that our monetary aggregates have been increasing of late at a rate that is simply unacceptable, and these increases have been widely advertised. I think it's highly important to recognize the fact that the moderate monetary policy that we've been pursing has made a certain contribution to the return of confidence across our economy. And if confidence in the economy and in the Federal Reserve System is to be maintained at its present high level, I think we must respond to the apparent explosion that is now taking place in the monetary aggregates.

At the same time, I think we should proceed cautiously because this spurt that has been experienced recently may be a temporary aberration, and we should not overreact to what has taken place. Some definite reaction I think is in order, but we must not, in my judgment, run the risk of overreacting to the oversized increase in monetary aggregates.

Now, we will be discussing the specifications for the monetary aggregates and also for the federal funds rate, and let me indicate my own thinking. The members of the Committee may feel very differently than I do, but perhaps by indicating my own thinking I'll give you something either to assent to or to criticize, as you see fit.

I think that the federal funds rate suggested by alternative B is acceptable, but I would raise the lower limit, and I think in view of what has been happening, the federal funds rate should not go as low as 4-3/4 percent. I would therefore suggest a range for the federal funds rate of 5 to 5-3/4 [percent]. Now that would permit a moderate increase, if necessary, in the federal funds rate. It would indicate a reaction on the part of the System to what has been happening to the monetary aggregates. I don't think that, as of today, I would want to see the federal funds rate go above 5-3/4 in the month ahead.

Now, as for the monetary aggregates--there I would be inclined to be less liberal than any of the alternatives specified on page 6 of the Bluebook. I would place the upper limit of M1 at 7-1/2 percent. I think that's high enough. And as for M2, perhaps reduce the upper limit to 9 percent. I think that's high enough. As for the lower limits of those ranges, well, I'd be flexible in my own thinking. We could continue, perhaps we should, with a 4-point range or possibly make it a little narrower if the Committee were so inclined. I have no strong feelings on that, one way or the other.

Now that's where I come out at the moment, and I'd like to listen to my colleagues. I've given you figures to attack or to endorse as you see fit. Who would like to speak first? Mr. Mayo.

MR. MAYO. I find myself subscribing completely to your reasoning and your figures on the federal funds constraint. I think the 5 to 5-3/4 would be quite appropriate here, a central point of 5-3/8 which gives us another 1/8 nudge if it should be deemed necessary.

I am less sure however of your recommendation, Mr. Chairman, on M1 and M2, feeling somehow [that] it wouldn't be quite as consistent if we were to lower the ranges as much as you suggest and that it might hasten the arrival at the 5-3/4 percent [upper bound of the federal funds rate] range earlier than we otherwise would anticipate. I would favor, therefore, maybe something like 5 to 9 and 6 to 10 on M1 and M2. Of course, if we were to adopt your prescription we could still have an intermeeting telephone or wire session to perhaps change the 5-3/4. But I feel the same way that you have indicated, that you don't really see the need right in the month ahead to go above 5-3/4. And I merely have that one reservation as to whether adopting too low a range on M1 and M2 might make the increase faster than we really want.

CHAIRMAN BURNS. Let me comment on that. Your analysis, I think is entirely correct and that specifications I suggest might land us at the 5-3/4 figure sooner than would otherwise be the case. But [in] looking ahead as best I can at the moment, I doubt I would want to see the federal funds rate go above 5-3/4. An upward adjustment between meetings might take place of course, but I would not want to contemplate that because the federal funds rate moved up some 50 basis points within the past month. A range of 5 to 5-3/4, assuming that the 5-3/4 figure is reached, would mean another increase of 50 basis points, and to go faster than that at this stage strikes me as premature. I thought more confirmation would be too sudden a jolt. Well, that's my thinking.

MR. MAYO. My reasoning is exactly like yours on the federal funds rate, but I think that if we lower the top of the M1 and the M2 range, we are putting the Manager, Mr. Chairman, in a position of getting to 5-3/4 too soon, and then what do you do next. I don't want to go above it either.

CHAIRMAN BURNS. I think our Manager, well, let the Manager speak for himself. My guess would be that he would stretch things out and not get there too soon.

MR. MAYO. But again, my point is, Mr. Chairman, are we being unduly constraining? The Manager can [encounter] this by having M1 and M2 ranges that have too low an upper limit.

CHAIRMAN BURNS. Well, Mr. Holmes, do you have a comment?

