TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

June 20, 1978

Prefatory Note

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

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

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

Staff Statements Appended to the Transcript

Mr. Pardee, Deputy Manager for Foreign Operations
Mr. Kichline, Associate Economist
Mr. Sternlight, Deputy Manager for Domestic Operations
Mr. Axilrod, Economist

<u>Meeting of Federal Open Market Committee</u>

<u>June 20, 1978</u>

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, June 20, 1978, at 9:15 a.m.

PRESENT: Mr. Miller, Chairman
Mr. Volcker, Vice Chairman
Mr. Baughman
Mr. Coldwell
Mr. Eastburn
Mr. Gardner
Mr. Jackson
Mr. Partee
Mr. Wallich
Mr. Willes
Mr. Winn

Messrs. Balles, Black, Kimbrel, and Mayo, Alternate Members of the Federal Open Market Committee

Messrs. Guffey, Morris, and Roos, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis, respectively

Mr. Broida, Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist

Messrs. Burns, J. Davis, R. Davis, Ettin, Keir, Kichline, Paulus, Truman, and Zeisel, Associate Economists

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

Mr. Kalchbrenner, Associate Director,
Division of Research and Statistics,
Board of Governors
Mr. Siegman, Associate Director, Division
of International Finance, Board of
Governors
Mr. O'Brien, Special Assistant to the Board
of Governors
Mr. Smith, Chief, Financial Markets Section,
Division of International Finance, Board of
Governors
Ms. Farar, Economist, Open Market Secretariat,
Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat,
Board of Governors

Messrs. Balbach, Boehne, T. Davis, Eisenmenger,
Scheld, and Sims, Senior Vice Presidents,
Federal Reserve Banks of St. Louis, Philadelphia,
Kansas City, Boston, Chicago, and San Francisco,
respectively

Messrs. Brandt and Broaddus, Vice Presidents,
Federal Reserve Banks of Atlanta and Richmond,
respectively

Mr. Ozog, Manager, Securities Department, Federal
Reserve Bank of New York

Transcript of the Federal Open Market Committee Meeting of
June 20, 1978

[Secretary's note: Prior to the start of the meeting, a group photograph was taken.]

CHAIRMAN MILLER. We do have a busy day and I am going to once again ask your cooperation in trying to stick to the subject matter and I'll try to do the same. Before we begin, I want to call to your attention a letter I received from Chairman Henry Reuss about the possibility of raising the long-run ranges for the monetary aggregates. I call it to your attention because I'm sure that when I testify in July he will be anxious to know that you have received this and considered it. And, of course, our ranges will come up for consideration in July.

I would also mention that I have some concern about how we establish the ranges for M1 in July as we look ahead twelve months, realizing that on November 1 the automatic transfer regulations go into effect and M1 is going to change in some unspecified way. It's going to be very difficult to guess how to establish ranges for a measure that's going to be drifting on a string in the period. Whether or not it would be wise, possible, desirable, or agreeable to temporarily suspend the ranges for M1 until we can find out what's happening, I don't know. But it's something you might think about because otherwise we're just guessing. We don't know whether the change is going to be x or y.

MR. MORRIS. There's another problem, Mr. Chairman, and that is that there is a cyclical variation in the relationship of M1 to M2 and our present range structure reflects the kind of relationship that you typically get in an easier money period. As money tightens, the rates of growth of M1 and M2 tend to come together and we have not recognized this, I think, in the present structure. It seems to me that we ought to. That's another issue, which works in the opposite direction of this one.

CHAIRMAN MILLER. Yes. Any thoughts along these lines, if you'd like to share them with us before the next meeting, would be appreciated because I think it is going to be a tricky time for the establishment of these ranges.

The first order of official business is to approve the minutes of the actions taken at our FOMC meeting on May 16. I think you've had the minutes and, unless there are any corrections or additions, I will record them as approved. Hearing none, we will assume you've done your usual good job, Mr. Secretary, and gotten concurrence. [We move on to] foreign currency operations and a report on the activities since the last Committee meeting. Scott Pardee.

MR. PARDEE. [Statement--see Appendix.]

CHAIRMAN MILLER. And the attitude is different [depending on] which way you are going. Would you repeat [the figure] so that we all have it for the total amount of purchases of marks--Treasury and Federal Reserve--for the period?

MR. PARDEE. $879 million.

CHAIRMAN MILLER. Dollars?

MR. PARDEE. Dollars.

CHAIRMAN MILLER. Thank you. Any questions, comments?

MR. PARTEE. We ought to commend the Desk for a very good job.

CHAIRMAN MILLER. Well, we don't know. Compared with what? You're just impressed with the numbers; you're not impressed with [unintelligible] they've done a good job. Henry.

MR. WALLICH. Scott, how is the program going--that we buy moderately but as regularly as we can?

MR. PARDEE. That's why I stressed that we bought $200 million worth of marks in the market and that we've acquired over $100 million worth of marks through our agency, the BIS, or the Bank of England on days in which the dollar was steady or firming in the European market.

MR. WALLICH. What percentage of days would that be, approximately, in this last period?

MR. PARDEE. We've been in a period in which the dollar has been declining on more days that it was rising so I think it was maybe five, six, seven days--or a quarter to a third of the days.

CHAIRMAN MILLER. Our next action is to ratify the transactions in foreign currency operations since the previous meeting. Is there any dissent from that action? Then we will consider that action approved. [Next is] consideration of the Manager's recommendations with respect to foreign currency operations. Alan.

MR. HOLMES. Mr. Chairman, as Scott has noted, we have made good progress in repaying our System D-mark debt, particularly the drawings of the earliest maturities--those drawings [totaling] about $800 million that we incurred last October, November, and December. They have all been repaid. We are now working against the drawings incurred in January, which will be coming up for a second renewal in July. Specifically, there are ten swap drawings up for second renewal by July 26, totaling $448 million and one drawing for $35 million up for first renewal. As you know, the Bundesbank had earlier agreed to second renewals of swap drawings maturing in April, May, and June, all of which have been paid off. They have now agreed for second renewals of swap drawings maturing in July, should we not be able to pay them off by maturity. I should note that the swap arrangement with the Bundesbank has been in continuous use since October 5 and any swap drawings that we renew in July for 3 months, even those incurred this year, will lead to a situation in which the swap line will have been in continuous use for more than 12 months. Paragraph 1C of the authorization specifies that any drawings shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn unless the Committee, because of exceptional circumstances, specifically authorizes a delay. To me, this 12-month limit applies to the actual drawings on the line rather than to the line itself. The language is somewhat ambiguous, however, and to avoid any misunderstanding I think the Committee should recognize that these second renewals could result in the continuous use of the swap line--not drawings but the line--for more than twelve months. We would, of course, make every effort under current arrangements to repay the swap debt in full by October 5th.

Finally, Mr. Chairman, at the last meeting the Committee reduced the net open position limit under paragraph 1D of the authorization to $2 billion to conform to the pace of our swap repayments. With our swap drawings having been reduced by another $500 million to just over $1 billion, it would be appropriate to reduce the limit by $500 million. Accordingly, I recommend that the net open position be reduced to $1.5 billion. That's all I have, Mr. Chairman.

CHAIRMAN MILLER. Thank you, Alan. You have recommended two actions. One is to approve the renewals of drawings with July maturities and the second is to reduce the [limit on the] open position [in paragraph 1D] of the authorization to $1.5 million. Any questions or comments? Any dissent from those actions? Hearing none, we will approve those two items. Thank you very much, Alan. I do concur that the Desk has been operating quite successfully during this period.

The next item is the matter of revisions to the procedural instructions for foreign currency operations and this involves a report of our ad hoc subcommittee. Henry, I believe you are the Chairman of that subcommittee and you circulated a paper. [Do you have] any particular comments or should we go directly to the revisions that are recommended?

MR. WALLICH. I think we might go to the revisions, Mr. Chairman.

CHAIRMAN MILLER. I think you all have Attachment A, a strike-through [version that shows the] changes that are recommended.

MR. WALLICH. I can summarize.

CHAIRMAN MILLER. Would you please?

MR. WALLICH. We are [proposing] essentially six things. First, as you know, we want to get rid of the gross transactions limit, which has proved cumbersome in active trading. There is a reason for it, namely that the limitation on the Manager of not being able to change the overall open position by more than $100 million a day and $300 million in the intermeeting period is ambiguous. He could make very large transactions, reversing totally the entire position from plus to minus, even though he couldn't do intermediate-size transactions that would change the position moderately. He is very unlikely to do that, but it was just procedurally defective to have such a provision. If we should ever get audited in this area by the GAO, which I assume we will not, it would become apparent that our procedures were not watertight. So to replace the gross transactions limit, which is to be dropped, we add the net position. The net position refers to positions in a single currency and is taken with respect to signs that make a difference whether we're long or short whereas the overall [limit] makes no distinction between being long or short; it's just the measure of risk. By adding the net position and giving the Manager the same right--$100 million a day and $300 million between meetings--we have relatively simple numbers. They are the same as on the overall open position. At the same time, we make the regulations watertight and prevent a Manager who was going haywire from making very big changes that would be possible under the overall open [position limit]. Then we add a restraint on substantial trading. The Desk has found that it can achieve desirable market effects by making a two-way market--offering bid and ask deals--and that can add up very rapidly to large transactions without changing the net position very much if at all. So in order to make sure that when that happens we do have a control, it is also entered into the procedural instructions that a Manager must communicate that.

[Also, we have proposed] two minor things. We say "operation" now where in the past we have said "transaction." Transaction presumably refers to any single $5 million affair. Operation means a kind of campaign undertaken to achieve a given objective and it seems more meaningful to have the Desk communicate on operations rather than transactions. And finally we adjust the authorization, which is the more fundamental instrument compared with the procedural instructions, so that we refer there now to the [net] position rather than the [open] position. It's a terminology change that seems to make sense if we say "open" for something that involves risk and "net" for something that is merely a position without indicating whether it actually involves an open position or not.

MR. PARTEE. The proposal is that it be net.

MR. WALLICH. The proposal is that it be on the net position. The overall open [position] is the major risk measure and the net is in a single currency, taking account of sign--either way. In other words, plus is not the same as minus but on the open [position] plus is the same as minus.

We've also sent you a set of papers on disorder. It was not possible to be very precise in defining this. The term is used all around the world and everybody is very careful always to claim that he is intervening only to counter disorder, not to influence the rate. We have found that disorder is a fairly flexible term but disorder can [have] a cumulative aspect. So if rates as a result of [changes over] a series of days move continuously in one direction, one can regard this as a disorderly market and accordingly intervene to overcome that.

CHAIRMAN MILLER. Thank you. The action that is being requested is the approval of the amended procedural instructions, [shown in] Attachment A, and the amended paragraph 1D of the Foreign Currency Authorization in Attachment B. Are there any questions? Comments?

MR. PARTEE. I wonder if the Manager has any comments on these proposals.

CHAIRMAN MILLER. Alan, do you have any comments on these proposals for change?

MR. HOLMES. Well, Mr. Chairman, I never have felt the need for written procedural instructions because I felt there was a joint understanding between the Committee and the Desk about how we did things. But I have no objections to what I hear. I do find some slight problem with the fact that the overall net limits of $100 million and $300 million are exactly the same as those for any one currency. That means we're going to hit one of them before we can get past either of them. In other words, if we hit $100 million on the overall, that means we only have $50 million on an individual currency. That concerns me some, but we can live with it as it is.

MR. PARTEE. I was wondering particularly, Alan, about [what seems to be] rather a term of art in subsection C, any operation that might generate a "substantial" volume of trading in a particular currency.

MR. HOLMES. This is something that we would normally report all the time, whenever it happens. This is the language that I think Scott himself had suggested and it's nothing that would bother us.

CHAIRMAN MILLER. Scott, did you have any comment?

MR. PARDEE. No. I was just saying that we would work this out in close consultation with the Board's staff. Remember the day on which we did exceed the gross transactions limit? We had consulted; we had informed the members of the Subcommittee that an operation was under way that would lead to substantial operations. We just didn't pin it down by asking for an approval.

MR. PARTEE. My only point, Scott, is that "substantial" means different things in different contexts.

CHAIRMAN MILLER. You have the other limits so you do know almost where you are. Any other comments? Is there any dissent from approving these recommendations? Hearing none, they are approved. We move from foreign currency to the economic and financial situation and outlook, and Jim Kichline has a report.

MR. KICHLINE. [Statement--see Appendix.]

MR. ROOS. May I ask a question? I'm confused about the interrelationship of some of the figures in the Bluebook and some of your Greenbook projections. It's my understanding that your nominal GNP projections in the Greenbook, for example, are based on money and interest rate projections in the Bluebook. Just to use an example, you project for the first quarter of 1979 nominal GNP growth of 11 to 12 percent and in the Bluebook, if I read it correctly, under alternatives A and B M1 growth is projected at maybe 2 to 2-1/2 percent for the last quarter of 1978 and interest rates are up in the area of 9 to10 percent for the last quarter of 1978 and the first quarter of 1979. How could you conceivably, unless you have almost an unrealistic projection of velocity growth, anticipate the sort of GNP growth that we're talking about early next year with M1 growth of 2 to 2-1/2 percent and these other Bluebook projections? Is there a relationship between those?

MR. KICHLINE. Yes, we make a strenuous effort to have a relationship between the two. As I noted, the forecast of the GNP is based on the low interest rates that are in that range [shown in alternatives A and B]. It's a 9 percent funds rate and in the first quarter of 1979 we have an 8-1/2 percent Treasury bill rate. So in terms of the mechanism for which we have impacts on GNP in our forecasting process, we believe it works through interest rate channels and that's critically important. The problem that you're focusing on is one of the policy Q1-to-Q1 in which you have a burst of money in Q2 and then in order to achieve 5-1/4 percent [for the year] one has to look at significantly lower rates of growth over the three remaining quarters. Now, one of the problems here, among many, is the question of the extent to which velocity would be growing without any interest rate pressure. And the staff forecast for some time has assumed that there would be additional slippage in the money demand function, which we had experienced from mid-1974 through the first quarter of 1977. More recently, however, that has not occurred so that's an open issue. If it didn't occur, you'd have higher interest rates--at the upper end of the range or perhaps even higher. That's one problem. Another difficulty relates to the fact that we do have in the second quarter a much higher level of money stock than would be expressed in a 5-1/4 percent range and the extent to which that higher level of money stock would be sufficient to finance transactions and economic activity, for example, into the third quarter without much interest rate pressure, I think is an open question. But looking at the past would suggest that there is room to experience some velocity growth in the shorter run without having substantial further increases in interest rates.

MR. ROOS. Jim, do you look at the output of your model or do you do a certain amount of subjective wishful thinking?

MR. KICHLINE. Professional judgment we like to call it! We use two approaches. The forecast that you're looking at is the staff projection; it's what we refer to as a consensus forecast. It is heavily reliant upon judgment of individual sector experts as well as combining that [with other] inputs. One of the inputs is indeed a model run which we do each and every time and from which we tend to modify our judgmental projections. So what you're looking at is a consensus. If you look at our model, what you would find if you specified, for example, the interest rates that we have, is that you have to have a substantial further downward drift in the money demand function in order to achieve the GNP forecast that we currently have. If it did not continue to drift down, then you would experience higher interest rates or, more likely, lower real growth and lower activity.

MR. BLACK. I just had in mind a question, Mr. Chairman. Jim, were there any significant revisions in the GNP figure or just minor ones?

