Meeting of the Federal Open Market Committee

February 1-2, 1982

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., starting on Monday, February 1, 1982, at 2:30 p.m. and continuing on Tuesday, February 2, 1982, at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman
Mr. Boehne
Mr. Boykin
Mr. Corrigan
Mr. Gramley
Mr. Keehn
Mr. Partee
Mr. Rice
Mr. Schultz
Mrs. Teeters
Mr. Wallich

Messrs. Balles, Black, Ford, Timlen, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. Guffey, Morris, 1/ and Roos, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis, respectively

Mr. Axilrod, Staff Director
Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Mannion, Assistant General Counsel
Mr. Kichline, Economist

Messrs. Burns, Ettin, 2/ Mullineaux, Prell, Scheld, Truman, and Zeisel, Associate Economists

1/ Entered the meeting prior to the action to ratify System Open Market transactions in Government securities, agency obligations and bankers acceptances.

2/ Attended Tuesday session only.

Mr. Cross, Manager for Foreign Operations, System Open Market Account

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account

Mr. McIntosh, 1/ First Vice President, Federal Reserve Bank of Boston

Mr. Coyne, Assistant to the Board of Governors
Mr. Siegman, Associate Director, Division of International Finance, Board of Governors
Mr. Promisel, 3/ Senior Deputy Associate Director, Division of International Finance, Board of Governors
Mr. Kohn, Deputy Associate Director, Division of Research and Statistics, Board of Governors
Messrs. Lindsey and Slifman, 3/ Assistant Directors, Division of Research and Statistics, Board of Governors
Mr. Johnson, 3/ Economist, Division of Research and Statistics, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. J. Davis, T. Davis, Fousek, Keran, 1/ Koch, and Stern, Senior Vice Presidents, Federal Reserve Banks of Cleveland, Kansas City, New York, San Francisco, Atlanta, and Minneapolis, respectively

Messrs. Broaddus, Soss, and Syron, Vice Presidents, Federal Reserve Banks of Richmond, New York, and Boston, respectively

Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York

1/ Entered the meeting prior to the action to ratify System Open Market transactions in Government securities, agency obligations and bankers acceptances.

3/ Left the meeting prior to the action to adopt the domestic policy directive and returned prior to the action to establish longer-run ranges.

Transcript of Federal Open Market Committee Meeting of
February 1-2, 1982

February 1--Afternoon Session

[Secretary's note: Chairman Volcker opened the meeting by calling on the staff to make their "chart show" presentation.]

MESSRS. KICHLINE, ZEISEL, TRUMAN and PRELL. [Statements and related charts--see Appendix.]

CHAIRMAN VOLCKER. Do we have any comments or questions on how these people see things?

VICE CHAIRMAN SOLOMON. I have a question. I understand that in most or all of these new wage agreements that are coming in at much lower levels, such as the Teamsters and others, there is for the first time a clause indicating that labor can reopen the contracts if conditions improve in the industry. Do you know more about this? And to what extent is that likely, when recovery starts, to bring about a very sharp reversal in the downward trend in labor costs?

MR. ZEISEL. Yes, it is apparently a fairly common part of a limited number of such agreements so far, and one can understand why. In a sense it's one of the things the union is trading away; that is, the union is willing to accept a generally reduced fixed rate of increase in wages leaning heavily, let's say, on cost of living adjustments. But they want the opportunity to come back in to take advantage of any improved profit position of corporations. And I think your point is well taken that it creates greater flexibility and a more rapid response of wages to any change in demand. Usually there is a lag situation with 3-year contracts; it takes a while for any tightening of the labor market to be evident in a wage adjustment. I think this will occur more rapidly but, of course, it depends in a sense on how tight labor markets get. Our forecast certainly does not suggest an environment that would be conducive to very effective bargaining on the part of labor.

CHAIRMAN VOLCKER. You have the line for compensation per hour going down pretty steeply; it's all in the future. What gives you that great confidence?

MR. ZEISEL. Well, it's not entirely in the future, but you're perfectly right that in large degree it is. We did have a reduction in compensation over this past year. As I noted in my presentation, I think one has to look through that compensation figure a little to the wage figures behind it. The wage rate figures improved somewhat more than compensation last year. We had an $18 billion social security tax increase that raised compensation costs by about 3/4 of a point; and if we adjust for that, we have a better performance of compensation. Beyond that, we expect further improvements in the rate of increase in wages. We have an extremely poor labor market projected: 9 percent unemployment persisting through another couple of years. This will have been, by the end of the projection period, about 4 years in which the unemployment rate was higher than anybody's [estimate of the] natural rate that I'm aware of in any event. And the logic leads us to feel that this is going to result in further easing in wages. [Looking ahead,] we have as well less of the self-inflicted damage that occurs when social security taxes are raised. We have a relatively small tax increase of about $5 billion this year as opposed to last year's $18 billion and a relatively small increase next year as well. So, we think things are working in our favor.

CHAIRMAN VOLCKER. The Federal Reserve had a bigger increase in compensation [and is] looking forward to a bigger increase in compensation on some catch-up theory. How many other people are engaged in that?

MR. ZEISEL. Well, it's hard to know, but one can--

MR. GRAMLEY. The Federal Reserve's recession hasn't hit yet!

MR. ZEISEL. The kinds of adjustments that President Solomon mentioned a few minutes ago suggest that we finally are getting the wage adjustments that we were really hoping for.

CHAIRMAN VOLCKER. Yes, we see some signs of this, and some wage agreements that are reported in the newspapers suggest that some industries are under very heavy pressure. But I do hear a lot about other industries that in the total I'm sure are much more important. I'm just wondering what other people hear. Banks in particular tell me they are raising salaries by 11, 12, 13, 14 percent this year.

MR. SCHULTZ. I'm delighted.

CHAIRMAN VOLCKER. You'll have to explain that comment.

MR. SCHULTZ. Well, we do studies to see what the comparable salaries are out there. And when comparable salaries go up, why it's consistent.

CHAIRMAN VOLCKER. They will be looking at ours and then we will be in the hole next year!

MR. ZEISEL. You're perfectly right. In analyzing those industries where institutional wage adjustments remain [to be made], they did tend to be characterized--in industries that were under very substantial pressure--by market pressure of one sort of another. There are other sectors, for example petroleum, where a wage adjustment apparently occurred which was in line with the kinds of inflationary wage increases that have been occurring in recent years. But we expect spillover effects from this [pressure]. It creates an atmosphere in which bargaining is done against standards that are less inflationary than in the past. And we feel this will have an effect. In addition, of course, we have had a cost-of-living pattern recently that has been somewhat less inflationary; it has been rising somewhat less rapidly. That has a feedback effect as well.

VICE CHAIRMAN SOLOMON. I'd like to offer a thesis. As I see the data, the services sector part of the economy is likely to continue to be characterized by relatively high wage settlements and prices. The divergence in the price trend between the services sector and the rest of the economy in the last year is remarkable. In fact, in the second half of 1981, prices of services went up again at a 10 percent rate whereas [other] prices continued to come down.

MR. ZEISEL. That's generally true of wages as well. They have held up really quite well in the services sector. We feel that market considerations will be operating there; that is, the generally slack product and services markets and relatively slow growth in real income will be operating to damp prices somewhat.

CHAIRMAN VOLCKER. They don't seem to operate very well in that sector. Governor Wallich.

MR. WALLICH. Aren't we somewhat in a minority in regard to a hopeful outlook for inflation in '83 and beyond? I see that outside models we review seem to feel that in '83 inflation will pick up again with recovery. I look at our own alternative long-run strategies and the easy strategy, number 2, has inflation virtually leveling off in '84. It still goes down in '83. Now, is all this due simply to differences in assumptions on monetary policy or are there more real sector things built into these estimates?

MR. KICHLINE. Well, I'm not sure. We have not examined outside forecasts in detail. We have a running tally of four commercial forecasters and, in looking at those, I would judge that monetary policy differences have a great deal to do with that. A mean of four commercial services has M1 growth of something like 6-1/2 percent in 1982 and 5-3/4 to 6 percent in 1983. That's two years of really quite a bit more money growth as compared to the Board's numbers. In addition, they have alternative fiscal policies. The net result is that they have a much stronger recovery in activity; they have something like a 4 percent rate of increase in real GNP in 1983 compared to our forecast of 2-1/4 percent. So, all of those things do have an impact on the price side. And you're quite correct: Relative to outside forecasts, we have a fairly optimistic price projection.

MR. WALLICH. Thank you.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. To pick up on your comment, Mr. Chairman, I did get the impression as we went through the chart show and discussed the outlook [at the Board briefing] this morning that this is not a forecast that emphasizes the negative. Everything's possible, but you have a really remarkable decline, as the Chairman said, in compensation per hour. It could occur. But, as you know, it's toward the extreme of what one might think could happen. I must say that your output per hour forecast strikes me as being pretty strong, given the fact that there won't be much recovery in the economy under your projection. As a matter of fact, for the period from the latter half of 1982 to 1983 you have the longest sustained increase in output per hour that we've had since 1977. When you look at prices relative to unit labor costs on the next page, the price index goes down nicely, mirroring the decline in unit labor costs. There apparently isn't anything that occurs in food or anything else that tends to [push] prices up.

On the real side of the economy, it seems to me that you have an extraordinarily optimistic projection for plant and equipment [spending] given the capacity utilization chart shown and also the financial factors that are on the page previous to that. And finally, you have consumption really doing pretty well. Apparently, none of the alleged effects of cuts in tax rates is working in terms of stimulating savings. So, therefore, consumption remains high relative to after-tax income. The general impression I get is that this is a pretty upbeat forecast that you're giving us, under the circumstances. Would you like to comment on that?

MR. KICHLINE. Yes. It depends in part on whether you're employed or not!

MR. CORRIGAN. Is that a personal reference?

MR. KICHLINE. Not yet! In any event, you're quite correct that, looking at the assumptions we have, we do foresee some real growth. It's small relative to past cycles, but it's an extraordinary period, given our monetary assumptions. We have what I believe to be a realistic price forecast, given the assumptions, and I view that as quite optimistic. I think something very important is happening on the price side, and 1982 is a key year. I'm fairly optimistic on the price outlook. There very clearly are downside risks in the forecast. Mike pointed to some on the financial side; things can go wrong. Jerry pointed to business fixed investment, which is a sector where there are clear downside risks. I would only say that we are sure to be surprised by some bobbles in the numbers over the two-year time horizon that we're forecasting. But on average, this is our best view, given the assumptions, and I think it's realistic.

MR. PARTEE. Well, as a matter of personal preference, would you say that there are more downside risks or upside risks in your projections?

MR. KICHLINE. Given the assumptions, I think there are more downside risks, particularly in the shorter term.

MR. PARTEE. That's my impression too.

MR. SCHULTZ. Can we pursue that for just a minute? I believe it is of some importance to think about the possibility of a real shock, a break of some kind. It is difficult for me at this point in time to see a single domestic shock to the system--the kind of thing that really sends a big tremor through the system--of the size of Penn Central in '70 or Bank Herstatt in '74. If International Harvester or if Chrysler goes [belly up], I don't think those would create that kind of shock in the system. The paper market seems to be in so much better shape. Now, if Ford goes, that would give us considerably more to be concerned about. One worries in the international area about all the East European loans and about the condition of the German banks. And yet whenever one asks the question the answer always is that [the German authorities] would keep any major German banks from going under. They may have a problem. So, it certainly is worthwhile to think about where the shocks could be. We had, what--about 43,000 corporate bankruptcies in 1981? It seems clear that the number is going to be larger [this] year. The order of magnitude is very difficult to forecast, but one would think that the erosion of those balance sheets would cause more difficulties. However, it doesn't seem logical that that would provide a shock to the system of the kind that a single traumatic event would. Or would you disagree with that? Do you think that the number of bankruptcies could reach such proportions that it could provide major problems to the financial system?