MR. HOLMES. Well, Mr. Chairman, I think it all depends on whether the current forecasts of the growth rate of money over the next two months are anywhere near right. If they are, we would be unable to reach the upper end of this [federal funds rate range] even with a 7-1/2 percent [upper bound to the M1] range. But given the normal margin of error, if we are too conservative in our estimates, yes, we could hit that upper end, and obviously you hit 7-1/2 before you hit 8-1/2.

CHAIRMAN BURNS. Well, Mr. Volcker, I think you wanted to speak.

VICE CHAIRMAN VOLCKER. Well, I don't know that I have very much to add at this point. My reasoning on the federal funds rate is very similar to what has been expressed by Mr. Mayo and yourself. I could visualize going above 5-3/4 percent, but I wouldn't want to do it without another crack at it in some kind of a meeting, so I'm happy with that upper limit and the general specification.

I share, for some of the same reasons and maybe some additional reasons, Bob Mayo's feeling that you've set the ranges [for the monetary aggregates] a little on the low side. The additional reason would be we've recently set long-term targets, and I don't see any reason to deviate from them very far. I would kind of straddle that basic target that we have on M1, and we probably have to adjust M2 a little lower relative to M1 for technical reasons. So I came out about 6 to 10 in my own mind for--

CHAIRMAN BURNS. You came out where?

VICE CHAIRMAN VOLCKER. Six to 10 for the M2 number and the same as we had last month, 4-1/2 to 8-1/2 for M1, or 4 to 8, which straddles pretty much the long-term target. In either event, I would think that we are talking about moving the federal funds rate by at least one-eighth now, and maybe one-fourth, certainly contemplating it may go to 5-3/4, but I don't want to make any judgment about going beyond that. So the crucial thing, I guess, is that upper limit on the federal funds rate, so we can pause and take another look before we exceed that.

But I would expect some tightening here. It seems to me appropriate for the reasons you mentioned [regarding] the general economic climate, including the fact that some people are going to be concerned when the exceptionally good price moves that we had in the first quarter are dissipated, as I think is inevitable in the short run at least.

CHAIRMAN BURNS. Thank you, Mr. Volcker. Mr. Jackson, please.

MR. JACKSON. I would generally share the approach that other people have expressed, Mr. Chairman. But I would be inclined to think that perhaps a more stable approach towards that solution would be to use a federal funds range of 5 to 6, which would indicate a gradual movement towards 5-1/2 over the immediate prospect, but then widen the range of M1 and M2 to, say, 4 to 8 or 4-1/2 to 8-1/2 for M1, somewhere in that range, and a 6 to 10 for M2, which would mean that you'd need strong validation of the continued growth [of M1] before you'd go above the midpoint of the 5 to 6 range. It is the same approach, just a different way to get there.

CHAIRMAN BURNS. Thank you, Mr. Jackson. Mr. Kimbrel, please.

MR. KIMBREL. Well, I come out pretty close to Governor Jackson, but maybe for slightly different reasons. I've felt that since the first of the year it looks to me that M1 and M2 have exceeded the upper bounds of our long-run targets, and I think it is not an exaggeration to suggest that the banks and thrift institutions in much of our area are almost awash with liquidity. South Florida for instance--the banks and savings and loan associations have reduced the rate on their certificates, and actually the thrift institutions are turning away funds in excess of $10,000 for any account already existing or any new account. So what we see at least in that area is that capacity is available to finance expansion.

So, for logic alone, it seems that we at least ought to limit our short-term maximum to the top of the long-term maximum that you have suggested. So I guess I would want to reduce even more than 7-1/2, to the 7 number relating to logic. I guess the M2 does not make a great deal of difference. But then for the exact same reasons Governor Jackson suggested, I'd like to see the 5 to 6 percent range [for the federal funds rate], with the idea that we're going to center that maybe slightly above the current rate. I guess this is not the point, but I would also like to inject that I hope we would be prepared to move promptly even with the discount rate if the [federal] funds [rate] moves above the current level.

CHAIRMAN BURNS. Thank you. Mr. Coldwell now, please.

MR. COLDWELL. Mr. Chairman, I think our economic recovery is proceeding generally satisfactorily except for the continuing high unemployment and the threatened price advance. And our policy move this past intermeeting period to counter a rising aggregate trend seemed appropriate to me.

I am concerned about overreacting to what I saw as some extraneous [factors temporarily increasing] the growth rates of the aggregates, and if the aggregates are now going to subside to their fundamentals, and we don't get some more of these extraneous things on the downside, why then I'm perfectly willing to continue resisting the higher rates of growth. On the other side, though, we have moved the rate 50 basis points in an intermeeting period, and I'm hesitant to continue that pace of movement, which I presume was in some of your comment also.