MR. KICHLINE. We had a number of minus 0.4 percent rate of growth and it's now 1.0. The implicit deflator went from 7.1 to 7.0 and the fixed weight from 6.5 to 6.2. There are a number of small revisions throughout. This is normally a time in their revision process when they get final data, or virtually final data, on the foreign sector. And the national income accounts basis of net exports of goods and services was reduced by $1 billion; instead of $24-1/2 billion, it's $23-1/2 billion. So, there are small changes throughout.

MR. WILLES. I'd like to come back for just a minute to the little dialogue between Jim and Larry. One of the things that's obviously going on now is that the econometric relationships in most of the models we have don't work as well as maybe they have in past times. But one of the reasons for that is because it's not possible to model effectively the way people form expectations and then the decisions they base on those expectations. And it's not at all inconceivable to me to have--and I think you gave up too easily, Jim--

MR. KICHLINE. I didn't give up.

MR. WILLES. It seems to me that if in fact you had higher interest rates, there is a way in which that might be perceived in the world as reducing the expected rates of inflation, and that would have a rather substantial positive impact on investment and other forms of spending and, therefore, a rather positive impact on real growth. For that reason I'm not sure, even if we have higher interest rates than you're assuming in your forecast, that that automatically means lower real growth. It depends on the context in which that takes place. If it takes place in an environment where those higher interest rates are perceived as having a moderating impact on inflation, then the impact on real growth could be neutral or it could be positive. I'm not sure we will know until we get there, but it's not at all clear to me that higher interest rates automatically mean that real growth will be smaller, particularly in light of--

CHAIRMAN MILLER. How do you handle housing on that?

MR. WILLES. Well, housing is a very difficult sector; [its performance] depends a lot on what happens to Regulation Q ceilings and the impact that has on financial flows. I will readily admit, however, that if interest rates escalate significantly in a short period of time, housing will have a difficult time sustaining itself. It would still be possible, however, to have that compensated for and then some by business and other types of spending. Jim commented that one of the reasons we don't see business spending coming along the way we'd all like to see it is because of the uncertainty and so on associated with inflation. If we could really do something--as we might have the possibility of doing--to change that perception, then it seems to me we could have a rather vigorous growth and be [unintelligible]. I'm not predicting that but I think that's--

MR. ROOS. If you have to hold down money growth, though, to 2 to 2-1/2 percent in the last quarter of this year in order to give that reassurance that we're doing something about inflation, doesn't that have an effect on GNP growth early next year? In other words, there are two factors--interest rates and money growth. And if we crunch down the money growth to 2 to 2.3 percent, which are the projections in the Bluebook--I have many doubts about whether we'll do that--to give reassurance to the world of our determination to deal with inflation, I question whether that wouldn't have an effect of reducing GNP.

MR. WILLES. I guess all I'm saying is that I'm not really sure. That may well be the case. But I think one can make an argument that under the very special circumstances we face, we could get quite a different reaction than one would normally expect.

CHAIRMAN MILLER. May I suggest a procedure? I'd like to have this continue for a while but I'd like to cut it off at some point and do a round robin, as we did the last time, and get the comments from everybody, if you don't mind. So I'll run through a few more comments here and then I'd like to [move on]. Last time we went clockwise; this time we'll go counter-clockwise. Steve, do you want to make a comment?

MR. AXILROD. Well, I just wanted to mention this: Mr. Roos indicated that [the figures he cited] were the projections in the Bluebook, but they are simply the results of arithmetic. That is, if the Committee is going to achieve a 5-1/4 percent growth [in M1] Q1-to-Q1, that's the arithmetic of it. Next quarter, depending on the Committee's attitude toward the high rate of growth in the second quarter--whether it compensates for it or not--those rates are [likely to be] substantially higher.

MR. COLDWELL. Jim, this gets down to your judgmental forecast. Where is your strongest level of confidence in this forecast--in the GNP or inflation? Or to put it the other way around, where is your weakest level of confidence?

MR. KICHLINE. Well, I think it's a fairly risky forecast in lots of ways. On real growth, my gut feeling would be that if this is an inappropriate forecast, given the conditions, the odds would weigh very heavily on the downside rather than the upside. On inflation, I think it's the other way around with serious concern about going into 1979. I noted just this morning that the postal workers were reported in the papers to have started out with a huge request [in terms of wage increases.] It was worked down from that, but that's sort of the nub of the problem. I think on inflation this forecast right now is a good one. Of the forecasts I've seen, we rank on the high side of most outside forecasters on inflation--I think for good reason. I think the odds are pretty much favoring the current forecast we have; but again, if it's wrong, I think inflation will tend to be higher rather than lower.

MR. COLDWELL. Second question. If I understand you correctly, this forecast is based on the 5-1/4 percent midpoint of the target range. If it were based instead on the 7-1/2 percent actual we've been achieving over the past period of--I forgot what it is but let's say this last 18 months or whatever it is--where would you be coming out on the GNP and inflation forecasts?

MR. KICHLINE. I would tend to raise the real growth, I think, perhaps back into the area where we were months ago. I'd put the number surely over 4 in the short run. We're talking about a time horizon here that is just to the second quarter of 1979 but for the short run I'd say it would have a more favorable impact on real growth.

MR. COLDWELL. You call that short run. [Do you mean through] 1979 or are you talking about "short run" through the rest of 1978?

MR. KICHLINE. No, I'd say our forecast is really short run. If we begin to talk about the impact on real [growth] and inflation, the problem here is the differential effect. On the fourth quarter impact, I think you can look forward to something like one half of a percent or more on real growth assuming what happens is that we get lower interest rates out of that. If the relationship that we specified in the forecast is right--so that 7-1/4, for example, results in lower interest rates than we have assumed in the forecast--on inflation, I think it might add another quarter or something like that over the next year but you'd have much more adverse impacts as you go out to three years. So, I think you change the rules of the game. But it hinges importantly on whether we've specified correctly this money demand, interest rate, and GNP relationship.

MR. PARTEE. I just wanted to confirm, Jim, the figures for May that you cited. Although they are below the earlier figures in the year, they are still pretty high. The production index is an annual rate of increase of more than 7 percent. Nonfarm employment is growing at 175,000; that's more than 2 million a year. I see the retail sales in May were 4 percent above the first quarter average, which is a 16 percent annual rate of increase. It's going to take a significant further moderation in those growth rates, I take it, to be consistent with the GNP projection for the third and fourth quarters.

MR. KICHLINE. Not much I don't think. But you're right, some further modification.

MR. PARTEE. You mean to say that a 4 percent GNP will be associated with more than 7 percent in production?

MR. KICHLINE. No, you mixed up a couple of things there. One was a quote of the average sales ratio in May over the first quarter. Part of the problem here in Q1, Q2, Q3 on GNP is again arithmetic and not economics. You're going to have a very high second-quarter average level of activity. So to get a large increase in real GNP in the third quarter would require substantial further growth

MR. PARTEE. Well, perhaps I should have mentioned that, but what about production and employment?

MR. KICHLINE. I would expect that production would edge down a bit further. But I think I phrased it--I know on production I did--that developments still involved large or healthy rates of increase but I said I would read into these numbers that we did indeed experience something that was transitory and we are now on a path toward slower real growth.

MR. BAUGHMAN. Mr. Chairman, I would like to ask Jim what kind of reaction he would have to the proposition that rather than the current high level and rapid rate of growth in consumer installment debt setting the stage, as it has in earlier periods for a number of years now, for a slower rate of growth in debt and/or maybe an actual decline in purchases of consumer durables that we might be seeing now instead a basic cyclical change. Could we be seeing a phenomenon reflected in a change in consumer attitudes based primarily on a gradual embracing of the idea that inflation is probably a permanent part of the environment? So over a period of time, we might see an acceleration in the rate of purchasing durables both in anticipation of continued price increases and a willingness, or maybe even a desire, to carry more debt and less dollar-denominated assets, which would be similar to what we seem to have been seeing in residential mortgages. And, therefore, we might--or that there's at least a fair chance--toward the latter part of this year not be looking at a weakening in the demand for consumer durables but possibly a maintenance or maybe even an acceleration in demand for consumer durables.

MR. KICHLINE. I think you've raised an issue that is very important and one that's difficult to sort out. Again, it hinges on consumer expectations and I think the evidence available in the short run from survey reports and what's going on in the auto market, is suggestive of the substitution effect--the desire to acquire real or durable goods. I would expect that to be short- lived, though, in the sense that the rate we're looking at is well above anyone's expectations, including, I think, most of the major manufacturers. The reports there would indicate some slowing from this pace. The question is to what pace and what would be the underlying rate of growth thereafter. You would, I take it, raise the issue that perhaps it's higher than we thought before. That's possible. In the housing market I think one can make a stronger case because a house can be viewed as an investment and there is a secondary market that's well-developed. If you get into other kinds of durable goods--washing machines or whatever--it's difficult to develop a secondary market. I think cars you can talk about in terms of an investment. If one were looking at consumers who anticipated a major outlay, the tendency would be to accelerate that purchase. And that in the short run should tend to hold up outlays--perhaps for the balance of the year, as you suggest. I am increasingly concerned, though, about the debt side. Look at these numbers again. The issue was raised about a year and a half ago and over the last year and a half the debt has grown tremendously. And I believe that will result in some lessened capacity and willingness to take on major outlays. The issue here is what happens to income growth to support that debt burden. If indeed income growth fails to keep pace with inflation and increasing tax burdens, I think it will act as a dragging influence; that, indeed, is what's built into our forecast.

MR. MAYO. Mr. Chairman, I have great sympathy for the staff's dilemma here. My interpretation of what you might call the wishful thinking department of it, however, relates not only to what Larry described as wishful [thinking] but rather to the assumption that has been forced on them by us of the 5-1/4 percent M1 growth central point. The model, as I recall the figures, comes up with from Q2 this year to Q2 next year an increase of only something like 2.3 percent in real GNP. And what I would call their more real-world model in the Greenbook comes up with an average of 3.8 percent. I think this is a much more realistic model. But to tie it back to 5-1/4 percent involves straining staff credibility in a way that I think we should all be aware of. Really, to me, we're talking about a consistency of the real GNP forecast with more like a 6 percent M1. I don't think we have to go as far as Phil's question suggested, to the most recent 18-month period, but I think we should view realistically the assumption. Really, we're assuming 6 percent [M1 growth] here in moving from the model to the judgmental forecast. I think this is supported by what Larry pointed out--that we have a rather absurd set of figures in terms of velocity to tie to the money supply figure estimates for the last quarter of 1978. I was just wondering if the staff would care to comment on what I just said.

MR. KICHLINE. Thank you.

CHAIRMAN MILLER. Do you need any more answer to that, Bob?

MR. MAYO. Well, I guess not.

CHAIRMAN MILLER. Three more comments; then we'll do a go-around. Henry Wallich.

MR. WALLICH. I'd like to make a suggestion, which really follows in the footsteps of what Bob and Larry have said. This is a very artificial performance where three different kinds of unlikely assumptions have to be made in order to get a halfway presentable result--namely, that the demand function for money shifts, that Regulation Q is raised again, and that interest rates remain at the lower level of the estimated range. All these things are not likely to happen at the same time. It's a purely formal exercise. I wondered if we could not authorize the staff to do the following in addition to [not] instead of what they are doing now: simply assume that the 5-1/4 percent midpoint growth rate that follows from our M1 range [goes from the current actual level of M1]. Likewise the M2 midpoint would be employed on the basis of where we are with the money supply so that the overshoot is in essence integrated into the existing money supply rather than trying to come back on track as, of course, the exact observance of the targets would require. We could do two projections, perhaps--one the rigorous one and the other with this modification. We would get a better answer to Larry Roos's problem.

CHAIRMAN MILLER. Any reaction?

MR. KICHLINE. I think it may cause some potential problems in looking at the Bluebook and trying to maintain and develop a consistent financial and real forecast. I think perhaps one of the ways to go about this is to discuss in greater detail the implications of the assumption. And for major variables, if there are significant problems developing, perhaps [it would be helpful] to provide the Committee with information using an alternative forecasting technique.

CHAIRMAN MILLER. Yes, rather than do the whole thing. I think that's right.

MR. WINN. Two comments, Mr. Chairman. First, one inconsistency that I have trouble identifying is that if you look at freight truck traffic it doesn't really seem to relate to the other measures of economic activity that we have. Has something gone wrong in those measurements?

MR. KICHLINE. The answer is, I don't know. We have someone looking at this. This was called to our attention in the Redbook, in which transportation is discussed; freight cars, for example, are mentioned as in very short supply. So I don't have an answer to that, but we will be checking into it.

MR. WINN. You'd think that inventory would pile up or something if you look at production figures and those other things. My second comment is that I think it's important in terms of cyclical behavior in the future to look at the dissimilarities from what we've had in the past. For example, take the housing problem. As we look ahead, if financing does tend to pinch off that activity, it would be occurring at a time of the lowest vacancy rates since World War II. This could in some ways be salutary in terms of the price impact, perhaps some offset by Q or some other factors here that may not be altogether bad. We looked at other cyclical behavior. I think you'll find a difference in terms of the structure of the real economy now versus other kinds of excesses that have given rise to cyclical behavior in the past.

MR. BALLES. Is this the go-around, Mr. Chairman?

CHAIRMAN MILLER. No, you're the last commenter before the go-around.

MR. BALLES. In terms of the outlook, it's terribly difficult, as I think we all recognize, to really judge what inflation expectations are going to do, especially to the consumer sector. We're somewhat less optimistic, frankly, than the Board staff. We've done something like Larry's people evidently have done; we've looked at the difference between the Board's model output and the judgmental forecast. I'm not saying that the model outlook is the thing you should rely on. In fact, I'm glad you do apply judgment to the econometric forecast. But it's true, if we read the numbers right, that more than half of your increase in consumption spending is a judgmental outcome and not what the model is telling you. In a nutshell, we're less optimistic about the economy starting with late this year and going into 1979. While this gets into a lot of methodological detail, a part of the result stems from the fact that for a year or a year and a half now my staff has been convinced that one gets somewhat better results, though not dramatically better results, from forecasting the economy on an M2 basis rather than an M1 basis. We circulated a paper to this group, I think it was 18 months ago, to that effect and we're still getting similar results in the ongoing experiments.

So, looking at the projection of M2, we come up with a somewhat less optimistic economy starting late this year. To be quite specific about it, by the time we get into the first half of 1979, the real growth the Board's staff is showing averages 4.2 percent for the first half of the year. We have less than half of that, at 1.9 percent. And we think most of it's going to be in the consumption sector, with the principal explanation of that being that we're afraid the inflation expectations factor is going to cut deeply into consumer spending. There's already been quite a rise in the saving rate if we look back four or five quarters. I think what is happening in the Board's forecast, Jim, if we interpret you right, is that you're borrowing some consumer spending in effect by counting on the saving rate going down. We're not certain that's going to happen. That's where I think the big differences come between the outlooks of our two staffs.

MR. KICHLINE. If I may comment, it is quite correct that it is borrowing in some sense and that can't be done forever. The only other comment I would make is that the Board's model --I can't remember the quarters [exactly but] I think for something like the last 5 or 6 quarters has underestimated significantly the consumption spending that has taken place. So in terms of the difference between actual and projected, the judgmental forecasts have been much closer. That doesn't mean it's going to be that way in the future, which may be a totally different environment. But that has been an equation causing difficulties.

CHAIRMAN MILLER. Thank you all very much. Now we'll have a go-around and I hope that each of you will comment on your own views and the views of your staff organization on the outlook for real GNP, prices, and unemployment. And note any other factors that you want to mention regarding the 1978 Q2 through 1979 Q2 period. Paul, we'll start [with you].

