

TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

July 19-20, 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.

7/20/76

Meeting of Federal Open Market Committee

July 19-20, 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 Monday and Tuesday, July 19-20, 1976, beginning at 6:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Gardner
Mr. Jackson
Mr. Kimbrel
Mr. Lilly
Mr. Partee
Mr. Wallich
Mr. Winn 1/

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

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

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

1/ Attended Tuesday session only.

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. Pizer, Advisor, Division of International
Finance, Board of Governors
Mr. Struble,1/ Chief, Government Finance
Section, Division of Research and
Statistics, Board of Governors
Mrs. Farar,1/ Economist, Open Market
Secretariat, Board of Governors
Mrs. Deck,1/ Staff Assistant, Open Market
Secretariat, Board of Governors

Messrs. Balbach,1/ Boehne,1/ Doll,1/
Eisenmenger,1/ and Scheld,1/ Senior
Vice Presidents, Federal Reserve
Banks of St. Louis, Philadelphia, Kansas
City, Boston, and Chicago, respectively
Messrs. Burns1/ and Cox,1/ Vice Presidents,
Federal Reserve Banks of Dallas and
Atlanta, respectively
Mr. Meek,1/ Monetary Adviser, Federal Reserve
Bank of New York
Mr. Duprey,1/ Senior Economist, Federal
Reserve Bank of Minneapolis

1/ Attended Tuesday session only.

Transcript of Federal Open Market Committee Meeting of
July 19-20, 1976

[Executive session]

CHAIRMAN BURNS. Gentlemen, we have a brief meeting scheduled for this afternoon. There are two items to take up. First of all, when I testified recently--what was the date?

MR. BROIDA. June 30.

CHAIRMAN BURNS. Yes, June 30, before the Joint Economic Committee, I was asked about the Memorandum of Discussion by Mr. Reuss and also by Mr. Proxmire. I'd previously heard from Mr. Proxmire, who had written me a letter, and both urged that the Committee reconsider its decision to eliminate the Memorandum of Discussion. Now, I believe that Mr. Broida sent you a copy of the transcript of that discussion. As I recall, at the hearing, I dealt with the questions adequately, or at least I thought so at the time. The Memorandum of Discussion and what we should do with it was considered very carefully by the [Committee], and we discussed it formally over a period of several months, and informally all of us have thought about it for some time.

There's only one new fact that I'm aware of, which is that, since we reached that decision, the only criticisms that we've received have come from these two gentlemen. And I indicated that at the hearing, and since then I haven't heard a word from anyone, either directly or indirectly. That is the only new fact that I know of. Now the question is before the Committee [unintelligible] to reconsider that decision. If so we shall do so. If not, we shall inform the two chairmen that this was taken up by the Committee and we've decided that the earlier decision should stand. What is the wish of the Committee?

MR. JACKSON. Mr. Chairman, I don't think we ought to change [that decision]. I think the best example I know of in our government of the reason to [not] change is the highest decisionmaking body of people in our government, the Supreme Court of the United States, composed of a number of learned people who give decisions that affect the lives of our people as much as we do, if not more so. And if I [understand correctly], and I'd bow to members of counsel around the table, they don't give the deliberative process by which they arrive at a conclusion. They give a conclusion which was concurred with by all.

And to a significant extent, our minutes of actions or the type of disclosure that we give now goes substantially beyond anything that the decisionmaking process in the judiciary goes through, and outlines all alternatives that were considered and the range of discretion. And I think from the public policy point of view that is sufficient. I don't see any outcry on the part of attorneys claiming that the Supreme Court of the United States must keep a verbatim transcript for scholars to research later. And I just frankly never understood why there was this outcry for this body to do the same thing.

CHAIRMAN BURNS. Well, we haven't had any outcry. That is really what we anticipated--we anticipated that there would be very little criticism, but I must say I did

anticipate more than we've received. To repeat, we've been criticized by Mr. Reuss, by Mr. Proxmire, and I'm not aware of any other criticism from any other source. Yes, Mr. MacLaury.

MR. MACLAURY. Thank you, Mr. Chairman. Phil, I wonder whether the Supreme Court analogy is apt or exact enough. I personally have not made up my mind. I don't feel strongly one way or the other on the substance of the issue of whether we reconsider our decision or not. But in some sense this whole judicial system as I understand it is set up so that the final court of appeals is the Supreme Court, and their word, so to speak, is the last word.

I don't think anyone has quite accorded this group that same distinction or place in our system. We are accustomed to being second guessed from beginning to end, and therefore, maybe the arguments by which we arrive at our conclusion are just fodder for second guessing in the press or otherwise, whereas the Supreme Court has spoken and there's not much point [to seeing a transcript] because there's no place else to go. That's my only comment on that particular analogy.

CHAIRMAN BURNS. Well, I don't think, if I may say this, I don't think that the Supreme Court analogy which Mr. Jackson has just made played any role in the Committee's decision. Mr. Jackson has given his interpretation. Well, that's the way he looks at it. I see the world a little differently. The real question is not whether you agree with Mr. Jackson's special, personal interpretation. The real question is whether or not you believe that we ought to seriously sit down and reappraise our earlier decision on the Memorandum of Discussion.

MR. MACLAURY. In that context, though, one of the things that we did discuss a good deal in arriving at this conclusion, one of the things that we cannot really discuss except in executive session, is the role of the Government in the Sunshine bill, and not just the particular bill but where we stand on the court suit that was brought by the Georgetown lawyers. And, frankly, I have lost track of where that stands, that court test of our disclosure of the minutes of January 1975. I would just like to be brought up to date if I could. I do think that it has some relevance for our consideration. And then, finally, I'm just musing personally about whether or not the Memorandum of Discussion for the year 1972 might not have been a useful document in the public domain to somehow dispel all of these false accusations about--

CHAIRMAN BURNS. Well, that document will be in the public domain.

MR. MACLAURY. Right, but I'm just thinking in terms of the future as well. We have been subject to charges that we were politically motivated, partisanly motivated in 1972, charges which I know to be entirely false. And it seems to me that the Memorandum of Discussion is perhaps the only document to which historians can look for some sort of truth in that particular issue. We can make all of the protestations we want. I just put that on the table. I don't know what it implies, but I think it's something to be considered in our discussion.

CHAIRMAN BURNS. Well, let's be clear about one thing. Do we want a fresh debate on the Memorandum of Discussion? Let us not go into the merits one way or the other. Let us have a show of hands on that.

SPEAKER(?). Voting members or all?

CHAIRMAN BURNS. What's that?

SPEAKER(?). Just members or all of us?

CHAIRMAN BURNS. Yes, well, let's have a show of hands of all of us.

MR. LILLY. Before you have a show of hands, could I ask a question? When you considered this before, did you consider the [unintelligible] that there is an electronic recording made of the same and just keep the recording?

CHAIRMAN BURNS. Well, perhaps Mr. Broida can. I do not recall specifically enough.

MR. BROIDA. The recording is made solely for the purpose of preparing whatever records--

CHAIRMAN BURNS. But that's not the question.

MR. LILLY. That's not my point. Is a recording made and why not just file the recording? I don't want to ask that question, I want to know if that was considered? I don't want to start a debate.

MR. BROIDA. No, that came up only in connection with the Government in the Sunshine Act. That was not specifically considered independently of that.

CHAIRMAN BURNS. I don't recall. Yes, Mr. Mayo.

MR. MAYO. I'd like to follow up on the point that Bruce made, which is really my only question. I favor continuing our present position. I don't think we should be frogs and jump around just because two people who happen to be in a particular position like to see us jump. But I would like to have Mr. O'Connell's counsel on this, as to whether he sees any prejudice to our position on the openness of our records in the instant case that Bruce referred to, by a decision one way or another in this particular instance. Is there any relevance at all?

MR. O'CONNELL. May I comment on that, Mr. Chairman?

CHAIRMAN BURNS. Yes, please.

MR. O'CONNELL. If I may, President Mayo, at the time the Committee was considering its move with respect to the Memorandum [of Discussion] and the questions put to me then--did I see any adverse impact--I gave the opinion that I saw none. In the interim I have been presented with no fact or occurrence or development that changes that opinion. So, as I said then, I think the Committee's action was not in any sense adverse to, nor did it impede the pursuit of, that lawsuit, which is on appeal to the Court of Appeals from the portion of the District Court's order that dealt with the action record of the Committee. We did not take an appeal to pursue the ruling of the court with respect to the Memorandum of Discussion. If now the question is, does the possibility of reconsidering the Memorandum of Discussion action constitute an impediment to the pursuit of our cause of action, I think not. I think wholly

consistent, though, is the action the Committee has taken, and I'm perfectly satisfied to remain right where that is.

MR MAYO. Thank you, Tom. In view of that, I see no reason why we should change our mind.

CHAIRMAN BURNS. Mr. Wallich.

MR.WALLICH. Well, if that plaintiff wins his suit, would that mean that, subsequently, Memoranda of Discussion might have to be presented or a precedent set so that others could request the same thing?

MR. O'CONNELL. Governor, I see nothing in the opinion of the lower court that mandates this Committee to keep a Memorandum of Discussion. Relating to the two Memoranda demanded, the court order would reflect upon those and those only. Later, someone could bring a suit; if they did, the answer could be given that we no longer keep a Memorandum of Discussion. We move to dismiss.

MR. WALLICH. But if we still kept one and if someone else brought a suit, given this precedent, would that increase the probability that subsequent Memoranda would have to be released [unintelligible]?

MR. O'CONNELL. I think definitely the answer would be yes.

MR. BROIDA. I don't think you'd need a suit.

MR. O'CONNELL. You wouldn't.

MR. BROIDA. We'd simply respond affirmatively in the issue of [unintelligible].

MR. WALLICH. That is the main argument, then, against the Memorandum.

MR. COLDWELL. Because we don't know yet the outcome of the suit.

MR. BROIDA. That part of it, I believe, is completed. It's not appealed. It's not on appeal.

MR. O'CONNELL. The lower court's order with respect to the Memorandum would declare, and we haven't pursued the appeal in that respect, that the Memorandum of Discussion should be made available.

MR.BROIDA. [To release] segregable facts.

MR. O'CONNELL. Segregable facts. With respect to the two Memoranda that were under discussion, the court's order did not mandate disclosure by this Committee of facts and related [discussion] that were not "reasonably segregable facts"; only the latter were ordered to be made available. If we reinstated keeping the Memorandum of Discussion, it would require that, after each meeting, as promptly as possible, staff would go through that Memorandum and

segregate reasonably segregable facts and have them, I think, set apart in a publicly available record if someone wanted to come in and ask for them.

CHAIRMAN BURNS. Mr. Volcker now.

VICE CHAIRMAN VOLCKER. I just wanted to clarify one question on which I think you have already expressed a judgment. It seems to me that a very pragmatic question of great principle is at stake. As near as I can see, we made a pragmatic judgment with good and sufficient reasons. We ought to dispense with this [discussion]. The only new thing that has entered in is a congressional complaint.

Pragmatically, I would say, if the [congressional] committees are going to be upset, we would have to retreat if it got to the point of a [congressional] committee action. I think I wouldn't want to [before then]. Your judgment is, as I understand it, that this is far from a matter of great concern to the [congressional] committee; it really looks like these two people are not going to go further. So we're not going to have to [unintelligible] in the future. And if this is all the complaint we have, there's no reason that I would agree with that. If indeed that is the correct judgment--

CHAIRMAN BURNS. Well, I don't know if it's a correct judgment or not. I am impressed by the fact that no one, literally, apart from these two gentlemen, has raised any question, in writing or orally, directly or indirectly, with me.

And while I did not anticipate much criticism, we've looked into the matter, and Joe Coyne explored this for me. I did anticipate a number of protests. And there haven't been any. Now Mr. Reuss at the hearing called on the journalistic fraternity, you see, to communicate with him. Well, I haven't heard from one [journalist]. I haven't seen an item in the press on this. On the other hand--what do you call it, the monthly policy record?

MR. BROIDA. Yes.

CHAIRMAN BURNS. Well, the press is paying a good deal more attention to that, I think for two reasons. First, because we put it out more promptly, and second it's a more informative document than it used to be. And in my testimony, I indicated that our staff is learning how to do this job. And I meant that most sincerely. I've had numerous conversations with our staff on that, and I think that the monthly policy record is going to improve in quality and become increasingly more informative. I think the public is far better informed now than it was before. And as this document improves, that will continue to be the case.

Well, gentlemen, we're almost involved in a debate, whereas the real question at the moment is whether or not we should be debating this issue. And therefore, I return to the question--does the Committee want to reconsider our earlier decision with respect to the Memorandum. If there is sufficient interest in that, we'll schedule a full-fledged debate on it and take whatever time is needed. You have a question, Mr. Guffey.

MR. GUFFEY. Well, only a comment, Mr. Chairman. It seems to me, as you look back at what has happened, the [unintelligible] for doing away with the Memorandum of Discussion was a lawsuit and the fact that what happened at this table would go in the public domain very soon

after the meeting if they were successful in the lawsuit. We decided to do away with the Memorandum of Discussion. I can see nothing that has changed since that decision was made. If the congressmen feel strongly enough about it to give us the type of statute or legislation that says it would be held out of the public domain for five years, which they seem to agree is a good rule, then I would be prepared to go back to the Memorandum of Discussion. I think it serves a useful purpose, but not in the context that we're now facing.

MR. COLDWELL. Well, Mr. Chairman, as the only one who voted against this decision, I must say that I would prefer that we continue on with the Memorandum of Discussion. But the Committee clearly voted it down, and I am not interested in fighting [unintelligible]. So I'm not going to suggest we consider it.

CHAIRMAN BURNS. Any other comments?

MR. BLACK. When you report back, wouldn't it look about, as you said, we had reconsidered it?

CHAIRMAN BURNS. Oh yes, that's exactly what we're doing now.

MR. BLACK. It's a question of degree.

CHAIRMAN BURNS. We've reconsidered it before the question of reconsideration is put.

MR. BLACK. If words will be just as effective, well, that's one thing. I would think a little more discussion might sound not too [unintelligible].

MR. WALLICH. Well, there's another aspect to this. It seems to be one could be responsive to Reuss and Proxmire by being more specific about [unintelligible] improvements in the policy record.

CHAIRMAN BURNS. That's exactly what I intend to do [unintelligible] in the response.

MR. BLACK. If Mr. Chairman, they offered some--

CHAIRMAN BURNS. I listened with the gravest of interest to Mr. Guffey's comment, and I cannot very well suggest any such legislation to the Congress. But I would welcome it. Because, in that case, if there were such legislation--listen carefully, Tom--I assume that the court would not interfere, and that we could withhold that Memorandum of Discussion for a full five years as being the will of the Congress that we do so.

MR. O'CONNELL. Absent, Mr. Chairman, the possibility that a court of law could be asked to look at that particular statute to see if it contravenes the existing mandate of law in another statute, such as the Freedom of Information Act, these [unintelligible].

CHAIRMAN BURNS. Well, it could be the language of the statute. Now, I'm not a lawyer, but you could write the statute indicating that this is the law without regard to what any other statute may say on a related subject.

MR. O'CONNELL. You could indeed. In fact, [given] that [the new law] postdated such an existing statute, even reference in the new law to the congressional knowledge of the existence of that [earlier statute] would help. It could be avoided. I'm merely saying that the possibility existed.

CHAIRMAN BURNS. And also, I think such a statute would help enormously in the whole debate on secrecy. But I don't think such a statute is going to be written by the Congress, and I don't think I'd be in a good position to suggest it, but I would welcome it. Yes, Mr. Roos.

MR. ROOS. I wonder if we should not be very aware of the public relations aspect of this whole issue at a time when everybody from presidential candidates on down are harping on openness and sunshine, etc., etc. From the point of view of our image with the public, it seems to me that it is an awfully difficult thing to defend in the public arena that [we are] having this record [made public only] after five years. I don't suggest that we should flip flop, because I don't think we want to be frogs, but if I were a Reuss or a Proxmire, I could have a field day exaggerating how secretive we are and how fearful we are and how we are dragged screaming to the summons of sunshine.

I think that, in the public arena and in the political arena, we're vulnerable in these positions we're taking, but maybe the other concerns are far more compelling than just the public relations or public image of it.

CHAIRMAN BURNS. Well, we could turn the tables here. Here we have two members of the Congress urging us in effect to maintain secrecy over a period of five years. And this is something we're not willing to do because we believe in openness and therefore we will reveal our doings after a period of only approximately 30 days. And that's exactly what the monthly policy record does.

Now, it [omits] one thing, and one thing only. It omits the names of individuals. But after all, what the public wants to know is the thinking, the range of facts, the range of considerations that went into the Committee decision. I do think that the monthly policy record will have to be expanded considerably. It should become a richer document than it is. And I think the second one was better than the first, and the third will be better than the second. I think our staff has to learn how to do this job better than it has yet done it. This could be an artful letter to write, and let me call on you for assistance on that letter.

MR. JACKSON. Be careful in writing the letter that we don't suggest or bring up the subject of [the Government in the] Sunshine bill [in regard to] the Open Market Committee. You be very, very careful that we don't bring that up.

CHAIRMAN BURNS. Oh no, no, no, no, no--

SPEAKER(?). Well, [unintelligible] does our answer to this request have any bearing on what Congress might do on the Government in the Sunshine bill?

CHAIRMAN BURNS. I doubt it. I doubt it very much. What does have a bearing on it, I'm afraid, and this is surmise on my part, is the pronouncement that Mr. Carter made on the Sunshine [bill] the other day. Now I believe that Mr. Carter referred to [unintelligible].

Unfortunately, the Sunshine legislation as it stands in the Congress is very imperfectly understood by members of the Congress.

And the fact is, or at least I'm so informed time and again by our counsel, no Sunshine statute in any of our states calls for a verbatim transcript. And if the present legislation were amended to eliminate the requirement of a verbatim transcript, not all of our criticisms or difficulties would be met, but the greater part of our difficulty would just vanish. We consider ourselves in reasonably good shape. But I doubt if Mr. Carter knows this, and I would bet that, of the 535 legislators on Capitol Hill, you couldn't find a half dozen who know this and understand it. That's the difficulty with the legislation. [Its] name is so attractive. Particularly at this time. However, there is this about the political situation--I think some understanding is gaining on Capitol Hill.

Mr. Horton is going to offer an amendment, and he may offer more than one. Well, suppose that the Horton amendment carries. Very well, then Sunshine legislation will still pass the Congress, the House overwhelmingly--[but] with the Horton amendment--and we will be in reasonably good shape. Now, next, if the Horton amendment fails, then I think members of the Congress will still overwhelmingly vote for that legislation. What I'm saying is, therefore, that those who understand the difficulties that the Sunshine bill [present for] the Federal Reserve and one or two other agencies are not taking any significant political risks in voting for the Horton amendment. They'll still be for the Sunshine legislation, you see, no matter which way the Horton amendment goes. And this is now understood by a fair number of congressmen.

Also, I've been away for a few days--and Mr. Guenther couldn't help, he's been away, too--but the "Dear Colleague" letter has been prepared by Mr. Horton's office, and it's an excellent letter. And a fair number of signatures of Republicans and Democrats are now attached to it, and we're going to have the strong support of Mr. Pepper, a Florida Congressman who has considerable influence, I think, as an elder statesman in the House of Representatives and a man who's known for his liberal views. Do you have any knowledge of that, Tom? How that is progressing?

MR. O'CONNELL. The last word I had from Mr. Horton's chief of staff, who's handling this matter, was that they were quite pleased both with the number and the mix of signatures they had gotten. They had gotten from us a suggestion that they visit both sides of the aisle in assembling these signatures, and they proceeded on that basis, and he said he was quite pleased with the number. I don't know the exact number, Mr. Chairman.

CHAIRMAN BURNS. Well, we have a chance, anyhow. Three months ago, two months ago, it seemed almost hopeless, but we kept on fighting. And we will continue.

MR. O'CONNELL. I will say, Mr. Chairman, that the Horton staff exhibited a good deal of pleasure in the Bella Abzug[unintelligible] colleague that she to some [unintelligible] had peaked a little bit in advance. She anticipated that the bill would be on the floor of the House before they recessed, and they missed that. Her letter was distributed, and he feels that the impact of that letter has been severely diminished by that fact. And he's pleased with the calendaring of his letter.

CHAIRMAN BURNS. Well, you know calling [unintelligible] Abzug is not doing us any injury in the House of Representatives.

MR. O'CONNELL. No.

CHAIRMAN BURNS. --whether that is entirely fair or not, I don't know, but I'm not complaining. Any other question or comment on this first item of reconsideration?