I would prefer that we be a little more constrictive in this sense and aim at a federal funds rate lower limit in the range of 4-3/4 to 5, and I don't care whether you put it at 4-3/4 or 5. I'd rather not go down into the 4 range, having reached the 5 level, but I'm somewhat nervous about going up to the 5-3/4 range. I really would not like to see another 50 point rise in the intermeeting period. This could build expectations to a point where the market could take it away from us and move much further than perhaps we intend.

So I really prefer that we put a ceiling on [the federal funds rate] at 5-1/2 with the expectation that these aggregate numbers come out somewhere in this general ballpark we are talking about. I don't hear much around the table except that your 7-1/2 deviates from somebody's, someone else wants 10, that's a fairly wide number--you move more rapidly if you get a much lower figure, but somewhere in this 6 to 10 range doesn't bother me. I don't pay that much attention to that wider range, and if we continue to have a fairly broad zone of indifference, then it doesn't matter that much.

CHAIRMAN BURNS. Now wait. It does matter because it can cumulate, you see.

MR. COLDWELL. It can cumulate if the extraneous factors were as insignificant as Steve seems to be portraying them--then perhaps the fundamental is a 7 to 8 figure. If they're a little more important, as I thought they were, then perhaps we get away from some of that. We might even get some downward pressure on this. And if that were to develop, and we drop below a 6 or 7 percent range, then we would be forced into a question of whether we move the funds rate down again. I would really rather keep this moving in a very slow fashion. If we see the fundamentals continuing on in a 7 to 8 percent [range], then I'd like to move up another one-fourth, but I would hate to move up to a full 1/2 percentage range again in this intermeeting period.

CHAIRMAN BURNS. Thank you, Mr. Coldwell. Mr. MacLaury now, please.

MR. MACLAURY. Thank you, Mr. Chairman. As you know, the view from the North Country for some months has been that the economy is stronger than the staff had been forecasting, and I think we are still in that extended position of believing that the staff is underestimating the strength of the recovery over the next four quarters. I can't see any risk of aborting recovery or substantially damaging confidence by continuing gradually to show some resistance to the kind of monetary aggregates [growth] we have been getting in the last couple of months. Indeed, on the contrary, as I think you said, Mr. Chairman, the country has looked to us for a resistance to the resurgence of inflation, and I think we ought to continue. We may indeed inspire sustained confidence by continuing to act as we have, and by that I mean resisting monetary aggregate growth that seems on the high side.

I've been impressed in the Bluebook this time by two points in particular. On page 8, it points out the path for the year ahead, given what looks like, at the bottom of that page, a 9-1/2 to 10 percent rate of growth for M1 in the second quarter. It points out that, for the following three quarters, one has to look at a 4-1/4 percent rate of growth if the midpoint is to be hit for a year as a whole. I think that's significant.

And similarly, on appendix table 4, toward the back--it's not a numbered page--it is likewise important. [It is] projections and therefore has to be given a degree of uncertainty, but it points out that for the various alternatives, alternative C at the moment, with a funds rate path for the second quarter of 5-3/8, leads to a lower funds rate range throughout the year than either of the other alternatives. And that impresses me, and I happen to believe that it's correct.

And it’s for that reason that I am inclined to buy--not alternative C in its pure form, because I think that going above 6 would be undesirable in the funds rate at this point in time. But since I endemically would prefer narrower monetary aggregate ranges and wider funds rate ranges--not that I deviate very far from what’s been said--but for an M1, I would like to see a 5 to 8 percent kind of a range, 3 percentage points rather than the 4, and similarly for M2, maybe 6 to 9. And for the funds rate range, it seems to me 5 to 6 percent, where Governor Jackson came out, is the place I, too, would like to [come out].

CHAIRMAN BURNS. Thank you Mr. MacLaury. Mr. Balles now, please.

MR. BALLES. Mr. Chairman, I’d like to set my remarks, if I may, in the context of a memo I took the liberty of sending to this group on May 12. It took up the subject we discussed at length in the March meeting of this Committee, which had to do with really fixing our position, trying to get away from what we all recognized are a lot of random fluctuations and statistical noise in any given week’s or any given month’s monetary data. The purpose of this exercise was to determine what I call the basic trend in the monetary aggregates, taking advantage of the well-known device of smoothing the series through a moving average. We happen to use in this case a 13-week moving average.