VICE CHAIRMAN VOLCKER. First, I would just observe, Mr. Chairman, that we see more optimism--a better feeling on the part of businessmen that have reported to us--than we've seen in a long time. I don't have the sense that this is leading to great changes in spending plans, though there may be some acceleration of what they were doing. Certainly they have no big inventory plans but they do seem to be feeling better [about the outlook] despite the fact that when I look analytically at the figures I think we're in for a slowdown all right, along the lines that the staff has projected. But I also think that it could be lower than that. It's just hard when you analyze these figures to see where much new thrust is coming from; and consumption doesn't seem to me likely to provide the leading edge. The investment surveys are certainly not ebullient despite a little better tone of conversation of businessmen as I observe it. Home building has no place to go but down, I suspect; it's just a question of how much. And government isn't doing anything all that different from what it has been doing. So I share the view that has already been expressed by several people that the staff forecast may indicate the general direction of things or, if anything, may be a little bit on the high side.

I would share the view that if the money supply were really going to be as tight as the targets suggest, it's then very hard to see the business picture being as strong as projected. I assume that that practice [of using the midpoint] might be relaxed somewhat. We'd do well to hit the top of our range instead of the midpoint over this period. Now, this outlook doesn't particularly disturb me, I hasten to add, if that's all it is--a slowdown in this area. We could use it on the inflation side and we could use it on the balance of payments side. It would concern me a bit if, in the event, this kind of slowdown were to coincide with a slowdown abroad. I'm not projecting that but I don't think it's impossible; and then we might be in trouble. We might begin interacting at each other and our balance of payments isn't going to improve under those circumstances. That prospect does concern me. I think it's worthwhile when we're slowing [unintelligible] to somehow or another get Europe rising faster and Japan continuing to rise. If that doesn't happen, I think we're going to have problems. I hope it does happen. So I suppose, on balance, I'm a little less than the staff [on GNP growth] and I'd be a little more pessimistic than they are on the inflation figures. Maybe those two are related.

CHAIRMAN MILLER. Any specific numbers, Paul?

VICE CHAIRMAN VOLCKER. [For] the second quarter to the second quarter, I'd be closer to 3-1/2 percent or below in terms of GNP growth. For the GNP deflator, I think probably you're talking 7-1/2 percent, anyway, and for unemployment around 6 percent.

CHAIRMAN MILLER. Thank you. Phil.

MR. JACKSON. I don't guess my attitude has changed much over that I expressed last month. I'm perhaps more optimistic on the short run than the staff forecast would indicate, but I'm not as optimistic over the long run. I do feel that we're in the usual situation [in terms of the attitude typical of] most North Americans. No matter how well you do, somebody wants [you] to do better. That's not bad; I'm not condemning that attitude, but we're in that situation economically where no matter how well we continue to do and how well we do in the current quarter, somebody wants the next quarter's figures to be good and strong, too. I think that's unlikely. However, I do sense a great deal of momentum going forward--perhaps more and more momentum than otherwise one would expect. Sectorally, I think we are entering a period of speculation as a consequence of inflationary pressures. It's hard to identify. It hasn't shown up yet in business inventories--[at least not] that we can clearly identify. I think it's obviously reflected in consumer expenditures and consumers' willingness to take on additional debt. Automobiles seem to be the best example of it. I would expect that trend to continue [going] forward. And everybody talks about the housing sector, although we're really only talking about $100 billion out of $2 trillion, so you have to put it into perspective.

CHAIRMAN MILLER. That's the first time I've heard "only" $100 billion!

MR. JACKSON. Well, we're talking about 5 percent of the total and we're talking about a reduction of maybe 10 percent of the 5 percent. So you really have to wonder whether you're getting excited about things that aren't that significant in terms of the level of total activity and that's more my concern. If I had to push some arbitrary number--I couldn't prove what I'm about to say but if I had to guess--I would say that from the second quarter to the second quarter we probably will see something in the 4 percent range, with the early part being stronger than we expected and the latter part being weaker than we expected.

I continue to be very pessimistic about inflation. First, I think we will do the proper thing here, namely that we will look at the real economy rather than our arbitrary monetary rates of growth. And I think that's proper; anything less than that would be grossly improper. So for that reason, despite our public relations campaign about monetary aggregates--and again I'm not critical of that but we're going to have to face the real world--I think that we will do whatever it takes to make sure we don't create a problem ourselves by arbitrary or numerical slavishness. We have to face the fact that that is not going to create any inflationary shock. Second, I think it most unlikely, whatever the consequences, that we will see any major changes in fiscal policy that will have an impact on inflation. Third, I don't see the American public yet willing to pay the prices that it will be required to pay to do anything substantive about this--whether it's the postal workers or many other groups.

Let me just tell you one quick story. The Nebraska bankers were here, Roger. I asked the roomful here who was willing to step forward and in their own bank and in their own way try to do something specific about wage inflation and price inflation. There was not a single banker willing to do anything, and in every case they said "we're grossly underpaid." If we once catch up, then we'd be willing to be responsible. It's the same story you get everywhere.

MR. PARTEE. Like the labor unions.

MR. JACKSON. Absolutely. The point I'm making is that there is no difference between management and labor when it comes to "my ox is being gored." They all have the same attitude and for that reason I think--

CHAIRMAN MILLER. Unlike the Federal Reserve family.

MR. JACKSON. Absolutely. We're part of the problem, too. What I'm really saying is that I am not optimistic that we're going to be able to do anything. For that reason I think the instabilities that will result toward the end of the year are likely to [remain] with us and it could be costly.

CHAIRMAN MILLER. Phil, do you have a number on prices?

MR. JACKSON. If I had to guess, I'd say 7-1/2 percent. Unemployment probably would go up by the year-end.

CHAIRMAN MILLER. Over 6 percent?

MR. JACKSON. By the end of the year. If I had to guess, I'd say 6-1/2 because I think the participation rate will go up but it will be difficult to maintain employment levels at the end of the cycle.

CHAIRMAN MILLER. Thank you. Chuck.

MR. PARTEE. Well, if I had to present a standard forecast, my forecast would be very much like the staff's. I think it's a safe forecast and a reasonable one. Not only that, it's not much out of line with other forecasts. But I have to say that I think I'm much closer to Phil Jackson than I am to the staff forecast. And I do believe, although it's all right that we put the numbers out, that we ought to talk about the process. The process is not developing well at this stage. I think there's a substantial risk of a period of speculative exuberance and influence in the period immediately to come that would be followed by significantly weaker conditions, probably within this year that Philip's talking about. So the average, looking second quarter to second quarter, might not be that much different from the staff forecast, but it might be associated with substantially higher inflation than the 7 percent rate forecast for the second half and substantially higher GNP growth than the 3.4 percent rate that is forecast for the second half of this year.

MR. MORRIS(?). Would you elaborate on what you mean by "speculative exuberance"?

MR. PARTEE. Well, I sort of agree with Ernie that consumers are going to stay in there and buy for a longer period because they'll figure that it's their last opportunity to do so in what looks like an inflationary environment. I think housing demand is very strong. As for business--maybe I'm being misled by the Redbook--the Redbook reports sound to me a good deal stronger in tone than the staff projection with regard to capital spending. They're not yet talking in the Redbook about inventory accumulation, but I would expect that also to occur in the period immediately ahead. And I just don't see the inflation rate slowing down that much. Today Alcoa [announced] a 6.1 percent increase on flat roll products, which is a large part of their line. It's their second raise of the year and they had the gall to say that they thought it was consistent with the President's program. That's going to happen, you know, in very many areas. Steel is up 10 percent, as I understand it. I didn't get a staff confirmation on that, but it's close to 10 percent with all the increases they've put in this year. They do it just a little bit at a time, but it adds up. That is what's occurring, I'm afraid, in the economy. And finally, I've had a healthy skepticism about food prices moderating to the extent that has been forecast for several months and I continue to have it.

So what I foresee as at least a substantial risk is a period of more rapid growth, with more rapid inflation, that lasts not too long--two or three quarters--followed by a significant weakening in the economy. Now since everybody else has spoken about monetary policy, I have to say that that projection does not take into account the possibility of 3-1/2 percent growth in the money supply. In fact, it doesn't take into account the possibility of 5-1/4 percent growth and maybe not 6-1/2 percent. But what it takes into account--

CHAIRMAN MILLER. A standard 7-1/2?

MR. PARTEE. What it takes into account is the prospect that interest rates will rise moderately throughout the forecast [horizon] or at least until the second quarter, say, of next year and bring some problems.

CHAIRMAN MILLER. Chuck, do you have specific numbers for us on our three [measures]?

MR. PARTEE. Well, I'll buy the ones that Phil Jackson mentioned.

CHAIRMAN MILLER. Okay. Bob.

MR. BLACK. Mr. Chairman, I share some of the apprehensions that both Phil and Chuck have expressed about what I perceive to be some surge in speculation. If you look at the Redbook, you get a pretty clear indication there of accelerating inflation, increasing demands for credit of all types, pressure on interest rates, tightening labor markets, scarcity of certain skilled labor, developing shortages in some commodity markets, stepped up demand for capital equipment, and a worsening balance of trade which frequently occurs before you do have a downturn. Having said that, I don't see the inventory excesses yet. I know those figures are notoriously bad, and a strong increase in business loan demand suggests to me that there may be more building of inventories than the figures now show. But absent further evidence of that, I think I would come out fairly near where the staff has come out, although I don't think it is beyond the realm of possibility that [activity] could drop off before then. I would be a tad higher on prices and I would not expect much change in the unemployment rate.

CHAIRMAN MILLER. Thank you, Bob. Willis.

MR. WINN. That sounds like [my view] too. But those in the business community certainly have the bit in their teeth and are running hard with the feeling that this year is going to be better than most of the projections that have been given. And it seems to me that momentum is going to carry longer. Second, the unrest on the inflation [front] seems to me to be increasing. The tax revolt in California was part of this but I sense it is everywhere--the bitterness about prices and the feeling that we are losing ground. And this is true at all levels of income, not just the lower levels. My guess is that everybody attempts to take care of themselves under those circumstances, so we are probably going to get more [unfavorable] price behavior. Should we get the slowing down that [the staff is] projecting, my guess is that the fiscal assumptions will be altered. Things change very rapidly. And attitudes can alter in six months of time so that a projected cutback may be an increase rather than a cutback. If that holds, it gets pretty precarious in terms of one's projections, but my roll of the dice is that I suspect the real GNP will be up 4 percent and I'd say maybe 7-1/2 percent on prices.

CHAIRMAN MILLER. Unemployment [unintelligible]?

MR. WINN. That is right.

CHAIRMAN MILLER. Thank you very much, Willis. Dave, we haven't heard from you yet.

MR. EASTBURN. Mr. Chairman, in our briefing discussion last week, we spent a good deal of time talking about what has already been discussed here. We discussed the difference between the forecast that would come from the model and the one that we have in the Greenbook and the kinds of judgmental decisions that are made to revise the model. My inclination is to move closer to the model results than the judgmental Greenbook results. The main reason is the third point that Jim mentioned and that is the uncertainties that come from inflation. We have had a number of discussions with businessmen and I think I have one clue to what appears to be developing here in terms of assessing their sentiment. I have detected that when you talk to a businessman about his own attitudes toward his own business, it is good, generally. But when you talk to them about the overall environment, it is bad. And the main factor there is inflation. I think this may account for some of the difference in the tone of the Redbook, Chuck, where you get individual reports from individual businessmen, as against the overall sentiment that may exist. So my conclusion is that we are likely to have less growth than the Greenbook has. In terms of numbers, generally speaking, I would say 1 percentage point or so below the Greenbook; in terms of unemployment, it may be up to 6.1, 6.2, or 6.3 percent, and inflation at something around 7-1/2 percent.

There is one other aspect that has not been touched on that may have some implications for the future and that is that if you look at the term structure of interest rates, it does suggest a leveling off of interest rates as you move out in the future. Some of this may simply be uncertainty but I wonder whether the money market isn't already telling us that the economy may be slowing down more than we think and if [market participants are] feeding this into their own judgments about the likely course of interest rates.

CHAIRMAN MILLER. Thank you, David. Bones, we haven't heard from you either. You are quiet down in that corner!

MR. KIMBREL. I think our view, [based on reports] from directors and visits with businessmen, would very closely parallel Dave Eastburn's, which is something odd to have happen in our area. We would be slightly less optimistic than the Greenbook numbers. [There are exceptions in] a couple of instances, particularly employment. I really think employment may continue somewhat near the present level; you could say that in our area at least. Jobs are still available. The soliciting [through] ads continues to be very, very strong. I think we are beginning to see some surplus and some shortages in other areas. Price increases are broadening; maybe this has been influenced largely by our agricultural relationship. But also we are hearing more and more [about price increases] in building materials and some of those [areas] mentioned by others. Smaller labor groups are suggesting that they have to increase prices now, possibly anticipating that they may have some restraints later on. Inflation psychology, we gather, is spreading rather rapidly. Homebuyers do not seem to be deterred by higher costs. We are learning that a much larger number of institutions are limiting the loans they are making for homes, but the buyer himself does not at this moment seem to be very restrained by the cost. We are also seeing office buildings that are being started with considerably fewer tenant commitments than would have been true fairly recently.

On the inventory build-up, just an aside: The chairman of one of our larger department store chains suggested very confidentially that they felt they were over-extended and that this fall his buyers would either be heroes or unemployed. He didn't know which it might be. The availability of trucks and rail cars are distorting a lot of our operations. Farm products can't move because the trucks and rail cars are simply not available; phosphates can't be moved to the ports; oil from the ports can't be moved inland. This is distorting, and how long that will continue, we certainly don't know. Final demand may be slowing down, but we think the catastrophe [involves] inflation pressures; price increases remain very, very strong. In trying to reduce these to numbers, I guess maybe a deflator of 7-1/2 percent; on unemployment, though, I think we would stick pretty much to 6 or maybe 6.2 to 6.3.

CHAIRMAN MILLER. And GNP?

MR. KIMBREL. About 4 percent.

CHAIRMAN MILLER. Thank you. Larry.

MR. ROOS. For the second quarter of '78 to the second quarter of '79, assuming growth in M1 is 6 percent, we would estimate inflation at 6-1/2 percent, which is somewhat less than others. This does not mean that we think [inflation in] late 1979 and 1980 is going to increase significantly, but to the second quarter of '79 we have it at 6-1/2 percent, unemployment at 6 percent, and real GNP about 3-1/2 percent. I would just reiterate that I believe we have it within our ability, if we have it within our desire, to keep money growth to a 6 percent rate without disrupting the economy. Regardless of what Alcoa does and regardless of what the postal workers do, I think it is important that we recognize what we might be able to do.

CHAIRMAN MILLER. Thank you, Larry. Roger.

MR. GUFFEY. Thank you, Mr. Chairman. I think that my staff and I come out very close to where the Board staff comes out on all three of these numbers, providing we don't screw it up by focusing in on the 5-1/4 percent. Rather, our staff would suggest that if we are at 6 to 6-1/2 percent money growth over the year ahead, we indeed could have a real GNP number perhaps a little more vigorous than the Board staff's 4 percent. We think there is underlying strength in this economy that is going to carry through not only in '78 but well into '79. We think that [the rate of increase in] prices quite likely would be in a range of 7-1/4 percent. But that is based in part upon some research and analysis that our people have done with respect to what food prices may do in relation to farm prices. As I think you all know, there has been a rather substantial increase in both commodity and cattle prices. We are talking about small grain prices--for wheat and corn--up some 50 percent over the last six months. The same is true for cattle; 90 days ago we were talking about $40 cattle and now we are talking about $60 cattle. Our analysis is that that probably is at or near the top for both of those major commodities; [they] might rest for the remainder of this year. But that does not imply a slowdown in the rate of increase in food prices, by our staff analysis. Food prices will continue to add to the inflationary pressures, thus coming to about 7-1/4 percent over this period. Lastly, I would say with regard to unemployment--and our view perhaps is biased by the regional information--we again have information that unemployment in the mid part of the country is at a very low level. Depending on what metropolitan area you're talking about, it's someplace between 3 and 5 percent, which is substantially below the national rate. And if the projection that the economy is vigorous and will continue so over the period ahead [materializes], it is going to put some upward pressure on prices to be sure, but also it will hold that national unemployment rate at around 6 percent or moderately above. That would be our judgment.