SPEAKER(?). It seems to me, Mr. Chairman, that Mr. Guffey has summarized it about right. We did consider all available facts, and there has been no substantial change in the facts--therefore, no substantial basis for changing our views.

CHAIRMAN BURNS. That is the letter that will be carefully written. I'll do my best to do that--emphasizing the new document and the plans for improving it and how much more enlightening it is going to be.

MR. COLDWELL. I can't resist, Mr. Chairman, commenting that if that new document is enlarged far enough, we'll have a Memorandum of Discussion without [unintelligible]. And promptly released.

CHAIRMAN BURNS. No, it will not be. It will continue to be an analytic document, whereas in the Memorandum of Discussion you have the flow of conversation back and forth and therefore, to make much sense of it, you have to analyze it and distill what you can gather from it.

MR. PARTEE. I can't resist then, Mr. Chairman--of course the document can't have more in it than the discussion had. Something has to be said at the meeting to give the staff the basis for saying something on the analytic end.

MR. MACLAURY. I thought that was one of the strong points you made, Mr. Chairman, in your comment. The criticism was that the first examples [of the expanded Record of Policy Actions] were very bland, and your comment was that you can't be less bland than the discussion. And I think in that context the reverse is also implied, that if there are dissents or discussions, that those will be fully put on the record, and I would hope that that is really the answer to the criticism of these two gentlemen. And maybe that would be said in the letter.

CHAIRMAN BURNS. That's a good point. I'll keep that in mind.

MR. WALLICH. Now, why is it, Mr. Chairman, so long as we have an opportunity to go over the draft, that names can't be mentioned? I wouldn't have an objection to having my name used in a way that I didn't understand [if I could] protect myself.

CHAIRMAN BURNS. I think it can be done. I think the sentiment of the Committee was that this should not be done. That would also be my view. I think when you start mentioning names, identifying positions with individuals, one is inviting a certain emphasis on differences. And remember that this is a document that is now released approximately 30 days after our meeting. To have the differences displayed by name could excite some of us unduly to extreme utterances. And I think also that our critics on Capitol Hill and elsewhere would maximize and

exaggerate the differences among us, and the unity and the consensus that we should be striving for might well be lost in the process.

VICE CHAIRMAN VOLCKER. You've got to be incited.

CHAIRMAN BURNS. Well, that option is still available. As a matter of fact, we have an opportunity right now because Mr. Broida indicates to me that we should have a formal vote on the reconsideration.

SPEAKER(?). Mr. Chairman let me just suggest that both the real problem and the strategy with our congressional friends would be ill served by reconsideration at this time. And I say that simply [because] we have a request only from the chairmen of these committees. They do not [unintelligible] at this Committee, and for us to react too quickly because they requested it would be viewed by some of our very strong friends, I am afraid, as something [unintelligible] and I would be reluctant to do that at this juncture.

MR. BLACK. Mr. Chairman, just a matter of parliamentary procedure, shouldn't we vote not to rescind our earlier action, rather than vote to reconsider?

CHAIRMAN BURNS. That's right. The vote will be not to change our earlier action. Not to rescind.

MR. BROIDA. To reaffirm the action to discontinue.

CHAIRMAN BURNS. All right. Let's put it positively. We'll vote to reaffirm our earlier action. We're voting on that motion.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Mr. Balles	Yes
Mr. Black	Yes
Mr. Coldwell	You just changed the ground rules. I have to vote No
Mr. Gardner	Yes
Mr. Jackson	Yes
Mr. Kimbrel	Yes
Mr. Lilly	Yes
President Mayo	
as alternate for	
President Winn	Yes
Mr. Partee	Yes
Mr. Wallich	Yes

It's 11 to 1, Mr. Chairman.

CHAIRMAN BURNS. Very good. Let's turn to the second item, which is the lawsuit [regarding the appointment process for Reserve Bank Presidents].

We discussed this lawsuit at the last meeting of the Committee, and we discussed it once again in our telephone conference. Now in that telephone conference, members of the Board did not participate apart from myself, but all the Bank Presidents did. The reason it was done that way was that I had heard about a criticism coming from a Bank President, and therefore I wanted to learn what I could about the sentiments of [all the] Presidents. Therefore, we could decide what other action to take.

My understanding of that telephone conference was that every one of the Bank Presidents was generally satisfied with the procedures that we had developed for handling the lawsuit. Mr. O'Connell would you inform us now on this lawsuit's status?

MR. O'CONNELL. Yes, Mr. Chairman. I think I can be rather brief. You may recall that the lawsuit originally called for filing our response within 20 days of June 22, either with a motion to dismiss or other answer. In the interim, we have, with stipulation of counsel for Mr. Reuss, obtained an extension until the 30th of July. The court approved that extension of time, so our pleading, whatever its nature, is due on or before July 30. And that, again, is in the Federal District Court for the District of Columbia, before Judge Parker.

At the same time, plaintiff's counsel filed an amended complaint, which procedurally doesn't enlarge or extend our time for answer, nor as we've read this complaint--and copies were given to [counsel at each Reserve Bank]--doesn't really change the name of the game in terms of what we would be defending. What the plaintiff's counsel has attempted to do in amending the complaint is to be more specific and to shore up, as we read it, the grounds on which he bases his claim that he is entitled to bring this lawsuit. The legal title of such a claim is called "standing." And as we're preparing our defense, of course, we intend to directly challenge, by motion to dismiss, the standing of the plaintiff to bring the lawsuit.

The two bases for standing as originally filed were that, [first,] as a member of Congress, he had been deprived of certain legislative rights of voting and action by the five Reserve Bank Presidents who are members of the FOMC and their participation in the FOMC meetings. And that secondly, as a citizen holding a government [financial] obligation having \$10,000 in value--he said 20 but he only needed 10 for jurisdictional basis--he had been deprived because, by the action of these same five individuals, the value of that security had been adversely impacted.

He has amended his complaint to further substantiate the basis of this claim, or has attempted to. I think he's done himself as much harm as good. One of the add-ons that he put in was that it deprives him of the right to negotiate with the Senate in their voting on a presidential appointee, which he claims to be a prerogative of a member of the House of Representatives.

CHAIRMAN BURNS. Well, I don't understand that at all.

MR. O'CONNELL. I don't understand it either, Mr. Chairman.

CHAIRMAN BURNS. He seems to be taking on the Senate as well as this Committee.

MR. O'CONNELL. It would appear so. That's my reason for saying I don't think he's helped himself. But he seems--

CHAIRMAN BURNS. Well, but encourage him in that.

MR. O'CONNELL. I have other chores than to encourage him, Mr. Chairman.

CHAIRMAN BURNS. All right.

MR. O'CONNELL. I don't think he needs too much, as we may find out.

CHAIRMAN BURNS. What other argument? I haven't read this supplement.

MR. O'CONNELL. The supplement also substituted Tom Timlen of the New York Bank as a named defendant in place of Dick Debs. That and the substituted cause of action claim are the only two changes he made in his amended complaint. Other than that it's identical to the original complaint.

CHAIRMAN BURNS. How does he argue the case that the five voting Bank Presidents have done injury to him as an owner of Treasury securities? Does he try to substantiate that?

MR. O'CONNELL. No, sir, he doesn't. In my judgment he makes the allegation and assumes that the five voting Presidents constitute the action "impulse" of the Committee, and that by their vote alone, actions of the Committee are to be reflected. Namely, that what they voted, according to his allegation, [constitutes what] the Committee did, and his injury followed.

Now, without picking that apart, he doesn't go further to substantiate or identify his alleged injury with the five individuals named, or with the five Presidents and their alternates in the complaint. It's for that reason, of course, that we take the position that his thesis has to be read as a complaint against [the entire] FOMC.

And that is the essence of his complaint, that the actions of the Federal Open Market Committee [are so important]--he claims [they are] the most imperative and important actions short of [dropping] the A-bomb that can be taken by any governmental unit--it follows that individual members who participate in this Committee action should be appointed by the President of the United States. Because of the import of their work and their function. But I think he fails to substantiate his allegation, Mr. Chairman.

CHAIRMAN BURNS. Well, does he make any attempt to substantiate his allegation?

MR. O'CONNELL. As I've told you, he alludes to the function that these five Presidents [perform] on the FOMC, and he thereafter describes the action of the FOMC. He places them on that Committee, alleges that they were not constitutionally appointed to the Committee and that, in their participation with other members of the Committee, they formulate and cause the result of this unconstitutional action. And he asks the court to prevent them from doing so in the future, and he asks that the Banks be enjoined from carrying out the directive in [whose formulation] they participate. That's as far as he goes, Mr. Chairman, as I've read the complaint.

SPEAKER(?). How, Tom, does he suggest that five [Bank Presidents] can outvote seven [Governors]? I've never quite understood this.

MR. O'CONNELL. To my reading he makes no effort to suggest that five can outvote seven. Perhaps he'll argue that as he develops [an argument]--either in his motion of summary judgment or his reply brief--that all it takes is two members of the Board component joining with five Presidents if they so wish, and you'd have a majority vote. And that this could be the result and that's exactly what it is, a "could-ism." And that may well be what his [argument] would be.

CHAIRMAN BURNS. Well, you know, I haven't done this recently, but I've made an analysis of the voting by members of the Board and by the Bank Presidents and there is no difference, really. And I believe that this is true. You've been examining this figure.

MR. BROIDA. I was going to give a report on that.

CHAIRMAN BURNS. No, go ahead, please.

MR. BROIDA. We've examined all formal votes shown on all policy records since March 1936. We found one case in which a majority of the Board was outvoted by a minority of the Board plus Reserve Bank Presidents; that was the vote on the policy directive in December 1961. There are six cases in that span in which one Board member was absent, and the Board split three to three, and the decision was in effect made by the Presidents.

SPEAKER(?). It may only be speculation, Tom, but wouldn't it be interesting if his \$20,000 of government securities are of high-coupon issues that are now selling at a premium?

MR. O'CONNELL. It would. He hasn't identified what he holds. As a matter of fact, in his amended complaint, he withdrew and removed the so-called allegation with respect to the \$10,000--satisfying the \$10,000 requirement. It's contained later in the paragraph relating to the impact of Reserve Banks in carrying out the directive of the Committee.

CHAIRMAN BURNS. You know, I'd love to argue the economics of his complaint, which is something very different from the law, because if his Treasury securities are worth anything at all, it's in large part due to the existence of this Committee and how this Committee has functioned over the years. It's been a restraining force, and inflation has not ruined Mr. Reuss. He has this Committee to thank more than any other group or individual. Left to himself, he'd even be in ruins. We saved him from his mistakes.

VICE CHAIRMAN VOLCKER. [Unintelligible.]

MR. O'CONNELL. President Volcker, if our motion on standing fails and the matter goes to trial, he has made known his intention to produce expert witnesses who will--starting with the security purchase--trace its value over a period of months. [The experts] purportedly will testify that its value has now diminished and it's directly the result, according to the experts, of the action taken by the FOMC.

Now hopefully it won't get to that point. We hope that as a matter of law on which we all agree, an individual who is the owner of securities of the nature he describes does not have sufficient status in law to bring such a lawsuit. He doesn't have sufficient standing. He can't separately identify injury to himself sufficient to enable or warrant a court undertaking a case or controversy here in the lawsuit.

MR. BLACK. Tom, does that case that was brought in Billings, Montana, years ago along these lines--

MR. O'CONNELL. Bryant v. FOMC.

MR. BLACK. Didn't that make essentially the same claim?

MR. O'CONNELL. It did. He was holding a Federal Reserve note, a piece of currency, but he was making the same kind of noise with respect to its invalidity and demanding that he be given gold in place of it, and the court dismissed that on the same thesis that he hasn't established a standing to bring the lawsuit. Yes?

MR. BALLEES. Is the complaint invalidated on one standing but supported on another standing of its government [unintelligible]?

MR. O'CONNELL. Yes, the answer is yes. We have picked at both of his so-called bases for standing, [the other being] his membership in the House of Representatives and the role that he asserts he's entitled to play.

Now there are multiple [court] decisions, probably 11 or so, that bear on this issue. And we have cases such as [that of] Senator Kennedy, who brought such a lawsuit and was successful, the court holding that he did have standing. But in each of those cases, we believe we can point specifically to the particular right that was involved as it related to an individual vote, either on statute or a proposed statute or on a confirmation of a Presidential appointee--some individual right that he had been deprived of. We think much more nebulous and vague are the allegations of right, generally as a member of Congress, such as his participation in negotiations with the Senate on a confirmation of a Presidential appointee. Hopefully, that would be the downfall of the standing position.

Mr. Chairman, from the outset of your conference conversation with the Presidents, we have been in almost daily touch with counsel at the New York Reserve Bank, whom we find to be representative of Reserve Bank counsel. We had a meeting a week ago Friday with such counsel and the Department of Justice. Subsequently, we exchanged initial drafts, pleadings, that we received from the New York Bank. We've also received communication from the Atlanta Bank and a communication from Minneapolis. We are working closely with these gentlemen. We're grateful for their help.

We have another meeting scheduled Wednesday with Mr. Guy and Jim [unintelligible] coming down from New York. And Ned Guy is acting at my request to immediately communicate with the other Bank counsel exactly what our status is. Hopefully, within the next three or four days we will complete what I hope will be an agreed position in final draft that we can circulate to all counsel for their comments and views. Our time grows somewhat short now. I think we're on pretty good schedule.

CHAIRMAN BURNS. Tom, what are you going to do in this instance? Merely argue on the point of standing, or do you go beyond that?

MR. O'CONNELL. At this time, the decision hasn't been made, and I'll defer to a meeting with all counsel. I can give you my own judgment, and that is that we are better served at the outset to combine a challenge to the standing of the plaintiff to bring the lawsuit and to place before the District Court, on the merits, our challenge to the invalidity of the constitutional issue raised in the complaint.

Hopefully, we will move to dismiss for failure to state a claim upon which relief can be granted on the merits and hope to show the court, with whatever rationale we finally adopt, that [even] accepting everything he says to be true, there is no constitutional law issue involved. That the appointive process of the Presidents comports fully with article II, section 2 of the Constitution, and hopefully we'll be able to clearly [relate] both the provisions and the court decisional law that support this position.

And perhaps we will secondarily add an article that says, even if that isn't true, in the alternative, [we have] the history of the so-called constitutional provision enabling Congress to itself delegate since the First National Bank Act. We had a history of functional performance by the First National Bank, the Second National Bank, down through the National Banks themselves, to this FOMC--a function that may sufficiently partake of current FOMC type of activity to support an allegation that this does not involve in any respect a challenge to executive appointment power. That it's congressional passage and that it's totally consistent that Congress itself has by statute, by section 12A of the Federal Reserve Act, given to the FOMC the authority that historic [unintelligible] started with the First National Bank.

Now this is an argument that has been developed in a rather lengthy paper by the Federal Reserve Bank of New York. We haven't [yet] agreed that it would be a supportive argument. At this time, [our] briefs take the sole position that looking directly at article II, section 2, the composition, the functioning, the appointed process, and the process of the FOMC comports and is consistent with that clause. And that is a result we hope to establish to the court's satisfaction. The plaintiff has not raised a valid claim upon which relief can be granted and we ask for a dismissal.

CHAIRMAN BURNS. Tom, let me just pursue this question of procedure. Assuming that you proceed in this fashion, then what are the alternatives before the court?

MR. O'CONNELL. Mr. Chairman, if we proceed in the manner I've described, namely, that [we file] a motion to dismiss based on standing and in the alternative on the merits issue, a court can dismiss for failure of the plaintiff to have standing to be before the court. Finished.

CHAIRMAN BURNS. All right.

MR. O'CONNELL. And may I say, that's one of the reasons I am urging that we give very serious consideration to including in our motion to dismiss the merits issue, namely, to give the court a sense or flavor that, "If I don't dismiss on the challenge to standing and it goes to the merits, it looks as though there's 'color of right' in the defendants. They might win." On the other hand, [with] that same feeling that the court might receive from seeing our statement on the merits, it can say, "I can dismiss with clear conscience because I believe they would win. And from what they've shown me, they would. So I'm not depriving the plaintiff here of anything.

I'll dismiss on the standing issue, won't take up the merits, and I can do so with [good] conscience because I think the plaintiff would have lost on the merits."

CHAIRMAN BURNS. All right. You present your case.

MR. O'CONNELL. Yes, sir.

CHAIRMAN BURNS. Now what about the plaintiff? Is he finished now?

MR. O'CONNELL. No.

CHAIRMAN BURNS. Can he present counterarguments?

MR. O'CONNELL. Yes sir, and he will. When we file on or before the 30th of July, whatever our response of pleading is, he has a stated number of days thereafter to file a reply pleading.

CHAIRMAN BURNS. All right. Do you have the opportunity to respond once again?

MR. O'CONNELL. It depends on the nature of that [reply]. I would suspect that we do. He will file a motion, I would suspect for summary judgment. And accompanying that with--

CHAIRMAN BURNS. Motion for summary judgment means--?

MR. O'CONNELL. I'm sorry, Mr. Chairman, a motion for summary judgment is somewhat more broad than a motion to dismiss. It more directly encompasses an approach as to some of the merits of the issue. On the basis of his complaint, and whatever further documentation he [attaches to] this new pleading, called a motion for summary judgment--perhaps affidavits, perhaps an affidavit of an economist supporting the allegations of the original complaint--he would ask the court as a matter of law to declare that his cause of action is valid and that no judicial issue of fact exists--he would ask the court to decide this as a matter that he's entitled to judgment. And that is exactly what the motion for summary judgment would do.

If it's granted by the District Court, then a judgment is rendered with costs for the plaintiff. On the other hand, if that motion is denied, he still has a complaint before the court, and with our motion to dismiss being denied and their motion for summary judgment being denied, we would then be obliged to file a total answer to the complaint as originally filed, with answers to each allegation. We would deny the allegation of paragraph 6 and answer on the contrary, A, B, C; deny the allegation of [paragraph] 7. The only thing we would probably admit is that it's called the Federal Open Market Committee, and I think that admission could be safely made.

Mr. Chairman, once that's done, "the issues are joined" is the saying that is used, and the court would then set a given date for trial of those issues, and the complaint would go to trial.

CHAIRMAN BURNS. Now wait, trial means that there will be oral pleadings?

MR. O'CONNELL. Trial means that there will be oral testimony, yes.

CHAIRMAN BURNS. Oral testimony by attorneys or attorneys and witnesses?

MR. O'CONNELL. A little bit of both, I suspect. The plaintiff has said that he would bring in economists and finance and market people to establish the validity of some of his complaint as to loss of value and so forth. [The response we make] would await our understanding and our knowledge as to what his principal case and chief [unintelligible] would be.

I describe this, Mr. Chairman, only in response to your inquiry as to what would happen. I would like to believe that this case will never get to that point. I believe that with well-written briefs and memoranda of law and support of our motion, this case will go off on pleadings on the motions and on oral argument. We will ask for oral argument, and the court will set a date upon which the motions that I've been discussing would be heard orally, and at that time the plaintiff's counsel and your counsel would be given an opportunity, usually 15 to 20 minutes, to argue orally the points made in our written pleas.

CHAIRMAN BURNS. All right. Yes?

SPEAKER(?). Just one question? Tom, in the telephone conference a question was raised [unintelligible] and your answer, as I remember, was that [there is] enough time to bring in outside counsel. It might be advisable later, [unintelligible].

MR. O'CONNELL. That was the gist of my answer, yes, Dave.

SPEAKER(?). How would outside counsel be brought in later once the position has been established? You shift [unintelligible] away the ground leeway [unintelligible].

MR. O'CONNELL. All right, fine. I think that in the Buckley v. Valeo case, which is the principal case cited by the plaintiff as the basis for his suit, the substance of law that the Supreme Court adopted was that found in the Supreme Court briefs, not as extracted or drawn from whatever pleadings that were made in the District Court or even in the Court of Appeals.

I think Archibald Cox and those who participated at the Supreme Court level in writing the briefs probably had the greatest impact on the Court. As a result of the action at the District Court level, we [may] start our appeal process through a three-judge court or a single-judge Court of Appeals and perhaps later a nine-judge Court of Appeals reconsideration, and then to the Supreme Court. I think that at any one of those four stages [unintelligible] the opportunity [exists] to bring in a constitutional law expert if that is what is then necessary.

It's quite possible that the case could have turned off on a procedural motion that doesn't have the smack of constitutional law. And to overweigh it now--with the thrust and import of outside counsel giving the apparent feeling that we think that enough substance is raised in that complaint on the constitutional law issue that we brought in Archibald Cox to write [that] small portion of the memorandum--I think would be a mistake. He gives it too much color of substance and validity at this stage. Later I think far more [unintelligible].