I appended several tables to that memorandum displaying graphically where the moving average stands in conjunction with our most recently determined range of growth of the aggregates for both M1 and M2. I have also incorporated into that what I thought was a very useful suggestion from Steve Axilrod that we extend the latest actual weekly data, which the Board forecasts by week, for five weeks ahead to see what that in turn would do to the moving average. And based on that exercise it’s clear to me, just from looking at the figures specifically on column 4 on each of these two tables, M1 and M2, that we have been moving consistently in a bigger amount above the upper limit of our 12-month ranges, week by week, since early March. The gap has been getting bigger and bigger, creeping up rather slowly.

I’ve been impressed recently by some articles in the press--one was by Joe Slevin, I believe, another was by Henry Kaufman--that sort of took the market to task for acting irrationally in response to week-to-week fluctuations in the monetary aggregates, overreacting, as it were. I was impressed when I saw the recently released report of the Bach Committee [unintelligible] by the Board of Governors. One of their recommendations was that the System do something to sort of alert the market to the existence of random or nonpermanent deviations week by week or month by month in the trend of the monetary aggregates.

I think one device by which we could do that is this smoothing device of the moving averages. In trying to put to work my own personal view of what the basic trend is in the level of the monetary aggregates, and feeling that we need some device for linking the short-term targets to the long-term targets, I come out for this particular period [with recommendations] somewhat similar to [those] that you make.

A federal funds range of 5 to 6 actually is what I had in mind. I would not only support your upper limit of 7-1/2 [for M1]--if anything I would shade that a bit since our long-term range is 7 percent. Unless we do something now to hold that upper limit down in the intermeeting period below the longer-term range of 7 percent, we may continue to move even farther away from the range we have set for ourselves. If I had my druthers I'd put the upper limit of M1 at 7 percent just so we wouldn't drift further away from the upper limit of our longer-term range. And if we were to make any effort to get back at least within the range within say a two-month period, the lower limit would have to be 2-1/2 percent, 2-1/2 to 7 would be how I would come out on the M1 range if we were to try to put this new analytic device to work.

On M2, [I support] an upper limit of 9, simply because that's the upper end of the longer-term range, and a lower limit of 5 because a 5 percent rate is what would return it to the upper limit of the longer-term range within the month of June.

This would all, of course, have to be subject to a federal funds constraint, and even though I would recommend a federal funds range of 5 to 6, I would agree with you that we shouldn't go beyond another 50 basis points or to a level of 5-3/4 before the next meeting.

I believe that you have correctly stated the case, we should move with all deliberate caution in this upward adjustment of short-term interest rates. But unless we begin to do it now, we'll be faced with what Mr. MacLaury said, that [with] a squeeze later on in the second half of the year, we'll have to really bear down on the growth of the aggregates. I'd rather do it a little bit sooner and in less drastic moves than if we were to delay action now and be forced to take more vigorous action at a later date.

CHAIRMAN BURNS. Well, thank you, Mr. Balles, for very instructive comments. Mr. Gardner now, please.

MR. GARDNER. Mr. Chairman, when we were discussing business confidence and expectations, I didn't hear any mention of the experiences we've just been through in this economy, which seem to me to add a dimension to our deliberations on what we set as our goals or our short-term targets for a funds rate or monetary aggregates.

It seems to me that we are aided a little bit because of the experience of our private sector in the last couple of years, and I do not believe we have to get people's attention by beating them over the head with some heavy object any longer. I think the whole country is sensitized to the problems we faced, and the ample evidence of the recurrence of inflation is a grave concern. I would therefore feel that our actions should be taken [in the context of] that particular new development. I think recent history, Lyle, does make some immediate difference on expectations, the capital spending plans, and what have you.

I would be perfectly satisfied to see the federal funds rate in the range of 5 to 5-3/4. What I am trying to say simply is that our signals need not be as dramatic as maybe they [once] needed to be. I think that's evident from our experience in the last month, and so I would agree with much of what Mr. Balles has said, except that I'm cutting a quarter off of his federal funds rate, but I would be happy with a 4 to 7-1/2 [range] on M1 and 5 to 9 on M2.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Mr. Winn, please.

MR. WINN. Mr. Chairman, Bruce really made my speech and so I won't really elaborate on that except to indicate that I think we really need to think of the longer scenario in terms of what we do today rather than in just the short run. If we take the lower M1 and M2 targets as suggested, it seems to me we are in trouble already with what we have built into May in this period. We would have to be at the top of the range already to achieve our objectives, so it seems to me that [we] are inconsistent in the way we're trying to formulate them.