CHAIRMAN MILLER. Thank you, Roger. Bob Mayo.

MR. MAYO. Mr. Chairman, I have a basic agreement with what Chuck Partee and Phil Jackson said with regard to perhaps a little more strength than the Greenbook forecast for the third and fourth quarters. The economy is still very strong in the Midwest. People are optimistic. But I see the ingredients here of a slowdown, which makes me feel that the staff forecast is too optimistic for the first half of next year. We still have the social security increases, and I think they will stick, to temper any tax cuts that will eventually take place. I would venture to say that in picking our period here for comment today, Mr. Chairman, you have caused me to be a little more pessimistic than the rest because my elbow tells me--and that's all it is I guess at this point--that the second quarter of next year is going to be kind of soft. I would expect unemployment, therefore, of more like 6-3/4 percent. I'll probably end up high man on the totem pole but, after all, we are talking about the rate of unemployment in the second quarter because the year-to-year figure doesn't mean anything. I think we will have a soft economy by the second quarter and some [softness] in the first quarter, too, as we work through whatever you want to call it--maybe a growth recession is as good or as bad a term as we have. I would consider that the overall increase in real GNP from the second quarter to next year might only be about 3-1/4 percent, which I don't think is anything to be ashamed of. I think it is part of a moderating process that is going to be taking place almost regardless of what we do on monetary policy--not that I am fatalistic or a defeatist on that. But as we get into the next part of our meeting I think [we ought] to realize a great humility regarding our ability to contribute substantively to some moderation of the process that I am trying to describe.

I feel that the price pressures are very great. I am more pessimistic than Roger on food prices; I think food prices '78 over '77 may be up 9 to 10 percent. Therefore, I come out with a personal appraisal on the GNP deflator of more like 7-3/4 percent. I hope I am wrong. I pray I am wrong. But I see a basic block here that I don't see how we can crack on the labor negotiations front in terms of the price pressures that are already built in. Even if the President is reasonably successful in his 5-1/2 percent wage increase program for much of the economy, I don't think he will be successful with big labor. I am a little more optimistic, I think, than Paul Volcker with regard to the danger of a coincidence of a slowdown here and a slowdown abroad. I still have an innate optimism on that. Well, Germany improved again in April, for whatever it's worth, after several bad months. I see some improvement abroad that is lagging ours but is not going to be turned around by a slowing in our own economy. So that is about where I come out, with real GNP maybe only 3-1/4 percent, as I say, second quarter to second quarter. I wish it were better, but I don't think it is in the cards.

CHAIRMAN MILLER. Thank you, Bob. Mark.

MR. WILLES. Thank you, Mr. Chairman. I will try to be brief. First, farmers are smiling. And if they scowl when their net worth is down to a million dollars, you can imagine how good it must be if they are smiling. We have a couple of the largest food processors in the country, General Mills and Pillsbury, and they confirm what Chuck said. The rate of increase in food prices is not going to moderate during the rest of this year. And I think that does give real pause in terms of what the overall rate of inflation is going to be. In terms of second quarter to second quarter, for prices our guess is 7-1/2 percent; if we are wrong, our guess is it will be closer to 8 than to 7. In terms of unemployment in the second quarter, frankly, I don't know. Unlike some others around the table--

CHAIRMAN MILLER. Now, that is no excuse, Mark. None of the rest of us does either.

MR. WILLES. My feeling is that it does depend on what we do. I don't think that is cast in concrete. I find the scenario that Phil and Chuck outlined all too likely. I think we could do something about that. I doubt that we will--"we" meaning both the Fed and the Administration--but I think we could. I am somewhat encouraged by the Miller reduction in the deficit, at least that is how the paper described it in our part of the country.

CHAIRMAN MILLER. I thought that was a Federal Reserve action.

MR. WILLES. Well, whatever it was, I thought that was good. If we had more of that, I could get fairly optimistic, but I don't know how much more there is going to be. [On unemployment], for a number my guess is that by the second quarter of next year we will be at 6 percent or a little above. I think it is going to go down a little bit, but then it will start coming up; and how high it will get, I don't know. In terms of real GNP, since we are talking about an average, I feel a little more confident about that. I think that will be somewhere between 3-1/2 and 4 percent over that period simply because we are going to have so much going on between now and then.

I would like to make just two additional comments. One is on housing because of high interest rates. If you look at a l0 percent mortgage, which we are starting to look at in some places around the country, those interest [payments] are tax deductible for those who pay [taxes]. If you have an inflation rate of over 7 percent plus the full l0 percent is tax deductible, consumers aren't going to shy away from 10 percent mortgages because the real cost to them is very, very low. So if we have a problem in housing, it is going to be because the financial markets aren't going to be allowed to work in such a way as to keep the money moving into that sector. Second, I think that the prospect for real growth depends to an unusually large degree on the prospects for inflation. And the kind of scenario that Phil and Chuck outlined I think is a direct consequence of people's expectations with regard to inflation. To the extent that we in our policy discussions can impact on that, that will make me more optimistic than I am.

CHAIRMAN MILLER. Thank you, Mark. John.

MR. BALLES. Mr. Chairman, I think I already covered part of the story in my earlier remarks, but let me just go over a few figures quickly. As far as the last half of this year is concerned, our staff has very little difference with the Board's staff in terms of real growth, inflation, and unemployment. The principal difference will show up in the first half of next year, as I said, when we would show real growth of a touch under 2 percent versus the Board staff forecast of a little over 4 percent. We expect less real growth--and I am going to pause at this moment to [note] the reasons, which I didn't mention earlier--in part because of the supply constraints both in terms of skilled labor and really useable cost-effective capacity. We hear about skilled labor shortages all over the country. It shows up in help wanted ads and complaints that I hear from directors about the ability to get people to fill skilled jobs. In one sense I think we have been running at an unsustainable rate in the economy in the first half of this year. And the constraints on the supply side, both in labor and capacity, will be a factor at work in slowing down real growth in the economy as we get into the second half and the first half of 1979. Because we expect somewhat less real growth than the Board's staff does for the first half of next year, we show a touch higher unemployment--6.1 percent to be specific for the first six months of next year versus the Board's staff forecast averaging 5.9. About the only hopeful thing that we see in this is that we may, therefore, see less pressure on prices since aggregate demand will slow down. And our forecast on inflation for the first half of next year would be about 1/2 point under the Board's staff forecast of 6.9; we have it running about 6.4. Those are the highlights.

MR. PARTEE. What was it second quarter to second quarter, John? Could you summarize?

MR. BALLES. No, I haven't recapped this into Q2 '78 to Q2 '79, unfortunately. I'd have to go back to the drawing boards to do that.

CHAIRMAN MILLER. Thank you, John. Ernie.

MR. BAUGHMAN. Mr. Chairman, as you all know, the Southwest continues to be boom country, and I have the impression that that is becoming a more and more common state of affairs around the country. As to the general economic picture over the next year, I am inclined to think that we are going to see, as has been suggested, a continued strong picture for some time. And it seems to me that the odds are fairly good that that time frame may well run through our forecast period. But I don't think it is possible to predict with any degree of confidence when an expansion period will reach that set of circumstances which will cause a turning point to come. At least historically economists' ability to predict turning points before turning points arise has been demonstrated to be very close to zero. And I don't see any reason why we should be more successful this time than in earlier periods.

CHAIRMAN MILLER. On a daily basis.

MR. BAUGHMAN. Yes, I think the record shows that, according to studies that have been done. I think how soon it comes to an end depends on how much of a speculative surge develops. While I am pretty sure it is developing, I would hope that it will not come forth with such a thrust that [the expansion] has to be as short-lived as Chuck and Phil suggest. And as I say, I think there is a fair chance of [continued strength for some time], particularly if, as Governor Wallich has suggested, we [view] the inflation aspect as our major problem and undertake to give it our major attention. So I would suggest that we might see somewhat more real growth over the next l2 months than the staff has suggested, probably averaging 4 percent or maybe even a point or two above that. Along with this I think we are likely to see more price increase than the staff has suggested, probably something averaging in the 7-3/4 to 8 percent range. With respect to unemployment, I wouldn't expect to see very much change in the percentage of the labor force unemployed during that time period, notwithstanding the fact that, as has already been reported, the areas of severe labor shortage probably will become more widespread rather than less widespread.

A significant part of this pattern of expectations is my reading of the consumer's performance with respect to consumer installment debt at the present time. While I am not unaware that the retailers represented on our board of directors are reading this development in the historical pattern that we have had for a number of years, I am inclined to think that a different pattern may be emerging this time. We are seeing consumers undertaking to find ways to get a bit of protection against the impact of inflation in sectors other than residential real estate, which has been the one that has been available to them thus far.

I might just take a moment to make a reference to a very fine seminar that the Boston Bank, under Frank's leadership, sponsored at the end of last week. I was interested to note that the preponderantly academic economists continued to present models and to draw inferences from them which say, in effect--if I understood [correctly]--that the inflation problem is not attributable in any significant way to structural aspects of the economy. [Their view was] that the economy does have the flexibility to respond to appropriate monetary and fiscal policies. I would have to report that that is the preponderant view among the economists and the staff at the Federal Reserve Bank of Dallas, [unintelligible] to be persuaded that that in fact is the situation. And it seems to me that unless we find some way to address in a more meaningful way than we have thus far what has come to be known as the structural rigidities in the economy, we will not be able to achieve Governor Wallich's much publicized and I think very desirable soft landing.

CHAIRMAN MILLER. Thank you. Frank.

MR. MORRIS. Well, Mr. Chairman, a month ago I was concerned that the third quarter was going to come in a lot stronger than the staff had projected. In particular, I thought that was a possibility because I feared that a surge of investment might be accompanying the changed thinking that was then evident in Wall Street. And I found my reaction a little "too bad" in the sense that quite clearly we don't have room in the economy for a capital goods boom. Even though in the long run that is exactly what we have to have, there is no room in the system at the moment to accommodate it. I say I feared a strong third quarter because I think that would have put us in an extremely difficult situation, with strong [rates] of growth in the aggregates in the second quarter. But the evidence coming in over the past month, although it apparently hasn't changed Chuck's mind, has changed mine. The May survey of plant and equipment showed a surprisingly poor performance and it is confirmed, I think, with the figures on capital appropriations and new orders for plant and equipment. The figure that I thought might be coming in just isn't there.

We have a new factor in this situation because the Proposition 13 effect, which we can't measure very well, quite clearly is going to reduce state and local spending in California but its influences are being felt as far east as Massachusetts where we have under way a momentum for a referendum to place a limitation on the size of state government expenditures. It appears to be having a fairly general sobering effect on plans for state and local spending in general.

If you look around the economy to find areas where we might get this speculative enthusiasm, the consumer sector is the only one that you can really hang your hat on. Investment has not come through. Government spending--Federal and state and local--is not going to provide much net stimulus. And it appears that housing has already peaked. But to hang your hat on the consumer sector--I agree with the staff on this--is pretty hazardous in light of the fact that in recent months we have seen the consumer finance more of his spending by credit than at any time in our history. Both the ratio of consumer credit to current expenditures and the growth of consumer expenditures are at all-time highs. The ratio of household debt to disposable income is at an all-time high. And Mark, I don't think the average consumer thinks an awful lot about real interest rates. When he looks at a 10 percent mortgage, he says: How much of a down payment is this going to mean for me? It may turn out to be a great investment, but can my cash flow finance this situation? And with his debt already at an historic peak, the amount of further expansion in consumer debt that would be required to have the consumer continue to lead the economy ahead just seems to me improbable.

So in looking at the staff projections, I think I'd be inclined to be a little more pessimistic on real growth and a little more optimistic on the price side. That's because if we do get this deceleration of real growth that we're talking about, historically a deceleration of growth rates has been accompanied by at least some deceleration of prices as well. Geoffrey Moore had a paper in our conference along these lines--Ted, you have it and I think that might be worth passing out to everyone. Maybe I'll send it to all the members of the Committee because it demonstrated, I thought rather convincingly, the relationships between the rate of growth in the economy and the rate of inflation, and not just the level that the economy is at. So I would expect that we'd be easing back to the 6 percent rate of inflation that we had seen earlier. But this means also that my unemployment rate figure would probably be higher than the staff has projected.

CHAIRMAN MILLER. You don't mean 6 percent. Do you mean 6 percent over the four quarters?

MR. MORRIS. Yes.

CHAIRMAN MILLER. Okay. I was only making sure we got it right.

MR. MORRIS. Well, I don't know what the average of the four quarters [would be], but I think we will be moving back to a 6 percent inflation rate over time.

CHAIRMAN MILLER. Yes, I understood that.

MR. MORRIS. But the real question in my mind is whether we can avoid a recession in 1979. That I think is the key.

CHAIRMAN MILLER. What would be your unemployment figure?

MR. MORRIS. Well, I'd say it would probably be somewhat above 6 percent. But I think we're going to have a very difficult job, even with a lot of luck, engineering things so that we can avoid a recession in 1979. Now, I think Larry called our attention to this projected deceleration in monetary growth rates, which comes automatically from Steve's arithmetic. Clearly, if you look at that and you say we're going to decelerate M1 growth down to the 2 to 2-1/2 percent level and decelerate M2 growth down to the 6 to 6-1/2 percent level, then on the basis of past history, you'd have to project that we'd be moving into a recession by the second quarter of '79.

MR. PARTEE. You'd get a credit crunch at that time.

MR. MORRIS. Sure. So it seems to me that the fundamental issue is not what the growth rate is going to be in '79, but whether policies can be geared to avoid nosing into a recession in say, the second quarter. Now, you might argue perhaps that a mild recession--if it could be kept mild enough--might not be all that bad. That's off the record, I assume. But on the other hand, the economy is extremely illiquid. The corporate sector has really not gone far in building up its liquidity. The consumer sector, as I said earlier, is at an all-time historic debt position. As for the banking system, while it has worked out a lot of its problems, if we moved into another recession in '79, I can tell you that I think I'd be spending more time on bank supervision than I am now. So that's the thing that concerns me. I think we may be building a trap for ourselves in the way we've presented our long-term ranges in terms of trying to juggle two measures--M1 and M2--that do not move in a constant way over the business cycle. So I think your idea, Mr. Chairman, of dropping M1 this time is a very good one. And I think we ought to drop it for all times.

CHAIRMAN MILLER. That would be ideal.

MR. MORRIS. But at least you can tie it to this automatic transfer effect; that's a good rationale for departing from it. And maybe you could add M3, since M2 and M3 do move together in a reasonably predictable way and we'd be out from under M1 as a guideline. I think that would be a great step forward and save a lot of trouble in the future.

MR. ROOS. That's like walking out on your wife every time you have an argument!

MR. MORRIS. The problem is we're supporting two women and they're running off in different directions.

SPEAKER(?). It's very expensive.

CHAIRMAN MILLER. I've always liked a more stable woman myself.

MR. MORRIS. I think we're all monogamous at heart.

CHAIRMAN MILLER. Thank you very much. Phil.