MR. KICHLINE. Oh, I think it clearly could. I don't think that's the most likely forecast one would want to run with at this time. I very much agree with your assessment early on that the failure of Chrysler or of International Harvester probably wouldn't provide the kind of shockwaves that a large corporate bankruptcy might if it were totally unanticipated. I wouldn't rule that out. Things that are unanticipated are precisely that; we can't predict them. What we do know from looking at some of the individual cases as well as the aggregate numbers is that a large number of corporations appear to be [financially] strained. And part of the outcome, in fact, hinges on what happens to the economy. If cash flows were to erode or stay depressed for a longer period of time than we have in our forecast, then those pressures would tend to build.

In the numbers you cited on corporate bankruptcies are a lot of smaller enterprises that have gone out of business. Some of that is related to the federal bankruptcy laws and it can be a misleading guide as to the pressures on the system. But our perception is that there are many corporations, and probably individuals, that over the next year or two could find themselves under severe financial strain given the nature of this forecast.

MR. BOEHNE. Just to add to what you were talking about, Fred, I agree that it's hard to see the sequence of events or the big shock that would cause a real bust. But I must say that in recent weeks I've heard the term "depression" used by businessmen and ordinary people more than I can ever recall. It just keeps coming up. It's not that it's on everybody's lips, but the term or the concept seems to be bubbling up more than I would have expected.

MR. FORD. It has a lot to do with the FDR television show. It has been on every channel and everybody is reading about it or looking at it every night.

MR. PARTEE. Yes, but that was just a few days ago.

MR. BOEHNE. That was just a few days ago. I'm talking about--

MR. BLACK. We always hear more of these things when the economy is near the bottom.

MR. SCHULTZ. Are you hearing as much of that as you did in late 1974 and early 1975? I'm not, but maybe it's because I still only get a parochial point of view.

MR. BOEHNE. No, I wouldn't say it's more. But I just get asked the question: Are we in a depression or are we going into a depression? I have found the frequency of that question picking up in the last few weeks.

MR. KEEHN. I think there's more comment along that line, Fred, than there has been before. When you stop to think about it, Penn Central was an isolated incident. It was a tremendous shock, but it did occur all by itself. Herstatt, while a tremendous shock, occurred all by itself. But a whole series of companies now are moving toward this line, along with the S&Ls. One does worry that the clock is running on all these companies and that if there isn't some relief soon, it could begin to get ahead of itself and a lot could occur all of a sudden.

MR. FORD. May I ask what the staff does know on that subject? I have the same feeling impressionistically--that there are two or three of the major airlines, a substantial number of thrifts, Chrysler,--

SPEAKER(?). International Harvester.

MR. FORD. Yes, at least two of the major farm machinery manufacturers. So right there, just based on impressions, I can come up with over a half dozen big corporations. But has anyone looked at the so-called raw z-scores, the predictors of bankruptcy, as to whether the actual number of firms that in all probability are close to bankruptcy is rising sharply or--

MR. KICHLINE. I'm not aware of that. Mike or--

MR. FORD. Would that be interesting do you think, Mike?

MR. PRELL. Well, I don't know how large and how reliable the current data base is that we have access to. I know much of the individual firm data that are available are dated and not very reliable. But it might well be worth looking at. Of course, as you mentioned, there are large companies in the agricultural machinery business and strings of suppliers to the automobile industry as well as strings of suppliers in the aerospace industry who are affected, given that commercial aviation is off. So, there may be hard times for many industries. What is different about this period versus 1974 is that we have very high real rates of interest as best we can measure them. And that does have an eroding effect on corporate cash flows. I think that's one of the fundamental differences in the picture now.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Well, the thing that troubles me most in your forecast is the level of unemployment. There is very little progress made during the period of the next couple years. With the supplemental unemployment benefits starting to disappear and with the situation in the states being worse than projected--I think you get your totals because of Alaska and Texas, which are in very strong positions--we have a widespread absence of support for the [affected] population group, in light of the reduction in some of the federal programs in this area. And I think the FDR [television series] is not helping us much in terms of a background on that. I sense in the labor movement and in the political movement a stirring that I don't think is going to let this thing grind out in the kind of sequence that we see. Then supplement that with further bankruptcies in some of these sectors, and it seems to me that we haven't factored into this [forecast] a scenario that could be quite explosive. This level of unemployment is quite different than in previous [recessions] in terms of the hard core element. And we're removing support [by scaling down] some of the programs that perform the cushioning effects there. So, I think there is more explosiveness in these numbers than is apparent in the actual figures.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. May I ask if, as I take it, this chart show is correlated with the projections in the Bluebook? It is. There's something very interesting in the chart of long-range projections that I think is wonderful, but I don't understand how it can happen. That is, on strategy 2 you have the fastest money growth associated with the lowest interest rates and the highest inflation. How did that work out? Do you see what I mean? On the strategy 2 you have the highest inflation with the highest money growth, which I would expect. But then you also somehow get the lowest interest rates out of it; that's the part that puzzles me. How would you explain that?

MR. PRELL. Well, there are lags in these relationships, of course. And within the time period, in essence we're getting a movement down the demand for money curve. There is more money and people hold it only at lower interest rates. So, within this time span, that does hold interest rates down. And that also produces the stronger performance of the economy, the tighter labor markets, and the greater cost pressures on prices. I think there is a clear consistency. Now, perhaps someone who believes in rational expectations and is of a monetarist persuasion would say: Well, if we know that the money stock is going to be growing 1-1/2 percentage points faster forever, then under the base forecast here, interest rates would adjust instantaneously. That's conceivably an outcome. But as we model short-term interest rates primarily through a transactions demand for money [approach], this is the outcome we get.

MR. WALLICH. Could I pick up on that? We often find ourselves saying that we cannot control interest rates except maybe very temporarily at the short end. And here we see that apparently we're supposed to be able to bring down Treasury bill rates for three years and make that stick. I find it hard to see the consistency of what one finds oneself saying about the difficulty of providing interest rate relief and these numbers here.

CHAIRMAN VOLCKER. You get out of the model what the model says. And what the model says is the more money, the lower the interest rates.

MR. KICHLINE. In the short run. I would say you can argue about the lag because if we had 1985 on the chart, you'd find interest rates under that strategy rising sharply. And maybe it wouldn't take until 1985. But that very strategy would provide higher interest rates in the long run than any of the other strategies.

MR. PARTEE. Is that really true? It wouldn't equilibrate?

CHAIRMAN VOLCKER. Unless you provide more money.

MR. PARTEE. I'm struck by the fact that your chart show has real GNP relative to potential dropping to the lowest level since 1960. That is a fairly long time period. If you were to raise that level relative to potential by a point or two--from 91 to 92 or 93--I wouldn't think it would do an awful lot for inflation or interest rates because that would only produce a somewhat [higher] lowest level since 1960 in the GNP relative to potential.

MR. KICHLINE. All I can say is that the way this model works, as I think many others do, is that if you raise the money stock, it just takes a matter of time--and one can quibble about the time--but over the longer run, it's reflected in prices and not output.

MR. PRELL. You can see that just in that table for '83 and '84 on the high money alternative. The 5-1/2 percent does have a bottoming out of the bill rate in the second year. It's a perceptibly different pattern from the others.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. I'd just like to ask Jim a question on these fiscal policy assumptions. In the Bluebook, of course, a discrete range of alternatives was set forth--strategies one, two, and three, depending on whether we follow the high end, the midpoint, or the low end of the specified monetary growth ranges. On the fiscal policy side, Jim, I wouldn't know of more plausible assumptions to make than those you have made here. But having said that, how the federal budget will really turn out is in my view one of the big uncertainties now. I'm just wondering whether you experimented with any alternative scenarios on the budget and how sensitive real growth, the unemployment rate, and inflation are to different scenarios.

MR. KICHLINE. Well, we did, and we had so many alternatives that it was a question of which one to present or what to talk about. It was a real problem. We did try something that was a much tighter fiscal policy by getting rid of the 1983 personal tax cut, for example, and the 1985 indexing. We stripped that out and assumed more expenditure cuts, and in that process we found that in 1983 when the stimulus of the budget was taken away, output dropped and the unemployment rate rose. That was the short-run effect; but the long-run effect gives you a much better posture with much lower interest rates and a better inflation performance. There is this output cost in the short run but that fiscal alternative of a tighter posture does in fact provide a good deal of relief on the interest rate front, according to the model, and does provide opportunities over the longer run for improved inflation performance.

VICE CHAIRMAN SOLOMON. How much relief for interest rates do you get in your model with a tighter fiscal policy?

MR. KICHLINE. With this fiscal alternative and the judgmental money assumptions, the model reduced the bill rate in 1983 by some 2-1/2 percentage points; the bill rate was a little under 10 percent versus 12-1/2 percent. So, it's 250-300 basis points. But I must say that was a package of about $50 billion on the tax and expenditure sides. It's a big fiscal change from what we have here.

MS. TEETERS. This was with no change in monetary policy?

MR. KICHLINE. That's correct.

MS. TEETERS. You didn't postulate that if we had a [tighter] fiscal policy we might have a more--

MR. KICHLINE. Yes, we did. Fiscal alternative [unintelligible] higher money. In 1983, we'd get a 6-1/2 percent bill rate instead of 12-1/2 percent. One can get all sorts of things, but that was an outcome that at least in the first 3 years produces a much better performance on most of the variables you might be interested in. Then it begins to get worse as you go out further in time.

MS. TEETERS. Does that give you an increase in business fixed investment and housing and so forth? It must.

MR. KICHLINE. Yes.

CHAIRMAN VOLCKER. What are you assuming here on the budget? You're assuming a higher level of expenditures than the Administration is going to project by a considerable margin, right?

MR. KICHLINE. I presume so. Those numbers were still being changed, I am told, even as of this last weekend. I really lost track several weeks ago. I think we are higher because of the economy as well as--

CHAIRMAN VOLCKER. That's what I was going to ask. How much is the economy and how much is a difference in [the fiscal assumptions]?

MR. KICHLINE. Well, in fiscal '83, they have an unemployment rate of around 8 percent or so and we have a little over 9 percent; that alone probably is worth roughly $30 billion on the deficit. Also, I'm told that for fiscal '83 they have something like $15 to $20 billion of tax raising measures and $30 billion of expenditure reductions, and we've taken about half on those sorts of things.

CHAIRMAN VOLCKER. You've taken half of what you expect them to propose?

MR. KICHLINE. Correct.

VICE CHAIRMAN SOLOMON. That's probably as good a guess as any because they certainly don't expect to get all of that out of the Congress.

MR. WALLICH. Jim, isn't your model in a sense vitiated by the fact that you have data going way back into the '50s when inflation wasn't very important but fairly sizable actions were taken both to curb inflation and to get the economy going. So, you have a history of large actions, large swings in the economy, and modest reactions on inflation. The model then gives you these same answers for the present period when it would seem to me that large swings in the economy would also have large effects on inflation.

MR. KICHLINE. Well, I think that's possible. When talking about long-run forecasts I'd be very cautious simply because for most of the very important variables we're out of the range of historical experience. So, I wouldn't disagree with that.

VICE CHAIRMAN SOLOMON. I find it interesting that the interest rate projections in the bond market that are consistent with your GNP scenario show virtually no change. [The bond rate] is projected to be between 15 and 16 percent over a 2-year period. What does that say about inflationary expectations and investors affecting the bond market at a time when you're showing such a sharp drop in actual inflation? How do you tie this whole thing together? Are you in effect saying that bond market investors are going to continue to have a fairly high level of inflationary expectations notwithstanding the major progress that you're assuming in '83 and '84?

MR. SCHULTZ. But think of the deficit that they're assuming [in their forecast].

VICE CHAIRMAN SOLOMON. I'm not disagreeing. I just want to be sure that I understand what the man said.

MR. KICHLINE. I think that's right. Our forecast would be one of continued high or, in fact, rising real rates given that we have inflation coming down. So you'd have to be thinking in terms of disbelievers in the market; that's certainly a possible way of reconciling these differences.

MR. PARTEE. You're talking about real rates building to 10 percent or thereabouts, aren't you?

MR. KICHLINE. Well, as Governor Wallich would say, before taxes--

MR. PARTEE. Just a little on the economy--

CHAIRMAN VOLCKER. That is, if there is any tax left!