I would prefer the 5 to 6 range, thinking that the market's absorption of the 50 [basis] point increases has been really quite outstanding. I would hate to see us get above the 5-3/4, but I'd rather be on record as being in favor of 5 to 6 to face the issues should they develop in this direction. And I think we have got to give a little wider spread to M1 and M2 than I'd like purely because of what we've built in already in the May figures. And certainly in terms of estimates, we are already at the top of the range. So I think you would have to have a 5 to 9 M1 range to give any kind of maneuverability.

CHAIRMAN BURNS. Thank you, Mr. Winn. Mr. Partee, please.

MR. PARTEE. Well, Mr. Chairman, I just have a couple of comments. I do believe that the business situation is strong, perhaps stronger than the staff projections for the immediate future, in any event. And with the kind of an increase we've had in employment in the last month, and the recent performance of the production index, and the possibility that something is going on in the business investment area and the inventory area, why, I have to agree with what I think is the general view of the Committee that it's too dangerous to just let strong monetary growth run unrestrained even though, in fact, it may well turn out to be an aberration.

We don't know, but the fact is that it's a dangerous thing to not recognize it, given what we see in the economy generally speaking. So I guess that puts me in the camp of saying that probably we have to move against this and we have to tighten a little further. Actually, I think we've already made the really significant tightening move. That is, in the past month, that switch into a rising funds rate is having a marked effect on market interest rates, as we thought it would, given the sensitivity of the market. So this is just a question of how much continuation we are prepared to see here in the period to come.

Well, I think that what we take in the way of a constraint on the funds [rate] and what we take in the way of a range in the aggregates is very much interrelated. That is, you can have your choice. As Bob Mayo pointed out this morning, you can have a constrained funds rate but also constrain your aggregates, and then, chances are, you are going to move right up to the top of whatever funds rate range you've specified. Or you can have a somewhat broader monetary aggregate range around the most probable point estimate and have a little larger funds rate range and maybe not use the top of it.

I have some inclination for going in the second direction rather than the first because I think I agree with what Willis just said, that given the April profile as it leads into May, it looks like we are going to have a fairly substantial May, and I wouldn't like to see us immediately giving the Manager a signal that indicates he ought to be at the top of the range.

Well, I think my preferences for the specifications were exactly the ones that Phillip Jackson gave, that is, an M1 growth range for the two months of 4-1/2 to 8-1/2--it would be a surprise if we got 8-1/2, but the staff estimate is 7-1/4, and so it's not that much above it. Look how much we've been surprised in the past month as we ran from 8 to 15 or something like that--5 to 15. And for M2, I think 6 to 10 is certainly better, even if we take your specifications, Mr. Chairman; 6 to 10 is better than 5 to 9. I don't see that there would be that much impact yet on M2, although I certainly agree there's a sensitivity to interest rates in that, and that at some point we'll start to see these deposits run out.

And the funds rate, I think 5 to 6 is perfectly good as a range, recognizing that we wouldn't get to 6 unless we had a high monetary aggregates [reading], that is, 8-1/2 for the two-month M1 and something like 10 for M2.

And no one else has commented on this and so I would throw in also that I believe we ought to continue to give something like a 50-50 weight to our reading of M1 and M2 as we have done in the recent months, certainly because of the performance of M2, [but also because it is] a proxy for M3, and M3 is very important to us in this period. That's all, Mr. Chairman.

CHAIRMAN BURNS. Thank you, Mr. Partee. Who would like to speak next? Yes, Mr. Wallich.

MR. WALLICH. I'd like to be guided by some of the same considerations that others have mentioned, and broadly I follow what Mr. MacLaury has said. I am concerned that we have increased the annual rate of growth of our money in the past by about 1 percentage point for the last recent period. We've used up something like 1 percentage point of our range for the year ahead. The thing that gives me some pause is not the move in the funds rate and associated other short-term rates, but the move in long-term rates. That, I think, is a pretty critical event. One did not have to expect that this would necessarily happen [as a result of] short-term rates moving. It shows the sensitivity of the market, and that is a crucial element.

I would not like to see long-term rates move up very fast at this juncture. Even so, I think one has to bear in mind that the impact of all this is likely to be quite late--late this year, early next year--so that if, by that time, a strong investment boom is under way, it would not be inappropriate to have moved relatively early with interest rates, even long-term rates. As I look at the short-term rates to which we're likely to be pushed if we stick to our long-term targets and don't move relatively fast now, I am concerned because that gets into 9 percent federal funds rate territory, and, again, that I think is something we ought to try to avoid.