MR. COLDWELL. Mr. Chairman, I am troubled with trying to give a forecast, troubled between what I think is coming up against what I'd like to see come. I think I'd agree with much of what Phil and Chuck have said--that it looks like we've got strength here that if left unchecked is going to create a sharp downturn next year. I'd like very much to cut the peaks and valleys off of that forecast. I think the consumer does have a problem with the degree of debt he's assumed and a problem with the inflationary cycle. Inflation, I think, is going to be higher than what our staff has forecast, unless it's hit pretty hard, and I expect it's going to be in the 7-1/2 to 7-3/4 percent range. Unemployment looks to me like it will be very strong in the sense of a lower figure; and I wouldn't be terribly surprised if it went down to the 5-3/4 percent range. I don't gain any comfort out of that because I think it's a short-run [development] which I see then causing significant adjustments into the summer of '79. I question whether we are at a sustainable level of GNP in other facets, given the level of inflation and other matters. It seems to me that expectations are rising for higher rates of interest and higher rates of inflation, and we're even seeing some acceleration in wage rates also. So it seems to me a desirable aim of policy would be to moderate this. I don't gain any comfort by what fiscal policy has done so far. I see an early '79 increase in the minimum wage--in the 9 percent plus range--and yet I hear them saying they want to cut wage rates. If they're going to cut wage rates, you can't have a 9-1/2 percent increase in the minimum wage. The forecast our staff has given us, admittedly at the low end, still requires an 8-1/4 to 9-1/4 percent federal funds rate. And if that's in the cards just to achieve what they have [forecast], then I suspect we're not going to be looking at the staff forecast. The artificial velocity assumptions here I think are just out of the ball park. I can't see an 8 percent velocity change. So I guess I'm more pessimistic in one way in that I'm afraid we're headed toward a sharp retrenchment next year unless we do something about it now.

CHAIRMAN MILLER. Did we get your GNP number?

MR. COLDWELL. If you want to forecast GNP without much change, you're going to have it somewhere in the 4 percent [area]; I'd prefer to aim at a little less than 3. The unemployment figure I've given you.

CHAIRMAN MILLER. Thank you. Henry.

MR. WALLICH. Well, it looks as though we are coming in for some sort of landing. It is not clear whether it will be a soft one and I think it very much depends on what we do. If you look ahead one year, monetary policy has time to be effective. If we do what is in the Bluebook which, of course, is a purely statistical exercise, I think we tilt the probability very clearly in favor of a recession. Now, I think we're not going to do anything like that. We may or may not suspend [the range for] M1; that doesn't cause the concept to go away. I would say that M1 [will be] interpreted excluding automatic transfers, given the past behavior of our group to something like this; we will think of it as moving at the upper edge of the band. We're not going to change the band very much, if at all, and we added 1 percent to overshoots in the second quarter so that 6-1/2 really becomes 7-1/2 and that is not an unsustainable thing if you think of GNP as moving somewhere around 11 to 11-1/2 percent in nominal terms. Some rise in interest rates plus the normal uptrend of velocity will make that, I think, roughly livable. So that's not a guarantee of a recession at all.

Now, I do think we need to come down from the relatively high growth estimates that still exist. I think our potential is probably closer to 3-1/4 than 3-1/2 or 3-3/4 percent. The IMF seems to have taken us to task in their consultation for having a higher potential than seemed reasonable. We looked at the rapid growth of the labor force recently. That must have involved some borrowing from future increases, which would mean that given rather poor productivity and not a very fast growth of the labor force hereafter the potential can't be very high. That's why I say 3-1/4. I would think that we ought to expect and try for GNP growth of that level. It would also be confirmed and supported by the suspicion some of us have about capacity; the paper that John Balles circulated suggests that. I've always been skeptical about how much the capacity level really is in both the labor force and in manufacturing. So again for that reason--approaching capacity--we ought to slow down. Given all this I think we still have a chance of a recession but a less than even one. It depends very much on what happens to inflation. If inflation remains halfway moderate, we will not be driven into actions, and the economy will not be driven into reactions, that will precipitate a recession. I'd be surprised if we got away with less than 7-1/2 percent inflation; 8 percent is a more likely number and that is barely consistent with thinking that we may be spared a recession or may at worst have a growth recession.

MR. PARTEE. From here on? From the second quarter--

MR. WALLICH. Yes, the next 12 months. And likewise on GNP I'd be inclined to say that we would be at 3-1/4 percent a year from now. We might have a little more, of course, over that period. Unemployment [I'd put at] 6 percent. But the main issue really depends on whether inflation becomes such that the economy and any reasonable monetary policy would create pressures that would push the economy down.

CHAIRMAN MILLER. Thank you, Henry. Steve.

MR. GARDNER. Well, you just heard a very scholarly presentation and you're not going to get one now.

CHAIRMAN MILLER. We've heard sixteen! Fifteen--you and I are left. We're in trouble.

MR. GARDNER. I have no staff so I'm glad to accept the staff's work and material. I noticed the Presidents often comment on their staff and the Board's staff but I don't have that problem since I don't have a staff at all. The feeling I have is always related to where we've been. I think back to a year ago and unemployment was just beginning to break at this time. I'm not quite certain when it was but a little before June I think it began to subside. Employment continued to grow in great measure.

Now, all I want to suggest is that the common interest today is inflation. The President has appointed an inflation fighter czar. Everybody is talking about inflation. Everybody is being asked to do something about inflation. I just don't believe these pleas will fall entirely on deaf ears. The public is terrified about inflation. I think that when we set the national mind to achieving something we have to estimate as best we can what will be achieved. I think there will be stop-and-go on inflation in preventing its growth. We just released more South American beef into this country to offset somewhat the rising price of beef here at home and that's kind of a courageous act; nobody's really pleased because our farmers had a couple of tough years. So, I think a national purpose to do our best to control inflation will be respected.

In any event, I'm also persuaded that there's a little more strength in the economy than many of you are willing to [suppose]. I see in my own routine survey that the conglomerate movement is starting up again. Why the heck is the conglomerate movement starting up again? It got us into all kinds of trouble the last time it started up in this fashion but we see it happening all the time. At the present time banks who have for two years been doing their best to control their bought funds--to reduce them and to get rid of their bad loans--are now in a position where they're more aggressive. They've been through that cold shower. So I think credit availability is likely and in time that will add some fuel to this recovery we're in. I have always thought that capital investment was due to be part of this at some time in the future and it is now beginning to be. Some people are telling me that it isn't likely to persist but if we're talking about inflation and investment, we've got two connected things. If you can put in a process or machinery in a plant that will reduce your cost, you're being very patriotic on the inflation side. So I expect to see an inflation push coming on.

I don't think unemployment will go high. All the country has been dealing with this question, or trying to deal with it, of unemployment in an affluent society. It is down to 6 percent now. All possible policies have not been used; more can be. Chances are that minimum wages can be ameliorated in the future to keep the youngsters employed who would otherwise be priced out of the market. So I think we're going to have a fair experience with employment. When I put all this optimism together I get to the point where I think the staff forecast is, if anything, about right. I don't think that employment will go much over 6 percent. And I don't think inflation will go much over 7-1/2, particularly if it's a national purpose of this country and our whole society to keep inflation down the best we can. I think the housing activities will continue. As Phillip said, it isn't a great activity but nevertheless it certainly is [important] at the Federal Reserve Board.

CHAIRMAN MILLER. Steve, you put your GNP at what?

MR. GARDNER. Four.

CHAIRMAN MILLER. Thank you very much. Let me make a couple of observations. One is that I would think this exercise this morning has proved conclusively that economics is a science. Second, I would ask the Secretary to retain all of these estimates that we've been getting since March. And when we come around to next March, we'll be able to start putting your score cards together on how well you've done on what you have estimated each time. So please sharpen your estimates for next month and remember you'll be measured over time--that is if you're planning to stay with the Federal Reserve.

MR. JACKSON. Do we get a raise if we're right?

SPEAKER(?). No, you get a cut if you're wrong.

CHAIRMAN MILLER. I'll tell you. The deal is you get to keep your job if you're right. Okay?

Let me make a few quick observations. One [relates to] the Redbook. My experience with business people is that they're always looking at last month's performance and they look at it the end of the following month. They're always, therefore, slightly out of touch [if they are large] corporations. Small corporations are in very close touch, but large companies are extremely out of touch with reality and with day-to-day reality. So I think there's always the lag effect.

In terms of where we are and where we can go, it seems to me that we're at a high level of activity that will carry us forward at substantial growth rates. I don't see it [continuing] in the automotive or durables [sectors] because certainly there's probably been anticipatory buying. But like everything else, that will run its course; the credit involvement and the cash flows will begin to restrain that. So I don't see a great deal of buoyancy in that area. Housing certainly isn't the area for buoyancy because it's going to be headed down. As far as business fixed investment is concerned, that doesn't have time to crank up in this period of time to create a substantial increase in our outlook for [activity]. When it comes to government spending, I think we see it going somewhat toward less stimulation. When it comes to other consumer spending, the consumer has spent so much money on durables and I doubt that the consumer will want to shift quickly into nondurables. We're looking for a period of consolidation plus there will be credit restraints. Inventories and business I should have mentioned in passing. I think we're going to see businesses very concerned, as they now are getting their financing from banks, because they're unwilling to take down long-term money and they're going to be cautious about building up more short-term debt to carry inventories at high levels in the face of their expectations.

So I don't see the conditions for a great deal of ebullience in the period ahead. I do think that what we do on monetary policy is critical. If we should crunch the economy, we can bring on a recession. If we use a steady and sure hand to restrain the growth of the aggregates and bring it down at a more measured pace, then I think we see conditions for bringing the rate of growth down to a more sustainable level that will counter inflation but avoid the overshoot that would carry us into a recession. We particularly have to be conscious of that overshoot if the amount of fiscal restraint is going to be removed toward the end part of this year at the same time some of the impact of our restraint will be taking hold. My numbers would indicate, therefore, real GNP growth over this period in the 3-1/2 to 4 percent area--probably nearer the 3-1/2 but in that area. I would think that inflation is going to take time to abate and that we'll see 7 to 7-1/2 percent on prices in this period. If we get the kind of growth rate that I've indicated, I think employment is not going to be a major additional problem and I would see it in the 5-3/4 to 6-1/4 range as a prospect. And with those comments, I think we should take a 10-minute break.

[Coffee break]

CHAIRMAN MILLER. Well, ladies and gentlemen, let me call the meeting back [to order] and remind you that we have a luncheon at one o'clock and a meeting on membership at 2:15 p.m. And I'd remind some of you that we're meeting tomorrow on delegation. While this morning's session has so far been outstanding, particularly in the degree of eloquence with which each of you has spoken, it has not been outstanding with respect to the degree of time you took to be eloquent. So I would like you now to be both eloquent and brief. The results will be the same, and you'll be able to have lunch and have your meeting on important membership issues. The first order of business, however, is to hear the report on open market operations since the last Committee meeting. Peter Sternlight.

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

CHAIRMAN MILLER. Thank you very much, Peter. Any questions? Bones.

MR. KIMBREL. Peter, did I understand you to suggest that the dealers would be upset with an increase after today's meeting?

MR. STERNLIGHT. If something were done in a very highly visible form just in the next day or so, I think that might be a bit [upsetting] because they're bidding on a coupon issue. But they would not be that surprised by something that developed by the end of this week.

CHAIRMAN MILLER. Any other questions? We need the approval of the Committee to ratify transactions since the previous meeting. Hearing no dissent, we will record that as approved. Let's turn to the comments of our chief economist, Steve Axilrod.

MR. AXILROD. [Statement--see Appendix.]

CHAIRMAN MILLER. Thank you very much, Steve. Are there any questions to Steve? Yes, Dave.

MR. EASTBURN. Steve, I wonder if you have any thoughts about the possibility of a leveling of interest rates five or six months from now.

MR. AXILROD. Well, President Eastburn, if I abstract from that 2-1/2 percent and assume that the Committee permits this--doesn't attempt to make up, in effect, for the second-quarter overshoot and doesn't attempt to make up for the third-quarter overshoot--then I believe that it is quite possible that interest rates will begin to level out for a while. But then beyond that point, where you then get into the question of whether that generates further inflation, you wouldn't have a leveling out for long. That would have to be assessed, of course, depending on the economy at that point. But in terms of this arithmetic exercise I see no hope. If I track past Committee behavior and average it out, I believe there's some hope for the short run.

CHAIRMAN MILLER. Well, gentlemen we have two major matters of business: (1) the directive and (2) the language. I would suggest that we run through the Committee to get your suggestions for the directive first and look at the language second. Since I cut our Vice Chairman short the last time and left him to the end, the least I can do is to put him up front today. Paul, would you like to lead off?

VICE CHAIRMAN VOLCKER. Well, I'll try to be short, Mr. Chairman. Despite the comments I made earlier on being skeptical about the longer-term outlook for business, I do think it's strong at the moment. We do have these inflationary pressures. We do have speculative concerns that have been referred to. I think we have an expectation in the market of some Federal Reserve tightening and I think we probably should meet that expectation or we would be feeding some of the adverse speculative feeling. I do have some concern over the value of some tightening in terms of the continuing stability of the dollar internationally as well. Therefore, I do think we should move. The 7-1/2 to 8 percent range seems right to me and the B alternative, with some implication that we go to 7-3/4 percent as promptly as the people at the Desk think that's advisable. I would be a little reluctant to go beyond that but not absolutely allergic to it if that's necessary--if the aggregates come in on the high side. That raises the question of what ranges we should put there.

Those ranges specified under the B alternative look awfully high in terms of our longer-range objectives. I recognize that the projections are also fairly high. It seems to me that we could at least widen the range on the downside, because I don't think we want to ease very [readily], and I would suggest a lower level of 5. And if we widen the range a little bit, we could leave it 5 to 10 percent. As I say, if it really got to the top part of that range, I think I would go to 8 [on the funds rate], but I would do it with some reluctance. Perhaps the way to express that would be a money market directive and the new language or some other kind of device to make clear that, while we might be willing to move to 8, we'd do it with some due deliberation after a good deal of further evidence comes in.

CHAIRMAN MILLER. Thank you, Paul. Why don't we run down the Committee alphabetically. Ernie.

MR. BAUGHMAN. Mr. Chairman, I would accept Paul's suggestion and the alternative B suggestion for 7-1/2 to 8 for the federal funds range. But I would like somewhat narrower and significantly lower ranges on the aggregates--4 to 8 on M1 and 4 to 9 on M2--with the directive in the aggregates form and embracing most of your suggested new language or, as far as I'm concerned, all of it. I'd have a further instruction to the Desk that they move 1/4 point of the 1/2 point range, assuming the aggregates come in strong, in each of the first two weeks. And if at that time we're at the top of both the fed funds and the aggregates ranges we would have a meeting for further consideration of the situation.

CHAIRMAN MILLER. Phil Coldwell.

MR. COLDWELL. Mr. Chairman, I approach this from a standpoint that we're having too high a rate of inflation and, therefore, have to cut it back. If you want to translate this into what we should do now, I think we need to tighten up and that means raising the federal funds rate. I would go to 7-3/4 percent promptly. I would leave ourselves leeway of at least 1/4 point, preferably 1/2 point, above that. And I wouldn't be reluctant to take it up there if the aggregates are growing above what I consider to be very high figures in relation to what we have set as targets or even in relation to what we have accomplished over the last year. So I would put the federal funds range in the neighborhood of 7-1/2 to 8-1/4; I would put the aggregates limits at 4-1/2 to 9-1/2 on both M1 and M2 and that gives me a midpoint of 7 percent, which I think is still too high. Nevertheless, I'm willing to buy it because of the projections for this. But I certainly would be very reluctant to see us accept anything above 9-1/2 percent.

CHAIRMAN MILLER. Thank you. Dave Eastburn.