MR. BALLES. Another question on your tighter fiscal policy assumption: How did that translate, if you did this, with Mike Prell's chart on the Treasury borrowings and the percent of total funds raised? The chart shows that percentage shooting up to 40 percent by 1983. Would we get any significant relief under that tighter scenario from the crowding-out phenomenon that I'm quite afraid of?

MR. KICHLINE. The borrowing that we have with that tighter alternative would drop about $45 billion, which is about 10 percent of total funds raised. So it would make a substantial difference in terms of the federal borrowing as a share of total funds available.

MR. CORRIGAN. Let me pick up, John, if I may, on the point that Tony started to get at. I think there's a natural coincidence of conversation about the downside phenomenon here, but this real/nominal interest rate issue strikes me as something that really may cut the other way, even if it's only in the realm of possibility. As I look at all of the numbers here, basically, you have nominal interest rates unchanged between 1981 out to 1983. And that's true whether it's mortgage rates or bill rates. But at the same time, you do have in that time frame a very sharp change in the measured rate of inflation, ending up with 5.7 percent or something like that in 1983. My question is: Isn't it at least conceivable, everything else equal, that you could end up with quite different nominal interest rates, particularly when you're also talking about higher savings? In Mike's flow-of-funds tables, I must say I am struck by the fact that even with the deficits the way you have them, total funds raised as a percentage of GNP is down fairly sharply from where it was as recently as 1980. Now, I wouldn't project it, but isn't there clearly some [possibility that], if things worked a little differently, we could be looking at something much more favorable in terms of nominal and real interest rates?

MR. PRELL. I'd make a couple of observations. One is that, of course, that outcome on flows is the outcome of supply and demand. And one of the things holding that flow down is our basic interpretation of the monetary target and the constraint it places on the supply of funds. The other thing is that, indeed, if one adheres to this policy and sees the progress on the inflation front and a slowing of all the underlying indicators of inflationary trends, then one might anticipate some improvement in nominal interest rates reflecting a decreased inflation premium. We've been cautious in that. Given the short-term interest rates we see as in essence clearing the money market, we've been hesitant to put in a big drop in long rates at the same time that short rates are pretty much stable and at some points higher than they are now. It's just totally against all history to have a pronounced drop in long rates when short rates are under this kind of pressure. But it's not inconceivable in this kind of environment.

MR. FORD. Well, if I may, again on the same question that the rest are asking: If you do calculations on trends in real rates and compare them under the three strategies--strategy 1 being the one that I assume starts with 4 percent growth--the way it seems to work out is that by 1984 under strategy 3, which is really tight money, the real rate of interest is 8.6 percent versus 3.1 percent under the most expansionary monetary policy. And if you give any credence at all to the expectations notion, it would seem to me that after 3 years in a row of tight money and dramatic reductions in inflation down to 3 percent, the real rate of interest would be smaller under that strategy than the others--certainly not 3 times as high as it is under strategy 2 by 1984.

MR. PRELL. Well, this is a short-term rate of interest. And I don't think there's any clear evidence that as one models the demand for money one can find clearly a separate influence of the expected inflation rate. In essence, the nominal interest rate captures the opportunity cost of holding cash balances and, therefore, there's not an obvious place for inflation expectations per se to enter into that. But the farther out you get on the maturity spectrum, the more plausible it becomes that this kind of inflation expectations effect will have a significant impact.

MR. FORD. In other words, if instead of just the T-bill rates shown here you also had shown, say, rates on 5- or 10-year notes or bonds, the apparent inconsistency there would be less apparent. That is, you could have the [lowest] long-term rates under the tightest monetary policy.

MR. PRELL. Not necessarily, using a traditional model. That probably would tend to show rising long-term rates because short-term rates are rising.

MR. FORD. Does your model put out a long-term rate or a 5- or 10-year rate?

MR. PRELL. It [does use a long-term rate], but it has not been especially reliable. That's one of the reasons we have not used it very much. In fact, it has been underpredicting long rates over the past year.

MR. CORRIGAN. You have mortgage rates on there.

MR. BOEHNE. Getting at this real rate effect: Don't you have to trade off the effects of the inflationary expectations, which have become commonplace, versus the demand effect that comes from this very large deficit? It seems to me that it's the demand side that is driving up the real rate and more than offsetting the positive effects you're getting from inflationary expectations.

MR. KICHLINE. That's right. And I wanted to mention that I think it's both the federal side as well as the private sector. On these tight money alternatives, essentially the economy very much wants to grow more rapidly in nominal terms than monetary policy is permitting it. And it's that kind of squeeze in the short end that is driving these rates up. So, I'd say it's both the federal government sector as well as the private sector; even though we have a fairly sluggish private sector, in our view there are still demands that would be satisfied at these rate levels. And you need those sorts of rates to restrain the economy over this time horizon.

MS. TEETERS. You still have a fairly substantial shift in the demand for money in 1982, don't you?

MR. KICHLINE. We have assumed about 2-1/4 percent.

MS. TEETERS. How does that compare to what happened in 1981?

MR. KICHLINE. Well, 1981 is bordering on 6 percent, I guess.

MR. PRELL. About 5-3/4 percent.

MR. KICHLINE. Yes.

MR. PRELL. And we have greater drift in later quarters.

VICE CHAIRMAN SOLOMON. It seems to me, notwithstanding the rapid decline in the actual rate of inflation that you are projecting, that inflationary expectations will stay high for two reasons: (1) the short-term volatility of rates; and (2) as two years go by, if we stay at 9 percent unemployment and very depressed housing conditions, etc., notwithstanding the progress on inflation, there will be less and less patience with that situation in the political arena. If you add to that some changes in the election in '82 or changes in the polls of public opinion, then I think there is going to be pressure for reversing some of the spending cuts. On the other hand, there may be some willingness to do something on the revenue side, so I'm not sure what the net effect on the deficit would be. But I don't see any realistic scenario that assumes that the country will simply stay with this situation for two years, notwithstanding the very attractive drops in the rate of inflation. I don't know what follows from that because there are so many different possibilities as to what form the reaction would take.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, we had very little in the way of differences in the forecast for '82, although a slight difference in quarter-to-quarter performance. The main difference we had was the one that Jerry elaborated on more than anyone else. With the projected decline in inflation, I think rates have to come down more than what we see projected here. And on the point that Mike Prell developed a while ago: If long-term rates did come down, I would expect short-term rates also to follow as people use the proceeds of that long-term borrowing to liquidate some of their short-term debt. So, our guess would be that we are underestimating the amount of real growth and overestimating the amount of unemployment that we would have in '83.

CHAIRMAN VOLCKER. On that happy note, Governor Gramley.

MR. GRAMLEY. Well, I think one of the answers to why real rates are so high is contained in one of the charts that the staff had in its briefing [to the Board] this morning. I don't happen to have it with me, but it showed the components of GNP and the trends in those components over time. It had consumption going up like [a rocket] to 65 percent [of GNP], the highest ratio since 1948; it had defense expenditures going up from something like 4 percent to 6 percent, as I remember the numbers, and investment dropping out of bed. In effect, what is happening is that when we have a fiscal policy that stimulates consumption and is designed to increase defense expenditures, real interest rates have to go high enough to hold down the rate of business fixed investment to the point where it will fit within the monetary growth assumptions provided. If you look at the numbers for monetary growth and nominal GNP, you find that strategy one provides for an increase in velocity of roughly 4 percent in 1982, 3 percent in 1983, and 3.8 percent in 1984; it's 3.3 percent on average. And what has to happen, if we're going to get a better economic performance than what the staff has provided here, is that we have to get awfully lucky and have another one of those big downward shifts in money demand. That may happen, but I think the staff is quite right in saying one can't be sure.

CHAIRMAN VOLCKER. Are you saying anything different--in an elegant way--than that the deficit is pushing interest rates higher?

MR. GRAMLEY. It looks at it in a different way. It says when we have a combination of--

CHAIRMAN VOLCKER. But you're going to get those same velocity shifts regardless of what the deficit is, on one theory anyway. Well, you get it at lower interest rates.

MR. GRAMLEY. I wouldn't subscribe to that theory at all.

CHAIRMAN VOLCKER. Well, you get the same velocity but at lower interest rates.

MR. GRAMLEY. I don't subscribe to the theory that you get the same nominal GNP no matter what fiscal policy does.

CHAIRMAN VOLCKER. You get a lower nominal GNP; you get more unemployment, too.

SPEAKER(?). That's right.

MR. GRAMLEY. A lower nominal GNP with a smaller deficit, right.

CHAIRMAN VOLCKER. And you get lower [employment] and less growth.

MR. GRAMLEY. You get more unemployment and somewhat less growth. Yes.

MR. PARTEE. In the short run.

MR. GRAMLEY. In the short run. But you'll get an economy--

CHAIRMAN VOLCKER. Why is it only in the short run?

MR. GRAMLEY. Well, over the long run--and by long run I mean over the next 20 years--if you believe that prices are sufficiently flexible, then the real GNP will be related to productivity and real resource use.

CHAIRMAN VOLCKER. Eventually prices will go up, too.

MR. PARTEE. I guess what you're saying is that that big hunk of 42 percent of the demand for funds is not interest sensitive at all. Therefore, you have to force the real rate up on the residual in order to keep the total down to the point that it fits within your monetary assumption.

MR. BLACK. To the extent that inflation comes down, that nominal rate does not have to go up as high.

MR. CORRIGAN. But Chuck, under that argument, if you didn't have the 42 percent, you could end up with the best of both worlds in the sense that all credit demands were interest sensitive and the real economy could be stronger even though you had lower deficits.

MR. PARTEE. Well, the first effect would be lower GNP because you have the reduced federal spending; but the second effect would be the impact lower interest rates would have on expanding total demands.

CHAIRMAN VOLCKER. Does anybody else have any comments? How full is the strategic oil reserve these days, Mr. Truman?

MR. TRUMAN. I don't know. My memory is that it's about--

CHAIRMAN VOLCKER. How much are we putting in it now?

MR. TRUMAN. We're putting in about--. Let's see, I do have that figure.

MR. SCHULTZ. We were putting in 100,000 [barrels] a day. And then didn't they raise it?

MR. TRUMAN. Well, it was moved up, I think, to 1/4 million barrels a day. If you hold on a minute, I'll tell you what they did last year, at least. Last year it was 340,000 barrels per day on average. And that was high relative to the previous periods. We have in the forecast something only on the order of a little over 100,000 barrels per day. They put a lot in over the last three quarters.

CHAIRMAN VOLCKER. You have it going down.

MR. TRUMAN. The rate of fill has gone down. I think that is one of those things that is locked up in the budget financing situation with Mr. Stockman. It's no more certain than some of these other factors.

MR. SCHULTZ. Is 120 billion what they're trying for?

MR. TRUMAN. 120 billion?

CHAIRMAN VOLCKER. No.

MR. SCHULTZ. I mean million.

MR. TRUMAN. As of the middle of 1980, it was 91 million barrels and they've been putting more in at the rate of about 100,000 [per day]--I'd have to multiply that out--for the past two years.

CHAIRMAN VOLCKER. This last compensation figure--I keep staring at Mr. Zeisel--you have plotted: Is that the third quarter or the fourth quarter?

MR. ZEISEL. The last real figure would be the fourth quarter.

CHAIRMAN VOLCKER. The fourth quarter.

MR. SCHULTZ. Was it 5.7 percent in the fourth quarter?

MR. GRAMLEY. This is year-over-year as the chart reads?

MR. ZEISEL. Yes.

MR. SCHULTZ. What was that figure for compensation in the fourth quarter--5.7 percent or something like that? It was pretty low.

MR. KICHLINE. For total private business it was 5.7 percent; for total private business for the full year 1981 it was 9.3 percent, and that was down a percentage point from the year earlier.

MR. SCHULTZ. I never did get to ask the question. Why was it so low? I recognize that there's a lot of volatility in those quarterly figures, but that 5.7 percent did seem to be quite low. Do you think that's an aberration or was that indeed indicative of some real progress?