All told, therefore, I come out with a funds rate more on the high side, 5 to 6; an M1 which is the same as our long-term range if we are to get back to that 4-1/2 to 7; and M2, 5 to 9.

CHAIRMAN BURNS. Thank you, Mr. Wallich. Who would like to speak now? Mr. Black and then Mr. Baughman.

MR. BLACK. Mr. Chairman, I have sometimes shared the doubts that Governor Coldwell expressed about the [estimates for the] aggregates, but I must admit, those doubts are becoming weaker as time passes, and I'm now prepared to believe that there is a substantial amount of the bulge that is real demand for money. Accordingly I think we ought to move against it in more or less the manner you described. I would agree with your specified range of 5 to 5-3/4 on the federal funds rate, and the ranges you suggested for the aggregates strike me as reasonable, although I could shift a little either way depending upon what the group wants to do.

CHAIRMAN BURNS. Thank you, Mr. Black. Mr. Baughman now.

MR. BAUGHMAN. Mr. Chairman, I'm impressed with what John Balles announced as the situation and his suggestion about the need for paying respect to the long-term ranges that we project. At the same time, I would have to admit to being a little bit weak-kneed at the present time with respect to moving as aggressively as his prescription comes out from that particular analysis. So if I were a voting member I'd be prepared to go with your suggestion, Mr. Chairman, on the federal funds rate and also with your suggestions on the aggregates. This means that we would probably be at the top of the federal funds rate fairly soon.

Alternatively, if we want to maintain the significant element of flexibility in the funds rate, then--and I guess I'm winding up pretty nearly in the same corner that I believe Governor Partee was--[I would support] a somewhat higher and little bit wider range on the federal funds rate; so [then] you will be working pretty much around the middle of that range but expecting to be associated with that somewhat higher rate of growth in the aggregates than proposed. So it seems to me it's kind of a 50-50 proposition and--notwithstanding my general orientation toward narrower ranges on the aggregates and wider ranges on the federal funds rate--at this point in time my inclination would be to go in the other direction, which leaves me very close to your suggestion at the outset, Mr. Chairman.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Yes, Mr. Roos, please.

MR. ROOS. Mr. Chairman, briefly I think that if we have to take a step, then no time is better than the present, and I would shudder to think if the appendix table 4 projections are valid. If we procrastinate and have to, in the fourth quarter of this year and the first quarter of next year, face up to the sort of projection which is shown under alternative A and under alternative B, table 4, I think that could have disastrous effects--it would be a clamping down that would be really very painful to the economy. So I would agree with Mr. Balles. If I were a voting member, I would be a 4 to 7 man on M1, 5 to 9 on M2, and 5 to 6 on the federal funds range.

CHAIRMAN BURNS. Thank you, Mr. Roos. Anyone else? Mr. Guffey.

MR. GUFFEY. I'd like to go on record aligning myself with Mr. MacLaury. I think he stated our feelings very, very well and I wish I had said it.

CHAIRMAN BURNS. Very well, thank you, Mr. Guffey. Who would like to speak now? No one else. Well, I think the general direction of the Committee's thinking is quite clear and uniform. On specific numbers there is some dispersion, more dispersion than we've had in the past meeting or two, but that is thoroughly understandable.

Now, let me test the Committee's thinking. The range is fairly large in the case of M2, but a figure of 4 to 7-1/2 may be somewhere close to the average. Running from 4 percent to 7-1/2 percent for M1 may be close to being the mean of Committee thinking. Let me therefore put the question to the Committee, and ask for a show of hands on the part of members of the Committee, whether a range of 4 to 7-1/2, while not preferred necessarily, would seem broadly acceptable.

MR. WINN. May I ask a question on that. What would that mean to the Desk in view of what we know about the aggregates already?

MR. HOLMES. Well, it would mean that if we're getting up to the 7-1/2, we would be moving the funds rate up relatively rapidly. Our own estimate of M1 over the two months is something like 6-3/4, so there's some leeway if it's anywhere near right. It may not be.

VICE CHAIRMAN VOLCKER. The Board's estimate is 7-1/2.

CHAIRMAN BURNS. Well, I would say this. Now, I think Mr. Holmes has given the correct answer as far as normal Desk operations are concerned. But I would still space out the adjustment of the federal funds rate. Rather than move up promptly, I would move it up gradually over the month, and that is something for the Committee to decide.