CHAIRMAN BURNS. Well, I'm glad to see that attorneys pay attention to psychological factors, something that economists are beginning to do. Any other question or comment? Yes, Mr. Balles.

MR. BALLEES. Tom, I was wondering whether anyone had found out whether the lawyer representing Reuss is doing so in his capacity as, well, a private lawyer for a private client, or is he on the staff of the Banking Committee, or just what?

MR. O'CONNELL. He's on the staff of the Banking Committee, John. He's operating as best I can tell at the cost of the plaintiff, although his salary to the best of my knowledge continues as a member of that staff. When I say costs, certain fees that had to be paid were to the best of my knowledge paid by Mr. Reuss. But also, to the best of my knowledge, Mr. Crews continues as a member of the staff drawing a salary. At some point it may come out that the time he utilized in preparation of the plaintiff's case was time that should have gone to the staff committee. I haven't raised the inquiry, nor have I asked anyone to do so.

MR. BALLEES. Well, I was wondering whether you thought--

CHAIRMAN BURNS. I think it's very wise not to raise that question, but if you incidentally discover these facts, just file them away for some use I can't anticipate. But it would be useful to know the answer to that question. Let's not pursue it in any deliberate manner.

MR. O'CONNELL. I think maybe John had a different question.

MR. BALLEES. Well, no, I was simply going to ask, if it turned out that what you've heard is in fact true, that his salary is being paid by the committee, whether that might offer any opportunity for us to sort of complain to other members of the committee and raise the issue of the use of his time.

MR. O'CONNELL. I think it might as a matter of total--

CHAIRMAN BURNS. Members of that committee are giving some thought to that possibility--some members--but I have not raised that question, and I'm not going to. I think it would be a mistake. It's a question that obviously arises really in the minds of different individuals, and that thought has already been conveyed to me.

MR. O'CONNELL. Better brought by them than us.

CHAIRMAN BURNS. Exactly--oh no.

MR. BALLEES. If I may, Tom, I just have one other question. Could you share with us any impressions you have as to the caliber of the particular individuals from [the Department of] Justice that will be arguing this case? I understand they will carry the ball in court rather than you. Is that the way it works out, or what?

MR. O'CONNELL. If standard operating procedure obtains, that will be the case, President Balles. The counsel is one Vincent Turlep. On Friday, he argued the much publicized

case involving an Army sergeant that the Army, as you know, has been trying to dismiss from the service because of his status in the Army community. That came to oral argument Friday before Judge Gessell. Mr. Turlep argued against the plaintiff's position and won in a ruling from the bench. And I heard from another lawyer that he had done an excellent job.

We've had two lengthy meetings with him, and at the last meeting, Ned Guy and Jim [Oltman] were present. I think he acquits himself very well. He has a penchant for listening. He identifies issues that he doesn't understand, and I think he drew heavily on Jim and Ned and on us a bit for some descriptive analysis of what he didn't understand. He's asked some very pointed questions, and he's very much interested in this lawsuit. Those are about the only factors or characteristics I can give you. He's a young man.

MR. BALLEES. Sounds promising.

MR. O'CONNELL. Been with the Department I think for four years and has handled some very important cases for the Department.

MR. BALLEES. Good.

VICE CHAIRMAN VOLCKER. How much help does a fellow like that get [unintelligible]?

MR. O'CONNELL. How much help? Not a great deal, only because he has 40 other cases assigned to him, at least that used to be the way it was when I was there. He's got one secretary and two other attorneys in the room with him. It's sort of an impacted working condition. And he tries to scramble for help. I know a week ago Friday night, when I wanted to get a draft of some material over to him, I went over at 8 p.m. and he was still there working. Had a girl [to help] him, but he said he brought her in from one of the other agencies, a friend of his wife's. So--

MR. O'CONNELL. We made it very clear to him that if at any point in time he has any need of secretarial or [copying help] or any material like that, call me day or night and we'll get it done. And the reverse is true, too.

CHAIRMAN BURNS. Any other questions or comments?

SPEAKER(?). One question on timing [unintelligible]. What kind of time, Tom, is involved in possible [unintelligible].

MR. O'CONNELL. It could come on July 30. If the court said, "I want to hear this motion right now," that won't be the case. After we file our motion, as I indicated, he has time, say 10 days, within which to file his reply. The court would then set a calendar date for oral argument. [Although] the court could say "I won't hear oral argument on this, and you'll hear from me when I've reached a decision," that's not likely to be the case. And depending on the summer calendar of this particular judge, once he gets a portion of the summer cases out of the way, he may say, "I don't want to hear argument until September," when the fall term begins. It could be between now and the first of September.

CHAIRMAN BURNS. What do you know about this judge, Tom, that has a bearing on the outcome?

MR. O'CONNELL. I've made some inquiry. I have run across a group of lawyers that work with him on a judicial conference committee. They've indicated that he has a penchant for inquiry with respect to issues he doesn't understand. No one opined on his level of receptivity to complicated issues. I have some concern [unintelligible] on some of the statement of issues that are raised by this article II, section 2; we have to be very careful how we word our pleading.

Mr. Chairman, in all honesty, I know nothing adverse in terms of his approach to issues of law or his tolerance of counsel and presentation of views in the pleading. So hopefully, we have a judicial mind who will approach this in a very judicial manner. Hopefully.

CHAIRMAN BURNS. Gentlemen, a motion to adjourn would be welcomed by the chair.

SPEAKER(?). I move we adjourn.

CHAIRMAN BURNS. A motion has been made. Any objection? All right.

[End of executive session]

July 20, 1976

CHAIRMAN BURNS. Gentlemen, we will get under way now, please. We need to act first of all on the minutes of the June meeting. Any problem with regard to the minutes? Is anyone bold enough to move that the minutes be approved? The motion has been made, presumably seconded, no objections are being raised, so therefore we're ready for Mr. Pardee, who will instruct us on foreign currency movements.

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

CHAIRMAN BURNS. Thank you. I understood Italy will repay part of its debt to us in a few days. Is that correct?

MR. PARDEE. That's right, this Thursday. An exchange of cables has been made. And we fully expect them to repay the other [unintelligible] at least by maturity.

CHAIRMAN BURNS. Good, any questions?

MR. JACKSON. Is the Mexican situation stable? What are the prospects there?

MR. PARDEE. Yes, well, the Mexican situation is stable, but it hasn't turned [out] as favorably as they had hoped. They had the large outflows at Easter time, occasionally drawing on us, and then several newspaper articles in the U.S. suggested they might devalue, which halted the usual reflows after the Easter period. Now the outflow from Mexico has slowed, but there is still a steady drip drip of outflows. They've passed their election period, they have their new President, but there remains a lack of a reflow to--

CHAIRMAN BURNS. Has the new president been inaugurated?

MR. PARDEE. He will be inaugurated on December 1, and most of the people in the financial community are counting every day until that is done.

CHAIRMAN BURNS. You mean they fear damage before he takes office?

MR. PARDEE. Well, they've lost confidence in the current President, and there are serious labor negotiations that are under way now. The talk is of 15-25 percent wage increases, which could seriously undercut all of their efforts at this stage to restore stability.

CHAIRMAN BURNS. All right, Mr. Wallich, please.

MR. WALLICH. I wonder, Mr. Chairman, whether I should report on the gold discussion [at the Bank for International Settlements] in Basel.

CHAIRMAN BURNS. Well, this might be very timely in view of what happened yesterday, and more so today, in the gold market. Perhaps before we do that, would someone report on precise movement on the price of gold.

MR. WALLICH. Well, when gold--

CHAIRMAN BURNS. Down to \$110 is it?

MR. WALLICH. It's now \$105-\$106 in the afternoon market, between the two figures.

CHAIRMAN BURNS. Oh yeah? Let no one say that prices do not move down. All right, Mr. Wallich, please.

MR. WALLICH. We received the report that had been agreed on in central bank negotiations on gold sales. The way the BIS handles this is that the general manager of the BIS gets full information on quantities and prices, and I asked him to give us assurance that he has received that in the form agreed on, which he gave. He passes this on in the form of a table that contains considerably less information but is nevertheless more complete than most of those present anticipated; we have country detail on who sold or bought what.

Very little actually seems to have gone on in the market. The French and the Swiss both bought a ton in the IMF auction, through the BIS, and assuming the report to be complete, that seems to be all they bought. The largest seller at the auction, other than the IMF, was Canada, which sold for the purpose of [unintelligible] medals or coins.

As a result of these sales, there is now a leeway under the ceiling, that is to say, by virtue of the G-10 agreement, a central bank would be allowed to buy as much as 35.2 tons. To get the dollar value, you have to multiply by \$4 [million] at the price that prevailed a few days ago and by something more nearly [like] \$3 [million] at the price that prevails today, \$3 million per ton, approximately. In other words, the ceiling is on the order of \$120 million now.

Well, there was general approval of this, an expression of gratification that the report was complete. I had to note that some things seemed to be not fully stated, and there is in that report evidence that one has to watch carefully what information one is given. But I think there's goodwill to supply the data correctly, and so far nothing [unintelligible] seems to have happened.

CHAIRMAN BURNS. What did you learn about prices? Prices charged by the BIS to the central banks which purchased gold. I--

MR. WALLICH. Yes.

CHAIRMAN BURNS. --I don't mean detailed, but what percent did the price deviate from the auction price?

MR. WALLICH. The price at which the BIS sold to Switzerland and France was the same as the auction price. On the other BIS sales, they didn't tell us. However, from public sources--that is, leaks--we did know roughly what the bidding pattern was; namely, the BIS, and possibly the Swiss National Bank, had spread out a considerable volume of bids in such a way as to, in effect, support the price had there been pure bids from the market. It turned out that this tail of [unintelligible] bids not accepted was fairly close to the market price. This is something that we extracted at the meeting and [unintelligible] was present there, said that they were going to publish the price of the bidding pattern without names, which they've done. I don't have it here now.

CHAIRMAN BURNS. Well, it's very interesting, up to a point even instructive. Thank you very much. Any questions?

MR. BAUGHMAN. Mr. Chairman?

CHAIRMAN BURNS. Yes?

MR. BAUGHMAN. This may be an inappropriate question. Is it expected that the IMF will continue to sell gold almost irrespective of price trend, or will the IMF's volume of sales likely be determined by the price trend?

MR. WALLICH. The agreement is for regular auctions. The next auction is to be on September 15, I believe. There was at the [unintelligible] meeting not among the Governors, at least not that I heard, but at the level of the BIS Committee on Gold and Foreign Exchange, which Scott Pardee attends, there's some pressure for postponement of the auction on the grounds that the market was saturated and the sales had not been fully absorbed. Well, the price pattern since that time doesn't seem to contradict that statement, but the U.S. position is that gold sales should continue on a regular schedule.

MR. MACLAURY. How might the LDC's [less-developed countries] feel about that issue? They must be--

MR. WALLICH. They have to lose on account of the trust fund, and even more, Italy and Portugal, whose main resource and [whose] present difficulty is their substantial gold stock, are of course involved. The [BIS] may be concerned about their collateral under the Italian loan,

which is at a level now above the market. With respect to their Portuguese [unintelligible], they have a margin call facility, that is, a maintenance-of-value clause for that collateral.

MR. BAUGHMAN. Mr. Chairman, I might just comment with respect to the Mexican situation as observed along the borders, so to speak. We see no letup in the demand for large-denomination U.S. currency.

CHAIRMAN BURNS. Any large denomination currency [unintelligible].

MR. BAUGHMAN. Pardon me?

CHAIRMAN BURNS. Any large denomination currency left in the Dallas Bank?

MR. BAUGHMAN. I can't answer that explicitly as of today, but we are shipping. They're taking it up primarily from El Paso, however, to Dallas. We have recently drawn from another Federal Reserve District a substantial volume which is being transferred to Mexico. We continue to hear reports of substantial purchases of real estate by Mexican nationals, and also the banks [unintelligible] despite that are recording rather phenomenal increases in time and savings deposits attributed in part to Mexicans.

CHAIRMAN BURNS. [Unintelligible] confused these purchases of real estate. Where are they taking place, in Mexico, or in the U.S., or both?

MR. BAUGHMAN. Those that I'm hearing about are taking place in Texas.

CHAIRMAN BURNS. All right now, Mr. Pardee, do you have any recommendations to the Committee?

MR. PARDEE. Yes, painfully. We have the remaining \$82.4 million equivalent of the Belgian franc drawing coming up to the 20th renewal for their [unintelligible]. We've made good progress on this one, and with any luck we might even be able to repay the full amount within the next three months. On that basis I recommend renewal. The Swiss franc swap drawings in the amount of \$1.1472 billion are also up for their 20th renewal on August 13. Although the Swiss franc rate has stabilized, it is still at an exceedingly high rate, and I see no immediate prospect of our beginning to acquire significant [unintelligible]. I recommend renewal there, too.

CHAIRMAN BURNS. You've heard the recommendations, and what is the will of the Committee--

SPEAKER(?). So moved.

SPEAKER(?). Seconded.

CHAIRMAN BURNS. The recommendations made by the Manager, hearing no objections, are approved. We also need to confirm the transactions that have taken place at the Desk. Is there a motion to approve and confirm?

CHAIRMAN BURNS. Motion made seconded, no objection. Let's hear from Mr. Reynolds.

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

CHAIRMAN BURNS. Thank you Mr. Reynolds. Any questions?

MR. WALLICH. Mr. Chairman?

CHAIRMAN BURNS. Yes, Mr. Wallich.

MR. WALLICH. When you try to anticipate the possible movement of the dollar--you mentioned interest rates and the current account--do you regard [unintelligible] rates of inflation as an additional separable factor or is that sort of factored into the current account expectation?

MR. REYNOLDS. Well, I think it's only partly factored into the current account expectation. I guess I don't want to be very firm about an exchange rate prediction. We know remarkably little about it. But the dollar on a weighted average basis has been really rather steady for quite a long while now, and it's just that at the moment we haven't got reason to imagine that that stability will be upset soon.

MR. WALLICH. Thank you.

CHAIRMAN BURNS. Any other questions or comments? Very well, let's turn to the domestic economy. Mr. Gramley.

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

CHAIRMAN BURNS. [Unintelligible] Mr. Gramley, and thanks to you, Mr. Zeisel. I think we ought to have now a discussion of the condition of the economy and the outlook, and let us defer consideration of alternative monetary policy until we turn to the next subject, namely our longer-term targets. Who would like to comment on the economy? In particular, you ought to be emphasizing, or calling attention to, or questioning factual observations and a little comment made by Mr. Zeisel. Mr. Wallich.

MR. WALLICH. I'm puzzled by the great steadiness, quarter by quarter, that you anticipate for real GNP growth. It goes at a rate of 5 percent. First, it seems not very likely that this degree of stability can be maintained. Second, I'm puzzled by the relatively low rate of growth, which is considerably below what I would have thought the economy might be doing. I ask myself what are the ingredients of this forecast. I realize that it's partly the model, which is geared to a rate of money supply growth that will come out at that rate in the very long run, but I take it that's not decisive here. This is in good part judgmental.

And what I'd like to hear is--given that there are a number of elements in the GNP that are not strong now, like housing, business fixed investment, and even inventory, even state and local government--there seems to be more room on the upside for things to accelerate than on the downside. Is that a reasonable view?

MR. GRAMLEY. Well, those are quite a few questions all wrapped up in one, Governor Wallich. Let me try to answer in [unintelligible]. Obviously, we don't really expect the rate of real GNP to be 5 percent every quarter. And if it were to come out that way, no one would be more amazed than the staff. It just doesn't happen. I do think, though, that the situation we face now could easily develop into a prolonged period of relatively steady expansion in real output.

I have been struck by the similarities in many respects that this expansion [bears to] the expansion of 1960-61. Let me recite for you what happened during that period. After the first year of recovery, real GNP growth in the second year of recovery rose 6-1/2 percent; in the third year of recovery, 3-1/4 percent; in the fourth year, 6 percent; the fifth year of recovery was 5 [percent]. Now that sort of pattern is one that I think would be unlikely to develop in the current recovery if we have the continuation of relatively balanced expansion which seems to be going on now.

I do not regard a 5 percent growth rate after the first year of recovery as low. On the contrary, if you look back at [unintelligible] experience, what you find is that the second year of recovery typically finds the real GNP growth rate falling by about half, about 8 [percent] to 4 [percent]. Once you lose that tremendous thrust from the turnaround in inventory investment--from deep liquidation to accumulation--it's quite common for the growth rate to be slow.

Whether or not the potential for overrun is greater than the potential for an underrun of this projection, I'm not at this juncture sure. We have projected a very sizable expansion of business fixed investment for the period immediately ahead. For example, the projection we're making on plant and equipment expenditure year over year for 1977 is a little over 20 percent. That's a fairly heroic projection at this stage of the game, and I can easily see possibilities that plant and equipment spending did not build up that kind of steam, so I think there are real possibilities for an undershoot as well as for an overshoot.

MR. ROOS. Mr. Chairman, please sir, may I ask that you read the first two or three sentences of your report, just as a lead-in because--

MR. ZEISEL. "The [unintelligible] of business activities slowed perceptibly [from a] rapid rate earlier this year. Preliminary GNP estimates for the second quarter are being released."

MR. ROOS. I have the feeling in listening to this that the lead-in has a rather negative ring to it and that everything that you referred to [later] in your report and Mr. Gramley's remarks are much more positive.

MR. ZEISEL. Well, I was starting off with a flat statement that reflected the numbers [unintelligible] suggest that I thought that things were moderating from an unsustainably higher rate to quite a healthy balanced expansion in the economy.

CHAIRMAN BURNS. All right, thank you. Mr. Black, please.

MR. BLACK. Has this reduction--4.4 percent growth in real GNP in the second quarter from the assumed 5 percent rate--changed your feeling about the rest of the year? I know you

haven't probably had a chance to run all of your simulations. I gather from what you said this probably wouldn't change. I--

MR. GRAMLEY. I would regard the 4-1/2 percent estimate that came up today and our 5 percent estimate as equivalent. We can't come anything like that close to approximating what is happening in the economy. I would remind you also that these figures are still preliminary.

SPEAKER(?). Oh sure.

MR. GRAMLEY. We do not have June inventory figures yet. The basic difference between the actual figures and our projection is that inventory investment went down a little in the second quarter rather than up a little as we had projected. I wouldn't consider that as being anything which would require a modification in any way.

MR. BLACK. And my second question. You've assumed less upward pressure on interest rates than you were assuming in June, presumably because of a high assumed level of money supply. And yet looking at growth in domestic investment, and specifically fixed investment, you have revised this downward from what you were projecting in June. I was a bit puzzled as to why, because we now have a few more indications of strength in business spending on capital than we had this time last year.

MR. GRAMLEY. We've made only very, very minor adjustments in our projection of business fixed investment. The news as I interpret it has been relatively neutral over the past months. We had the new orders [data] a month ago, and I reported that, too, as I recall. I don't know that anything very decisive is coming one way or another, and it was not our intention to make any significant modification of the business fixed investment projection.

MR. BLACK. But it is large. I was just puzzled by the direction of it because the Greenbook summary seemed to [emphasize] an improved outlook; on page I-2, that last paragraph--that looks more favorable than anything we've seen other than that.

MR. GRAMLEY. I think that the Greenbook statement had to do generally with the improvement in the outlook over a longer period rather than the outlook over this past month.

MR. BLACK. What I'm talking about really is the downward revision of your figures over the next four quarters.

CHAIRMAN BURNS. What was the revision, Lyle?

MR. GRAMLEY. As I remember, Mr. Chairman, the revision in our projection is very minor.

MR. BLACK. It is not particularly large, Mr. Chairman.

CHAIRMAN BURNS. What was it down, Lyle?

MR. GRAMLEY. Pardon me?

CHAIRMAN BURNS. Did you reduce the estimate, and if so, what were the factors that led you to that projection?

MR. BLACK. It's a \$4.3 billion reduction, Mr. Chairman, in the second quarter of next year, from what they were projecting in the last Greenbook. And a good part of this is in business fixed investment, which is revised downward from 193 to 189.5. I was just curious as to what your thinking might be on that. It now looks a little more solid to me than it did at that time. Maybe I'm reading too much significance into small changes. I guess it's the direction rather than the magnitude, because certainly, if we left it in, the range of error--

MR. GRAMLEY. The business fixed investment figures from the second quarter of 1972 through the first quarter of 1975 show increases this time of about a half a billion a quarter, at an annual rate, lower than before. The [reason for the] downward revision there was basically that the shipment figures that were coming in during the second quarter were slightly lower but [unintelligible] off a bit.