MR. ZEISEL. I would think it's an aberration. There's a certain amount of--

VICE CHAIRMAN SOLOMON. For the first three quarters, the average earnings per hour figure was coming way down while the compensation index was not. And then finally in the fourth quarter, there was this delayed parallel trend movement in the compensation index. For the first 9 months of the year, as I remember, we had a significant drop in average earnings that we did not have in compensation.

CHAIRMAN VOLCKER. Let's take a couple of minutes [on recent developments in the aggregates], since it bears upon what people think about the long run--or at least what I do. Although I don't know the answer on what has been going on in the money supply in the last 2 or 3 months, maybe you can say something, Mr. Axilrod, in terms of the composition and the surveying that your people have been doing and so forth. Then let's get comments from around the table on how everyone is looking at this.

MR. AXILROD. Well, so far as we could tell, in the last 2 or 3 months we have had this very sharp run-up in the money supply, which partly was expected, given interest rates, and partly unexpected. I can't divide it very easily between the expected and unexpected parts, but I would point out, as many of you have heard, of course, that we have had a fairly sharp turnaround in all of the components of money; but in particular the turnaround in other checkable deposits seems to be correlated with a turnaround in savings deposits. For example, the savings deposit component of M2 declined over the 6-month period from April to October '81 at about a 21 percent annual rate at a time when other checkable deposits were growing at around a 15 percent annual rate. I picked that period because that is after the bulk of the shifting into other checkable deposits was finished in the first 4 months of the year. Since October--in the last 3 months--savings deposits on the new seasonals have increased at a 12 percent annual rate, compared with this 21 percent decline, and other checkable deposits have moved from a 15 percent annual rate of increase to a 53 percent annual rate of increase. At the same time, of course, demand deposits have turned around. They had been declining at a 6 percent annual rate and are now expanding at a 6-1/2 percent rate through January. But the bulk of that expansion in January occurred in the first week and is now ending, whereas the expansion in other checkable deposits has remained strong through the balance of January. So, I think the demand deposit expansion is working its way out whereas as yet we have not seen the NOW account and savings deposit expansion working its way out.

We've tried to investigate the various reasons for the increase in savings and in demand deposits. We have surveyed the banks and we have not gotten very satisfactory replies. In my view some of it is related to nonconsumption, just savings resulting from a failure to consume [and funds] flowing into the easiest alternatives for a while--demand deposits, NOW accounts, and savings deposits. Some of it is related to actual financial uncertainties. We see that in time certificates; small time certificate growth slowed very noticeably in December and January, and that money is being placed elsewhere, at least temporarily, in more protected forms. And we have heard bits and pieces of evidence that corporate demand deposits were rising toward year-end and early in the year, partly for corporate window-dressing and partly for compensation balances. However, those were bits and pieces of evidence and they were not very clear-cut.

This rapid expansion has tended to exhaust much of the growth for the year [allowed for] in the tentative targets, as the Committee can see by observing chart 1, following page 11 in the Bluebook. That range of 2-1/2 to 5-1/2 percent is plotted from the actual level for M1 in the fourth quarter of 1981. As you can see, the January expansion has brought growth well above the range; growth is well above the parallel dashed lines [unintelligible]. In effect, much of the expansion for the year has been used up. It is quite possible that we could get negative numbers in February and March. As the Bluebook points out, we had that in 1981 following the April bulge at a time when short rates rose very sharply. And that has occurred on rare occasions at other times. But absent such a sharp drop, the amount of monetary expansion [that could occur] over the balance of the year is relatively limited [if money growth is to be] within the tentative range adopted by the Committee. That, of course, Mr. Chairman, brings up questions about the range and its basing and whether it should be raised.

CHAIRMAN VOLCKER. I don't quite want to get to those [issues] now. But, obviously, what you think is going to happen in the next few months makes quite a difference in how you look at a lot of things. Everybody has been looking at this to some extent. We have this phenomenon of big NOW accounts in particular, although other things are mixed in with it. We don't even know whether the seasonals are any good, and they may well not be. Does anybody feel that they have any stronger insights into what is going on here? Mr. Morris.

MR. MORRIS. I may have a feeble one.

CHAIRMAN VOLCKER. We want a strong one.

MR. MORRIS. I think one of our problems is the assumption that we made at the last meeting--that the adjustment to NOW accounts nationally was over. The New England data lead me to suspect that that may not be the case--New England being the only section [of the country] with mature NOW accounts. I looked it up to see if we have had any bulge in NOW accounts and we have not. They have been quite flat. So, that at least is a little evidence that perhaps the problem is that the national NOW account adjustment is going to take longer than we had assumed.

MS. TEETERS. Do your back data show anything on--

MR. AXILROD. The data we got show that--

CHAIRMAN VOLCKER. Let me just pursue that for a second as a possible explanation. My understanding was that very few of you, if any, found much of the explanation in the opening of new accounts instead of [an increase in] existing accounts. Is that true?

MR. AXILROD. That's right. This was all [accounted for by] existing accounts going up.

CHAIRMAN VOLCKER. There seems to be a little inconsistency with that explanation, but that's an interesting phenomenon.

MR. MORRIS. Well, maybe it's not the right explanation. I thought it might be because it's not clear to me why New Englanders should feel more secure and not need to put more money into NOW accounts than people in the rest of the country.

MS. TEETERS. In the past have you had increases in NOW accounts in the first part of January? You've had NOW accounts for what, five years now?

MR. MORRIS. They go back to the middle of 1972.

MS. TEETERS. But do you show in those early years a sudden jump in January?

MR. MORRIS. No, I don't think so.

MR. RICE. Did your demand deposits increase along with the rest of the country?

MR. MORRIS. Yes, our demand deposits were up.

MR. RICE. Have they fallen off recently?

MR. MORRIS. I haven't seen [data for] the latest week when they apparently have fallen off nationally.

MR. BOEHNE. The demand deposit [increases] have been more on the corporate side, not the personal side.

MR. PARTEE. What kind of seasonal do you have on the NOW accounts? Are you using your own seasonal because you have this--?

MR. MORRIS. We've just been comparing our nonseasonally adjusted data to the national--

MR. PARTEE. Unadjusted data, I see.

MR. MORRIS. The unadjusted data.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. Well, I don't really have any answer, Mr. Chairman. I do have a couple of questions that I thought I might try on Steve. We couldn't find any good reasons for this explosion we've had in NOW accounts in the Twelfth District. Our banks weren't very helpful in throwing any light on why it has occurred; it just seems to be happening. Maybe it goes back to the thought that you expressed; it could be a belated reaction to interest rates having fallen late last fall. It could be increased liquidity preference in a period of uncertainty. The more I mull over why it's going on, the more I just have a hunch that we may be asking the wrong question in a sense. I recall a debate around this table some years ago in the mid-1970s--I can't remember exactly when it was, perhaps 1976 or 1977--when we were agonizing over an excessively rapid and unexpected rate of monetary growth and why it was occurring. I think it was Chairman Burns who said at that time: Well, it's very simple; we've been putting too many reserves into the market. And I wonder if that isn't really the basic answer when everything is said and done.

MR. AXILROD. Well, there's a correlation, obviously. It wouldn't be there if we hadn't put the reserves in. The question one has to ask oneself is: Why this much money at current interest rates or rising interest rates? That is the question, mostly, that we are trying to answer. Why has the demand for money at current interest rates expanded? If we had somehow managed to get all those reserves out and not permitted this much money in these NOW accounts and demand deposits and currency, then it's our thought that, of course, interest rates would have been a lot higher. So we'd have to ask if you'd still be wanting to know the answer to the question at that point. If we had succeeded in doing that and had these high interest rates, you would want to know why interest rates were so high in the middle of a recession and we'd be trying to explain why the demand for money was strong. That's what we're looking for, those kinds of explanations.

MR. BALLES. Well, taking the whole period of November through January, Steve, when we had this very rapid growth, net, do you have an impression of how much of it was due to changes in multiplier relationships? Does that explain very much of it?

MR. AXILROD. Well, I'd have to go back and review. We tried to [determine] the extent to which we might have been off on the multiplier relationships that we put in the reserves to money path. Of course, we change these each week as we get data, and with lagged reserve accounting in some sense we are always perfect on it. But the current relationship doesn't mean anything and the lagged one does. I don't recall to what extent we've had to change them. We've made considerable changes, but I don't recall that as being a big source of error with the lagged reserve accounting.

CHAIRMAN VOLCKER. The trouble with that explanation is that we've been putting in reserves since July or so and it has only been in November, December, and January that money growth suddenly took off.

MR. BALLES. It suddenly grabbed and the question is why.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. As you requested, we did a survey. And if it's bad to contribute, then we're guilty, because our growth in the last month has been distinctly above the [national] average both in demand deposits and other checkable deposits. We've had a particularly strong kick in terms of percentage growth in NOW accounts, the area that you expressed an interest in. There was virtually no change in ATS-type accounts. I asked my staff to take a sample of the banks around the District that were contributing particularly to this growth above the trend growth for the whole nation and, like the others who commented, we could not find any clear, simple, new explanation. The facts we came up with were that virtually all of it was in existing accounts--to address the possibility that you raised, Frank. We did not see any surge in the number of new NOW account openings; growth was in existing accounts.

MR. MORRIS. Is there any evidence of higher minimum balances being imposed now that might have led to a change?

MR. FORD. We didn't pick that up. There's a drift higher. Right now in our District there's very heavy competition among [financial institutions] on pricing of all types of deposits, particularly the IRAs. And the terms and conditions for IRAs seem to be getting more and more competitive from the consumer standpoint. I didn't check any trend on NOWs, but I haven't noticed it. I just don't know. So, we didn't get any strong indication of any surge in new NOW account openings. It's just the existing accounts that are building up.

As far as the speculation as to why, a couple of bankers said that they think people are holding off, waiting to see what develops in IRAs, and are just parking money in these NOW accounts until they figure out the best IRA deal, at which point they will switch to an IRA. The IRA deals are still being unveiled in our District. Another explanation is the simple old one that people are just saving more and spending less. It seems consistent with other information we have. There's nothing really exciting, though, on the demand deposit side; we don't see anything particularly interesting there. We looked at it and considered it normal corporate window-dressing during this year-end period; nobody believes it's an unusual amount of corporate window-dressing.

CHAIRMAN VOLCKER. Mr. Roos, as I remember, money growth wasn't very big in your District. It probably means you have better monetary policy out there!

MR. ROOS. I asked our staff to see if they could churn up some figures that perhaps would explain not the IRA thing but why M1 acted as it did. And they did come up with some interesting figures that I'll be brief in touching on. The bottom line of the figures they gave me indicated that we were somewhat slow in our willingness to change our nonborrowed reserve path under certain circumstances. They looked at four periods. One, for example, was the 3 weeks ending August 19 and, Steve, let me see if I can explain what I'm trying to say. In those 3 weeks, the projected deficiency of total reserves relative to path averaged about $152 million, according to our records, and in that period we did not change our nonborrowed reserve path nor did we change the discount rate. The average in the 4 weeks ending September 15--and this was when the aggregates were undershooting--was about $244 million. The deficiency in the 3 weeks ending October 7 was about $405 million. And in each of those periods, if my staff's figures are correct, we apparently did not change our nonborrowed reserve path nor did we change the discount rate. Now, back in May of [last] year, when total reserves were projected to be about $500 million above path, we increased the discount rate and we reduced the supply of nonborrowed reserves by about $375 million. And as a result of those actions, M1 began declining immediately and we did avoid a continuation of that. We, in effect, interrupted the bulge that occurred then. Is there any logic in their conclusion, based on that type of evidence, that one of the problems has been a problem of our not moving our nonborrowed reserves as quickly as we should?