MR. EASTBURN. Well, I think there are risks in further tightening, but I think they are risks that we have to take, and I like Paul's prescription. I think that we should move the funds rate up to 7-3/4. We might want to pause at that time and consult depending on what the aggregates show. And somewhat lower on both the top and the bottom of the ranges I think would be preferable--perhaps something like 5 to 9 for both M1 and M2.

CHAIRMAN MILLER. Thank you, Dave. Steve Gardner.

MR. GARDNER. I can agree with Paul and Dave on the measures specified. I'm a little bit concerned about going up because everybody expects it, and the market has discounted it and everything else but I guess there's no alternative.

CHAIRMAN MILLER. They've got to be right once in a while. Would you prefer the 5 to 10 or the 5 to 9 range, Steve?

MR. GARDNER. I would much prefer 5 to 10.

CHAIRMAN MILLER. Thank you. Phil Jackson.

MR. JACKSON. I would concur that we need to go up [on the funds rate]; I wouldn't move as promptly as has been discussed. I would move perhaps over the next week to ten days to 7-3/4 instead of jumping immediately, as I got the sense was the others' inclination. I am concerned about lowering the ranges from the point of view that that means a lower midpoint. And if the present projection of about 9 to 9-1/4 percent for M1--and not too much different for M2--for the month of June is correct, that means you would force yourself into [needing] a very weak July or an automatic rise of the federal funds rate. It strikes me that that is not the sense of what I heard [people] say. Some of you said otherwise--that you wanted to consult before you made any other precipitous action. For that reason it strikes me that by lowering that range you would force yourself into an inconsistent position.

CHAIRMAN MILLER. Phil, you could use the money market directive.

MR. JACKSON. Yes, but even then it strikes me that you're running a danger in that sense. So for that reason I would be inclined to use the 6-1/2 to 10-1/2 and the aggregates directive. If we're going to use a money market directive, it strikes me that the top might well be 9 to 9-1/2 because I think if we have a July that runs 9 percent or better there's a basis for genuine concern and perhaps for further action. But if we're going to use a monetary aggregate directive, it strikes me that you force yourself [to act]. Did I express a preference, Mr. Secretary? I'm not sure I did. I'm willing to go either way based on what the Committee okays as the top of the range.

CHAIRMAN MILLER. Either way. Well, we always like flexibility! Chuck.

MR. PARTEE. I would be reluctant to cut the aggregates limits because I think there's a considerable exposure to July being a fairly big month on M1, which has been the case in the last number of quarters for the beginning month of the quarter. Also, M2 [growth could be strong] with the new money market certificate, which under the circumstances could be pretty saleable. That first week's result is that sales of the certificate are very large, indeed. And I think we ought to recognize the probability that for M1 par for the course is 8 percent and this range has only an 8-1/2 percent midpoint. So if we just abstract from our preferences and look at what's going on, [the staff has] something that is already pretty moderate here in terms of a projection. If you want to widen [the range], as Paul did--and I certainly don't see any harm in widening on the bottom--I would also widen on the top and make it 5 to 11 for M1, indicating a certain amount of uncertainty as to what might happen with regard to that figure. For M2 I think we might take 6 to 10.

Now, on rates, I would point out that we've had a considerable adjustment in rates thus far this year. I just looked at my book and compared to the fourth quarter, the funds rate is up 125 basis points, the bill rate is up 60, the triple A long-term corporate is up 75, and the primary mortgage rate is up 75 basis points. Those are pretty considerable increases. And I do think that we can get to the point here where we endanger the prospect for the kinds of spending that depend on the flow of credit in the period ahead. So I would think that from this point on we ought to move pretty gingerly. I could accept the 7-1/2 to 8 percent range, Mr. Chairman, but I think I would move very moderately within that range in an upward direction--maybe, given the market, just a little knock here in the next few days to 7-5/8 or something like that. But choosing the 7-1/2 to 8 percent range, I wouldn't want to bias the outcome by taking aggregates [ranges] that are so low that we're almost certain to signal that we'd be at the top of the funds range by the time the period is over.

CHAIRMAN MILLER. Thank you, Chuck. Henry.

MR. WALLICH. Well, I would like to move up the funds rate. I'd like to give us room to go from 7-1/2 to 8-1/4 but with consultation at 8. I think we have to recognize that, whatever we call it, we're really on a funds rate target and that every move now is very sensitive, so we ought to have more consultation. As far as the directive is concerned, I still would prefer an aggregates directive because it may provide for a smoother movement over the month than a money market conditions directive. I wish I could find a way of pulling down the ranges somewhat and getting them more in line with what we say our long-term one-year ranges are. But that does set in motion immediately a movement of the funds rate. So I'll go with the staff's alternative B, 6-1/2 to 10-1/2 percent for both.

CHAIRMAN MILLER. Thank you, Henry. Mark.

MR. WILLES. Let me make just one comment on interest rates, since so many people have commented on them, before I give my projections. We have moved interest rates up fairly significantly this year. And yet if you look at the increase in rates in this expansion relative to a comparable point in previous expansions, we're way below where we normally would be. And given the fact that inflation is higher than in those earlier expansions, it seems to me that no matter what your persuasion--whether it's monetarist or Keynesian or anything else--our interest rate policy has been very moderate indeed. And the level of real interest rates is very low. The 90-day Treasury bill rate currently is zero in real terms. If we're talking about being essentially at full capacity with inflation accelerating, I find it difficult to be concerned about a rather substantial upward movement in interest rates. However, being the moderate person that I am, I must say, Mr. Chairman, that I'm troubled by the fact that there's always a reason why we can't do what we kind of would like to do. Somehow it seems to me that we ought to force ourselves to at least push in that direction. I like Ernie Baughman's suggestion very much of having an M1 range of 4 to 8. I think it would do exactly as you suggest, Phil: It would force us quickly to move the rate up, which is precisely what I'd like to see us do. I'd like to have a federal funds range of 7-1/2 to 8-1/4 and I'd be happy to have discussions before we move above 8 percent. But I think we must go toward 8 relatively rapidly. On M2, I think 6-1/2 to 9 is a more prudent range than the one that has been recommended.

CHAIRMAN MILLER. Thank you very much. Willis.

MR. WINN. Mr. Chairman, I have a feeling that we stopped reading on page 6 when the problem got severe and didn't look ahead to what is an alternative for us.

CHAIRMAN MILLER. Some of us may have stopped earlier than that!

MR. WINN. My feeling is that market conditions are more favorable for action now than they will be in the future, with possibly accelerating credit demands, and that we should push now to try to moderate things rather than be faced with rate increases in the fall. My inclination would be a federal funds range of 7-1/2 to 8, with narrower ranges [for the aggregates, which] probably would force us to look at it. I thought 3-1/2 to 8-1/2 [on M1] and perhaps 5 to 9 on M2.

CHAIRMAN MILLER. Thank you very much. John Balles.

MR. BALLES. Some of my colleagues happened to hear me say my glasses fell apart when I came into the room this morning so I suffer from a little case of myopia and I guess I lean toward short-sighted policies today. That was supposed to be a joke! My main concern for at least the last two years has been the lack of a systematic way of linking our short-run ranges with what we allege to be our long-term goals. And I think we're seeing another case of that now. I just don't think it's going to be possible to ever get down to the midpoint of what we said we would do on the long-term ranges, but that's a subject for next month. At the same time, I feel very strongly that if we let the aggregates run too strongly in the direction of an overshoot, it will feed back in a way that will really harm the economy by even worsening inflationary expectations and everything that that implies for the behavior of both consumers and businessmen. I don't think there's any choice but to tighten up right now and I like some of these formulations I've heard, particularly Ernie Baughman's, and I would go right along with it: 7-1/2 to 8 on the funds range, move quickly toward the 7-3/4 midpoint, but bring down the ranges for M1 and M2 to something like 4 to 8 and 4 to 9. I think it's going to be easier to bite the bullet now when the economy is still performing very strongly than it will be by later this year when I expect the economy to be slowing down somewhat.

CHAIRMAN MILLER. Thank you. Bob Black.

MR. BLACK. Mr. Chairman, I asked Art Broida if he would distribute a table here which I think brings into focus the major problem as I perceive it. It's not a very complicated table, and I think we're all aware of what it says. But it does go back to the first period when we set our target ranges a year ahead, back in March of 1975. And it goes on to the last one that's completely filled in--the one that we have projected for the current quarter, the second quarter of '78. If you look at this table, you can see very quickly that M2 as of late has been doing pretty reasonably, I think to a large extent because of Reg. Q. But look at the performance on M1 for the last 3 complete periods and it looks pretty lousy and the projection for the period ending this quarter is worse. I think this has certainly increased inflationary pressures on the economy and I think it has done real damage to our credibility.

There are several ways to deal with this. What I'm really suggesting is somewhat along the lines of what Phil Coldwell suggested and also what John Balles was saying. I would propose to deal with this mostly in the next quarter. Specifically, I have in mind trying to get this last line, the third quarter of '77 to the third quarter of '78 down a little bit more toward the top of our target. I think it's foolhardy to suppose that we could get it there, and I'd take 7.3 as what I hope it comes out to be. That's 0.8 percentage point above the top of our range and this would imply third-quarter growth at 5.6 percent, if we hit it, and 7.7 percent when you compare the third quarter to the first quarter. Now, if you assume that the monthly pattern of June and July is something like we have had in the past, a rate of about 5.2 percent would be consistent with that. So I would think of an M1 range of 2 to 6 percent and M2 of 4 to 8. I'd like to emphasize that this is in the spirit in which you said last time that these ranges should be viewed, Mr. Chairman. I don't expect that we'll hit these [ranges], but I would expect, as others have, that this would [result in] some upward movement in the federal funds rate through our failure to achieve them. So far as the federal funds rate is concerned, I would think a range of 7-1/2 to 8-1/4 would probably be about right, with an asymmetrical midpoint of 7-3/4 and the Desk moving soon--if we wait a day or so, I wouldn't object--right to 7-3/4 and going as high as 8 without checking back with the Committee.

I might add that I realize, as Dave Eastburn pointed out, that there are risks in doing this, but as he also pointed out there are risks in the other direction, too. The choice is either a risk of a relatively mild recession in the near future versus a more serious recession down the road. So I would opt for this sort of approach in the period right ahead. And so far as the form of the directive is concerned, I think the change you suggested last time was excellent and in fact made a [difference]. To me that really dealt sufficiently with the problem that you wanted to deal with. The new formulation goes beyond that to me, emphasizing money market conditions to the exclusion of the aggregates as trigger points for action, and I would prefer to leave it just like what we ended up with the last time.

CHAIRMAN MILLER. Thank you, Bob. Roger.

MR. GUFFEY. Mr. Chairman, I think Paul Volcker fairly well expressed my view. I have just a couple of comments about the range of 5 to 10. Somebody around the table mentioned that July could come in much stronger than is being projected by the staff and I guess I am fearful that that will occur. It seems that in each of these quarters for the first month of the quarter we have missed [always] on the downside and have been surprised. So, I'm concerned that July may come in very strong. In that context, the M1 range of 5 to 10 implies, I believe, a growth rate of about 12 percent in July for M1 if the June growth rate as projected by the staff is correct. That's a very vigorous growth, it seems to me.

MR. PARTEE. To be at the upper end.

MR. GUFFEY. At the upper end--that's correct. If we get that kind of growth, I would hope that the Committee, whether it be in consultation or otherwise, would indeed move onto the 8 percent funds rate level before the meeting next month. I'd really suggest Paul Volcker's range of 5 to 10, with a federal funds range of 7-1/2 to 8, and a money markets condition directive--that is, to move to 8 only in the case that July does come in much stronger than is now projected by the staff.

CHAIRMAN MILLER. Thank you. Bones.

MR. KIMBREL. Mr. Chairman, admittedly interest rates have been moving up. I, nevertheless, have failed to detect that it has deterred very much the hectic pace of bank lending. So

I think it's appropriate in that context, plus our enormous concern for continued inflation, to continue our move. I would like to see the funds range under alternative B, 7-1/2 to 8-1/4 and moving as promptly as appropriate to 7-3/4 and to 8 if necessary without consultation. To maintain some indication that we're trying to work these ranges down, I'd like to see us at maybe 6 to 10 for both M1 and M2.

CHAIRMAN MILLER. Thank you. Bob Mayo.

MR. MAYO. Well, Mr. Chairman, I think our dilemma here is pretty obvious, even to those of us who feel that some sort of an economic growth now and a slide maybe next year is likely. Again, I think we have a responsibility to exercise a very careful monetary policy that will steer us on this narrow road. We can't take the peaks off completely or fill in the valleys; our bulldozer isn't that big. I think we can have a real effect, however. And although I'm not eager to go to 7-3/4 in the next week or two, I think we ought to take a stance that will continue to see the string that we have here fairly taut in terms of the market pressures and the market understanding that indeed we are working toward a somewhat tighter policy as long as the growth signals are as strong as they are now. We can reverse that policy later on. I hope we will do it sooner than we did last time. I would buy the 7-1/2 to 8 percent with a money market directive. I have mixed emotions, as many of us seem to, on the ranges. I am perhaps even more skeptical than Roger on the July figures; we just haven't developed any confidence in our [projections for the] first month in a quarter. If it weren't for that, I would press for a little lower range, but I'm satisfied with 5 to 10 on both of them.

CHAIRMAN MILLER. Thank you, Bob. Frank Morris.

MR. MORRIS. Mr. Chairman, I guess I'm in a minority of one so far. Since I now feel that the third quarter is going to show the slowdown that the staff has been projecting for some time, I'm a little less hawkish on monetary policy than I would otherwise have been. So I would go for the alternative A funds range of 7-1/4 to 7-3/4 percent, with a money market directive, and I would stay at 7-1/2 until such time as we get confirmation that the July aggregates are in fact coming in strong. I'd use a range of 5 to 9, which means that if we get another 9 percent growth in M1 in July we would move to 7-3/4. At the current position of the economy, it seems to me that that is a sufficient move.

CHAIRMAN MILLER. Thank you, Frank. Larry.

MR. ROOS. For M1, 4 to 8 and for M2, 6-1/2 to 9. And the most important thing that we should do is to attempt not to inhibit the rise of the federal funds rate. Being a moderate like my friend Mark Willes, I'd say 7-1/2 to 8-1/4. I'd rather go above that and I do recommend to everybody who is sitting at that side of the table, as well as this side, the chart on what has happened in the past. We really haven't tightened our federal funds rate significantly. We have a long, long way to go, in my judgment, before it would have a detrimental effect on the economy. That's what I see.

MR. MAYO. Not if you look at absolutes.

CHAIRMAN MILLER. Well, we've had a complete rundown except for my comments. Let me just take these in order. For the range on the fed funds rate, we have one, two, three, four, five, six, seven of the voting members, not counting myself, who prefer 7-1/2 to 8, which would indicate the majority. I don't know whether those who preferred an 8-1/4 [upper limit] would be willing to accept the 7-1/2 to 8. It appears that the members also have a wide majority in favor of moving to 7-3/4 any time between tomorrow and two weeks, which would indicate Friday or Monday. Now, we have more trouble with the M1 and M2 ranges. We'll probably have even more trouble in trying to decide on the language. But let's see. Seven of them would be 9 to 11 on the upper side and 4-1/2 to 6-1/2 on the bottom side on M1. I don't know quite where we come out on this.

MR. COLDWELL. Looks like 5 to 10 would be a good average.

CHAIRMAN MILLER. Yes, I think that looks about right, Phil. Let me, therefore, formulate [a proposal]. If 5 to 10 is about right [for M1], it looks like it's almost the same thing for M2; I don't really see that much variation. Let me suggest for the ranges, just for a straw poll, 5 to 10, 5 to10, and 7-1/2 to 8 [on the funds range], moving to 7-3/4 probably by the end of the week.