We did add more into business fixed investment in the second quarter of 1977, and then continued fairly strong expansion in the latter half of that year. I don't regard this as at all a significant alteration. It still implies an increase in business fixed investment plant and equipment expenditures year over year considerably exceeding that projected in the last Commerce survey. I believe the figure we have is between 9 and 9-1/2 percent. And then a year-over-year increase on a survey basis next year [unintelligible].

CHAIRMAN BURNS. I think there may be a little confusion here. What we are talking about is an estimate of business fixed investment in the second quarter. Oh, oh, well, I'm sorry, then I was confused. I think Mr. Black has raised a fair question. Why lower the projections? The fact that shipments declined is not a good reason. If orders had declined that would be a good reason.

MR. BLACK. Mr. Chairman, I [unintelligible] really, this is over the next four quarters [unintelligible]. [For] that period, the projections made in June were above those made in July in the Greenbook. I was really looking at the long runs. I'm sorry I confused the issue by not specifying the--

CHAIRMAN BURNS. You didn't confuse the issue, no, I was confused not by anything you said. Well, I don't think you've gotten a good answer so far.

MR. GRAMLEY. Well, I would repeat, Mr. Chairman, that this is such a minor adjustment in the projection of business fixed investment that I don't consider it significant. I think our projection for business fixed investment is in the same ball park it was last time.

Now, as to why we use shipments. We have been looking very carefully at shipment figures recently because the shipment figures in the fourth quarter and again in the first quarter of this year were telling us things about business fixed investment which were in no other figures at all. And I think in part this reflects the fact that the downturn this time was much sharper, and we didn't get the cancellations that I would have anticipated, given that retrenchment [unintelligible]. But when these shipments began coming back again, we began recording this in the business fixed investment projection.

CHAIRMAN BURNS. Well, I would differ on that judgment, but I think Mr. Gramley is certainly right in saying that the difference between the two figures, putting the direction aside, is minor.

MR. BLACK. I agree, it was mainly a matter of why the change in direction. I realize that's well within the range of long [unintelligible]. This puzzled me a bit, and I thought maybe I might see something I was overlooking.

CHAIRMAN BURNS. Thank you. Mr. Morris, let us hear from you now, please.

MR. MORRIS. Mr. Chairman, I have one comment and one question. [My comment] is on this exercise of alternative policies. I am not talking--

SPEAKER(?). [Unintelligible.]

MR. MORRIS. --about monetary policies now, Mr. Chairman, I am trying to make a point about the usefulness of this as--

CHAIRMAN BURNS. I think that can be best considered when we turn to the longer-range targets. [What we are] considering now is the condition of the economy and economic prospects.

MR. MORRIS. Well, then, I'll turn to my question, and that is, you gave an optimistic report on prices, but in the past couple of weeks [we have been] getting a very sharp increase in the weekly indexes of basic commodity prices, which I find difficult to jibe with the overall analysis, [as] all of our indicators [are suggesting] a decelerating rate of growth, and I wonder if you could help me on that score.

MR. GRAMLEY. Well, the one thing that has disturbed us in our price projection is whether or not it's consistent with what's been happening to individual materials prices. The increases in industrial prices that I'm using here, the BLS [unintelligible] industrial price index, and the movements of these industrial prices are just all over the lot, so [unintelligible] we've seen increases much bigger in some previous upswings than we've seen recently.

But I would say that the increases are beginning to be worrisomely large. Our view is that these increases will be accompanied by a picture for unit labor costs which reflects what's been happening to compensation per man-hour as well as productivity and will keep unit labor costs rising in a range of around 5 percent. Now, if you project a much larger increase in general price levels than we have, and if unit labor costs stay in that range, what you get is a rise in corporate profits [the size of] which we can't believe. It's much larger than is characteristic of the second quarter of recovery. And that was a principal factor leading us to the judgment that prices would stay about in line with the rise in labor costs.

CHAIRMAN BURNS. Just to add an interpretative word, you have the extravagant increases in sensitive raw material prices. And that has been going on for some time, but the wage behavior is significantly better than one might have expected, and therefore the relatively optimistic price projection is not unreasonable. I would question it myself, but I don't think it's

unreasonable in view of recent wage behavior. That, of course, was contained in your reference to unit labor costs.

MR. GRAMLEY. Yes, yes. We do think that the rate of wage increase so far this year probably understates what will be going on for the year as a whole because this has been a period in which we have had a relatively light calendar of collective bargaining settlements. And also the timing of deferred adjustments under existing contracts is such that they tend to bunch in the second half.

CHAIRMAN BURNS. All right, any further comment or question, Mr. Morris?

MR. MORRIS. No.

CHAIRMAN BURNS. Thank you. Mr. Eastburn, please.

MR. EASTBURN. I would like to come back briefly to fixed capital investment. The readings we got on a qualitative basis is that things are slow and cost less. We don't see any evidence that businessmen are really anxious to step up their investment, and this leads to a question, Lyle, as to what the basis is for that quite optimistic longer-run projection that you had. Is it simply based on the normal cycles of spending in this phase or--

MR. GRAMLEY. It's based heavily on past typical experience, [which is] that when you have a strong run-up in final sales, particularly consumer expenses, it does induce businesses to become more optimistic as time goes on. It's based on a strong profit performance, which we expect will continue; the results of our model point in this direction. We also think that the Commerce survey, because of the way bias [unintelligible] to me, understated what has been happening to business planning. The bias adjustment this time is negative--

CHAIRMAN BURNS. Can you explain that, Lyle?

MR. GRAMLEY. Yes, the Commerce Department adjusts its raw figures on anticipated plant and equipment spending for what they consider to be systematic biases that they see in the data. This bias adjustment has a history to it, a very large movement over the course of the years. In the early years of the 1970s, Commerce was adding several billion dollars to its projected expenditures for plant and equipment to correct systematic bias. This year they're subtracting several million dollars.

CHAIRMAN BURNS. You still haven't explained what systematic bias they have in mind.

MR. GRAMLEY. If they find certain industries underestimating their expenditures regularly over a period of years, they will tend to adjust those expenditures upward. If they find other industries systematically overestimating, their expenditures, they adjust those expenditures downward.

CHAIRMAN BURNS. In other words, the systematic bias adjustment may really be a description of the past.

MR. GRAMLEY. Yes, sir. That's right. In this particular year, the bias is reducing anticipated expenditures by a couple of percentage points. If you leave out that bias adjustment, what you get is an anticipated increase of around 9 percent. And we think that--

CHAIRMAN BURNS. Do they publish the figures in both forms?

MR. GRAMLEY. I am not aware that they publish the unadjusted figures. I don't think the information is confidential, it is available to the public, but we get it over the telephone.

MR. WALLICH. Does that bias adjustment differentiate between expansion and contraction?

MR. GRAMLEY. They try to make no allowance for cyclical [unintelligible]. A deliberate effort is made to avoid adjustment for the position of the cycle.

MR. EASTBURN. Could I follow that with one other question? Suppose, Lyle, that this optimistic projection for fixed investment is too optimistic. Does this encourage you in the sustained expansion or does it mean that we might abort?

MR. GRAMLEY. I wouldn't wish to say that a downward revision in our projection of business fixed investment would lead to an abortion of the recovery. It certainly would weaken it a great deal. And [it] would get [us] into several [other] areas. Our inventory projection is conditioned on the hypothesis that once you get a buildup in business fixed investment going for quite some time, it generates a rather large increase in materials and supplies in the durable goods industries. Second, the induced consumption increase from the employment created by rising business fixed investment is also an important element in keeping the growth of [unintelligible] strong. So you'd have weakening in all three of these areas, but depending on how much you adjusted the projections downward, [it] might or might not lead to an abortion of the recovery.

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

MR. KIMBREL. Mr. Chairman, maybe I'm looking through a different set of glasses, but I'd like to ask, along the same line, just how confident Mr. Gramley feels about these construction projections. In our own case, you ask for specific examples, here are a couple. A major utility that shelved a nuclear construction project three years ago has recently announced the resumption of it at a much higher cost of construction.

And in the last couple of weeks, visiting with two of the larger builders in our area--one specializing in manufacturing plant construction and the other in industrial parks--the industrial builder said that within the last two months they had negotiated contracts for more construction work than they had in any previous two-year period in their entire existence. The other indicated that they were no longer pricing bids reasonably, that they were adding [to their bids] simply to miss the new contracts because they could not carry them out if they got them.

So maybe these instances are entirely unique, but at least in visiting with those [businesses, we see] there is construction under way in our area, and I am just wondering how confident you feel about these construction projection figures.

MR. GRAMLEY. Well, President Kimbrel, I guess if I had to express my concern about our overall projection of business fixed investment at this point, I would say that my concern lies in the direction, as President Eastburn suggested, that maybe there really isn't enough evidence at this point to justify as strong a projection as we have.

We are basing it very heavily on the fact that past experience indicates that once [you get] a good increase in final sales capacity, utilization rates, and business profits under way, it does carry through to a strengthening of business fixed investment--

CHAIRMAN BURNS. Well, that plus relative ease in financial markets and a strong stock market are also propelling strong [unintelligible].

MR. GRAMLEY. I think that--

CHAIRMAN BURNS. In other words, I think that you've got a good deal more to go on than past cyclical experience.

MR. GRAMLEY. Well, my thought here, Mr. Chairman, is that we've got strong order figures for the first five months of the year; the figures on construction contract awards have been notably weak, and we see no really significant [unintelligible] up there; and rising new orders will carry you through for a couple of quarters but not much beyond that. We really have to see some more basic signs of strengthening in the nonresidential construction area to be sure that we are going to get this emerging pattern we have projected.

MR. EASTBURN. I think this is very relevant to the long-run target, because if you have uncertainty in this vital area, it certainly has [unintelligible] implication for which way you go.

MR. PARTEE. Monroe, were these heavy construction--

MR. KIMBREL. Yes.

MR. PARTEE. You're talking in every case about heavy construction?

MR. KIMBREL. No, one is in industrial parks, but they are major industrial parks.

MR. PARTEE. I see.

CHAIRMAN BURNS. All right. Mr. Partee now, please.

MR. PARTEE. Well, Mr. Chairman, I have three comments. On the pattern of current GNP numbers, I've noticed that there tends to be a sort of zigzag. We've had that before in the economy, with one quarter stronger, then one quarter relatively weaker. Notably in the 1966, 1967, 1968 period. I think one might want to look at the second quarter's performance in light of averaging on the first quarter, and if you do that, you get pretty close to a 7 percent growth rate for the half year. That is, 9-1/4 and 4-1/2 roughly would be close to a 7 percent average rate of increase, which was quite a satisfactory rate of real GNP growth.

I understand that that's dangerous because the first quarter had a lot of inventory turnabout, and you can't reasonably predict that there would be that kind of contribution again in the second half of the year. But nevertheless, I think some averaging is called for, and we ought to look at the figures for the half in that light.

The second comment is that I agree with Mr. Roos that the outlook looks extraordinarily good, extraordinarily stable. There is a lack of speculation, and yet I think that there is sort of a growing buildup of plans and expenditures in a variety of fields without the hazards of overspeculation that results in a cutback later on. And I would remind the Committee of Mr. Reynolds's presentation, which indicates that that's not true just of the United States, that's true of the world. We're getting moderate recovery in the world, whereas we don't have any signs of speculation in capital or in inventory.

Yesterday, I happened to meet with a fellow from Japan, and he commented that his people had been very badly burned in 1973-1974 with their inventory speculations. And they are not going to repeat it. They've learned a lesson, and they're going to be very careful as far as making long future commitments for inventory of the kind that they have made before. Well, I think that is the general attitude everywhere. And I think that's a point of strength, which I think is what Larry Roos, was saying, rather than weakness, in the whole outlook.

Now the third comment is, having said all of that, I still agree with Governor Wallich that the 5 percent average rate of increase in real GNP is rather disappointing over the next six quarters, and I say that even though Lyle is quite right that 5 percent isn't bad historically. The reason I say it is [disappointing] is that, with 7-1/2 percent unemployment and production in the materials producing industries at 80 percent of capacity, we've got room for a lot more expansion than a 5 percent average rate over the six quarters.

But I would also point out to the Committee that when you look at this projection, there are a couple of areas that seem to me a little on the weak side. One is residential construction. I can't really believe that housing starts are going to increase only 60 thousand more at an annual rate from the current level and then peak. And that is what the projection literally calls for. Now I understand that that is due in part to the expectation that interest rates may rise. But the increases in interest rates here aren't really large, and the standard projection and availability of mortgage finance is very good right now. And [unintelligible] on that interest rate projection, if it's a little high it would mean that you would have better inflows. And I'm inclined to think that residential construction could come up appreciably--not a boom, but appreciably higher than the 1.5 million to 1.550 million that is in the projection.

The other thing that I would note is that government purchases of goods and services are in every quarter of the projection below the average rate of increase in nominal GNP. Now it may well be that government purchases for the next six quarters will continue to be quite weak relative to the performance of the total economy. But I think that all members of the Committee must recognize that there is at least a possibility that there will be greater strength in government purchases than is in this material, which I assume essentially projects the official budget numbers, looking ahead.

MR. GRAMLEY. No, no, our projections of federal expenditures for quite some time have been well above the Administration projections. We have a federal outlays figure for fiscal 1977 of \$410 billion; that compares with the congressional figure of \$413 billion; and as I remember, the official Administration figure is \$394 billion. So, we have been well above the Administration figures.

MR. PARTEE. Well, if you look at federal purchases, the second quarter is 3.4, the third quarter is 6.5, and the fourth quarter is 12.

MR. GRAMLEY. It is a very moderate increase

MR. PARTEE. And then it drops back again, a very moderate increase.

MR. GRAMLEY. That's what it would seem ought to be implied.

MR. PARTEE. I simply want to point out to the Committee that that is part of the projection. And, therefore, I guess I think that there is a good chance that the growth rate will be more than 5 percent on average--looking over the six quarters--more or less regardless of any small difference in monetary policy with [unintelligible].

CHAIRMAN BURNS. Thank you, Mr. Partee. Mr. Coldwell.

MR. COLDWELL. Mr. Partee asked my questions.

CHAIRMAN BURNS. Very good. Mr. Winn now please.

MR. WINN. Mr. Chairman, I'm afraid I'm suffering from data indigestion. The new orders data, to what extent is that influenced by primary metals? What's the weight of primary metals in there, and to what extent is their price behavior distorting the figures?

MR. GRAMLEY. We don't have an orders figure yet for June. The price increases in this field have not yet been reflected in the new orders that we have at this point. The only way I can think that the price factor would have gotten into this new orders figure is some anticipatory volume we have heard of that would have raised new orders for primary metals somewhat. Now so far as the weight is concerned, in durable goods industries, primary metals is about 9 billion [unintelligible].

MR. WINN. What, about 10 percent?

MR. GRAMLEY. Yeah.

MR. WINN. Not about 20, not 18 percent or more?

MR. GRAMLEY. We have had a good run-off in the primary metals industry, in part the consequence of the fact that inventories of durable materials generally were run down, and now we are at the stage of this cycle where that's in the process of being reversed. Some of this is a genuine increase [unintelligible].

MR. WINN. Our second problem, Mr. Chairman, is what's our productivity assumptions in the model? Three percent, is that what you've got in there, or--

MR. ZEISEL. Well, it's model projections, Governor. These are judgmental projections, and the average over the next six quarters is slightly under 3 percent. It tapers down, however, very slightly in a--

MR. WINN. Now, is that built into the projection? It's not in the model, as I understand it?

MR. GRAMLEY. It's in the projection.

MR. ZEISEL. In this system, that is the number that we come up with.

MR. WINN. As I understand the models, they show rather weird productivity assumptions for the period ahead.

MR. GRAMLEY. Well, productivity estimates by the econometric model have been considerably off for a long period. That is, if the model suggests that we ought to have a more rapid [unintelligible] productivity, then we judgmentally believe it will occur. But it's been off for so long that even the modelers themselves don't trust it.

MR. PARTEE. What did you say, Jerry, that it's 15 down to 3 percent?

MR. ZEISEL. No, we figure a rate of increase in the second half of '76 of about a little over 3 percent, and it drifts down to a 2-3/4 percent rate by about the end of '77.

MR. PARTEE. Under 3 percent?

MR. ZEISEL. Under the 3 percent. This is nonfarm productivity--the long-term trend is about 2-1/2. It remains slightly [unintelligible], and seems to us consistent with a rate of growth in real GNP and real activity that is somewhat above that.

MR. WINN. The third data problem I have is with our weekly reporting banks. I wonder how characteristic that is in terms of the total bank data. The Federal Trade Commission data would show an upturn in loans, you know, and the total bank data show a downturn. You start to examine the weekly reporting in the total and you get some really weird data behavior.

MR. GRAMLEY. One of the long-standing characteristics of the FTC centers is that they never performed any [unintelligible] to dig out of the banking data. Now the weekly reporting banks are a long ways from the all-commercial-banking materials that we get. [Unintelligible] estimates of what's going on in banks from which we do not get recent reports and indeed from which we don't actually have good loan data except for Call Report dates. In general, what happens is that the larger banks show much larger cyclical slants in business loans than do the smaller banks. The smaller banks can have a more steady rise and are often experiencing very substantial loan expansions when loan demands [elsewhere] are quite weak.

MR. WINN. I apologize for indigestion on some of these things. One comment, and Governor Jackson probably is in a better position to comment than I am, but when you look at the vacancy rate and some increase in rents, I think you can take some encouragement on the multiple housing prospects, at least for next year. There is an interesting institutional barrier to that, which is the fact that the savings banks and the insurance companies are very reluctant to go back into this market, even though there are some other attractive deals.

CHAIRMAN BURNS. So are commercial banks.

MR. WINN. Commercial banks go if the others go in on the construction; there's money there.

CHAIRMAN BURNS. This recent banking survey [indicates they] have no interest in multifamily housing.

MR. WINN. Yeah, I think this is true of savings banks and insurance companies, and yet the economics are starting to look much more favorable.

CHAIRMAN BURNS. They look more favorable, but these fellows have had bad experience.

MR. WINN. Yeah, they've been burned.

CHAIRMAN BURNS. Badly burned.

MR. WINN. The other interesting thing is that while the single-family homes are starting to price themselves out of the market, the manufactured home, which is the successor to the trailer and the mobile home, really looks like it might have a bigger potential with the \$20 thousand to \$30 thousand developments showing up here in this area. And so I think there are some plus factors showing up here to alter our outlook in some of these areas.

CHAIRMAN BURNS. That reinforces Mr. Partee's observation.

MR. PARTEE. What do you mean by manufactured homes?

MR. WINN. It's the mobile home adaptation.

MR. PARTEE. --another half a house.

MR. WINN. And they got away from the box idea. They've got artificial basements to put in.

CHAIRMAN BURNS. It's a double box.

MR. PARTEE. An artificial basement.

MR. WINN. Yeah, yeah, it's unbelievable, some of the things they do. And they're getting away from the trailer park idea, and they're putting them on larger lots. And this is altering--

CHAIRMAN BURNS. What does an artificial basement mean?

MR. WINN. It's boxed in at the bottom so it looks like there is a basement, and it doesn't look like it's on a block, like those today.

MR. GRAMLEY. Mr. Chairman, may I just point out that in our own staff projection, we have allowed some moderate increases in the multifamily starts area. I think that the Committee should be aware that there are some negative considerations in the single-family area also. The sales of existing houses have not risen since late last year. Sales of new houses, if anything, are declining now. [Unintelligible.] We don't have the underlying demand for single-family homes, [that] I think [is needed] to send the single-family starts up to a very high level.

CHAIRMAN BURNS. How good are these figures on sales?

MR. GRAMLEY. Well, they are a relatively new series. I don't know that we have any basis for evaluating this series.

CHAIRMAN BURNS. How good a sample?

MR. GRAMLEY. That I don't know. I don't have any information on that.

MR. JACKSON. Believe or disbelieve. I think the most interesting comment I've heard recently about rents and multifamily construction was from Baltimore this past week from a guest at lunch, Mr. Meyerhoff, who's very experienced with all kinds of apartment developers. And the question was asked, how much increase in gross rents will it take with today's levels of interest rates and construction costs before it becomes economical again or attractive for professional apartment developers to reenter the market in any strength.