VICE CHAIRMAN VOLCKER. May I raise a question or comment along that line, Mr. Chairman--7-1/2 does seem to me unduly constraining, but I would not worry. I say that partly because I still feel quite uncertain about where these numbers are going to go, and we're very much influenced by this big April figure. If you look back, we were right on target with the December longer-term projections we had because we were running low. So it depends somewhat upon the perspective [from which] one looks at these.

The 7-1/2 percent seems all right to me if, indeed, we're not going to go above 5-3/4 percent in the federal funds rate. I have a little trouble expressing a preference on it without knowing what the upper limit of the funds rate is because I think that, with a 6 percent federal funds rate, this would very likely carry us to 6, and I don't really want to go there soon.

MR. PARTEE. I would associate myself with that. I mean, I can either buy that with the low funds rate or higher [unintelligible] with the higher funds rate.

VICE CHAIRMAN VOLCKER. Right, right.

CHAIRMAN BURNS. Well, let's proceed then, tentatively. That is, we can retrace our steps, but let me continue the way I'm going. These are tentative indications of Committee thinking, and we're certainly not voting formally. I therefore ask for a show of hands on 4 to 7-1/2 percent [for M1]--whether that is generally acceptable even though not preferred.

MR. BROIDA. Five, Mr. Chairman.

CHAIRMAN BURNS. Then I would make that a pleasant six, it just tips the balance. Now and then, the Chairman--even though we are not voting--can make his influence felt. Now let me test the Committee's thinking on M2. There the range [of opinion] is narrower, and let me test the range of 5 to 9--5 percent to 9 percent for M2, and let's have a show of hands.

MR. BROIDA. Five.

CHAIRMAN BURNS. Well, we come out the same way. Now let me test the federal funds range of 5 to 5-3/4, taken on the assumption that the M1 range will be 4 to 7-1/2.

MR. BROIDA. Seven, Mr. Chairman.

CHAIRMAN BURNS. Well, we've had some test of Committee thinking. Would you like me to continue to test the Committee's thinking further?

MR. PARTEE. Let's try it the other way.

VICE CHAIRMAN VOLCKER. With slightly higher aggregates.

MR. PARTEE. And slightly higher funds rate.

CHAIRMAN BURNS. Well, then, you see, the high monetary aggregates are in the minority of the Committee, but let's take 4 to 8 for M1 and for M2--well, perhaps 5-1/2 to 9-1/2 and the funds rate of 5 to 6. How many would feel more or less comfortable with that specification as over against, I will have to repeat this--this is getting quite complex--an M1 range from 4 to 7-1/2, an M2 range from 5 to 9, and a federal funds rate from 5 to 5-3/4.

All right, I've got the numbers down, and now we have to get them in our minds. I'm going to distinguish between package A and package B.

Package A is as follows: M1 at 4 to 7-1/2, M2 at 5 to 9, and federal funds 5 to 5-3/4.

Package B is as follows: M1 at 4 to 8, M2 at 5-1/2 to 9-1/2, and federal funds 5 to 6.

Are the specifications of packages A and B clear, or should I repeat them? I take it they are clear, and we will now have a show of hands on which we prefer, package A or package B. Those who prefer package A will kindly raise their hands.

MR. BROIDA. President Volcker?

VICE CHAIRMAN VOLCKER. I guess so, I prefer....

MR. BROIDA. Six, Mr. Chairman.

MR. PARTEE. I think you forgot one.

MR. BROIDA. Oh, did you have your hand up?

VICE CHAIRMAN VOLCKER. Yeah, I had my hand up, but only because I think the funds rate is more important than the aggregates.

CHAIRMAN BURNS. Gentlemen, I don't know whether--you know the difference between A and B is not very large, and I would join those who prefer A. We're ready for a vote unless members of the Committee want further testing or further discussion.

VICE CHAIRMAN VOLCKER. Well, let me just try tentatively--maybe there's no sentiment for it--I'd prefer the aggregates more like you have them in B and the funds rate the way you have it in A.

SPEAKER(?). So do I, and I'm not voting.

CHAIRMAN BURNS. Well, all right, do you want to give me your numbers?

VICE CHAIRMAN VOLCKER. Well, I'll say--

CHAIRMAN BURNS. This is now package C.

VICE CHAIRMAN VOLCKER. Right--4 to 8 for M1, 6 to 10 for M2 [or] 5-1/2 to 9-1/2, I'm not going to fight about that difference, and 5 to 5-3/4 for the funds rate. So make M2 whichever way you want it.