MR. PARTEE. By the end of this week?

CHAIRMAN MILLER. End of this week or early next week. Chuck, what was your view?

MR. PARTEE. Well, I would want to move to 7-5/8 by the end of this week. There is also this financing question that Peter raised, and to do a quarter by the end of this week may be a little--

MR. STERNLIGHT. I don't think that would be a problem.

CHAIRMAN MILLER. I think the market is expecting it, so I don't think it's a big problem if we do it now or early next week.

MR. EASTBURN. Would this be an aggregates [directive] or--

CHAIRMAN MILLER. Well, let's come to the language before we--

MR. EASTBURN. It makes some difference.

CHAIRMAN MILLER. Yes, I can understand that.

MR. ROOS. Is there any significance to the fact that we would have our M1 and M2 ranges alike? It normally isn't that way; they'd both be 5 to 10, if I understand you. Would that signal anything unusual? We've never done that.

MR. AXILROD. No, I think [people might ask] to be sure it's not a misprint. [Unintelligible.]

MR. PARTEE. I think there is some case to be made for 6 to 10 on M2. We typically have a smaller range and it seems to be growing well very recently and it would make them a little different.

CHAIRMAN MILLER. One, two, three, four had a 6 or 6-1/2; I think your point is well taken. Let me come to the language for a moment and then I'll come back to those numbers. I would first like to find if there's a sentiment--we've all had now a month to look at this proposed language--in favor of this language. My own sentiment obviously is, though I don't take any pride of authorship in it because I didn't write it. It was written by some brilliant leaders at the Federal Reserve; it's associated with my interest in trying to accomplish some things with the language. I do think it is helpful. Also, in the context that we are now operating, on page 2 of the language--if we use it--my preference would be to let the Desk operate on the language in line 28. I just feel that under present conditions to let the Desk operate in connection with the ranges would be better than picking the midpoint. But that's just a personal preference. Now, is there sentiment to go to this kind of language? I heard only one negative comment.

MR. COLDWELL. Mr. Chairman. I have only one problem, and that's [with] lines 12 and 13; if that were moderated, I wouldn't have any trouble with the rest.

CHAIRMAN MILLER. Okay, Phil, what would you like?

MR. COLDWELL. It says: "In the short run the Committee seeks to achieve bank reserve and money market conditions consistent with the longer-run ranges for the monetary aggregates."

CHAIRMAN MILLER. You want to take out "in the short run"?

MR. COLDWELL. What I wanted to put instead was: "In the short run…seeks to achieve…that are consistent with the expected growth rate of the aggregates."

CHAIRMAN MILLER. To achieve bank reserve and money market conditions that are consistent with the expected growth rate of the aggregates?

MR. PARTEE. The longer-run growth rate or the short-run?

MR. COLDWELL. Well, I'm thinking of both long and short. What bothers me about the--

CHAIRMAN MILLER. I would expect it would be troublesome now.

MR. PARTEE. This is a linkage to the long-run statement of objectives.

MR. COLDWELL. Well, I understand it is. But we're really going to do what we're saying, [and] we haven't been doing [that].

CHAIRMAN MILLER. That's for sure.

MR. COLDWELL. And to say that in the short run we're going to seek these bank reserve and money market conditions consistent with the 4 to 6-1/2 percent--

MR. PARTEE. I know, but the problem may not be in the language. It may be in the specifications.

MR. COLDWELL. But the language says what we're trying to do, supposedly.

CHAIRMAN MILLER. Suppose we said "reasonably" consistent with the long term or used some qualifying word. Is that what you're worried about?

MR. COLDWELL. Yes, that's what I'm worried about.

CHAIRMAN MILLER. "Expected" gets us into a bit of a problem, I think.

MR. PARTEE. Yes.

SPEAKER(?). It sure does.

MR. PARTEE. The time period is just too difficult.

MR. JACKSON. We've got the right words at the wrong time.

CHAIRMAN MILLER. That's right! We are just not doing it.

MR. COLDWELL. We're just not doing it. And this was a directive [from] this Committee.

CHAIRMAN MILLER. You want to say "hopes to achieve"?

MR. PARTEE. "Moves in the direction of the longer-run ranges for the aggregates."

MR. BLACK. "Somewhat" in the direction.

CHAIRMAN MILLER. "Consistent with moving toward"?

VICE CHAIRMAN VOLCKER. The problem is really more fundamental. It says that we have an objective for the year, which Mr. Coldwell says we don't really have.

MR. COLDWELL. Come on. We just don't do it, and we are instructing the Desk to do it.

MR. WILLES. Instead of changing the words, why don't we just do it?

MR. COLDWELL. Now, that's another good alternative.

MR. PARTEE. That's an alternative.

SPEAKER(?). I'm not sure how good it is.

CHAIRMAN MILLER. I think the only instruction to the Desk starts in line 15. The other is an expression of what the Committee thinks it's trying to do and [then it] instructs the Desk. The Desk can operate [unintelligible] telling them about the ranges.

MR. MORRIS. Mr. Chairman, I think all this suggests that we're going to continue to have trouble until we get rid of the 2-month range as an operating device.

CHAIRMAN MILLER. I agree with that, but I haven't been able to do that yet.

MR. ROOS. Mr. Chairman, following what Frank says, you might consider this on lines 23 to 26 in an effort to downplay the importance of the short-term ranges. Instead of saying in the June-July period M1 and M2 in the following ranges of tolerance, can we say in the June-July period M1 and M2 in the annual ranges established in April? That is, we're [tying] the relationship of what we're doing to our longer-range targets instead of to the short-term targets, where there really is--

MR. MORRIS. The problem, Larry, is that the 2-month range is largely dictated by what happened in the first month. It has nothing to do with the long-term ranges.

SPEAKER(?). It's already finished.

MR. BALLES. We ought to go to a 3-month range.

SPEAKER(?). Yes.

MR. MAYO(?). I vote for that.

CHAIRMAN MILLER. I think you complicate it, Larry, because your instruction goes on to say that you look at these in deciding whether to move [the funds rate] within [its range]. You can't go back and look at both. Let me do this with those who are voting members: Just by a show of hands temporarily indicate--I'm not freezing this language and I'm not skipping Phil's point--who is willing to see if we can make this language of the current proposal, Attachment A, acceptable? I gathered there was [favorable] sentiment; I'd like to see it. Okay, I think we're all in agreement. So now, is this such a serious [problem]? We've been doing it so long.

MR. PARTEE. This has been in [the directive].

CHAIRMAN MILLER. Forever. Is this the time to [change it]?

MR. JACKSON. This isn't a change.

CHAIRMAN MILLER. This is the same kind of language we've been using all along, isn't it? I agree with you that we haven't been meeting it. I've always read into it that longer run means beyond a year even.

VICE CHAIRMAN VOLCKER. It seems to me that if we're not doing it, we ought to change the range. I mean that's--

SPEAKER(?). Yes.

CHAIRMAN MILLER. Well, we ought to raise the range of M1--that's the truth--or get rid of it. We have given our staff an impossible task to fit economic reality in ranges that are inconsistent with it. That's what we have been doing.

VICE CHAIRMAN VOLCKER. You really don't deal with the problem by fiddling with the sentence.

MR. PARTEE. You might change it to "reasonably consistent." You probably ought to have that in there in the first place.

MR. WALLICH. I think we're in some danger of talking ourselves into a change in policy. I wouldn't give up the one-year ranges quite that easily even though they are unrealistic.

CHAIRMAN MILLER. We ought to change them to be realistic, but we can't even do that right now. We don't even consider it until next month unless--

MR. COLDWELL. It's a modification, Mr. Chairman, but I think I'd be willing to buy it with "reasonably consistent."

CHAIRMAN MILLER. All right. Does that offend anybody?

MR. PARTEE. Or does "broadly" offend anybody?

MR. COLDWELL. "Broadly consistent"?

SPEAKER(?). Broadly? Generally? That's an even better word.

SEVERAL. Broadly.

CHAIRMAN MILLER. We bought broadly. Anybody else?

VICE CHAIRMAN VOLCKER. I have an editorial [suggestion]. It says "weekly average federal funds rate," which just has a degree of precision that--

CHAIRMAN MILLER. What would you like?

VICE CHAIRMAN VOLCKER. Just take out "weekly average."

MR. AXILROD. Does that mean daily average? I just want to be sure I understand, President Volcker, because that weekly average was in there to give day-to-day flexibility and--

VICE CHAIRMAN VOLCKER. I don't want to eliminate the day-to-day flexibility but I don't like the implication. I don't want [the Desk] to move on a Wednesday just to get the weekly average.

CHAIRMAN MILLER. Do you want to take the word "weekly" out and leave "average" in?

VICE CHAIRMAN VOLCKER. Leave average in. Maybe that would--

CHAIRMAN MILLER. Steve?

MR. COLDWELL. Average of what? A monthly average?

MR. AXILROD. So the Desk isn't tied each day [to a] target; when it changes it would be an average--

CHAIRMAN MILLER. When you say "initially" keeping the average funds rate you can't mean [the average over] three months. What do you want to do? Leave "weekly" in or take it out? How many want to leave it in? [Pause] How many want to take it out? The "ins" have it.

On page 2 we have to jot in some figures later. And if we decide on lines 27 and 28, we'll know how you all feel. My preference is line 28. How many prefer line 28? One, two, three, four, five. How many prefer 27? One, two, three, four. There are some non-voters.

MR. BLACK. I'm not sure the question was clear to some.

CHAIRMAN MILLER. This says "giving approximately equal weight to M1 and M2 if their rates of growth appear to be"--and you have a choice--"significantly above" or "significantly below" their midpoints. That's one choice. The second choice is "close to or beyond" the upper or lower limits. Normally, I would prefer 27 but in the touchy situation we're in at this time--with July being such a seasonally unpredictable month--I thought the Desk would be better served to give them the right to operate within our chosen range if they were allowed to go close to the upper or lower limits. If we get to the lower limits, we certainly don't want to cut the rate; if we get to the upper limits we certainly are all going to be able to express our views but we wouldn't be compelled to make a [move].

MR. AXILROD. Mr. Chairman, if I might add: If the Committee adopts this form of a directive, the staff would anticipate providing these two alternative languages each time just as it provided a money market directive and an aggregates directive.

CHAIRMAN MILLER. Sure. Last month I would have preferred line 27; this month I prefer line 28 because I think we are going to have a very tough time operating--

MR. COLDWELL. Have we set the upper limit on--

CHAIRMAN MILLER. No, that's the point. That's why I wanted to get this settled first and then you'll decide on--

MR. WALLICH. I can see the rate then staying put while the aggregates move and then comes the moment for their [unintelligible] when they have to take a jump. That's not a happy situation.

MR. PARTEE. In a range of 7-1/2 to 8 on the funds rate with a 7-3/4 percent midpoint, what's the jump? If the jump is up a quarter or down a quarter--

MR. WALLICH. At that point we might have a consultation to do another 1/4 so that the whole move then would be 1/2 and we might not have the courage to do that. I'd rather let the market do it for us.

CHAIRMAN MILLER. I will still put the question to you. Line 27 now is operating off the midpoint. How many prefer that? One, two--no, we have to have voting members only. One, two, three, four, five. How many prefer line 28? One, two, three, four, five. Who's missing?

SPEAKER(?). One of the Board members.

SPEAKER(?). That only makes 11.

CHAIRMAN MILLER. I'll call the roll. That's easier. Just say 27 or 28.

Ernie Baughman	27
Phil Coldwell	27
Dave Eastburn	27
Steve Gardner	28
Phil Jackson	28
Bill Miller	28
Chuck Partee	28
Paul Volcker	28
Henry Wallich	27
Mark Willes	27
Willis Winn	27

All right, 27 won, so 27 we're going to use. That's simple. It's a very democratic process. Now, we can, therefore, go back--it makes the ranges a little more difficult. The ranges we had talked about a moment ago were 5 to 10 and I think it might--pardon me? Does that mean more leeway would be desired by anyone who has expressed ranges before? Is it 5 to 10?

MR. PARTEE. Yes, I would feel with an aggregates directive that I would need 5 to 11.

MR. WALLICH. Mr. Chairman, I had moved [my ranges] in a lower direction because mine were predicated on being able to go as far as 8-1/4.

CHAIRMAN MILLER. All right. How many would prefer 5 to 11? Let's just take a straw vote on that. Four of us. How many would prefer 5 to 10? One, two, three, four. And how many would prefer something else?

MR. BAUGHMAN. Well, 5 to 9 would be stretching it a bit but I could ride there I guess.

MR. WILLES. Don't give up.

MR. WINN. Well, I would prefer 4-1/2 to 8-1/2.

CHAIRMAN MILLER. We'll go back and ask: How many now want 5 to 10? That takes care of that. All right we've got 5 to 10.

MR. PARTEE. I think 6 to 10--

CHAIRMAN MILLER. Now on M2, what is your pleasure? How about 6 to 11? All right, let's say 6 to 10. How many will accept that? It looks like a clear majority. We, therefore, need a final vote, Mr. Secretary.

MR. BAUGHMAN. Mr. Chairman, there was some earlier reference to moving from 7-1/2 to 7-3/4 but there was no comment in connection to the additional 1/4 point of the range. Is there any need for comment to clarify that?

CHAIRMAN MILLER. As I read the consensus, it was the 7-1/2 to 8 percent range, moving to 7-3/4 by the end of the week and thereafter operating on the directive. If we have strong aggregates, we go to 8. We're going to put [that] in the language. The language would read "During the period until the next regular meeting, System open market operations shall be directed initially at attaining a weekly-average federal funds rate slightly above the current level. Subsequently, operations shall be directed at maintaining…within a range of 7-1/2 to 8 percent." On page 2, we use 5 to 10 and 6 to 10 and we use line 27. That's the sum of what we got individual votes on. Now, may we call the roll for a final vote on that version?

MR. BROIDA. Mr. Chairman, in the background paragraphs, on line 17, according to the latest data we should change the 1-1/2 percent to 2 percent--that being the decline in the trade-weighted value of the dollar against major foreign currencies as of this morning.

CHAIRMAN MILLER. It would read 2 percent instead of 1-1/2. Now call the roll on the directive as outlined.

MR. BROIDA.

Chairman Miller	Yes
Vice Chairman Volcker	Yes
President Baughman	Yes
Governor Coldwell	Yes
President Eastburn	Yes
Governor Gardner	Yes
Governor Jackson	Yes
Governor Partee	Yes
Governor Wallich	Yes

President Willis	No
President Winn	No

Nine to two.

CHAIRMAN MILLER. We have a vote. Thank you all very much. Now we need to consider in the next seven minutes the memorandum that Steve Axilrod and Peter Sternlight have been putting together as their great debate. It may go on forever since we never seem to get to it. I don't think we're going to sell any agencies if we never get to this subject.

MR. BLACK. Maybe that's part of the plan.

CHAIRMAN MILLER. Is it so urgent that we can't put it over [to the next meeting]?

MR. AXILROD. The only practical problem may be that I think Peter has been somewhat reluctant to undertake his normal operations in agency issues because this is pending. If he felt free to do that, I see no problems in holding.

SPEAKER(?). In sales you mean?

MR. AXILROD. Both sales and purchases.

CHAIRMAN MILLER. Well, you all have had this before you for a couple of meetings. What is your pleasure?

MR. COLDWELL. Mr. Chairman, I wonder if there isn't a halfway house we could go with, without going into the full details. We could just ask the Desk to stop its rollover of new issues to reduce its portfolio and do some reduced buying.

CHAIRMAN MILLER. Gentlemen?