He said it would depend largely on various geographic areas. For instance, he said in the Atlanta area, Mr. Kimbrel, that rents had stayed so flat so long that it would take at least a 25 percent increase in gross rents to make it attractive. In the Baltimore area, where they were operating and where there had been some continual increase in gross rents, he felt 15 percent would do it. And I find that these comments of his are pretty typical of those around the country. I hear some comments, for instance, in California that it may take a 20 to 22 percent increase to make it economically attractive, where there is some prospect of profit.

MR. PARTEE. Is that prospective rents, or do they have it in hand before they start?

MR. JACKSON. Well, as you approach the margin you will find some people begin to anticipate, certainly. But here again, this feeds back to the attitude of the institutional investors--the insurance companies, the banks. They got burned because they made some investments on expectations of increases that did not materialize, and they will remember it a long time, in my judgment, and they won't fall for that again. They want to see bird in hand before they [unintelligible].

CHAIRMAN BURNS. To what degree do we have rent controls in our country at the present time? Does anyone have the facts in hand?

MR. KIMBREL. Rent controls in Atlanta, is that upon supply?

CHAIRMAN BURNS. Well, yes, but I'm thinking of governmental controls.

MR. KIMBREL. No, none at all.

CHAIRMAN BURNS. Well, they're spread around the country, but I don't know to what degree. Could we have a factual reading on that?

MR. GRAMLEY. In our areas, community pressures of the quasi-governmental kind operated on rent increases. That's true in the Washington area--we'll try to [obtain] as much qualitative information as possible.

CHAIRMAN BURNS. Very good. And I think we're having an excellent economic discussion today. Mr. Baughman.

MR. BAUGHMAN. Mr. Chairman, if for some reason we were to see a more rapid decline in the deficit than is built into the projection, would we [unintelligible] a bullish or a bearish development so far as economic expansion and prices go? Mr. Partee had one side of that picture, the government expenditure side. If Mr. Gramley would give us--

VICE CHAIRMAN VOLCKER. If I may just supplement that, Mr. Chairman, this is the same point that I was going to raise. We have had a fairly sharp decline in the full-employment deficit, and it levels off awhile, according to the projection, and then you get another decline and a movement into the surplus.

CHAIRMAN BURNS. But it's very small--those figures are so tiny.

VICE CHAIRMAN VOLCKER. The figure is bigger than that for the previous--

CHAIRMAN BURNS. No, no, I mean the projected full-employment surplus. The--

VICE CHAIRMAN VOLCKER. No, the surplus is tiny when you get to a surplus--

CHAIRMAN BURNS. No, I'm using the term surplus as a [unintelligible]. You take the projected figures on the full-employment surplus [unintelligible] they are very small, and I don't think the trend is of any significance.

VICE CHAIRMAN VOLCKER. Well, this is basically my question now, what significance Mr. Gramley attached to that--

MR. GRAMLEY. I certainly would agree with the Chairman that the movement in the surplus is small. The projected figure that we had for the second quarter--and I don't know how much revision will be necessary because of the statistics that came out this morning--but we had a high projection of \$5 billion, and we had a projected move to about a \$4 billion surplus for the fourth quarter of 1977. Now that's not a large move. It's in the right direction in the period in which business activity is expanding.

To turn to President Baughman's question, I confess to being a traditionalist. That is, I believe that, at this stage of the cycle, a larger deficit would have a stimulating effect on economic activity. And I believe it would have an adverse effect on inflationary problems, that is, it would tend to increase prices.

CHAIRMAN BURNS. I would dissent from that judgment. I think if we had a significant increase in the deficit, it would have negative effects on the economy at the present time.

MR. BAUGHMAN. Mr. Chairman, I would just like to call attention also to [the fact] that we seem to have a very rapid growth in deposits and loans in country banks in our part of the country. And the loan figures listed exclude their sales of federal funds, which are substantial. We are hearing what I think is a fairly optimistic discussion about possibilities of beginning some part [unintelligible]. We hear smaller figures [unintelligible] to the necessary increase in rents and [unintelligible] they may be about a point further down. [Unintelligible.] It seems to me I hear rather conflicting stories that, in some of these items, rather large inventories are being held, possibly in a speculative situation, and rather bullish expectations [unintelligible].

One of our directors reported that the [increase] in the minimum wage has raised labor costs 90 percent in their stores. Now I heard a number of store managements recently indicate that they have initiated rather intensive programs, frequently involving the engagement of outside firms, to come in to help them to hold down the longer [unintelligible] and increase the output for worker [unintelligible] hours. I'm not sure that's [unintelligible] anything, Mr. Chairman, but I just [unintelligible] indication of what's going on.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Mr. Volcker, do you have any comment?

VICE CHAIRMAN VOLCKER. No.

CHAIRMAN BURNS. Mr. Balles, please.

MR. BALLEES. Mr. Chairman, I would like to ask Lyle a few questions about the monetary assumptions underlying the Board's staff forecast. In comparing our own forecast with yours, Lyle, I find they're fairly similar up to mid-'77, but you begin to get some difference in the second half of '77. Our forecast is coming in considerably lower in terms of real growth, for example, than yours. In the structure of the GNP accounts, it tends to show up principally in things like personal consumption and inventories, but I think possibly one of the explanations may be on the monetary assumption. Just as a point of fact, am I correct in thinking that you were assuming a 5-3/4 percent growth path for M1?

MR. GRAMLEY. That's correct. And continuing that path beyond the second quarter of next year.

CHAIRMAN BURNS. Well, I want to comment on this point. That's the mechanical model, but then you introduce a judgmental factor, and at the end you don't know what the monetary assumption is.

MR. GRAMLEY. I would acknowledge that comment also, Mr. Chairman. And I would say that one of the chief problems we have had in developing our judgmental forecast is that we have not been able to come to grips with the kinds of financial restraints that past experience suggests should be developing with the growth rate of M1 at 5-3/4 percent. Now we have to make some judgment as to how much further downward movement in the money demand function will occur. And we take that number right off the wall; it's that subjective. And I think forecasters looking as far ahead as late 1977 can come to markedly different conclusions about the economic [environment] that will emerge from maintaining a 5-3/4 percent growth rate in M1.

MR. PARTEE. I [unintelligible] on that velocity.

MR. GRAMLEY. Pardon me?

MR. PARTEE. Your rising velocity continues right through '77.

MR. GRAMLEY. Yeah, right, that is, the rate of increase in velocity tapers off just a trifle because towards the latter part of the period both the rate of price increase and the rate of real GNP growth are just a trifle less, but basically it's a very large and continuing increase in income velocity of M1 in the projections.

MR. BALLEES. Well, this gets to the principal point I was going to make. In our own forecast, by the end of '77, the increase in M1 velocity will be just a touch above its long-term trend rate of 3 percent; for M2, it's just a touch above its long-term trend rate of close to zero. And I gather your velocities are somewhat higher than that.

MR. GRAMLEY. Yes, they are.

MR. BALLEES. Now, to be very frank about it, I think I would have to concur with the Chairman's observation at the last meeting, which was, if I recall correctly, Mr. Chairman, that we cannot expect the large increases in velocity to continue, and I come out with about that same conclusion.

CHAIRMAN BURNS. So does Lyle.

MR. GRAMLEY. Yes, indeed. You see over the last year the rest of the increase in income velocity on the order of 92 to 80 percent, but it's not just a question of the extent to which the income velocity of money goes [unintelligible] like that. What sort of financial restraints have developed? What does this mean for the future? And I think that what you are suggesting is that the kind of pressure on interest rates that we're forecasting is much too moderate--[you would] expect a much larger rise in interest rates, much more tightness to develop in financial markets, a weaker pattern to housing, and so on. And that's a possibility. But you see, that's the sort of thing we've been forecasting repeatedly since the middle of 1975, and we've been wrong.

MR. BALLEES. Well, I think, to put this in prospective, I have to say my faith in anybody's forecast, including our own, [decreases] in geometrical proportion to every quarter

added to the forecast horizon, so I can't really say that we have irreconcilable differences by the time it gets to the fourth quarter of '77.

MR. EASTBURN. Mr. Chairman, can I ask a small question here?

CHAIRMAN BURNS. Yes, please.

MR. EASTBURN. Lyle, would you say that, on velocity, your forecasts are in line with forecasts that other people are making?

MR. GRAMLEY. It's hard to say because the other forecasts of GNP that we have rarely explicitly forecast M1. There are three forecasts that I've looked at for which we have statistics all the way in terms of both M1 and real GNP. In general, the other two besides ours had a slower increase in velocity than we did and somewhat higher increases in M1 than we had projected.

MR. JACKSON. Mr. Chairman, may I ask to what extent is the impact of velocity projections being influenced by the changes in the character of the definition of money ?

CHAIRMAN BURNS. Well, that's a significant factor.

MR. GRAMLEY. Yes, we are maintaining our traditional definition of M1 [unintelligible] demand deposits. We are aware of the fact that a variety of changes are going on in the economic system which are leading to economization of money balances so defined. We are also aware, however, that merely redefining the stock of money to include the time and savings deposits at commercial banks other than large denomination CDs does not solve the problem. There is economization of that concept of money going on, also, and what we are projecting in terms of an increase in the income velocity of M2 is also high in terms of experience. We're projecting a rise of somewhere around a 2-3/4 to 3 percent annual rate over the next six quarters, whereas the trend rate of increase, as President Balles has suggested, would be close to zero. We know no way to merely redefine money to get around this problem. Presumably there is a way, if we only knew what it was, but we don't have the answer.

MR. WALLICH. Mr. Chairman, one of the hypotheses about the above-average rise in velocity in the first year of the expansion was that it was a normal feature of the early expansion. Now, to the extent that that was the explanation of what we observed, one would have to assume that in the latter stages of the expansion, velocity ought to expand below average, other things not taken into account here.

CHAIRMAN BURNS. Be careful. When you talk about "average," the average may be a long-run trend average or an average for the expansion phase of a business cycle or an average for successive phases of the expansion.

MR. WALLICH. That's what I had in mind.

CHAIRMAN BURNS. Now, historically, the latter [meanings feature a] progressive diminution on the average. But there is second fact to it, and that is changing financial technology, which has been extraordinarily rapid. Therefore, [business] cycle experience is one

guide, and then [there are] these changes in financial technology partly induced by our own regulations. It's very hard to judge the future--and I didn't know the staff projection of 5 percent; I just heard it today for the first time--but if I had been asked to make a judgment, it would have been in that area--above [the] average cyclical experience and certainly above [the] average secular experience.

MR. WALLICH. That puts a heavier burden on the technological [source of] demand changes because, looking purely at the cyclical pattern, there's a case for some secular slowing in the rise of velocity.

CHAIRMAN BURNS. Well, Lyle has moved from 8 percent to 5 percent. The question is should he have moved further. But you know, after you do all that, there's still a judgment, and that's partly mechanical analyses as to where these are going.

All right, before we break for coffee, would anyone else want to comment on the economy? If not, I take it this part of our discussion is at an end, and individuals may feel free to return to the subject as they see fit.

[Coffee break]

CHAIRMAN BURNS. Gentlemen, we are ready to resume our meeting and return to our discussion of the monetary aggregates over the coming year. I would like to make a few observations on that subject by way of introducing our discussion.

I think we always have to remind ourselves that our objective is not to achieve this or that rate of monetary growth that we project. Our objective is to do what we can in the monetary sphere to further our basic economic objective--that is the growth of our economy, a reduction of unemployment, and reductions as well in the rate of inflation. Nevertheless, it's useful to look back and see to what degree our projections have been borne out.

Between the second quarter of 1975 and the second quarter of 1976, the rate of growth of M1 was 5.2 percent, just a shade above the lower limit of M1 as we projected it a year ago. The rate of growth of M2 was 9.8 percent, a little above the midpoint of M2 as we projected it a year ago. The rate of growth of M3 was 12.1 percent, or just about at the upper limit of our projection of M3 a year ago. So if others want to judge us by our projections, we've once again done quite well. But I want to repeat that that's not the way in which we want to judge ourselves.

We are all keenly aware of the very sharp rate of growth of M1 during the second quarter. The rate of growth, I believe, was 8.4 percent. Even so, the rate of growth for the year, including that quarter, was merely 5.2 percent. In other words, we had a sizable overshoot in that quarter, and we had undershoots in earlier quarters. So let's keep that fact in mind as our discussion proceeds.

Now there are certain principles that we have been observing and that I think we should continue to observe in setting longer-range targets. One is simplicity in formulation. We don't want to inform the public of some complicated scheme of monetary calculation or monetary projection. We want to state something that is simple and can be readily understood. We've done that hitherto, and I think we must continue to do that.

Second, and I don't think one could overemphasize the importance of it, we must absolutely avoid any appearance of shifting our procedures. We have been making projections for a 12-month period, as the current [congressional] resolution requires. We've been doing it on the basis of a quarterly base. Now there ought to be a decisive reason for a change, and if there is a decisive reason for a change it ought to apply not only to what we do today but to some indefinite future. We don't want to be charged with manipulating our figures. We can be charged with stupidity; I can take that. We can be charged with incompetence; I can take that. But we must not be charged with a lack of integrity or with manipulation. The greatest asset that we have is our integrity, and we've got to keep that in mind in what we do.

Now today, as always, the arguments are for moving in one direction or another with respect to our growth rates, but I think that our discussion today is likely to revolve around the question, Do we leave the ranges unchanged or do we lower them? I doubt if there will be much sentiment in the Committee to raise them, and I will proceed on that assumption.

Let me turn primarily to M1, though I'll also have some observations to make about M2 and M3. I think there are some cogent arguments for lowering the range at this time. First of all, the prospect for continued expansion of the economy is good, and an additional small step toward a growth range that is more nearly in keeping with reasonable price stability could very well be defended. The second argument for lowering the range might be that we had an overshoot in the second quarter and that we may need to offset that overshoot.

There are arguments also for leaving the [growth] range [for M1] unchanged. We've had a very good economic discussion today. Some divergence of views were expressed. I happen to be more optimistic than the staff. Nevertheless, I think it's only fair to recognize that the real economy has recently shown some signs of hesitation. Consumer spending rose considerably less in the second quarter than in the first. The growth in industrial production has tapered off, and residential construction has been weaker than many of us had expected. Now I believe that these uncertainties are likely to be resolved on the side of renewed, rather vigorous expansion in the late summer and fall. Business capital spending should be gathering strength.

The general public would not understand a move toward a restriction at the present time. But once evidence of renewed vigorous expansion appears three months later, I think the public would interpret [that as the] more appropriate time to move toward a firmer monetary policy. [The public] would understand that we are doing better. That is one reason for not rocking the boat at the present time and for leaving the growth range for M1 unchanged.

Now a second reason is that velocity [growth], or the rate of growth of the turnover of money, has definitely moderated, and we cannot reasonably expect anything like the rapid increase of velocity that occurred last year to continue. That is a second reason for not lowering the growth range for M1, for leaving it unchanged.

The third reason is that, [although] the overshoot [in the growth of M1] that occurred in the second quarter was disturbing to us at the time and even in retrospect, it merely brought the longer-run growth since early 1975 to a pace that is entirely consistent with the current Committee range, and actually close to the lower limits.

And finally, if some of us, or the Committee as a whole, would wish to make up for the rapid growth of M1 in the second quarter, there is really no need to signal the move toward restriction. We have a pretty wide range. We can do that as we move along from month to month by aiming toward somewhat the lower part of the range. So as I think about the problem, and I have pondered this over recent weeks as I know the rest of you have, I reach the conclusion that there is really no clear reason to alter the range for M1 at the present time.

Now, I feel a little differently about M2 and M3.

MR. ROOS. Excuse me, Mr. Chairman, did you mean based on the quarterly adjustment of the base or on the original--

CHAIRMAN BURNS. All that I'm saying is, we had a range from the first quarter of 1976 to the first quarter of 1977 of 4-1/2 to 7 percent. I'm saying that the range from the second quarter of 1976 to the second quarter of '77 should continue to be 4-1/2 to 7 percent. That is my suggestion to the Committee.

As I say, I feel a little differently about M2 and M3. We had a considerable slowing in the inflow of savings during June. Now the inflow in the early days of July was much improved. I think most of us expect interest rates to rise later on in the year, although we'll differ as to the degree of rise. Therefore a lower rate of growth of M3 and of M2 is only to be expected.

I'd be inclined to reduce the upper limit of M3 by 1 percentage point, that is have the range run from 9 to 11 instead of 9 to 12. And I'd be inclined to reduce the upper limit of M2 by half a percentage point and have it run from 7-1/2 to 9-1/2 instead of 7-1/2 to 10. But I [propose those changes] not really for the reason that I indicated--[which was] mainly expectations with regard to interest rate behavior and savings inflows. I would like to do it for another reason. By this slight move we would continue to move gradually toward somewhat lower monetary growth rates that are more consistent with general price stability. And I think we can do that quite safely, quite reasonably, and the general stance of our policy both in the short run and over the longer run I think would be well served by such moves.

That's my advice to the Committee. We are likely to have more than one opinion at this table on a question that is so complicated. There'll be arguments in all directions. Let's hear from members of the Committee. Mr. Morris, please.

MR. MORRIS. Mr. Chairman, I like your set of prescriptions. I'd like to go back to a comment I wanted to make earlier on the usefulness of these alternative monetary policy formulations. Seems to me that they don't have an awful lot of relevance to us because of the time horizon of the projections. That is, whenever you ask an economic model to give you the economic effects of the more expansionary policy over a fairly short period of time, you're up against the fact that the lags in the impact of monetary policy are much shorter on production than they are on prices.

I think every sheet of this kind that I have seen in the past eight years around this table suggested that a more expansionary policy would produce benefits in greater real growth and very little in price effects, and I think that reflects the fact that the time horizon for this kind of exercise has got to be longer to be useful to the Committee.

It seems to me that for this kind of analysis to really give us much insight, we need to push it out to 1978 or 1979. Now I know that the further out you get, the more difficult time you have in projecting. Nonetheless, because of the differential lags of monetary policy between output and prices, I don't think that this kind of analysis is really very helpful. The other question I had--

CHAIRMAN BURNS. Let me just make a comment. To do what we can in the way of longer-run objectives is salutary. And that's not inconsistent with anything that we have to do today and in later meetings. But we have to do something very specific today, mainly to set monetary growth ranges for the next 12 months for the interval between the second quarter of this year and the second quarter of next year.

MR. MORRIS. I think that's right, sir, but I don't think we can set them solely on the basis of the projections of the next 12 to 18 months. I think implicitly we are not acting on that, and if we were, we would have to revise our monetary growth upward.

CHAIRMAN BURNS. Well, it's a matter of judgment, you see. I think that over the longer run, over the next few years, we should get our monetary growth ranges down to a level where they are consistent with general price stability. That was the last point that I made. That's why, even though I would like to stay with M1 where it is as of today, I did want to make a further move on M2 and M3 to continue what we've been doing in recent meetings--moving slowly, taking small steps. But taking small steps that are prudent and that inch [forward] over several years give us a chance to get back to something close to general price stability.

MR. MORRIS. The other question I had, Mr. Chairman, was more of a technical nature. Looking at the alternative B projections for the credit proxy, I see that we are projecting a slower rate of growth for the proxy than was the case three months ago. This seems a little curious to me. I don't know whether we are presenting the proxy to the [congressional] committee or not, but if we are--

CHAIRMAN BURNS. I have stopped doing that.

MR. MORRIS. I see. It's hard for me to understand why, if M1 is going to grow at the same rate, why the proxy would grow at a slower rate over the next 12 months than our estimate made three months ago.

MR. KICHLINE. We have consistently been underestimating the growth of the proxy. Historical experience accounts for part of the adjustment, the second part relates--

CHAIRMAN BURNS. They were underestimated--excuse me?

MR. KICHLINE. --to the fact that we--the targets have been higher.

CHAIRMAN BURNS. Oh yes, yes, very much higher.

MR. KICHLINE. --than the actual experience. Secondly, business loan expansion has been relatively modest in our projections throughout, but this time I think we also had a small marginal downward adjustment in our expectations for business loans and hence a little bit less

expansion in CDs that are forecast. That also would contribute to our expectation of slower growth in the proxy.

CHAIRMAN BURNS. You're a good student, Mr. Morris. I really paid no attention to the credit proxy in thinking of our long-range target because I don't understand it. I'm glad you asked the question because I ought to understand it.

MR. PARTEE. If M2 were a little less [unintelligible], it would account for a bit less of the proxy.

MR. MORRIS. Yes, but I assume that it's mostly CD policy that's dominant.

MR. KICHLINE. That's correct.

CHAIRMAN BURNS. All right, Mr. Balles please.