MR. AXILROD. Well, President Roos, maybe to put a little perspective on this--I don't know about those figures but I'm sure they're accurate--from September to December of [last] year the Committee originally wanted M1-B growth, shift adjusted, of around 7 percent. They changed it a bit in mid-course. By the time September to December was over, we had [M1-B] growth on the order of 8-1/4 percent. I haven't checked the most recent seasonal figures, but these are the figures before they were adjusted. That's not far off from what the Committee found perfectly acceptable and is probably on the order of what the Committee would find generally acceptable given what happened. What then occurred was that January growth was unusually high, going into a period when the Committee wanted growth to phase down into the longer-run range. It was made unusually high by a bulge in demand deposits early in the month, which I believe is in process of working its way out, though not entirely. And it has been maintained at a high rate by NOW accounts not quite working their way out so far but, in fact, growing faster in January on average than in the preceding two months. In light of all that and with total reserves running strong, of course, a downward adjustment of around $190 million was made in the nonborrowed path midway through this period. We put additional pressure on the funds rate. There's no way in a period as short as a month, given lagged reserve accounting or possibly even given contemporaneous reserve accounting, to have gotten that growth of 20 percent down to, say, 5 or 6 percent or whatever the Committee would have felt comfortable with, short of a funds rate moving up I would guess into the 27, 28 percent area, with contemporaneous accounting. I made a theoretical calculation at one point, which would not have changed the basic question that the Chairman raised as to why money demand was so strong in this very short-run period. One would have had to answer that question either way. But I think the actions taken with regard to the reserve path were such as to work in a constraining direction.

MR. ROOS. In other words, that's the answer: That you withdrew reserves by about $190 million.

MR. AXILROD. Yes.

MR. ROOS. The excess of the total reserves was up in the $300 or $400 to $500 million area. You say that if you had pulled all of those out, it would have had a dramatic upward influence on interest rates. And that's the reason you didn't.

MR. AXILROD. If we had pulled out $400 million, we would have had more borrowing, of course. But all the research I've seen suggests that to pull out $400 million of total reserves in a month--under contemporaneous reserve accounting, let's say, not under lagged--we would have to reduce nonborrowed reserves by something like $3 billion because the banks are going to offset that with borrowing. And if we reduced nonborrowed reserves by about $3 billion, the banks would borrow $2.6 billion to get the total down $400 million, and interest rates would go up extraordinarily high. That's how the mechanism would work in the short run. You might conceivably get January down, assuming contemporaneous reserve accounting, but then interest rates would be so high that February would be plunging negative. Then interest rates would have to drop very sharply to induce banks to expand again and get the February growth up. That's how the process seems to work.

MR. ROOS. Steve, our experience in May, though, when we had a similar bulge and when you did take strong action to reduce nonborrowed reserves--I think by about $370 million, if my numbers are correct--was that it did cause the fed funds rate temporarily to go to about 19 percent, but then it receded, didn't it? In other words, I wonder if we are exaggerating the possible volatility of those fed funds rates and whether we're not in the long pull affecting interest rates more meaningfully than if we really bit the bullet.

MR. AXILROD. Well, in my judgment, President Roos, last April that bulge probably would have come out to some degree without our doing anything--that is, with interest rates unchanged. And the rise in rates that occurred--because it was just [due to] temporary factors--of course encouraged it to come out more. It may even have contributed to money running low for the rest of the month. So, I'm not sure how the variability would have worked out in that respect. You can make the case that you could get less variability in money growth with less variability in interest rates if you examine these things carefully through a different procedure.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Well, Mr. Chairman, we tried to look at this question of the money supply both analytically and by relying on anecdotal information as well. Let me just touch on each of these briefly. On the analytical side, we really looked at two things. One was the seasonal adjustment, and there I guess what we found is a bit of good news and bad news. There was good news in the sense that using a different procedure than X-11 one could point to a pattern of weekly movements in January that is quite different from the one that the official numbers suggest. Now, I don't mean to imply that one method is better than the other. But it really tends to underscore how extremely volatile these seasonal factors are and how badly they can lead us astray in a given period of time. The second thing we did is probably more important. We tried to take a quick and dirty look at this question of how the measured money supply responds to changes in interest rates, recognizing that there are at least some people on the staff--it's not many--who argue that if you go back and look at declines in interest rates in the late summer and fall of 1981, maybe what we have been seeing over the last 3 months isn't all that unusual. We tried to look at that and found at least in a very tentative way that perhaps more of what we've seen can in fact be explained by declines in interest rates earlier on. Indeed, while this work is very tentative since it has been done in only about 8 days, it does suggest that the response in money to changes in interest rates or shocks in the federal funds rate is a lot greater than I thought possible. And it may well argue that the problem isn't so much too quick a response on the part of policy but the other way around: That the harder we hit the short-run blip in the money supply by jiggling reserve paths or whatever the more we may be creating a worse problem for ourselves a little further down the road in the sense that by hitting it hard it builds in this perpetuating cycle that we've seen a little of over the past 2-1/2 years or so. Of course, the argument could be made the other way as well. I don't know the answer yet, but certainly this work does suggest that more of the increase in money than I thought possible can be explained, at least by this exercise, by what happened to interest rates earlier. And to my way of thinking that's not inconsistent with the argument that we ought to respond more slowly rather than faster to some of these temporary blips in the money supply.

But even under the best of circumstances, I don't think either of those factors can fully explain the more recent developments in January. And there we did try to develop some anecdotal information. Certainly in our case we were able to find on the business side patterns of window-dressing by large corporations that involved larger amounts of money than both they and their bankers said had been typical in earlier years. And that phenomenon was very short-lived, which of course is compatible with the idea of that big bulge in business-type checking accounts in the first week with washouts in the next two weeks. On the household-type checking accounts, NOWs and so on, we really don't have much to add. In our area, in terms of Frank's point, we too didn't see many new accounts. It was all existing accounts. The bankers and others we talked to basically made the argument that we have some kind of precautionary phenomenon here, some of it related to the economy and unemployment, some of it related to uncertainties about the interest rate outlook, some of it maybe related to savings flows themselves, and some of it--at least in the case of our own employees in the Bank, based on a little informal survey we did--related just to a desire to build up larger balances to pay off bills incurred in December faster than they might ordinarily do. That's about it.

MR. AXILROD. Mr. Chairman, President Corrigan mentioned the effect of interest rates and I probably should point out to the Committee that our monthly money market model, which is very often wrong and is sometimes right, would have projected very sharp growth in the money supply. That is one of the reasons we thought [M1] would grow in November and December, way back when. And [the model] would project that growth continuing on, given interest rate moves that had already occurred, into January--but not at this rate--and February and March and petering out after that. On the other hand, if you look at our quarterly model, it would suggest that the money growth we've gotten in January is more than enough to finance the quarter's income, given interest rates. And to get what it says we would have for the quarter, then we would have to expect [M1 in] February and March to drop at around a 13 or 14 percent annual rate. That's just about what the money model says it is going to increase. So, the models tend to give varying results.

CHAIRMAN VOLCKER. We get explanations and counter-explanations for every phenomenon. Mr. Keehn.

MR. PARTEE. The only trouble is that we don't know if it's temporary or permanent.

CHAIRMAN VOLCKER. That's right. That's all I want to know. Mr. Keehn.

MR. KEEHN. In the surveys that we did with the banks in our area, we were impressed by the consistency of the compensating balance comment. Apparently corporations allowed their compensating balances to fall during the latter part of the year. We were surprised by how many banks commented on that and by how many companies apparently drew on their lines of credit to build up their [cash] balances, even their compensating balances, over the year-end period. Secondly, IRAs have been receiving a lot of publicity in the Midwest, and one institution that we talked with in January has accumulated $60 million in IRA accounts. They conjectured that if they were any sample at all, this is going to be a very big program. And there has been a lot of money parked in various NOW accounts waiting for the IRA programs.

CHAIRMAN VOLCKER. They had $60 million already in the IRAs?

MR. KEEHN. One bank had $60 million in IRA accounts.

MS. TEETERS. Which ones have the--

MR. SCHULTZ. That was First Chicago, though, and that was because they put that 2-point bonus on, wasn't it?

MR. KEEHN. Yes, and they are a very major savings bank, so they have a big base. The program was very big and they conjecture that if they are symptomatic--and perhaps [their flows] are heavier than most--there are a lot of people who had money saved up waiting for January and the opportunity to begin to open these IRAs.

MR. SCHULTZ. Did you find any other bank that had that kind of percentage increase?

MR. KEEHN. No, this was heavier than typical.

MR. BOEHNE. In fact, most of our bankers were rather disappointed about the IRAs.

CHAIRMAN VOLCKER. Anything else, Si? Mr. Boehne.

MR. BOEHNE. The only thing I can add that hasn't been said about the bulge in January is that we've found one of our large banks engaged in what I would call a reverse sweep--a sweeping out of interest-bearing assets as of [December] 31st and into demand deposits and then out of demand deposits back [into interest-bearing assets] in January. This was to take advantage of the Pennsylvania personal tax law on personal assets, and it was done this year more than any other year for some reason. And because of a long holiday weekend, this did cause an unusual bulge in demand deposits during that week of January 6th. That's just local in Pennsylvania, but perhaps other states have personal property tax laws that may have contributed to the bulge.

MS. TEETERS. Doesn't Illinois have something like that but the date is in March?

MR. PARTEE. It's April 1.

MR. KEEHN. They used to but they've done away with it.

MS. TEETERS. They've done away with that?

MR. BOEHNE. Just one other comment. There may be some flight from other checkable deposits. As I left the Bank this morning the lines were unusually long for the Treasury auction. The lobby was just full of people.

MR. PARTEE. One of their last chances to get a free one!

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. Our survey didn't turn up anything that hasn't already been noted to this point. But there is a bit of work that was done by our staff that may be of some interest to you. It relates to a float factor that might be being [double] counted. It's principally perhaps a reporting problem. Since we started charging for servicing checks, more and more of the checks have been collected through the correspondent system rather than through the Federal Reserve. And we have some indication that there's a bit of double counting in the correspondent system. That is, the collecting bank will record the checks in "due from" balances as opposed to checks in the process of collection. As a result it's a double counting in the demand deposit that they pass along to the customer and thus could affect M1, for example. And that would be magnified in terms of the checks drawn on NOW accounts simply because they start from a very small base.

CHAIRMAN VOLCKER. This is known as the Auerbach theory.

MR. GUFFEY. Well, he started at our Bank. I'd prefer to name it something else.

VICE CHAIRMAN SOLOMON. Irv Auerbach?

MR. PARTEE. This is a different Auerbach.

MR. GUFFEY. Oh, okay.

MR. AXILROD. We looked into that, President Guffey. The Bach Committee a long time ago recommended an alternative measure of the money supply which grosses up the demand deposits side by adding "due to" [balances] and grosses up the subtraction by adding "due from" [balances]. Presumably, then, we would not have this bias you are talking about. We keep track of that series seasonally adjusted and compare it with our current series seasonally adjusted. And they have shown similar patterns; that is, they both showed this sharp bulge in early January and they showed subsequent weeks about the same. Actually, the alternative series showed larger growth unadjusted in November and December than did the present series. So, we have used that as the basis for checking. We are well aware that this bias could arise and could get worse. It's there, but it could get worse. But it doesn't seem to be getting worse and making our present measure more biased in terms of growth rates at the moment.

CHAIRMAN VOLCKER. Another theory dashed, presumably. Mr. Balles.

MR. BALLES. Well, in searching for possible answers here, I have another question I'd like to raise with Steve. In each of the two years, Steve--in 1980 and 1981--when we have had a convergence of the federal funds rate and the discount rate, and the funds rate even has gotten down to a bit below the discount rate, that was followed by some very rapid monetary expansion, as we all know. With the benefit of hindsight, looking back on that period between the November and December FOMC meetings last year, total reserves were almost on target. They were a little above. But the nonborrowed reserve level was raised quite sharply, by almost $200 million. And that undoubtedly had the effect of keeping the interest rates down because if we hadn't raised that, borrowings would have gone up. And I suspect, as I look back on our feelings in December, that most of us would have viewed that as not a very opportune time to be letting the federal funds rate rise, which would have been the result if we had not increased the nonborrowed reserve path. I'm just wondering if maybe we aren't falling back into the trap of intuitively trying to keep interest rates down at a time when it seems logical to do that and then paying the price for it later on when we get this delayed reaction of sudden very sharp expansions in monetary growth, as we got in both '80 and '81. A companion question would be: With respect to that major study of our operating procedures that you headed up, as I recall there was a recommendation for more frequent changes in the discount rate. As I look back on it, we haven't really done that either. Well, those are just a couple of thoughts as to some deeper factors that might be at work here in these sudden surges of monetary growth. I'd like your reaction to that.