CHAIRMAN BURNS. Well, this is going to be good and complex and I'm not going to make it simple for you. You've got to blame Mr. Volcker, you can't blame me. I'm a servant of the Committee, the servant of every member of the Committee, and now Mr. Volcker's servant, and the complexity falls on his shoulders. We're going to indicate a preference as among A, B, and C. Is that the way you want to do it?

VICE CHAIRMAN VOLCKER. Well, I don't know. That's the simplest way, I think--

CHAIRMAN BURNS. Well, you got us into this.

VICE CHAIRMAN VOLCKER. Right.

CHAIRMAN BURNS. A is--

VICE CHAIRMAN VOLCKER. Depends on how you want to run your program.

CHAIRMAN BURNS. All right.

Package A: M1 at 4 to 7-1/2, M2 at 5 to 9, funds rate at 5 to 5-3/4.

Package B: M1 at 4 to 8, M2 at 5-1/2 to 9-1/2, and funds rate at 5 to 6.

Package C: M1 at 4 to 8, M2 at 5-1/2 to 9-1/2, and funds rate at 5 to 5-3/4.

Now, those members of the Committee who, on balance, prefer package A will raise their hands.

MR. BROIDA. Four.

CHAIRMAN BURNS. Okay, now those members of the Committee who prefer package B will raise their hands.

MR. BROIDA. Three.

CHAIRMAN BURNS. Members of the Committee who prefer Package C will now raise their hands.

MR. BROIDA. Three.

CHAIRMAN BURNS. Well, since package A would also have my dedication, I think we'll have a formal vote on package C, and the differences here--

ALL. A, package A.

CHAIRMAN BURNS. That's that. Well, the hour is advancing, and we have to vote also, of course, on the language of the directive. I would suggest that we stay particularly at this time with the monetary aggregates proposal.

MR. KIMBREL. Mr. Chairman, in that context, then, since we apparently really are [unintelligible], I wonder in the wording if we could add just one word in the fourth line, "money market conditions consistent with more moderate growth in monetary aggregates."

CHAIRMAN BURNS. Well, let's have a show of hands on that. The language as it stands as over against Mr. Kimbrel's suggestion to read "with more moderate growth." How many prefer the language as it now stands?

MR. BROIDA. Six as it now stands.

CHAIRMAN BURNS. Well, all right, we'll vote now on the monetary aggregates proposal, the language as in your work sheets--with a range for M1 of 4 to 7-1/2 percent, M2 of 5 to 9 percent, and a funds range of 5 to 5-3/4 percent--and with M1 and M2 receiving approximately equal weight at the Desk. And with the understanding also that if these numerical guides should suggest a prompt move in the funds rate to the upper limit, that the Desk would not proceed in that way--that if an upward move was indicated, it would be spaced out over the month in gradual fashion.

MR. PARTEE. Over the month?

CHAIRMAN BURNS. Well, would be spaced out in gradual fashion, which could mean over the month, which could mean over three weeks. I think we have to leave some flexibility for the Desk.

MR. PARTEE. Yeah.

VICE CHAIRMAN VOLCKER. He would understand that the presumption would be our current projections; it would be a small move right now.

MR. PARTEE. The center is 5-3/8.

CHAIRMAN BURNS. A very small move. I think you're just about where you are.

MR. BROIDA. A five-week interval.

CHAIRMAN BURNS. Well, there are no further comments, we've exhausted our arithmetical propensities, I believe, and we are ready for a vote. Would you be good enough to call the roll?

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volker	Yes
Mr. Balles	Yes
Mr. Black	Yes
Mr. Coldwell	No
Mr. Gardner	Yes
Mr. Jackson	Yes
Mr. Kimbrel	Yes
Mr. Partee	Yes
Mr. Wallich	Yes
Mr. Winn	Yes

Ten to one, Mr. Chairman.

CHAIRMAN BURNS. Now, what else do we have to do?

MR. BROIDA. Special item that can be carried over.

CHAIRMAN BURNS. Well, we'll carry it over then.

MR. MACLAURY. This is not something we have to do, but it's just a suggestion I'd like to make. In the Bluebook, I find the charts on the monetary aggregates particularly un-useful. They tell us nothing, at least in my view, and I would like to suggest that the staff consider alternative charts taking into account those that John Balles has prepared as perhaps more meaningful to the group. It's just a suggestion, and I'd like to hear some comment about what might be more useful to the group over time--

CHAIRMAN BURNS. Well, I think members of the Committee who have definite views on the graphic presentation should communicate those views to the staff, and the staff should take the thinking of the members of the Committee into account. Well, I think we've completed our meeting.

END OF MEETING