MR. BALLEES. Mr. Chairman, I find myself in substantial agreement with your conclusions, mostly for the same reasons. I would like to refer to a set of charts I have taken the liberty of distributing here to make two quick points.

I think you put into focus very well the fact that over the past year, taken as a whole, our growth rates of the various Ms have been either within or very close to the top of the range we set ourselves. I think that the fact that we shift bases every quarter makes us look worse in practice than we really are. That is to say, it doesn't bring out the point that you made so well, that we had been within our ranges over a period of a year.

That point is brought out on the second page of this set of charts, which shows [unintelligible] that we set, and growth ranges that we set going clear back to the beginning of this whole exercise. There are a lot of lines that tend to be somewhat confusing on this set of charts, but the net of all of this is that, preceding the overshoot that occurred in the second quarter of 1976, we had two undershoots--we were well under the ranges for both the first quarter of 1976 and the fourth quarter of 1975. That is one reason that I'm in favor of your final recommendations as to the growth ranges. But I view the second quarter as being something of a catch-up from the undershoots of the first quarter of the year and the last quarter of 1975.

More to the point, this chart shows that we missed the range altogether-- we're above it in the second quarter and below it in the preceding two quarters. To the extent that we have a sort of public understanding problem here, I think we would be better served sometime, certainly not now in my opinion, to perhaps consider shifting to a fixed base of, say, the fourth quarter of the year for the following calendar year.

I don't think this is the time to do it, and I am not recommending that it we do it now. But if we had gone that route in the past--say, if we had set for ourselves the fourth quarter of 1975 as a base--[growth through] the second quarter of 1976 would cover a six-month period and show a 5.6 percent increase in M1, close to the middle of the range, and an 11.1 percent increase of M2, which is just a touch above the upper end of the M2 range.

So, in terms of one of your guiding principles of simplicity, it might actually be easier for the public and Congress, academics, to understand if we had a fixed base rather than a shifting base.

The other point I wanted to make just quickly while I have the floor and you have the charts in front of you [relates to the] first page of the set of charts labeled M1. This is my continuing concern, that the market is reacting perversely, sometimes irrationally, to our weekly published figures of the seasonally adjusted data. One can find all sorts of illustrations of this. In this morning's *Wall Street Journal*, for example, there is a story about the wholesale dumping of bond inventories yesterday by dealers, at cut-rate prices, and the stock market was down sharply, and all apparently because of interest rate fears. It doesn't take much [to stoke such fears,] because the latest weekly figures of money show quite a jump.

To the extent that we can solve that problem, I think we ought to try. And I'm back to my favorite theme here, hoping not to be a nag, but I think this is an important point. We need--in my opinion--some sort of filtering device to put these weekly seasonally adjusted money supply figures in some better perspective, and the only way I know how to do that is to smooth them through a moving average device [unintelligible], what happened quite recently on the funds rate.

CHAIRMAN BURNS. Now, just a question, are you referring to the figures that we publish or are you referring to thinking by this Committee?

MR. BALLE. I'm referring to the figures we publish, Mr. Chairman.

CHAIRMAN BURNS. You would publish the moving averages.

MR. BALLE. I would publish the moving average to try to get away from what happened yesterday, where the market reacted, in my opinion, in the wrong way to a single week's worth of figures. We've seen this repeated again and again and again. And I am hoping that someday I can convince my colleagues around the table here to make some sort of device that we can publish ourselves so that the market would understand that there are a lot of random fluctuations in these weekly figures and, indeed, even in the monthly figures. We need a longer-term measure of where we stand in terms of levels of the aggregates.

CHAIRMAN BURNS. Well now, if your suggestion is that in putting out our weekly reports on the money supply we add a column that would show a 13-week moving average--without committing myself to that precise period--you are not going to have any difficulty convincing me. I think it would be a good idea.

MR. BALLE. I'm glad to hear that, that's exactly the sort of thing I am recommending. Not committing myself to 13 weeks as the optimum period, but that's pretty close to what the tests of statistical significance would show to be the number of weeks you have to have to dampen random fluctuations to a point where they account for less than half of the observed week-to-week movements.

CHAIRMAN BURNS. Yeah, Mr. Broida calls to my attention that your table has projections. I was referring simply to the weekly figures. When we publish the latest weekly

number, we also show, you see, the moving average, and I think that would be helpful, I think our staff ought to go to work on that and come forward with a recommendation one way or another. I think it is a good idea.

MR. PARTEE. I recommend that we do it, Mr. Chairman.

MR. JACKSON. We publish a four-week and a 13-week moving average, don't we?

CHAIRMAN BURNS. Do we not?

MR. GRAMLEY. We have a four-week average.

CHAIRMAN BURNS. Do we publish a 13-week or longer than three-month average?

MR. GRAMLEY. Not to the best of my knowledge.

CHAIRMAN BURNS. Well, I think that a longer--

MR. GRAMLEY. I would remind you, Mr. Chairman, that if you publish a 13-week centered moving average, the centering of that period will be 6-1/2 weeks prior to the current date, and I would be willing to bet my bottom dollar that market reaction to that would be one huge yawn.

CHAIRMAN BURNS. Now wait, now wait, the table that I visualize would show the figure for the latest week and on the same line, an average covering, let us say, that week and the 12 preceding weeks, which means that the centering would be at the end of the period rather than at the middle of the period.

MR. GRAMLEY. The centering in terms of the location on the page, but anybody familiar with statistics would know that that's a 13-week moving average. The center of that is 6-1/2 weeks ago.

CHAIRMAN BURNS. Well, you can interpret it that way, and I know all about that, but the simple interpretation would be that this is an average for this week and the preceding 12 weeks. You have a longer-term average. You have now a four-week average--all right, a 13-week average; now there is some uncertainty here as to what we actually publish, and it's embarrassing to me not to know what we actually publish. Mr. Jackson indicates that we were already doing it.

MR. JACKSON. I am not sure of the 13 weeks, but I believe I've seen in the last two, three days our most recent publication on the four-week.

CHAIRMAN BURNS. Does somebody know what we actually publish?

MR. STERNLIGHT. Mr. Chairman, I believe we give the latest weekly figure, the last four-week average, and then a comparison of that last four-week [period] with a four-week period three months earlier.

MR. PARTEE. Yeah, it's not exactly a 13-week period.

MR. STERNLIGHT. No, but I think you have a rather similar concept.

MR. PARTEE. We introduced it for this very reason several years ago. The same discussion occurred virtually--

VICE CHAIRMAN VOLCKER. I think that my impression is that the newspaper's pretty faithful in reporting it this way, too, but I think you are up against the fact that the only news is the latest week's figure, and that is what they look at on the ticker on Thursday afternoon or whenever it comes out, unless it's in the headlines.

MR. BALLEES. Paul, that's exactly why I'd like to have us educate the market to not place so much weight on what the very latest weekly figures show. I think they react irrationally to that. We're getting observations that are unjustified and disturbing.

CHAIRMAN BURNS. I would say the market reacts irrationally. I would also say that I think there is some tendency on the part of this Committee--and because of this Committee, at the Desk--also to react irrationally to these figures. I think we are in danger of becoming excessively mechanical monetarists.

MR. WALLICH. Well, Mr. Chairman, I think the problem is with the manner in which we pursue the aggregates. It's very difficult not to take into account recent data. In fact the whole idea of optimal control is to take full account of recent information, and if one doesn't do that, one finds that, a few weeks or months down the road, one is very far off target. But what we are doing now is to pursue the aggregates by means of the federal funds rate, and that attributes a great deal of importance to the rates, so that the whole structure of other rates have become hinged to it as if it were the discount rate in the United Kingdom.

Everything moves; that constrains our ability to move that [unintelligible]. If we could get by with operating in a way that isn't based on the funds rate, the funds rate would be simply a residual result, then the market wouldn't attribute that much importance to it; bill rates and other rates wouldn't be so tightly hinged to it; and we'd have more freedom to let the funds rate move about. That was the idea essentially of having a wider funds rate [range]--2 percent instead of what we've been having recently, 1/2 of 1 percent--and we've been moving away from that objective rather than toward it.

MR. COLDWELL. Are you suggesting, Henry, that we have a zone of indifference in the federal funds rate as we do in monetary aggregates?

MR. WALLICH. In one way or another, I think we ought to get away from the narrow range. Operating on nonborrowed reserves doesn't seem to commend itself in terms of the experience that is described in the Bluebook and in the New York report--maybe operating more directly on the aggregates themselves without using the funds rate would do the trick.

MR. JACKSON. The consequence of that, Mr. Chairman, as I understand that suggestion, would be to react more irrationally, because you'd have a wider range over which reaction would take place over the same uncertain information.

CHAIRMAN BURNS. Well, there are complex questions here. I do think that, during the past year at least, we may have been overreacting in adjusting the federal funds rate to temporary changes in monetary growth rates, and a little greater stability in the federal funds rate is an alternative, really, to what you're saying, Henry. But I think these are questions that we ought to continue discussing and debating. Perhaps we ought to set aside a full meeting for a discussion of this very question, and have good staff preparation for such a seminar.

MR. BALLEES. Mr. Chairman I would like to take just one more minute to make a point, and then I'll be quiet. On page 1 of these charts, I would not for public purposes have the Board [staff]'s own forecast with the five or six weeks ahead. I think it would be a very useful thing for this Committee to see, and I think it raises a point that is worth a little thought.

In June, the decline in the M1 growth rate occurred within the context of an overshoot in the second quarter as a whole. The Board staff's forecast of the weeks ahead on this page as shown in the [unintelligible], beginning July 7 and August 4 it shows a very sharp recovery will be occurring. And in that context I raise the question as to whether the recent reduction in the federal funds rate, apparently in response to the [unintelligible] June figures is really the appropriate response if one were to view the best measure of the level of M1 as the smooth series of a 13-week moving average.

Because once one incorporates the weekly forecasts, we have a forecast line here of what the moving average itself would look like based on that forecast of weekly data, and the moving average of the forecast of this also shows [unintelligible] upper end of the range. In short, I would also raise the question as to what our response ought to be when the single month's figures come in on the low side without having the full context of this smoothing or moving average device. That's not something we need to settle today, but I would like to just lay that thought on the table for future consideration when we have this kind of meeting that you suggested.

CHAIRMAN BURNS. I hope you keep on repeating that suggestion, and I do think we ought to plan for a seminar in the not too distant future on this question. Mr. ParTEE, did you have a comment?

MR. PARTEE. Well, I was just going to make one small comment on that, and that is, isn't the question of what we have done in the last four weeks a question of what this looks like compared to what we thought it would look like four weeks ago? And I think you'll find it's lower; that is, the June-July average is significantly lower than we anticipated at the time of the last meeting. Now your line here for the recovery, if you believe it, is a consideration for [judging] current policy this time. But not for judging current policy over the last four weeks, I don't think.

MR. BALLEES. I agree.

CHAIRMAN BURNS. I thank you, Mr. Balles. Mr. Guffey now, please.

MR. GUFFEY. Well, Mr. Chairman, I think I agree totally with the recommendation already made but I would like to focus on that part of the recommendation that suggests that you leave the range of M1 [growth] as it has been in the past, and I believe that's 4-1/2 [to 7] percent.

I subscribe to the proposition you set out, that we should be taking a cut each time at the inflation problem. And further, I understand you to say that these ranges would give us the latitude to do that, and I subscribe to that.

But now to move to my point, it seems to me that, if the staff's projection is correct and things are moving a little more rapidly three months from now as we move on into the fall, it is going to be a little more difficult to move that upper range down. And as a result of the pause we find ourselves in, and to affirm the position that has been stated publicly that inflation is our greatest problem, I would like to see us move the upper [bound] of M1 down 1/2 percentage point this time, which will bring us down to 6-1/2. I understand that it doesn't mean a great deal, but for public view I would like to see us do it now. I think it's easier to do it now than it would be three months from now.

CHAIRMAN BURNS. All right, thank you, Mr. Guffey. Mr. MacLaury now, please.

MR. MACLAURY. I find myself very much in sympathy with what Roger has just said. First of all, I start out with you, Mr. Chairman. I can't tell you really why I think the economic outlook is going to be stronger than the Greenbook forecast. Chuck has given us a couple of potential reasons, but it's my guess that it will turn out to be stronger. And furthermore, I think we have been happily surprised, at least in the wage rate area, that we have not seen the kinds of increases that we might have expected, and we can argue there that the prospect for inflation is better; at least we have a better basis for our expectations than we had before.

I point out that the way we have been moving the M1 range down 1/2 point on one end, and the next [on the other] end, if my arithmetic is correct, gives us 1 percentage point per year. If we were to do that continuously over time, well, if we're 4-1/2 to 7 now in '76, we'd be at 2-1/2 to 5 in '78, and so on. It would take us a very long time, even if we continuously followed this pattern that we have. We could accelerate that at some point if it seemed necessary.

The last point, I guess, is that it will be more difficult in October-November of election time to make a further adjustment downward in the M1 range than it is to do so today. And I think, therefore, for these various reasons, I would opt for a 1/2 point reduction in the upper end of the range today.

CHAIRMAN BURNS. Let me make one observation in timing. I can't be at all sure as to the date of the fall hearings under the concurrent resolution, but it would come normally either at the end of October or early in November, and I would certainly do everything possible to have that meeting come after the election rather than a few days before.

MR. MACLAURY. That would ease to some extent that dilemma, as I see it, if that could be worked out. I think I would still stick with the suggestion, but I don't feel all that strongly about it.

A couple of points on John Balles's comments. I have felt, as I said before, that the moving base is a bit of a problem. Rather than taking a fixed basis, as John suggests, I've always been more sympathetic to the idea of starting our targets in terms of dollar levels, which do not move when the basis moves out a year.

And secondly, the market overreaction. I think Henry's put his finger on it exactly. It doesn't matter so much what kind of average we publish. I agree with Lyle that as a longer average it'll be largely ignored. But [it is] rather our method of operation, and so long as we pay as much attention to the funds rate as our [unintelligible] and hold it in its narrow range as we have been doing, the market will be very understandably but incorrectly looking to this linkage that we have ourselves created. I think the only way we can prevent overreaction to moves in the funds rate is to be less circumscribed in those movements ourselves. I just want to reinforce what Henry said.

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

MR. WALLICH. Mr. Chairman, I find your list of pros and cons very complete, and I find the cons more persuasive, that is, cons against reducing the M1 range now. I would supplement that by saying I think 5 percent real growth is not very much. I think there's room for more. As I view the expansion, there probably will be more, and I wouldn't want to do anything at this time to reduce the prospect of that. Now so much with respect to M1.

With respect to M2 and M3, one point that gives me a problem with your suggestion is that, after all, we aren't operating on expectations of what these variables will be, which may well be influenced by outflows from the thrifts. But these are supposed to be our instruments which we set, and if there are outflows from the thrifts, that seems to imply that we ought to take some action to keep the growth rate of those aggregates nevertheless at the level that we thought appropriate. The staff seems to think that, for alternative B, a gap of 3 percentage points between the growth of M1 and the growth of M2 is the expected relationship, and I would be reluctant to alter that.

CHAIRMAN BURNS. Let me just say a word about that. I want to be corrected if I'm wrong, but my understanding is that the staff struggled hard with that question and finally came up with the conclusion that probably [making] no change would be more consistent with leaving growth rates for M1 unchanged; but this was a very delicate decision for the staff. Is that correct, Mr. Kichline?

MR. KICHLINE. Are you talking about M1 or M2?

CHAIRMAN BURNS. Talking about M2.

MR. KICHLINE. That's right. Our best judgment provided a forecast for M2 that is just marginally below the current range, and we felt that under those circumstances the staff would not specify a change, but the tendency was for our forecasters to provide somewhat lower deposit flows rather than higher.

MR. WALLICH. Well, that weakens my case somewhat. However, I would apply reasoning to M3 that is similar to what you have applied, Mr. Chairman. I have no great faith in M3 as an instrument. I wouldn't attach as much weight to it as a symbol of the tendency to bring growth rates down--and I think that's a valuable symbolism--as I would to M1 and M2. I would be quite prepared to make a small downward adjustment in the upper [end] of M3.

CHAIRMAN BURNS. Thank you, Mr. Wallich. Mr. Black, may we hear from you?

MR. BLACK. Mr. Chairman, I end up exactly where you do on M1, and I carefully compared these “moving megaphones” and found that there is sufficient overlap, so that if I move my own thoughts down to a lower rate of growth, they could be accommodated by the existing specifications.

I do get bothered by these changing bases, and I think what John Balles said has a good deal of merit to it. I personally prefer the sort of approach that Bill [Hooves] suggested in the memorandum that Frank Morris provided us, where we [would] express the growth from a midpoint. I think that would be less misleading to the public. That’s something we want to get into in that longer session.

So far as M2 and M3 are concerned, I value your suggestion because I think it is desirable if we work these down over time. I am a little skeptical about interest rates rising as much as the staff projects. However, I think it’s at least possible that we might overshoot those, but I would still accept what you’ve got there. In their assumptions, the staff has provided for an increase in Regulation Q [rate ceilings], and if the rates do rise as much as they think, and Regulation Q [ceilings are] raised, this increases the chance that you’d get more growth in M2 and M3. I’m a little skeptical there, but I think the proper thing to do is to lower them even so.

CHAIRMAN BURNS. Thank you, Mr. Black. Mr. Volcker now, please.

VICE CHAIRMAN VOLCKER. Mr. Chairman, as often is the case, we have somewhat mixed signals before us in a number of respects. In terms of a business outlook, I find myself wishing to believe the staff forecast of prices, and maybe that we can do it, but I am a bit skeptical of whether the outlook is that good. And on the other hand, I share some of Mr. Eastburn’s skepticism about the plant and equipment side of things. And hearing so much talk along those lines from businessmen, I don’t have great fears that the business situation is going to run away with us on the up side.

In the light of all that--and in very general terms I’m not very eager to make changes now--but if I convert that into a short-run interest rate kind of feeling, I wouldn’t want to make any aggressive changes in the federal funds rate. But you were talking about long-term targets on monetary aggregates, and the problem here is the one that you mentioned. We start with this high base, and I’m left a little bit with the feeling that if we don’t change M1, we have in fact eased. I’m not terribly happy about that prospect, and I think it’s of some significance. I realize that, if you go back over a longer period, you can say we have not [eased] because we undershot in the previous two quarters. The only difference is, I was happy about the undershooting and I’m not so happy about the overshooting, so I do think this is a bit of a problem.

My own reconciliation of this is that we ought to lower the M1 ranges a shade on the presumption that this could be explained as not a significant change in policy or any change in policy at all from what we arrived at last time because we do start from a higher base. I do share the third point that I think you made, that you don’t want to give any real signal of a change in policy, and if I thought this was going to be interpreted as a real tightening, I wouldn’t be very happy about it.

So I guess what I would still like to do is get some shading in the M1 figure in the context of your April explanation that this is no real change and that we are adjusting for the overshoot. To some extent that would be only a partial adjustment in the first quarter. I'm consistent with not wanting to make a very great change in M2 and M3; I will be content with their ranges as they are because I think the major problem here is in M1.

Now you've kind of reversed that in the context of the long-range objective, in which [you express a concern] I certainly share, that we've got to get these things down. I'm left not feeling very strongly about which way we do it but I do feel we ought to get something down. I guess my preference would still be M1 on the presumption that you could explain this quite reasonably in terms of the change in the base, and if you think you can't do that, I am somewhat affected in my own judgment.

CHAIRMAN BURNS. Well, I must give you a thoroughly candid response. I think I can explain it to your satisfaction and even to my own. But I do not think I can explain it to the satisfaction of the general public, including the Congress and the international community.

VICE CHAIRMAN VOLCKER. Well, this is, I think, a relevant question, and I think it bears upon my own judgment here, but I think in general terms that's where I come out.

CHAIRMAN BURNS. Thank you, Mr. Volcker. Mr. Eastburn, may we hear from you?

MR. EASTBURN. I would like to subscribe to the views that Governor Wallich has expressed, and essentially I agree with the specifications under alternative B.

CHAIRMAN BURNS. Thank you, Mr. Eastburn. Mr. Partee, may we hear from you?

MR. PARTEE. Well, I just wanted to say I have two things. I accept the change in the base. I think we do this with judgment and it's not that we don't know what's gone before, it's simply that we don't have an arithmetic practice that averages out. I average the first and second quarters, and M1 growth was 5-1/2 percent exactly--a little below the midpoint. I averaged the period for the whole recovery, of the first quarter of '75 to date, and I got 5.7.