MR. AXILROD. Well, there is nothing in any evidence we've ever looked at or in any experience certainly in the past two or three years and earlier that says that money demand is naturally smooth. In this large an economy, it seems to me that money demand is naturally volatile. And we're annualizing, and the numbers look terrible. A 1.5 percent change in a level looks like 20 percent because we're annualizing it. We probably shouldn't be annualizing those monthly figures. It gives a wrong impression.

CHAIRMAN VOLCKER. Hear, hear!

MR. BALLES. Yes, that's a point.

MR. AXILROD. So, I don't think that policy is ever going to get away from the question of: Do you want to try for a smooth growth path with what every bit of evidence anyone has dug up says will be sharp variations in interest rates--and you can only do that with contemporaneous reserve accounting, if then--or are you going to try for a path over a more sustained period of time and live with the short-run variations in money demand that seem to be built into the kind of economy we have? We have this huge economy with several hundreds of billions of dollars of money flowing daily, some of which happens to sit in demand deposits on top of which--and I don't mean this to sound preachy--we now have a narrow money supply that has savings in it. They are not being paid a very high rate, but they are what many people consider savings. When these NOW accounts were installed, people in many cases just transferred what were savings accounts into NOW accounts. So, for whatever reason, people decided to increase their savings, and it flowed into these accounts. You and I know they have very low rates of interest, but many people feel they are safe. And people are willing to take that [low rate] for a very short period. So, we have a mix that is changing over time, making it even more complicated to evaluate money movements, which to me means that one has to have a longer-term horizon to come to some judgment. Sure, we could begin to constrain it faster by letting interest rates rise faster, lowering nonborrowed reserves faster, raising the discount rate. But that again gets into areas of policy judgment for the Committee as to whether it wishes to put those kinds of interest rate variations in the economy or live with the potential for a little more money volatility or whatever trade-offs it can think of there.

CHAIRMAN VOLCKER. I'd be more impressed by these theories about reserves and all the rest if the increase in the money supply were not so divergent between the different components of the money supply. That doesn't prove that it's wrong, but it's just a little suspicious when the NOW accounts are going up at the same time the savings accounts are going up. And that's a sharp change in trend.

VICE CHAIRMAN SOLOMON. Could we get an explanation from Steve on the seasonal adjustment? As I understand it, starting in '82 we're doing a common seasonal adjustment for demand deposits and NOW accounts. Is that correct?

MR. AXILROD. We're trying. That's right. Last year we did some very complicated [calculations] by assuming that part of the NOW accounts were demand deposits and part of them were savings deposits. In concept, that's right, but it strikes me as a distinction that is going to be impossible to [judge] in terms of whether [the actual proportion] is 2/3 or 3/4 or 1/2. So, we felt that as time went on we should simply begin constructing a seasonal for total demand and NOW accounts based on the movement of the total and that whatever difference there is in the movement, with the increasing composition of NOW accounts, it gradually will be worked out in the seasonals. And that's how we have begun to proceed.

VICE CHAIRMAN SOLOMON. May I ask you a hypothetical question?

CHAIRMAN VOLCKER. Ten years from now we'll have a good seasonal!

VICE CHAIRMAN SOLOMON. My hypothetical question is: If you would apply to the NOW accounts the same seasonal correction that you applied to the savings, would you have had less of a bulge in January?

MR. AXILROD. I'd have to look up the answer to that. We'll check that out. I don't know, but I doubt it.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. This is purely a technical change, but a couple of banks with the largest increases in NOWs closed out their ATS accounts, so it was just a transfer. And that would still--

CHAIRMAN VOLCKER. Yes, but that would have been in the same total.

MR. WINN. [The total would] still be the same, but just for the NOW account category--

MR. AXILROD. Yes, it's an OCD.

MR. BLACK. Well, the [reserve] requirements were not yet phased in.

CHAIRMAN VOLCKER. Are there any other comments on this or any other insights, which seem to add up to not very much? Did you want to comment?

MR. BOYKIN. I was just going to say, but I really can't add anything, that we tested the corporate balance sheet question and the representations were that there was nothing unusual, just the traditional [window-dressing]. The only thing I did find, which I don't think has any bearing at all, was a relatively small bank that had a very large upswing. Inquiring about it, we were told it was simply the liquidation of a very sizable estate; temporarily several million dollars were put in, but the funds were being distributed.

VICE CHAIRMAN SOLOMON. Well, the only thing I'd like to add, since it has been mentioned and I think it's significant, is that the bulk of Christmas sales came much later this year than in previous years. And the bad weather in January also caused extremely weak sales. Credit card companies with whom we checked emphasized that the sales were very weak. That tends to give some logical common sense support to the view of various bankers that these are temporary increases. Add to that the precautionary reasons that call for somewhat larger balances. I don't have any hard proof, but my feeling is that a substantial part of this increase will be washed out over a period of time. I do not believe that we could begin to attribute such a sharp increase to economic reasons--advance indicators of a very strong economic recovery. There may be many factors involved; there probably are to get such a sharp increase. But I think it's hard to conclude that a substantial part is not temporary.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, before we leave this, I wonder if I could ask Steve if he could give us any further explanation on the projection for the week of February 3rd, which shows a further rise. New York shows a decline from the previous week on M1 and you show a pretty significant increase there.

CHAIRMAN VOLCKER. Neither of them knows anything!

MR. AXILROD. That's right; that's pure projection.

MR. BLACK. Well, if that's his answer, then that leads me to my final point. No matter how much we rationalize, I don't think we can explain all this away. And if we can't explain it away, we had better assume that there's some reality to it and act accordingly.

CHAIRMAN VOLCKER. Well, there's a certain reality in that some of it seems to have gone up quite rapidly, whatever seasonal adjustment factor one uses. But what is causing this is interesting, not just because of the short-run significance. If we knew the answer, it would tell us something about whether money is too tight or not. We have a system where the money supply balloons every time interest rates go [down] to 11 or 12 percent in the short run and the economy goes into the tank; when interest rates are 11 and 12 percent, we have problems at some point and it says the money supply is too low. I don't know how or when we will arrive at that conclusion, and I'm not arriving at it now, but I think that's what we are discussing here under the cover of what causes a blip--or more than a blip--in the short run. Does the economy want more money than we are allowing in order to grow in line, let's say, with the projections that Mr. Kichline presented? You are saying, okay, the economy will make that projection anyway even with the interest rates that we have. Now, that remains to be seen, but it all bears on where the targets should be. And I don't think we have much evidence to reach any sweeping conclusions on that point at this time.

The worst kind of result would be if people had a bigger liquidity preference in some sense, particularly in NOW accounts, than we assume and interest rates were to go [down] to 10 percent [and those accounts] began ballooning. What would they do if rates went to 8 percent even if the economy were shooting way down? And, of course, we would have this problem with NOW account interest rates at 5-1/2 percent. If you dream of that day when interest rates get down to 5-1/2 percent, the money supply is going to balloon. There is no question about it the way we now define [the money supply] with that [NOW account] component in there. Now, when we reach that point--and I would have thought we were nowhere near it with market interest rates at 10, 11, 12 percent, but surely that would happen some day if interest rates got low enough--are we going to say there's an enormous increase in NOW accounts because we are now under the NOW account ceiling and that's an excuse for tightening up money with an unemployment rate of 32 percent, just to exaggerate a bit? We'd have a problem, right? I don't think we're there and I don't mean to suggest that. But what is behind these forces is an interesting area about which we do not know enough. I'm struck by the lack of the explanation that I would have thought would be the most common one: That a lot of money is being parked temporarily not because interest rates are necessarily so low, but just because of uncertainty about interest rates and the fear--or not necessarily the fear on the part of the depositors but the hope--that rates will go up again and people could make a better deal on a money market certificate or something a month or two from now than they could in December or January. I hear a little anecdotal evidence myself on that point, but I won't--

VICE CHAIRMAN SOLOMON. That's all part of the temporary thing.

CHAIRMAN VOLCKER. Well, with that much background and elucidation or lack thereof, [we will proceed]. We had a discussion of long-range targets at the last meeting. I guess it's appropriate now to ask whether anybody has changed his or her mind or wants to make further observations on that point.

MR. BALLES. Well, Mr. Chairman, I have had a few second thoughts since both our July '81 meeting and also our preliminary discussion of this in December. And at the risk of being a troublemaker, I do feel fairly strongly that we ought to bite the bullet on the inconsistencies among the M1, M2, and M3 ranges, specifically by increasing the M2 range by a full percentage point over what it was last year and the M3 range by a point and a half. I've set forth in a brief memo the rationale and the advantages that would have, along with upping a bit the lower end of the M1 range. With your permission, I would like to have it distributed so that people could see what it's all about and see what the ranges look like. But that is the bottom line.

CHAIRMAN VOLCKER. You don't want to do anything about M1?

MR. BALLES. Yes, I'm suggesting, for reasons set forth in this very brief memo, that we ought to increase the lower end of the [tentative M1] range to 3 percent instead of 2-1/2 percent, keeping the upper end at 5-1/2 percent. Very briefly, the reason is that, as I looked back to last July, we hadn't known about the weakness now emerging in the economy. We had expected--I think more than we do now--the prospect of a further downward shift in the demand for money, and that downward shift seems to have slowed pretty considerably. Whether it will resume and go on in 1982 remains to be seen. But given the fact that we now are in a fairly serious recession that we hadn't really anticipated in July, and given the fact that the demand for money is no longer shifting downward as much--and maybe not at all--as compared to last summer, and given the fact that a 2-1/2 percent lower band would seem pretty Draconian right in the middle of a recession in terms of public announcement effects, I believe we would be better advised to use a 3 to 5-1/2 percent range. That would have the virtue of being uniform across the board; the upper end, the lower end, and the midpoint [of the M1 range] would all be 1/2 point lower than our 1981 range. And this would continue some credibility in our longer-run anti-inflation approach of gradually cranking down the growth ranges every year. If we were to hit the midpoint of the 3 to 5-1/2 percent range that I'm proposing, which is only a presumption, the growth would be 4-1/4 percent. And 4-1/4 percent is a pretty healthy decline from the actual observed M1-B growth of 5 percent last year. So, although I supported the tentative decision last July for the 2-1/2 to 5-1/2 percent range, I've changed my mind for reasons I've just set forth on M1.

On M2, it gets a little more complicated. The composition of the M2 and M3 aggregates, in terms of the portion that is sensitive to interest rates, has really changed dramatically, as we all know. My staff calculates that as recently as the end of 1978 assets yielding money market rates of interest comprised only 8 percent of M2 and that that's up to 45 percent now. The interest-sensitive portion of M3 at the end of 1978 was calculated at 21 percent and it's now up to 54 percent. We knew this last year, but we didn't really do anything about it. We decided for reasons the Committee felt satisfied with--and I didn't object because I thought it was a good idea--to keep those ranges down more or less for public reaction purposes. We didn't want to be in the posture of raising the M2 and M3 ranges. But as we all know, the actual [growth] last year, certainly not to my surprise, was considerably over the ranges that we set forth for the year. A final word--

CHAIRMAN VOLCKER. For M2? M2 did not go considerably over the range last year. [It was over by] 0.3 of a percentage point as I recall.

MR. AXILROD. Yes, it was 0.4 percent.

MR. PARTEE. Only a half point over.

MR. BALLES. It just seems to me--if we're willing to bite the bullet in terms of what might be a reaction among the general public or superficial observers of our policy that we are going to be accelerating monetary growth--that a range for M2 of 7 to 10 percent versus the 6 to 9 percent we've been talking about tentatively and a range of 8 to 11 percent for M3 instead of the 6-1/2 to 9-1/2 percent we've been talking about would simply be more realistic. I personally consider the likelihood of strong inflows into these interest-sensitive broader aggregates to be great in a year when there's a good prospect, as we've heard from the staff today, that interest rates are going to continue at pretty high levels throughout the year. I'd just hate to get in the middle of the year and then--

CHAIRMAN VOLCKER. I'm not sure I understand the reasoning here. Let me explore it. You say there is a lot more interest-sensitive money; that is certainly true. Why do you expect that to be more pronounced in terms of influence this year than last year?