VICE CHAIRMAN VOLCKER. That sounds all right to me--if I may enter in here--but in general I am [unintelligible] on the Axilrod side of this. It seems to me that we pay too much tender loving care to these agency issues and treat them too much as a special case. If we're going to use them, we ought to use them flexibly on both sides as [unintelligible]. The market ought to get used to that. Given the fact that the proposal is extremely modest in terms of any sales anyway, Mr. Coldwell's suggestion is a perfectly reasonable, pragmatic approach.

MR. BAUGHMAN. I don't fully understand Phil's suggestion.

CHAIRMAN MILLER. Phil is saying that on rollovers don't roll them over, thereby reducing the portfolio.

MR. COLDWELL. Reduce your degree of buying

CHAIRMAN MILLER. Reduce your buying and therefore cut back some.

VICE CHAIRMAN VOLCKER. Are you saying never roll them over? I didn't understand that it was never roll them over but when it fits in with some other--

MR. WALLICH. How quickly would we eliminate the existing stock?

VICE CHAIRMAN VOLCKER. Well, he's not suggesting--again, as I understand it--that you automatically not roll them over. If you happen to be liquidating at that time you might not roll over some of them, or maybe roll over some small amount.

MR. COLDWELL. It just reduces the degree but without going into a heavy or visible selling program at a time when I don't think we ought to be giving that kind of signal to the market.

MR. BAUGHMAN. But is your comment to reduce buying?

MR. EASTBURN. May I ask the Desk what this would imply in terms of maturity and how many are coming up? I don't have to have specifics but I think we need to have some [idea].

MR. COLDWELL. Mr. Chairman, I'm sorry I made the suggestion. I thought maybe we might be able to buy ourselves out of this quickly. But we apparently can't.

MR. AXILROD. Mr. Chairman, we have a very simple suggestion, I think. It simply is that the Desk cut down a little bit on its buying, which it has done already--probably more so than it would have if the decision had already been made. And that wouldn't be inconsistent with occasionally letting an agency [issue] run off, just as occasionally a bill is.

CHAIRMAN MILLER. You didn't ask us if you could do all that.

MR. AXILROD. In some sense, Mr. Sternlight and I view this as a rather simple--

CHAIRMAN MILLER. Why don't you fellows work it out?

SPEAKER(?). Yes.

MR. PARTEE. Mr. Chairman, I think this is a singularly bad time to be talking about any significant reduction in our participation in the agency market. Here we've been talking all morning long about the fact that housing is going to go down and that mortgage markets are tighter, and all this means that there's going to be a bigger supply of agency issues. For us to not be rolling over [agency issues] and so forth will tend to raise [rates on] those agency issues relative to other market rates. And it will be a problem, I think, in terms of the structure we're looking for.

VICE CHAIRMAN VOLCKER. We're not--or at least I'm not--saying systematically don't roll them over. I'm saying, I think, what Steve Axilrod said: [Do so] occasionally if it fits the pattern.

MR. PARTEE. To try to lighten a little over time.

VICE CHAIRMAN VOLCKER. We are buying on the other side, so maybe we don't actually go down on total agency holdings.

MR. BAUGHMAN. We're also getting in a position where we need collateral.

MR. PARTEE. Those are minor issues.

MR. COLDWELL. Not that minor.

MR. JACKSON. I think we need to bear in mind that if our discussion this afternoon should ultimately lead to significant reductions in reserve requirements, the consequences could well be that our capacity to collateralize currency would be impaired. And that in and of itself could influence our actions on something unrelated to that. For that reason I would hate for us not to take at least deliberate action on the agency side, given the fact that the Congress is unlikely to act in a timely fashion. I would agree, though, that doing something strong like a major reduction at this time is probably inappropriate for other reasons.

CHAIRMAN MILLER. Gentlemen, would there be a show of hands of those who would like to see us affirmatively selling out issues of agencies at this point?

MR. PARTEE. A little selling.

MR. WALLICH. On a small scale.

VICE CHAIRMAN VOLCKER. Occasional selling.

MR. COLDWELL. Not in this present market.

CHAIRMAN MILLER. We're talking now; if we instruct the Desk to do this, it will be [effective] now. How many would prefer to not have that happen?

MR. AXILROD. Mr. Chairman, you don't mean that the Desk would have to go out and sell?

CHAIRMAN MILLER. No, we would authorize the Desk to carry out the objective you had in mind in your recommendation, giving due consideration to the market conditions, and to demonstrate that there is another side of agency holdings. The timing is to be selected with great care and judgment and prudently.

MR. COLDWELL. About 1980 I'd buy it.

CHAIRMAN MILLER. Apparently there was a majority of the Committee unless I misread it. Who'd be willing to give Steve and Peter that [authority] now?

MR. BAUGHMAN. Mr. Chairman, while I'm willing to give that, it seems to me that Phil Coldwell's suggestion of just letting them run off is a preferable one.

CHAIRMAN MILLER. Well, they are able to do that now.

MR. MAYO. Let them sell agricultural ones and support the housing ones, not on the record.

CHAIRMAN MILLER. Would you like to vote again? I got a pretty strong sentiment that we would authorize you to go ahead, recognizing the cautions and constraints.

VICE CHAIRMAN VOLCKER. I think they should have the authority, but that doesn't mean that they should go ahead just to make a demonstration [in] the market.

CHAIRMAN MILLER. Exactly. The next item of business is to confirm the [date of the] next meeting, which is Tuesday, July 18. And the next item of business is an executive session for five minutes.

[Executive Session]

CHAIRMAN MILLER. Gentlemen, we are going to have John Denkler here in a moment, but you have seen the memo and we have a serious problem. Microwave communications can be intercepted. There is a general feeling that they are being intercepted and on a number of our actions where there are market consequences, [the information obtained] could be or might be used for gain either for international reasons or for reasons of organized crime and that sort of thing. [Secretary's note: Messrs. Denkler and Wallace came in to the meeting at this point] You all know John Denkler, I think, and Bill Wallace I think you also know. I've just begun to state the problem, John. Why don't you pick right up?

MR. DENKLER. The problem that has caused us to place this emphasis on security is that of the vulnerability of telephone communications to intercept. We have studied this problem rather extensively, and essentially [the situation] is that, as now used, telephone communications rely very heavily on microwave relay and as some of you, I am sure are aware, microwave relay is particularly vulnerable to intercept [even] by just an amateur. It is very inexpensive. [The capability] is there; it can be done and beyond that we know that it is being done. It is being done on a rather large scale by certain foreign governments. One of the ways to secure the microwave is to revert to the use of cables. This can be done relatively inexpensively but in doing that, of course, then you make yourself more vulnerable to wire tap.

So, looking at the cost of doing something about the vulnerability from those two perspectives, we have concluded that the best way to handle it is by using fairly sophisticated scrambler devices in the handsets that would be involved in the communication. Now, point-to-point communication involving these scrambler devices is relatively easy and is well within the present state of the art. As I said in my memo it can be done, for example, between Washington and New York for about $130,000. To go beyond that takes a giant step as far as the technology and the complexity of the problem are concerned. Tying in a third station requires a mixer--a conference bridge or some device to allow you to extend this beyond [two stations]. To go to the entire System, as an example, [would require] a thirteen station network and becomes even more expensive on a large scale. That [cost] would be approaching about $1 million.

Looking at the risks that are involved and at the comparative expenses of the measures that we could take, I came up with the recommendations that you have seen in my memorandum. It looks as if at the present time the most cost effective measure would be to render the Washington to New York circuit safe from interception and to defer anything beyond that until such time as the technology is better proven. Then we can look at that in any manner that would be appropriate. Right now, frankly, it is something of an unknown. That essentially summarizes the problem.

CHAIRMAN MILLER. Gentlemen, this presents a couple of problems for us. We were very reluctant to spend approximately $500,000 for an inter-connect, which is the cost of equipment that would allow us to link up the twelve Reserve Banks and Washington, in an area where probably technology in a few years will make it more likely to be accomplished in some less expensive way and where the benefit of it is in connection with FOMC telephonic conferences. On our daily calls, we greatly value the monitoring of the [Reserve Bank] President [on the call] and yet that is the vulnerable link because the calls are made on a daily basis at a given time, which makes an intercept [more likely] and use of the information particularly vulnerable.

An alternative to following John's recommendation would be for the call to be made with perhaps a Governor rotating on the call rather than a President just to have another member of the FOMC on a secure line. And the information passed to the President could be on market conditions without stating any of the dealer positions or program for the day. Of course, as you know, they would then get that within an hour or two of the program and the monitoring could be a little more after the fact, which I don't think would be a great impairment to the [process]. You'd have a chance then to still exercise surveillance in terms of the general trend of the Desk's operations and to raise a problem, if one exists, the next day. Certainly we'd get the input. It seems to me that that's a more reasonable course at this stage than to spend $1 million and a more reasonable course also in [terms of] time because to get the whole System network together will take 18 months or so, I gather. I think it will take a very much shorter time to do just the Washington-New York link.

The FOMC, I think, is going to be a very serious problem if we have to have a [telephonic] session. We are going to have to be extremely cautious in having voice conference calls in the future. It may mean that we will use other lines of communication that are more secure. We would include, however, a land line system in your proposal, John, as I understand it. And because the FOMC conference calls would be irregular, it probably would not be worthwhile to tap the land lines, so we probably could risk taking those calls on the land lines. But because the daily call is at a particular time, there I think tapping would be too much of a risk.

VICE CHAIRMAN VOLCKER. Let me ask, Mr. Chairman, how good is this scrambler now? The scramblers that we've used in the past were practically impossible to understand.

MR. DENKLER. This uses a new technique. It digitizes the signal. I have used it and Steve has used it and it worked well between here and New York.

CHAIRMAN MILLER. Rome Air Force Base developed this for the military and it's only in prototype. One of the risks here is that we'd be one of the first buyers, although the test that John has conducted--

MR. DENKLER. It's the best-grade system that we have. In point of fact, it very marginally degrades the voice signal. You will notice that you are on a scrambler, but when it works properly, it's a good system security-wise.

CHAIRMAN MILLER. What will happen in the next few years is that micro processors will develop and digital techniques will develop and you will be able to get very high quality signals at much lower cost, I think.

VICE CHAIRMAN VOLCKER. The old [scrambler device] was so annoying to use.

MR. DENKLER. That was an analog. Those old analog systems were terrible.

CHAIRMAN MILLER. Alan.

MR. HOLMES. Do I understand that each installation can have five handsets that can be used?

MR. DENKLER. That is correct.

CHAIRMAN MILLER. That is in New York and Washington--at each terminal.

MR. DENKLER. That's correct. Dialing would have to be centralized, but any one extension could talk to any other extension at the other end.

CHAIRMAN MILLER. Now, we need to discipline ourselves on all of our telephone calls. I am guilty of talking about sensitive matters on the phone with any of you or anybody else just because this has never been brought to my attention as a serious risk. But apparently, without saying more, we feel that it is a current risk and may be being used against us in ways that would be to our disadvantage. So I think that we should move rather promptly.

MR. MORRIS. What about the security of the wire?

CHAIRMAN MILLER. Well, once you use the scrambler--

MR. MORRIS. No, I'm talking about the daily FOMC wire.

CHAIRMAN MILLER. The wire? The current state of the market is known. If we don't give out dealer positions, which are not known, and the program to be executed and inform you of that after its execution has started-- When do you send out the wire? You do that within a couple of hours, don't you?

MR. AXILROD. We send it out very promptly. It goes out within 30 or 45 minutes. How long it takes to get there, I'm not sure.

CHAIRMAN MILLER. Are you asking if that information is secure?

MR. MORRIS. Yes.

CHAIRMAN MILLER. What is the answer to that?

MR. DENKLER. Well, it's relatively insecure, but more secure than the telephone. It could be intercepted.

CHAIRMAN MILLER. That it's after the fact is the main security. In fact, we may have to make sure we hold those wires until an hour after the fact or something so that we don't get [unintelligible]. Now, the problem is a very clear-cut one. Would the Presidents be willing to do their surveillance on the basis of [knowing the program] a few hours after the fact and reining in the Desk prospectively, rather than on each day? There'd be a 1-day lag in your ability to respond. I don't think that's a big risk; the way the Desk operates, it's a very responsible operation as far as I am concerned.

MR. PARTEE. And we would run a monitoring [from the Board]?

CHAIRMAN MILLER. Without myself participating, I would recommend that one of the Governors here rotate [as a participant on the call] to keep a second monitor under those conditions so that there is somebody from the Committee who is alerted at all times. Yes?

MR. ROOS. Bill, relating to this subject of security--I was involved in the service and probably some of the rest of you [were also]--and it seems to me that this might be a good time to review our whole security system in terms of the documents we receive. When we receive [communications designated] "eyes only" or "restricted confidential," quite candidly, nobody in our place puts much weight on what the different security designations really mean in practicality. Maybe there is a manual but-- I don't know whether the rest of you share that view.

CHAIRMAN MILLER. We need to upgrade our security all around and I think we need some instruction. As I say, I have been guilty of picking up the phone to someone in Washington and they ask me a question and I give them the answer. It will be terribly inconvenient, but in many cases I think we are going to have to wait [to discuss some issues] until we get together face to face. And, of course, you have to be careful. I don't think that Washington's a big risk, but in foreign countries the ability to pick up your conversation at a distance is tremendous. So any of you traveling abroad if you are walking in a park talking secretly and think you're secure, you're not.

MR. WILLES(?). May I ask: Has any President ever reined in the Desk?

CHAIRMAN MILLER. No, I asked that question. Would this be a problem?

MR. PARTEE. It's mostly against the rules.

CHAIRMAN MILLER. [The President on the call] raises questions and usually it is after the fact. That's why I didn't think a shift of procedure would be that objectionable. But I didn't want to [do] it without a full Committee discussion to get your sense of what you would like to see us do.

MR. BAUGHMAN. By way of one response to your question, I would see no serious erosion of the surveillance if we picked [the information] up either a few hours late or a day late.

CHAIRMAN MILLER. Does anybody disagree with that? Are you agreeable for us to proceed with this program and let John implement it as soon as we can? We'll post you on procedures as soon as we can get organized.

MR. BLACK. One minor thought, Mr. Chairman.

CHAIRMAN MILLER. Yes.

MR. BLACK. John, would it be safe if you transmitted the wire over the facsimile--over the land lines rather than over the Federal Reserve communication network?

MR. DENKLER. Yes, for the same reason.

CHAIRMAN MILLER. Yes, that's what we want to do. When we get the land lines, we want to use them for the facsimile.

MR. WALLACE. Bob, if I could comment on that particular question. Our staff is looking at a side issue of this and that is the possible development of a System-wide facsimile transmission system that would be far superior to anything that we have now.

CHAIRMAN MILLER. Faster, cheaper, and more secure--and that would help.

MR. MORRIS. And presumably this would permit us to organize a conference call in less than two hours, if we had these dedicated lines?

CHAIRMAN MILLER. Yes, I think the leased lines would allow us to organize a conference call much more quickly; we can patch it up on our own board.

MR. DENKLER. There are certain automated features in connection with a cable system that would allow us to do that.

CHAIRMAN MILLER. We can use it on off time, too. We will use it for our own calls.

MR. DENKLER. It's a dedicated network.

CHAIRMAN MILLER. We will lease it and we will have it just for ourselves.

MR. MORRIS. Well, that would be a big plus just by itself.

CHAIRMAN MILLER. And if Bill's plan works out, we will end up paying for that [to a large extent] with the reduced cost in the transmission of documents. So with your blessing, we will proceed accordingly. Now we will all have lunch. We'll see you upstairs as soon as we can.

END OF MEETING