I must say, Paul, I disagree with you. I can't understand saying now that we are going to lower the range because of the second-quarter overshoot when we didn't do any similar thing when we had a large first-quarter undershoot. I might also say that the character of the second quarter was not the kind of thing that leads you to make an adjustment like that. If we would have had continuous strength throughout the second quarter, it would be one thing, but as it is, we had one month of large increase in April, and then May was moderate, and June was low. And to come out now and say, well, that adds up to an overshoot and we're going to correct for it, I don't think I could understand that.

And I also can't understand it in an environment where we have 7-1/2 percent unemployment, where we just had a GNP number released by Commerce--right or wrong--that was very much lower than it was before; and where you are utilizing only 80 percent of materials capacity, according to our new revised index of materials. It would be a very difficult thing for me to justify, so I feel very strongly against reducing the range that you specified. Now--

CHAIRMAN BURNS. Let me just interrupt to simply amplify what you said, actually. Here are the figures for M1, starting in March 1975, when we first begin making decisions under the concurrent resolution:

Between March 1975 and the second quarter of 1976, which includes the overshoot, the annual rate of growth was 5.6 percent.

From the second quarter of '75 to the second quarter of '76, it was 5.2 percent.

The third quarter of '75 to the second quarter of '76 was 4.5 percent.

The fourth quarter of '75 to the second quarter of '76 was 5.5 percent.

That overshoot gets lost.

VICE CHAIRMAN VOLCKER. I know. If I may just interject a question in here that I think lies behind this: Were you happy or unhappy with the overshoots or undershoots? And I happen to be happy with the earlier undershoots. If we had not had the overshoot last quarter, in fact to an extreme we had an undershoot, would Governor Partee, consistent with his position, be in favor of raising the ranges now?

MR. PARTEE. Yes, in the economic situation I would. But we don't have fortunately--

VICE CHAIRMAN VOLCKER. No, I understand but, consistent with your position, I think you would have to get a higher range.

MR. PARTEE. Now, in M2 and M3, Mr. Chairman, I'm a little uncomfortable with reducing the upper limit on those because, if not worded just right, it might be taken as an indication that we do not wish to see a further substantial recovery in housing--M3 particularly is associated in the public mind with housing. And the fact of the matter is that, with a 9 to 11 percent range in M3, there is plenty of money to finance anything that even I see in housing, much less the staff--

CHAIRMAN BURNS. To say nothing about the liquidity that has been built up.

MR. PARTEE. That's what has to be negotiated now. I am inclined to believe that Kichline's right, that we have high ranges here. And literally speaking, what we ought to do is to reduce the lower limit of the range because chances are, if interest rates do move up, we are going to fall below the lower limits of these ranges. I'm not quite prepared to do that partly because that I'm not sure interest rates are going to move up very much this fall. But a little move I think is probably justified. So, in short, I accept the overshoot, and I accept your specifications on long-range growth rates.

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

MR. MAYO. Well, Governor Partee has finally made my speech for me all the way down the line. I'm not troubled by the overshoot. I think that [unintelligible] should be more broadly

measured. I have the same uncomfortable feeling that Chuck mentioned with regard to the housing thing, but I see no great difficulty in explaining that to the general public.

I have a slight qualm as to the tactics. We did explain to the general public that one of the reasons for moving the M1 range down last time was that there were new factors coming into parts of M2 that were really M1 in a way, and that [there were] movements out of demand deposits--corporate sweeps and so forth. We are now silent on that subject, and it might look inconsistent to people who view our reduction of the targets on M2 and M3 and keeping the target on M1 as a reversal of the previous explanation. But I don't think that that should cause us any trouble.

I must say I find empty the suggestion that we make a change now because it would be hard to do a change three months from now. I don't consider that any of us around this table is capable of judging the precise environment in which this discussion will take place three months from now, regardless of when you may be asked to testify. I am quite willing to be a procrastinator on that particular phase of decisionmaking today, so I would support the recommendation you have made Mr. Chairman.

CHAIRMAN BURNS. Thank you, Mr. Mayo. Mr. Kimbrel, may we have your views?

MR. KIMBREL. Mr. Chairman, I guess [I'm] biased towards an anticipation of a stronger renewed expansion than would appear in some quarters. Associated with that is my continuing anxiety about general price stability and the concern for the difficulty that we could experience later this year with a necessity for a larger degree of firming if we fail to take some modest move now. I could accept these ranges you suggest without difficulty. If I had my druthers, though, I think I would prefer a half point reduction in [the lower limits of] M1 and M2 [as well as on the topside], resulting in ranges of 4 to 7 and 7 to 9-1/2.

CHAIRMAN BURNS. Thank you, Mr. Kimbrel. Mr. Coldwell.

MR. COLDWELL. Mr. Chairman, I came prepared for a further notch at the bottom of this, bringing [M1] down to 4 to 7 and [M2 down to] 7 to 10. I have listened to the discussion, and I have looked over the alternatives that the staff has prepared. If I could really believe alternatives A, B, and C, I have to say that the trade-off with the rate of inflation is not materially different, and the trade-off in the unemployment rate seems to be somewhat better. I don't feel the high 6 rate on unemployment is an acceptable rate for the long-range package we're [considering] through 1977.

However, I don't think the forecast takes into account the possibilities of new congressional stimulus, so I suspect we're going to get some there anyway. And consequently, I'm not quite so disturbed about that. I can accept the rates that you suggested with lowering the upper end. Actually I would prefer to lower the bottom end of the targets and leave the upper end where it was and provide a little greater flexibility.

But I do think Henry has put his finger on something [on which] we need to do careful analysis, and that is the stickiness of the federal funds rate. And I'm not being facetious when I suggest we might consider a zone of indifference in the federal funds rate as we do on the

monetary aggregates. Perhaps reduce our sensitivity to some of the overshoots and undershoots on monetary aggregates and the sensitivity of the market to a particular rate.

CHAIRMAN BURNS. All right, I thank you. I'll just comment on the last. There may be a good time for experimenting along those lines, but I would hate to do it in any immediate future because you can upset the markets, and no one can be sure of the consequences of a zone of indifference for the federal funds rate. The consequences could be very serious in financial markets. They could be beneficial over the long run, but I would anticipate a difficult learning process.

MR. COLDWELL. We have enough upset with the changes in the market in reaction to what we've been doing over the past 90 days.

CHAIRMAN BURNS. Yeah, but you know the minor wiggles in the market make headlines today and they're forgotten tomorrow. The same thing might happen under your suggestion. Well, I think it's a thoughtful comment, and we ought to consider it and have it studied by our own staff, and possibly we ought to [bring in] some market specialists to discuss various possibilities and get their reaction. And we would do that without indicating anything about our specific thinking since we can discuss a range of possibilities and get their reaction. They'd have no way of knowing which way we want to come out, or perhaps we ourselves at that time wouldn't know the way we want to come out. We want to learn. Well, thank you very much.

MR. WINN. Mr. Chairman, when are you testifying on this?

CHAIRMAN BURNS. On the 27th of this month. I think it's this coming Tuesday. That's a week from today.

MR. WINN. I was thinking that, while we adjust to the second quarter, the market is going to adjust to the latest reporting data that we give out on the aggregates.

CHAIRMAN BURNS. Well, the market will when I testify--when will the June report be released, Mr. Broida?

MR. BROIDA. The June report gets released this Friday. It will be July 23.

CHAIRMAN BURNS. No, that will be pretty much on the minds of some members of the [congressional] committee, and its staff will examine this report undoubtedly, and questions will be passed on to members of the committee. In fact, I will have to reread that report myself for preparation.

MR. WINN. How do you show no change in policy under those circumstances, because we are kind of hung either way we move. It's kind of a lose-lose situation. If you really go back to the second quarter, it would indicate that we ought to move a little bit. On the other hand, I expect it would be easier to explain that we kept the percentages right where we had them. This week's data plus the June data are the things they're going to look at.

CHAIRMAN BURNS. There will be talk all over the lot, I'm sure. I hope to be adequately prepared.

MR. WINN. I'd stay with it. I think what Chuck Partee--

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

MR. GARDNER. I would encourage you to have more debate about this federal funds rate issue in the substitution for other evidence in the [unintelligible]. I may be at odds with most of my colleagues on this. You know, the federal funds rate can go from nothing to what have you depending on the supply of federal funds in the market, and I think an exercise to try to remove market curiosity from our actions will probably be futile. But I'm not so certain of my own views that I don't think we all will benefit by some further discussion, because many of us have expressed concern about the markets' sensitivity to our actions in the federal funds market, etc. I would welcome that, Mr. Chairman.

Number 2, I have to say, Bruce, that in matters of the kind we are discussing today, with the pause that none of us really believes [exists] in the economy, I just can't believe [the argument] that it's an appropriate time to act because it's easier now than it may be later, when we [are] a little more persuaded of exactly what our consensus view is. Sure, we've got a pause in the economy, let's be sure we don't have a real pause in the economy. In summary, Mr. Chairman, I'm very persuaded by Governor Partee, and I associate my remarks with his that we stay where we are.

CHAIRMAN BURNS. With regard to M1 or also on M2 and M3?

MR. GARDNER. Well, I'm not as sensitive to lowering the upper limit of M2 and M3, and I'm willing to accept that.

MR. PARTEE. I do, too.

MR. GARDNER. I thought you did.

CHAIRMAN BURNS. I thought you did, but I wasn't entirely sure. Thank you, Mr. Gardner.

CHAIRMAN BURNS. Mr. Baughman.

MR. BAUGHMAN. Mr. Chairman, it seems to me that it should be possible to characterize the conditions in alternative B--which are essentially the same as those described in your recommendation--as a no-change posture, and it seems to me that's what the current environment really calls for. And I'm for not extending it beyond that.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Would anyone else like to speak?

MR. JACKSON. I would like to add just one more reason for reducing the limits on M2 and M3, and that is the changing financial technology that has been discussed here today. It would make at least logical [sense to] say that, as these other measures become substitutes for

transaction-type purposes, they will naturally be more closely equated to M1, which we have long thought of as [a] transactions measure [of money].

CHAIRMAN BURNS. It's an increase in velocity.

MR. JACKSON. So therefore, for that reason, the rates of growth are not as necessary to sustain [given] patterns of activity, and that would encourage us to at least bring [those rates] down slightly.

MR. ROOS. Perhaps I should understand--if we were to take a position of maintaining the same ranges and apply those to the first quarter base instead of moving it up, would that signal to the public and to the markets a greater degree of restraint? In other words, that wouldn't give the same impression that we're holding the line?

CHAIRMAN BURNS. I think that would be the reaction. But what would trouble me more is that we would be charged with altering our techniques--manipulating to choose one base at one time, and the other time we choose another base. That would be most unfortunate. Now, we may want to change our procedure, but if we do it [unintelligible] that would hold for an indefinite future, and the indefinite future may be simply, oh, another year or so or two. But we would be charged with manipulating and chicanery, and I'm so sure of that.

Now we're going to be charged by some with being stupid because of the overshoot. I don't mind that nearly so much as the charge of chicanery. We can survive a charge of stupidity, particularly if we're confident that our basic policy is right, as I do, because that charge will not last. But in a world that has become so suspicious, particularly of government officials, and with so many critics of the Federal Reserve charging us with secrecy and what not, I would be terribly concerned about a charge of manipulation.

MR. BLACK. Mr. Chairman, as I indicated earlier, I subscribe to what you say, but there have been columnists that have accused us of that in situations like this. Some of the more sophisticated ones will say, for example, that we have really eased up more because we are starting from a higher base now. For this reason, I prefer the sort of thing they'll approve as suggested, which is hard to explain.

CHAIRMAN BURNS. I do think that we will have to do more explaining this time, perhaps, than we have in the past to minimize this interpretation or criticism. We can't prevent it or eliminate it. If we were God's angels on earth, we wouldn't minimize it beyond a point.

Well, gentlemen, I think we are ready to do some voting. I think that the majority of the Committee favors leaving the range for M1 where it is, but I think we ought to test that. Will the members of the Committee be good enough to indicate whether they are reasonably content with leaving the range at 4-1/2 to 7.

MR. BROIDA. Ten.

VICE CHAIRMAN VOLCKER. I'm reasonably content if we are going to reduce some of them.

CHAIRMAN BURNS. Well, we do these one by one, and then we can take the package together. Now there's more--it's somewhat less clear about M2--though I think that, looking at the summary, the majority seems to favor a range of 7-1/2 to 9-1/2, which means reducing the upper limit of M2 by 1/2 a percentage point. Let's have a show of hands on that range, 7-1/2 to 9-1/2 for M2.

MR. BROIDA. Eight.

CHAIRMAN BURNS. And again, I think a clear majority seems to favor a range of 9 to 11 for M3, which would mean a reduction of the upper limit by 1 percentage point. Let us test that. The range of 9 to 11. How many would be reasonably content with that?

MR. BROIDA. Eleven.

CHAIRMAN BURNS. I think we are ready for a formal vote then. Well, I'm advised by Mr. Broida--whose counsel I invariably take, but other members of the Committee need not follow me, obviously--that we have not voted on the longer-range targets formally in the past, and by implication we should not do so at the present time.

MR. PARTEE. I don't understand why; however, I'm repeating history by saying that. The same thing came up last time.

CHAIRMAN BURNS. I must say I hear the explanation each time, and I understand it when it's made, but I forget it a minute after.

MR. WALLICH. Mr. Chairman, it seems to me that, for those who might like to dissent, [we should have] some way--not, perhaps, in the way of formal votes--to leave the record clear.

CHAIRMAN BURNS. All right, now, Mr. Broida will state his reasons, and we will go on to Mr. O'Connell.

MR. BROIDA. Mr. Chairman, the last time this was discussed it was pointed out that we have a suit in court under which we may be ordered to release our specifications immediately. It was also pointed out that you testify typically a week after the meeting, and that if we were to vote on these formally, we would be releasing the long-run specifications the week before your testimony. Now, of course, the Committee is free to vote on it anytime. But that was the consideration that led to the decision not to vote formally last time.

CHAIRMAN BURNS. Well, they sound like convincing reasons. I didn't recall that at all. Mr. O'Connell.

MR. O'CONNELL. Mr. Chairman I heard that that was the earlier explanation given, and it had no [unintelligible], and there's no reason why there couldn't be a vote on these long-range figures. At the same time, there are modes of announcing a dissenting position other than the vote--the point the Governor made. I see no need for a vote for accommodating Governor Wallich's point.

CHAIRMAN BURNS. What is the judgment of the Committee?

MR. GARDNER. Mr. Chairman, you've had a majority vote, if we can trust the Secretary's count, which I'm sure we can, and I was waiting for Mr. O'Connell to say what he said. It seems to me that those who wish to express the dissent on any one of these particular issues [may do so], since we've already determined that the majority of the Committee concurs with the long-range target.

CHAIRMAN BURNS. I have some difficulty with that. In the monthly policy record, we record dissents on formal votes only.

MR. BROIDA. The distinction is whether the people who disagree with these long-run targets would be named. If there is no formal vote, we would indicate that three members favored a different long-run range. And we'd use today's discussion as a basis for that. If there's a formal vote, they would be named.

MR. PARTEE. Well, I must say, Mr. Chairman, I don't find the arguments very persuasive. We don't have a court decision. I think if we had court decision it would apply to every specification we had: the funds rate, the short-range target for the Ms as well as the long-range. And if we had to as a matter of fact, I'm inclined to think that there would be less public damage from reporting, say, our funds rate specifications for the very next period.

And so I just don't find anything [about] the long-range expectations that is so much more sensitive than the short-range that we should have this special system, and I do believe that there should be an opportunity for a Committee member to dissent from long-range specifications because he doesn't think it is [what] the economy needs, and therefore I think we should introduce a vote on this.

MR. JACKSON. There's a legal question only. As pertains to this meeting that we're having right now, is there any likely prospect that a court would order the immediate release of this vote prior to the testimony scheduled for the 27th?

SPEAKER(?). Quite frankly, the answer is no.

MR. JACKSON. Then I would like to suggest a pragmatic solution, that the decision be made [for] this meeting to go ahead and have the vote because the possibilities of damages or consequence are sufficiently remote as to not outweigh the merits, apparently, of some people's wishes to dissent.

CHAIRMAN BURNS. Let's see whether we have a practical problem or not. Assuming that we took a formal vote, would any member of the Committee be definitely inclined to dissent from a decision to have M1 at 4-1/2 to 7, and M2 at 7-1/2 to 9-1/2, and M3 at 9 to 11?

VICE CHAIRMAN VOLCKER. Let me make a comment in general. I wouldn't be inclined to dissent for this one. I would be perfectly happy to have a discussion that reflected some of the varying considerations, but the actual vote somehow puts you in a more rigid position than maybe the discussion in this particular case justifies. So I can see some advantage in not having a vote, but the particular reasons cited [for not having a vote] don't seem any more persuasive to me than to Governor Partee.

CHAIRMAN BURNS. I think in view of the apparent path that no one is clearly inclined to dissent at this meeting, I would suggest that we not have a formal vote today but that we give the most serious consideration to having a formal vote in the future.

MR. COLDWELL. I don't have any problem with that Mr. Chairman. I do think that it seems strange that we don't have a formal vote on long-range targets. We're having it announced as being future policy.

CHAIRMAN BURNS. We tested the opinion of the Committee, and apparently there will be no dissent, but one or another of us may still change his mind, and I would leave that to a later meeting and proceed today the way we have thus far this year. But I don't feel strongly on the issue. I think the considerations I have in mind, without spelling them out, are rather obvious. How many would want a formal vote today? Members only. How many would prefer a formal vote today?

MR. BROIDA. Two, Mr. Chairman, three.

CHAIRMAN BURNS. Well, let's postpone that in view of the majority sentiment. And I do think we ought to move toward formal voting. I agree with Mr. Partee and Mr. Coldwell. Who's the third one? Mr. Balles.

Well, how many would be in favor, in principle, of formal voting, not as of today but in the future. All right, I'm with you completely on it. I would prefer not to do it today.

Well, all right, then, I think that we had better break for lunch and come back and pick up the shorter-run targets and the directive. If we try to do it now I think we might hurry and rush it. I think some of you will want to catch a plane, and you may have made arrangements; therefore, 2:15.

[Lunch recess]

CHAIRMAN BURNS. Gentlemen, there's one item we have to return to in connection with the longer-range targets, and that is a growth range for the credit proxy. I suggest that we proceed as we did last time and leave that decision to our staff--that decision to be consistent with the money growth ranges that we've agreed upon. Is that suggestion agreeable? I hear no objections; we'll proceed that way.

Now, we should hear from Mr. Sternlight on what the Desk has done recently. Mr. Sternlight, please.

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

CHAIRMAN BURNS. Thank you, Mr. Sternlight. Are there any questions?

MR. WALLICH. On your nonborrowed reserves exercise, I thought that the idea was not to look through to the aggregates, but here, if I've understood you correctly, you implied that you

had been operating on that basis. Is that because you concluded that it isn't feasible not to look through?

MR. STERNLIGHT. Well, we try to envisage what the Committee might want us to do. It seems to me it's been the case right along that one could pursue this with different degrees of rigidity. In this case, we thought that it would have been more in keeping with the Committee's desire if we were to look partly through and not tighten against the background of weaker aggregates.

MR. WALLICH. Well, I regard it as a hopeful development, given that the experiment, it seems to me, has not worked all that well. Do you feel you are exploring a path to better performance there?

MR. STERNLIGHT. Well, I think we were trying to envisage how we would actually have operated, on the assumption that the Committee likes to make its moves, I think, in deliberate and gradual fashion and not shock the market with sudden new innovations. This seemed the more reasonable approach to a change in technique rather than something that would abruptly change the rules of the game.

CHAIRMAN BURNS. Yes, Mr. Black.

MR. BLACK. Peter, there were three things that struck me this morning in the news that might have significant effects upon the market's expectation regarding interest rates. And I wonder if you could comment on that--one is a sharp drop in gold prices; [second] another sharp plunge in futures prices in a number of commodities; and then the third thing would be the release of GNP figures somewhat lower than I think the market was probably expecting. Will this have much impact, do you think?

MR. STERNLIGHT. I think all of those could be in a direction of moderating inflationary expectations--I don't know that they would be of enormous impact. The markets were about steady this morning on the early reports that we got. I think the GNP number was just about in line with what had been anticipated in some earlier guesses about the second quarter. So, I think it's in the direction of moderating inflationary expectations but no large impact anticipated.

CHAIRMAN BURNS. All right, any other questions or comments? If not, we need to ratify the operations of the Desk. Is there a motion to that effect? Motion been made. I hope it's been seconded. It actually has been seconded. I hear no objection.