MR. BALLES. I don't necessarily think it will be more pronounced, Paul, but I don't think it could be diminished any in terms of rates of increase in these aggregates. Some of us brought this point up at the meeting the last time. If the staff forecast is correct, as I understand it, it implies a continuation of pretty high interest rates throughout 1982. And that's why I would just--

CHAIRMAN VOLCKER. Yes, but what do you expect could happen? If interest rates come down, what would happen to M2 all else equal? Or if they went up, what would happen to M2, all other things equal? Why is there a presumption one way or the other?

MR. BALLES. The presumption is that M2 and M3 in the future will continue to be more sensitive to interest rates than they were under the old definition.

CHAIRMAN VOLCKER. That means that M2 will go down if interest rates go down.

MR. BALLES. Yes, the growth rate would go down.

CHAIRMAN VOLCKER. Why? What's the mechanism?

MR. BALLES. Well, it's simply the huge proportion that is interest sensitive.

CHAIRMAN VOLCKER. Yes, but where else are people going to put their money?

MR. BALLES. Well, there are some things that aren't in either M2 or M3 such as Treasury securities.

SPEAKER(?). But those rates are--

CHAIRMAN VOLCKER. But what if those rates go down just like the certificate rates go down? Now, if people put funds in long-term securities, that will make a difference. But I--

MS. TEETERS. They could move them out just for [unintelligible].

CHAIRMAN VOLCKER. But that's also in M2.

MR. BLACK. One can make a clear case if you think about rising rates back when we had ceilings on some of those items in M2--

CHAIRMAN VOLCKER. I know what happened when there were ceilings on them, but the point is made that there aren't ceilings. I don't know what will happen now.

MR. BLACK. Well, it clearly slowed down then and there are no ceilings now, so--

CHAIRMAN VOLCKER. There is no question that when we had ceilings, [M2 growth] slowed when rates rose and increased when rates fell.

MR. BLACK. Right.

CHAIRMAN VOLCKER. It's not clear to me why it would do the opposite now.

VICE CHAIRMAN SOLOMON. We did not find when we analyzed M2 into those components that pay market rates and those that are below market rates--and we analyzed the movements in these two [components] --that we could arrive at any better correlation.

CHAIRMAN VOLCKER. I don't know what the answer to this question is. We have had 3 years since the market rate issue became important and in all of those 3 years the velocity change in M2 has been very close to zero. That's not a long enough period of time to conclude too much on that, but the evidence that we have since that time is zero [velocity change].

VICE CHAIRMAN SOLOMON. And last year [M2 growth] was 9 percent, virtually the same. Nominal GNP was also up in a range of about 9.4 or 9.3 percent, as compared to M2. And I noticed that everybody's projections were in the 8 to 9 percent range for nominal GNP. If that's one to two percent real growth, plus about 7 percent inflation, then one would think that we would come comfortably within the tentative M2 targets.

CHAIRMAN VOLCKER. Well, can the staff help here? Is there any evidence that they know about that says what the interest sensitivity on M2 is now?

MR. AXILROD. Well, it's getting much less sensitive to market rates. So, we wouldn't think it's [going to be] as volatile as [those] rates change. The conclusion we came to in evaluating this was that with more and more instruments in M2 having market rates, for any given reserve target aimed at we'd get more rate movement in holding money growth and prompter income movements, so to speak. That is, you hold if there's a money demand of so much--

CHAIRMAN VOLCKER. You're losing me.

MS. TEETERS. Yes.

MR. AXILROD. There is a money demand of so much. Market rates tend to rise. In the old days, people would shift out of M2-type instruments into market instruments. Now, instead of that happening, the institutions mark up the offering rates so people don't shift out. So, if you insist on holding [M2 growth down], then interest rates rise even more on both instruments until income falls back to where you're producing only enough savings to be consistent with your monetary targets.

CHAIRMAN VOLCKER. What are you saying: that M2 is just going to reflect nominal GNP, period?

MR. AXILROD. In the limit, not totally.

CHAIRMAN VOLCKER. But just to state the converse of that, would you or would you not make a presumption other than through the effect of interest rates on GNP that the interest rate level itself is going to affect M2?

MR. AXILROD. Well, I don't think the institutions will move their rates quite as fast as the market rates. So, I think it would have some effect.

MS. TEETERS. But it will have an effect of making M1 and M2 diverge?

CHAIRMAN VOLCKER. Reducing it.

MR. FORD. When the rates rise.

MS. TEETERS. When the [market] rates rise over and above the statutory ceilings.

MR. FORD. When they drop, you would expect them to converge, wouldn't you, because of this other phenomenon?

MS. TEETERS. Not at the level the NOWs are at.

MR. PRELL. Mr. Chairman, I think Steve has addressed the question, "If you're trying to control M2, what would happen?" To focus on the simpler question--the interest elasticity of M2--the work we've done indicates that it still has a negative elasticity of a minor dimension. When interest rates fall, it grows a little faster. The redefinition, taking out the institutional money market funds, should probably make it even less interest elastic because the lag in the money fund yields stimulated this kind of shifting of funds by institutions into M2 and out of M2. So, we say there's a very small negative elasticity on it.

CHAIRMAN VOLCKER. All right, now you're saying there is a very small negative elasticity; as near as we can say it's declining. If I understand this correctly, that's the opposite of the presumption that Mr. Balles is making.

MR. PRELL. That's right.

MR. BALLES. Well, I'd like to ask you, Mike, you are taking out the institution only money market funds but aren't you putting in the retail RPs? What about their elasticities?

MR. PRELL. Well, as for the retail RPs, once again they carry a current market yield. So, there are unlikely to be substitutions--a great shifting of funds from outside of M2 into M2--when interest rates change. Our supposition at least has been that most of the money in retail RPs has been diverted from small time deposits. Indeed, that's one of the rationales for putting retail RPs into M2; they are a close substitute for those things that already were in M2.

MR. BALLES. Coming back just for a minute to the facts, we do know for a fact that M3 grew by 11.4 percent last year.

CHAIRMAN VOLCKER. M3, I think, is a different animal. That shows you how fast bank credit is going up and how much financing is being pushed into banks, as one influence anyway. The more financing that is pushed into the banks, the higher M3 will be. If we didn't expect much bond financing, we'd expect high M3 growth.

MR. AXILROD. Mr. Chairman, it's very difficult to isolate the structural changes as they're occurring now, operating with an instrument that pretty much has market rates in it. For example, I would not argue that M1 was weak last year because in a sense M2 was strong. There was a partial element of that but there was a downward shift in the demand for M1, where people were taking money out of currency and demand deposits and putting it into a lot of other assets, some of which were in M2. But that was a substitution that didn't affect M2 itself. So actually, on the level of M1, the downward adjustment in M1 that occurred was a structural change that was evolving. When we get away from that structural change, it's quite possible that M1 and M2 will move closer together as we are projecting that they will this year. We really have a slower growth in the nontransactions component of M2 this year than last year, largely because income is growing more slowly and we expect M1 to grow a little more normally in relation to income than it did last year. With that combination we still would have M2 slowing in this coming year. We don't have a reason to think the nontransactions component of M2 will grow substantially faster in 1982 than it did in 1981 with a sharp slowing in income in prospect, regardless of the interest rates that they're offering on those [deposits].

MR. CORRIGAN. Is that another way of saying, Steve, that you view the midpoints of the tentative ranges for M1 and M2 for '82 as consistent with each other in a structural sense?

MR. AXILROD. Yes. We have growth a little above the midpoint for M2 but, rather than put our neck out on the line, I think the safer way to put it is that it's a lot more consistent than it was last year.

MR. CORRIGAN. May I ask one other definitional question? I saw the comment in the Bluebook about retail repos. Has a decision been made to take the IRAs out of M2?

MR. AXILROD. No. We are just going to be getting the first complete data at the end of February. We may not make [the decision] then.

MR. CORRIGAN. What about the ones that are already there?

MR. AXILROD. Well, we haven't done anything about the IRAs in M2. We're waiting to see what we're dealing with.

CHAIRMAN VOLCKER. Just one more point on M2. I don't know how strong a case one can make in practice because I don't know how much of this is mostly individual money and how much of that would go long term. But if you have a shift in preference toward longer-term securities, then I would think M2 would be depressed somewhat or vice versa.

MR. AXILROD. [From] the money market funds they can go into bonds.

CHAIRMAN VOLCKER. And if people really went out and bought bonds--but not many individuals buy bonds anyway. I don't know how much else is in there that's not--

MR. PRELL. The more attractive time deposit instruments that have been created will tend to limit that effect [on M2] in any event.

CHAIRMAN VOLCKER. Governor Schultz.

MR. SCHULTZ. Well, I argued last time for retaining the same targets that we had adopted tentatively. I want to come out the same place, having gone through a [lengthy] thinking process in the meantime because of the big jump [in monetary growth] that we got in January. Obviously, the question was why and one got very nervous about whether these targets were going to allow us to have anything like the leeway we might need. So, I went through the process of taking a long look at what would happen if we shifted the base: Should we go to [the average for] December or even the end of December or use November-December-January instead of October-November-December and all that kind of thing? I might tend to opt for some change in the ranges for the aggregates if I had a little stronger feeling that we knew precisely what all these relationships were. But it does seem that we have been a bit off in these from time to time in the past. All of which seems to me to argue very strongly for a broad family of aggregates and for some fairly wide ranges in each of the aggregates. If I had to make a bet, I would bet that whatever we come out with we're going to miss something along the line. And, therefore, if I felt it was really critical that we set these targets very precisely and say that absolutely we're going to stay within these ranges for the aggregates in every case, I might feel a little differently. But I have some considerable doubts on that score. The other side of it is: What do we give up?

CHAIRMAN VOLCKER. We may do that every now and then.

MR. SCHULTZ. Well, there's no question about that. That's a different subject. You know, there is some very good news. This is the last time I'm going to be with you and it's very clear that when I came on board things got worse and now that I'm leaving things are bound to get better! So you're going to do better this time than you have before. But even under those circumstances, it strikes me that there are some costs in making any changes. How big are those costs? I have talked to a lot of market participants and I can't find a single market participant who doesn't feel that it's going to have some impact if we change these targets. They will argue differently on how big that impact is going to be. But I think that's a vital question here. It's not only what we do that's critical but what people think we're doing and what we say we're doing, and that's going to make a heck of a big difference through the year. So, I would be perfectly willing to see us take our time getting back to the targets. I have a feeling that we probably are going to end up in the upper part of the range for M1, but I really do believe that if we change those targets, there is going to be a cost and I urge you to think carefully about that cost.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. Well, I have several things on my mind. One is that I think we're in a real box and we have a way to go with the monetary aggregates in 1982, M1 in particular. Given what has happened so far, if we were to reach the midpoint of the range by the fourth quarter, we would end up permitting an increase in M1 of all of 1.55 percent from January to November. And I just don't think we can live with that. With M2 I haven't made the calculation, but taking a rough ruler and laying it out and comparing it with this 6 percent growth triangle, to get to the midpoint must imply a growth of something like 6-1/2 percent from January to November. I don't think we can live with that either.

CHAIRMAN VOLCKER. What did we have last time?

MR. GRAMLEY. If we want to get to the midpoint of a 6 to 9 percent range, starting with where we are in January, a rough guess is that it must be around 6-1/2 percent. Have you made that calculation, Steve?

MR. AXILROD. No, but it doesn't sound wrong. It sounds about right.