Now, does the Bluebook raise questions of a kind that we need to turn to an economist to clarify? Or does the Bluebook answer its own questions? Or are the difficulties of the sort that no economist can help us on? We have an economist standing by, ready to answer questions on the Bluebook. Are there any?

All right, we will proceed then to our domestic policy directive and to its specification of the monetary aggregates and the federal funds rate for the month ahead. Who would like to speak first? Mr. Coldwell please.

MR. COLDWELL. Mr. Chairman, I'd be perfectly willing to stay with alternative B the way it's written.

CHAIRMAN BURNS. Very good--

[NOTE: Several members, including Balles and Black, indicate their agreement.]

MR. JACKSON. Same.

CHAIRMAN BURNS. Well, I'm going to be a little unhappy. The federal funds rate now is at 5-1/4. I, for one, would not like to see it drop by 50 basis points over the next month, nor would I like to see it rise by 50 basis points over the next month. And as for the growth ranges [of the monetary aggregates], I'd like to see these upper limits just slightly lower than specified, but my feelings there are less strong than with regard to the interest rates. Mr. Mayo, then Mr. Volcker.

MR. MAYO. I have the same feeling you do, Mr. Chairman, on the ranges for the aggregates. I think 4-1/2 to 8-1/2 in B is too high. The 4 to 8 under alternative C is all right, but I wouldn't even mind shading that a little bit. I don't see any necessity of placing our upper limit any higher, really, than 7-1/2 as a practical matter. However, I would keep the federal funds rate range of 4-3/4 to 5-3/4, but I would adopt the money market directive wording, which I think would work in the direction of keeping the rate closer to the 5-1/4 percent, where it is now.

CHAIRMAN BURNS. Thank you. Mr. Volcker.

VICE CHAIRMAN VOLCKER. I'd start the other way around on interest rates, as I guess you did, and I preface my comment with a note that our own projections in New York of the aggregates are lower than the Board's, as they were last time. Last time, reality, of course, came out lower than both by a considerable margin, but against the longer-range background, I wouldn't like to see the federal funds rate going down to 4-3/4 percent, and unless things really went haywire, I wouldn't particularly like to see it go below the 5-1/4 that we are at now. A range of 5 to 5-3/4 might summarize the view; it puts the midpoint a little above 5-1/4.

CHAIRMAN BURNS. Well, we could [have] asymmetry, you see. That is, 5-1/4 being considered as the central rate, it could go down to 5 or go up 5-3/4. We've done that before. I don't see any difficulty in doing it, if that were the wish of the Committee.

VICE CHAIRMAN VOLCKER. The ranges [for the aggregates], I feel a little bit trapped with [them]. We just set some long-term ranges, which we are below, so you could argue the logic is to let them go up a little bit in the short-run to get within the ranges we just established. I would not press the logic--not having agreed with putting the range that I would prefer, something like [in alternative] C, which spreads the long-term range that we have. And it doesn't make it quite so likely that we would be pushing interest rates further down for a temporary period. So I would [favor] something like the C ranges on aggregates. And more of a downward constraint in the federal funds rate; and a money market directive.

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

MR. PARTEE. Well, Mr. Chairman, I think there's a good possibility that July is going to be a strong month for the monetary aggregates. We started the month, as the newspapers reported, with a very strong week, and it seems to me quite conceivable that what we have was a surprising June sluggishness in the money supply that was associated with the change in the fiscal year, and that July will begin to bring back that strength. Therefore, I think that the Committee ought to be alert to the possibility that as it drops these ranges on M1, it thereby increases the probability of moving up in whatever federal funds rate range is specified. I guess I could [accept] the 4 to 8 M1, but I don't think I'd like to drop it as far as President Mayo, down to 7-1/2. We could have a somewhat lower M2 range, though I don't know that that's so significant. As far as the funds rate is concerned, I don't see any reason to prejudge, to have a nonsymmetrical--

CHAIRMAN BURNS. The only point about that is, if we were to adopt the suggestion--this is hypothetical--to have a range of 5 to 5-3/4, the midpoint would be 5-3/8, and therefore it means an immediate or an early increase to the central point, and why do that?

MR. PARTEE. Well, then, let me respecify. I don't see why we should allow for more room on the upside of where we are now in the funds rate than we do on the downside of where we are now because I can't say, given the economic information and the reasons for the behavior of the aggregates, that there's more prospect of moving in one direction than another in the short run. Therefore, I would prefer the 4-3/4 to 5-3/4, perhaps with an understanding that we're not going to use the far ends of range.

CHAIRMAN BURNS. Well, but we've agreed not to do that. The range that we specify is the range that we should be ready to use unless there is some significant factor that will lead us--

MR. PARTEE. Well, then, I would be prepared to pick 5 to 5-1/2, but I find it a little odd, since just this morning we were talking about the need to have more variation in the federal funds rate.

CHAIRMAN BURNS. That was one view expressed.

MR. PARTEE. Well, I think it was pretty generally, a lot of people want to subscribe to it--

CHAIRMAN BURNS. Oh, no--

MR. JACKSON. Let me ask a factual question of the Desk, Mr. Chairman. Would you move to the limits on the federal funds range unless the aggregates were clearly outside the ranges?

MR. STERNLIGHT. Well, I think our approach there has been to observe a zone of indifference within which we don't make any move at all; then as we see the aggregates moving toward the tops or bottoms of their ranges, making some move in the federal funds rate; and at the point where the aggregates are reaching the extremes, then going to the top or bottom of the funds rate range.

MR. PARTEE. So even if they were right up at the extreme, you would expect by the end of the period to have a funds rate right up at the extreme?

CHAIRMAN BURNS. That's the rule under which we operate.

VICE CHAIRMAN VOLCKER. I'd like to throw a suggestion in that I was tempted to make last time on precisely this point, and I'm rather sorry I didn't, in retrospect. The way you weigh M1 [relative to] M2 is somewhat troublesome. But it seems to me that, in some circumstances, and this may be one of them, one way of approaching it would be to say you don't move to the extremes unless you get confirmation in both these measures. That if M1 or M2 went above or below the range, that in itself wouldn't push you to action until it's confirmed by the other moving in the same way. Last time, I guess we had M1 going below the range whereas M2 stuck within it, and in fact was above the midpoints

CHAIRMAN BURNS. Well, now wait. M2 revived only toward the end of the month.

VICE CHAIRMAN VOLCKER. Yes, revived toward the end, I agree. For a while it was below the middle--

CHAIRMAN BURNS. Well below the middle.

MR. PARTEE. It was never out of the range, though, as M1 was.

VICE CHAIRMAN VOLCKER. It was never out of it. For a while it was low, and then it actually got back in the high side of the range.

MR. STERNLIGHT. No, just to the middle, it didn't get to the high side.

VICE CHAIRMAN VOLCKER. The middle range--

CHAIRMAN BURNS. I have some difficulty with that. You know, we must not become too mathematical, too mechanical. We must leave some elbow room to the Desk. We should avoid excessive fine tuning. I think our instruction to the Desk recently has been to give approximately equal weight to the two. We leave it to the Desk to interpret that. I would rather do that than proceed by more mechanical formula.

VICE CHAIRMAN VOLCKER. I agree with all the sentiment you're expressing, and I guess I think it's less mechanical than doing it the other way, on occasion, leaving some discretion to the Desk at the same time. I feel you get kind of a mechanical averaging here which may not always be suitable to the--

CHAIRMAN BURNS. Well, I also have the feeling that we ought to stay with a certain rule for a little while until misery, frustration piles up, and then we go to another rule, and misery and frustration pile up. We shouldn't change from month to month.

MR. PARTEE. I don't quite understand the logic, Paul, of waiting until both [M1 and M2] are out [of their specified ranges]. It seems to imply a knowledge as to the effect of the behavior of these aggregates on the economy that I, at least, don't have.

VICE CHAIRMAN VOLCKER. Oh, I think either way, that's--

MR. PARTEE. I know, but you know--

VICE CHAIRMAN VOLCKER. I don't profess any great knowledge of the behavior.

MR. PARTEE. I take it you're saying that not only M1, but M1 and M2 must be beyond the bounds; or not only M2, but also M1 must be beyond the bounds.

VICE CHAIRMAN VOLCKER. Because maybe you get shifts between the two, as we had said at ample length this morning. You know, how do you interpret it when one's going in one direction and the other in the other direction? Is an arithmetic average really better?

CHAIRMAN BURNS. Gentlemen, we want reach a decision, and who would like to express--we haven't heard from many members of the Board. Unless others want to speak, I'm going to make the suggestion that we adopt the alternative C ranges for M1 and M2 and a range of 5 to 5-1/2 for the federal funds rate. And if we do that we ought to have a money market directive. But last month we decided to be illogical; I think being illogical now and then is defensible, but to be illogical month after month is a little harder to defend. So if we took a narrow federal funds rate, I really think we ought to have a money market directive.

MR. PARTEE. But then it's hard to explain why it is we changed it. You have the same funds rate range last time--that is, the same half point and we called that a monetary aggregate directive and now with the same range we call it a money market directive.

MR. MACLAURY. Two wrongs don't make a right.

SPEAKER(?). It's more flexible.

VICE CHAIRMAN VOLCKER. Frustration's built up.

CHAIRMAN BURNS. I think an explanation can be worked out. It wouldn't make anybody happy. Yes, Mr. Balles.

MR. BALLEs. Mr. Chairman, since I was about the fourth one, I guess, to follow Governor Coldwell's proposal for alternative B as written, I've really got to say something on that federal funds range to the effect that a half point is, in my opinion, far too narrow. Those of us who served on the Subcommittee on the Directive ended up with a pretty firm conviction that overly close management of the funds rate was leading to these undershoots and overshoots. And I'd like just to see a better balance between the two. I'd settle for a 1 point spread, but when it gets down to a half, I really feel very uncomfortable, and for some of the reasons that Governor Wallich was speaking to this morning.

CHAIRMAN BURNS. Well, speaking for myself in the present environment, I could live even with a narrower range. Why do we want oscillating interest rates in the present environment? What advantage would we gain? Why not wait until trends clarify?

Now, we talk about the federal funds rate, but there are people in the marketplace who see fortunes made and fortunes broken and business thriving or business slumping as a result of these interest rate movements. Now, we ought to be sure of our ground before we take moves with regard to interest rates. Markets have gotten into a mechanical habit, unfortunately, and we are responsible for it. [First, the] federal funds rate moves, then the whole family of short-term interest rates moves, then three weeks later or some interval like that the prime rate moves; in the meantime the stock exchanges react. Are we doing something constructive by bobbing up and down? Well, these are my doubts.

VICE CHAIRMAN VOLCKER. Well, I have the same feeling. I'd just add to that, Mr. Chairman, that I think, inevitably, whether we like it or not, we give a pretty strong signal if we move by more than a quarter here in either direction. And the market is going to interpret it as a strong signal, and I don't think this is the time for strong signals.

MR. EASTBURN. Mr. Chairman, I certainly think this discussion reinforces your comment this morning that we need to have a session where we discuss this at more length--

CHAIRMAN BURNS. --and when we are less tired than we are this afternoon. I think we should plan for that--

MR. BAUGHMAN. I have to register a little different view, I guess, and fill in also an observation that at least some of the bigger bankers in the Southwest think that, in view of the loan demand situation, they are looking at interest rate weakness rather than interest rate strength for the immediate future, whatever that is. And it seems to me that if we embrace a very narrow or point interest rate target, we are in effect saying that we can predict interest rates--that is, what would be the normal path of interest rates in this uncertain economic picture--with greater accuracy or dependability than we can predict most any of the other great array of economic variables.

That--along with John Balles's observations that historically, at least, riding the funds rate fairly tightly seems to have imparted greater volatility to the aggregates--would lead me to urge--though I can't vote on it--that the Committee conclude that there should be a fair amount of range on the interest rate so that the Manager could begin to respond to sizable or cumulative deviations from the objective on the aggregates. It seems to me that, historically at least, it would seem to have given us a little better record. That leads me also to have sympathy for a monetary aggregate directive rather than a money market directive.

CHAIRMAN BURNS. Thank you.

MR. WALLICH. I can see many reasons why one would want to narrow the funds rate now, but the consequence of doing that is that one increasingly gets married to a narrow funds rate range, and the problems that come from that escalate. Each time it becomes more critical not to have the funds rate go too far; more short-run [unintelligible] effects come from that, and there is probably never a good time to broaden the funds rate [range]. Therefore, I believe that we ought to accept this painful discipline and stay with least the 1 percentage point range; 4-3/4 to 5-3/4 looks right to me.

MR. BLACK. Mr. Chairman, I pointed out a couple of years ago that there seems to be something of a seasonal aberration in the figures in the third quarter, when we typically get a decline in the rate of growth of M1, M2, and M3. We may not get it this year, but I would be surprised if we get quite the strength in the aggregates that some people think we may get, and I would like a little more leeway to move [the federal funds rate] down if, in fact, the aggregates do come in weaker.

MR. JACKSON. I would argue, Mr. Chairman, that now would be a good time to broaden the range. Using M1 as an example, we see April at 14.9, May at 6.4, and June at negative 1.2. If July and the projections for August would indicate something below the 4 we're discussing, I would argue that 1/2 point would not be too much.

Conversely, if we see the figures for that period going back into the 8 range, I would argue that a 1/2 point on the top side would not be too much. Because if we see the figure coming in low, it would tend to substantiate the June experience, which we really have some question about, and properly so. Conversely, if we see them coming up in the high range, this would tend to add validity to the April-May trend we saw and [imply] that June was in fact a statistical or maybe some other freakish type of situation that was not reflective of the underlying strengths. And therefore I would argue that using the full range would be a good thing to do under these circumstances.

CHAIRMAN BURNS. Even if the variations in growth rates reflected in large part merely movement from the public to the Treasury and [then] back from the Treasury to the public?

MR. JACKSON. To a certain extent the Desk has offset those by its actions.

CHAIRMAN BURNS. Yeah. I think this is perhaps a very large part of the explanation. Why should we [unintelligible] some markets if that is what is going on? Well, that is just a question.

The afternoon is drawing on. I'm moved to reflect a little on the time interval. Here we are, we meet once a month. We've got to do something during that month. Now if we met every three months, which is what this Committee did some years ago, we could have a pretty wide federal funds rate range. But meeting once a month, and when there is some uncertainty as to which way things may move, do we really want to see-saw markets? That's my doubt. This is going to be the Committee's decision. I've expressed my views. Who else would like to speak?

MR. WINN. I think that, since our posture this morning was to indicate no change, I'd hope that our short-range objectives could be in the same sort of a pattern. Therefore I've been associating myself with B, pretty well as given, and [with] the aggregate approach rather than the money market approach at this time.

MR. MACLAURY. I'd like to associate myself with Henry Wallich's point, and Phil's likewise: a zone of indifference. I don't think we are debating it now, but that's the direction in which I would like to move; maybe a half a point fed funds rate zone of indifference.

It seems to me that the Wednesday phenomenon is instructive in this connection. The market did not react at all, as far as I know, to the fact that the funds rate got out of our supposed

range of concern on Wednesday because they know that we don't react, and it doesn't mean anything. And I would think that that could gradually be broadened to be not just a Wednesday phenomenon but a Monday through Friday phenomenon within a more limited band. My own preference here--if we were looking for a compromise, [then] a compromise to me does seem like a 5 to 5-3/4 federal funds rate this time. That may not be totally consistent, but it's working out.

CHAIRMAN BURNS. Well, I'd be entirely happy with that.

MR. GUFFEY. I think, with respect to the funds rate, that 3/4 percent makes me feel better; 5 to 5-3/4 is a good range. I would like to point out--I guess it's obvious to everybody--that if we talk about alternative C, which would be my option, we are actually increasing the aggregate limits for M1 and M2. That is to say, for last month, they will be published as being 3-1/2 to 7-1/2, and we're talking about an alternative C of 4 to 8. I don't know how the market reads that or what it leads to, but my preference would be alternative C with a 5 to 5-3/4 range on the federal funds [rate].

CHAIRMAN BURNS. Any other?

MR. GARDNER. I think that narrowing the band gives me some concern. Just being totally pragmatic, I impute a public reaction to levels of interest rates perhaps more than [unintelligible] because of my prior experience. I would not want to see us up at 6 or down below 5. Therefore, I think there's some rationale for not narrowing the band but staying at 5 to 5-3/4 even though that is not symmetrical in terms of what we'd like to achieve; I think that the psychology of a 6 percent steady funds rate or something like that would be much too dramatic [unintelligible].

MR. PARTEE. I didn't understand Steve's point. We've been at 4-3/4, we've been at 5-3/4, why do you want to skew the funds range?

MR. GARDNER. I don't.

MR. PARTEE. You said 5 to 5-3/4. I myself much prefer 4-3/4 to 5-3/4, giving a range of 1 point.

CHAIRMAN BURNS. We are really talking about very small differences.

MR. COLDWELL. With a 5 to 5-3/4 range your midpoint range is 5-3/8, and presumably the Desk would move to that.

CHAIRMAN BURNS. No, you could have asymmetry.

MR. COLDWELL. Then you change the ground rules upon which the Desk operates.

CHAIRMAN BURNS. Well, we've done that.

MR. COLDWELL. We've done it in the past, but I thought I just heard you [say] you didn't want to change.

CHAIRMAN BURNS. Well, I meant that I would, I don't think we ought to--well, let me not try to explain that. I think that we've done that in the past, and that [is] something we may or may not want to do today.

VICE CHAIRMAN VOLCKER. Seems to me we lose a little sight, Mr. Chairman, of the one thing we are sure of--which is that these aggregates in this short-run perspective move very erratically. You haven't got any idea whether they are going to the upper end of the range or the lower end. They're likely to break one or the other.

MR. PARTEE. I think you have a little idea. We know that they started out being strong. There would be some presumption that it's going to be strong.

CHAIRMAN BURNS. I think that's a fair observation.

MR. JACKSON. I do, too.

CHAIRMAN BURNS. Gentlemen, I think that we are first of all discussing minute differences; second, I sense fatigue all around this table, and therefore let me test one or two ranges and see what the thinking of the Committee, or the inclination of the Committee, may be--I don't know how much thinking we're doing anymore.

I'll test the following: 4-3/4, 5-3/4, 5-1/2. Now those who would prefer 4-3/4 to 5-3/4 as against the other two possibilities [for the federal funds rate], members of the Committee, would kindly raise their hand.

The other question--4-3/4 to 5-3/4 is one possibility; let me call it A. B is 5 to 5-3/4. C is 5 to 5-1/2. Now if you are undecided you can raise your hand twice. If you are still undecided you can raise your hand three times. Mr. Broida will have an accurate arithmetical count. Those who would prefer A kindly raise your hands. Eight. Those who would prefer B kindly raise their hands. One. Those who prefer C kindly raise their hands. Two. Well, I think the majority of the Committee prefers a range of 4-3/4 to 5-3/4.

Now, I don't think we need to do much testing on monetary growth ranges. I think that sentiment ran largely in favor of the magnitudes specified under alternative C. How many would be more or less content with the ranges under alternative C for M1 and M2?

All right, next we have to decide on [whether] we prefer the money market directive or the monetary aggregate directive. I think that in view of the federal funds rate range, the argument now tips in the direction of a monetary aggregate directive. But let's have a show of hands [of] those who would prefer a monetary aggregate directive as over against a money market directive. Eight.

Well, there is one small change in wording that I would like to make. This is on line 5 of the draft of the directive. Instead of saying "an apparent leveling out" in the rate of inventory accumulation, have it read "little change" in the rate of inventory accumulation. Any objection to that?

MR. COLDWELL. Between the first and second quarter Mr. Chairman? I thought we had some evidence of rather sizable change in the inventory accumulation rate.

CHAIRMAN BURNS. Very small, very small.

CHAIRMAN BURNS. So we'll vote on the following: The monetary aggregates directive and the range for M1 of 4 to 8; a range for M2 of 7-1/2 to 11-1/2 percent; and the range for the federal funds rate of 4-3/4 to 5-3/4, and we will give approximately identical weight to M1 and M2. Any questions? Apparently not. We are ready to vote.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	No
President Balles	Yes
President Black	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
Governor Jackson	Yes
President Kimbrel	Yes
Governor Lilly	Yes
Governor Partee	Yes
Governor Wallich	Yes
President Winn	Yes

CHAIRMAN BURNS. Now, item 9 on the agenda--in view of the absence of the authors of the memorandum on operations and Fannie Mae securities, the authors being Messrs. Axilrod and Holmes, I think we ought to postpone it. Gentlemen, I think we have done our business for the day.

END OF MEETING