MR. GRAMLEY. Unless we're awfully lucky, I'm afraid those growth rates are not going to permit the economy anything like the kind of progress this year that the staff is projecting. We need to think seriously about doing something that will give the economy some breathing room. Also, I think this year we ought to start out giving more weight to M2 than we have. We ought to express that publicly so that the focus of attention is not all on M1 as it has tended to be recently. And I think there's a way to rationalize John Balles' suggestion that we raise the target range for M2 that's different from the rationale he uses, and that is that the increasing interest-sensitive component of M2 has probably raised the income elasticity of demand for M2. If you look back at history, the studies of demand for M1 and demand for M2 have always come out that M2, the luxury good, has an income elasticity that is bigger than 1 and M1 has an income elasticity of considerably less than 1. The main reason was that M1 didn't have interest payments on it and M2 did. But as more and more assets that are interest sensitive are shifted into M2, the chances are that its income elasticity has grown. And I [considered] the fact that Fred Schultz has said we will have some adverse reaction in terms of loss of credibility if we adjust our targets. But I said at either the last meeting or the previous one, I don't remember which, that I think our credibility basically doesn't depend so much on these targets and whether we stay within the ranges from one month to the next as it does on the basic fact that we've been following a very tough and tight monetary policy since October of 1979. That is what has gained us our credibility. If we stick with that basic posture, we will still have credibility. I think we ought to give serious thought to the suggestion of raising the M2 target range to 7 to 10 percent. And I think we ought to go further than just raising the bottom edge of the M1 target. I would prefer to do something like using a different base--starting out with the lower end of the range for 1981 as the base figure rather than starting from the actual.

CHAIRMAN VOLCKER. Let me make just one observation on your observation about how little room we'd have for M1 in particular to grow between now and the end of the year if we're going to stick to the midpoint. Your arithmetic is undoubtedly correct. It makes a big difference what you assume will happen, let's say, in February or March. If M1 comes down, we will have quite a different picture than if it doesn't. If it doesn't come down, it certainly will look as if we are too tight by every evidence, but it's just hard to make that judgment right now. That's where this explanation of the short run gets pretty critical.

MR. GRAMLEY. Unfortunately, we have to make the judgment in terms of what we decide for the long-run ranges.

CHAIRMAN VOLCKER. We have to do something. Governor Partee.

MR. PARTEE. Well, I would support John Balles and his proposals. I would prefer not to fiddle with the base because that's going to be so hard to explain and so difficult to deal with. I would rather consider the possibility that M1 growth is going to be high in the range because we had a shortfall of size last year that was just being made up toward the very end of the year and into January. I do think, though, that the fact that we have had a shortfall and that we obviously have a very weak economy is a pretty good reason for saying that on reconsideration we think a number as low as 2-1/2 percent for 1982 would be too low, and therefore we're going to nudge the lower end up to 3 percent and make the range 3 to 5-1/2 percent, which is our typical 2-1/2 point range [for M1].

On M2, I do believe that there are things that have tended to add to its growth relative to the economy over time. They keep happening. We had a number of them last year. Some, like the all savers certificates, didn't really work out, though it could come back this year if interest rates at some point rose to a high enough level. Others involve considerable lead times and change gradually, such as the IRAs and the Keoghs, some considerable part of which is going to be showing up. Maybe we can make some kind of adjustment for it but I really don't think we're going to have the figures to adjust M2 by taking out all IRA and Keogh accounts, which tend to be spread through the deposit instruments in the banks; they are not just in one deposit instrument. That's the terrible problem, I believe. Then we have things like the Treasury's proposal to start charging a fee [for noncompetitive tenders] or to shut off altogether the lines of people at the Federal Reserve Banks and at the main Treasury [building]. The effect of that will tend to be--and it is intended--to push money into deposits that are in M2 form rather than to open market instruments. So, there is a whole series of these things. It's not totally without reflection in the numbers. If you look back, you'll find that in 1980 nominal GNP rose 9.4 percent with a 9.1 percent growth in M2. Then in 1981, GNP rose 9.3 percent with 9.4 percent M2 growth. There is 0.1 less GNP with a 0.3 larger increase in M2. Most people are looking at something in the area of 8-1/2 to 9 percent for nominal GNP growth this year. That certainly is where the whole focus of the range of expectations for both voting presidents and nonvoting presidents and Board members is. And that suggests to me very strongly that we're going to have an M2 growth of 9 percent or above, maybe 9-1/2 percent. Therefore, I see no great reason for starting out with a range, which is supposed to give us some flexibility, in which we expect to come in at the very top right from the word go. So, I think it would be best to recognize that there has been a tendency for the kinds of instruments included in M2 to increase in popularity and also a tendency for the number to be high relative to our ranges and, therefore, to say that we're raising the range. And I think 7 to 10 percent is about right. So, I guess for somewhat different reasons, I'd come down with John.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I think what is happening to the variability of money suggests that our ranges in a sense are narrower than this variability. And the variability is also greater than the difference between expansion and contraction in the economy, so that interest rates really become the one meaningful check on what the aggregates are doing. Another possible but not very reliable check would be to say "Let's go to a single number for the target, which would be the midpoint of what we've had so far." Then we'd get rid of the problem of having a wide target and still missing even that. But the basic problem is to make a decision as to whether this January number is meaningful or not. We do not have worthwhile guidance on that. That leads me to the conclusion that we ought to do something about the base. I listened to Chuck and I listened to Fred; I can see the danger of manipulating these things. I think it is perhaps less dangerous to manipulate the base than to manipulate the ranges, because we've always accepted base drift. We had upward base drift in '80 and we're going to have downward base drift now if we're accepting where we came out. Therefore, I don't feel that the base is very sacred. I think there's something to be said for the Bluebook version of basing it on the lower edge of the band that we had because that was, after all, one end of our target. We're not going to have the base drift that events gave us but we'll take advantage of that much. That seems to me acceptable. Another acceptable rationale, it seems to me, is to say we will go back to July of 1981 when we set these targets and use where we thought we were then. We've shifted in a probably fortuitous manner since then and if we go back to where we set the tentative targets and reaffirm them on that basis, I think we have the rationale. I looked at the possibility of going even further back in order to eliminate past base drift, as it were. If we go back to late 1980 as a base, of course, we have to accept that we don't get the benefit of the upward drift that occurred during 1980. If we go even further back to 1978 and follow all the midpoints of the various ranges we've had, we are now within $100 million of the target. It's really quite a success.

MR. MORRIS. There's nothing like compensating errors!

MR. WALLICH. Of all these various devices, the Bluebook version strikes me as the most plausible. We do accept that something has happened. We don't take it fully into account. We have a reasonable rationale. I think on that base we can probably live with the [tentative] targets that we have and that's the [lesser] sensitivity than having to face a change in these targets.

CHAIRMAN VOLCKER. What Bluebook alternative are you talking about?

MR. WALLICH. The Bluebook alternative for the short-term ranges where the base takes off--. Where is it?

CHAIRMAN VOLCKER. For a short-term target?

MR. AXILROD. There's a discussion in the Bluebook of shifting the base, Mr. Chairman.

MR. WALLICH. Which page is it?

MR. CORRIGAN. There's a footnote on page 12.

MR. AXILROD. There's a text discussion in paragraph 14.

MR. PARTEE. I would be inclined to be sympathetic to that, except that as I understand it we were targeting in terms of M1-B shift adjusted.

MR. GRAMLEY. Well, you have to adjust M1 the same way. You just take the difference--the amount of shift adjusted in that period.

MR. PARTEE. I read that footnote on page 12 and that's what led me not to want to do that.

MR. GRAMLEY. It sounds too messy.

MR. PARTEE. Yes.

MR. WALLICH. The arithmetic is messy, but the concept is a reasonable one.

MR. FORD. Would you also shift to the lower end of the M2 band, Henry, to at least be consistent between M1 and M2? I'm serious; I'm not kidding.

MR. WALLICH. That doesn't sound--

MR. FORD. How can you rationalize shifting M1 up from the actuals to the bottom of the band unless you also do the same thing by shifting [M2] on some end of the band?

MS. TEETERS. You ought to shoot to the top of the M2 band.

SPEAKER(?). Oh, come on!

MS. TEETERS. Well, it's the same thing as widening the relationship.

MR. WALLICH. I don't think there's an absolute logic that we have to do the same thing for the two aggregates, particularly when they clearly have been moving in opposite directions.

MR. GRAMLEY. If you want consistency, you follow Governor Teeters' suggestion: Use the upper end of the band for M2.

MS. TEETERS. That's exactly the same thing that John is suggesting.

MR. GRAMLEY. The base drift.

MR. FORD. When my turn comes up, I'll--

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. I want to align myself with Fred Schultz. I also am very impressed with the perception, based on what I'm hearing from everyone I've talked to, that if we make any changes in the ranges, it could be misinterpreted. I would much prefer to see us hold with the tentative ranges that we have set. One thing that has a little appeal to me--we're not sure what is happening right now and you mentioned that things might look differently in March and April--is the thought that was expressed at the last meeting I think by Tony Solomon, who made some reference to the midyear review. That is an opportunity to reassess and take a look. It seems to me, if we're going to make a change [in the 1982 ranges], that rather than doing it now we ought to defer it for 4 or 5 months at least and we would have more information on all these changes that are occurring. Certainly, we might have a better explanation of what is happening to the money supply. So, given my perception of how [a change] would be interpreted, I would prefer to leave the tentative ranges and then have some kind of caveat that we could make a fairly serious [adjustment at our] midyear review.

MR. PARTEE. We said at midyear that we would look at it seriously in January.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. I have some sympathy with Fred's view, too, given all that has been discussed, that we should stay basically with the longer-run targets that we already set but [I would] pay a lot more attention to trying to get back into the ranges on both if we can. With regard to base drift, I'm very concerned about how this discussion is going. Look at the history of what we've done and think back to last year's big debate about what to do about base drift. It has been suggested, if I understand Henry right, that we not only change the way we handle base drift from last year by going to the lower end of the M1 band instead of the actual [outcome] but that on M2 we do yet another thing. My feeling is that the market people will take this to say that we're just fooling around so much that we're purposely trying to manipulate the game so that it will come out the way we want it. If we go with the established procedure, as I understand it, of not drifting the base a new way but the way it has been drifting--

MR. WALLICH. Which is a bigger drift.

MR. FORD. Yes, so? If we stayed with it on M2, it probably would solve the problem of having to adjust the M2 band upward because we would be starting way up there and will in effect have incorporated some of the past problems. We'd be able to project the existing band off the higher [base]. The real problem comes on M1. I think we will address that tomorrow morning when we get around to the question of how fast we will try to get back into the band. That's the place to discuss that problem. So, I would say, for the sake of the appearance of consistency certainly and to avoid the appearance of purposely manipulating the base drift issue, let's stick with the ranges that were already announced and then concentrate tomorrow on trying to get down to the question of how hard we should try to adjust to what has happened.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Mr. Chairman, I too have been around this a lot of different ways, and basically I come out to the view that we ought to maintain the targets that were adopted tentatively last July, in part for the reasons that Governor Schultz articulated and for a few others as well. I wouldn't be allergic to trying to do something with this base issue, but I've looked at that a number of ways and I'm not sure how to do it in a way that doesn't add more confusion rather than less. I am still a little concerned that any change we make here among the ranges that are being discussed is going to be perceived as tinkering that won't materially influence where things come out anyway. And I think we have to give some consideration one way or another to changing the targets at a point in time when some people are telling us to change them as well. To me at least all of those things point to--

CHAIRMAN VOLCKER. Would you amplify that last comment?

MR. CORRIGAN. Basically, the way I read the newspapers and things like that, the message that seems to be coming through both from the Hill and the Administration is that it's time to change this monetary policy in some [way]. The money supply has to be allowed to grow faster and it will grow faster even with the existing targets. But my point is that if we change the targets, the risk we run is a little different than just the risk Governor Schultz was referring to. I think we run the risk that credibility will be affected in a more amplified way because of the perception that the Fed has buckled under again; they always have and they always will. And that just elevates the concern that Governor Schultz spoke of.

CHAIRMAN VOLCKER. You remind me--and I will insert this in our consideration now, if you will permit me--that when I was testifying before Mr. Reuss the other day he wanted me specifically to bring to your attention his recommendation that the M1 band be made the same as last year which was 3-1/2 to 6 percent. He wanted that considered as a proposal from himself and maybe some of his colleagues.

MR. CORRIGAN. Well, that's the kind of thing I had in mind when I mentioned this point. Now, I know it can cut either way in terms of being responsive on the one hand or being whipsawed on the other hand. As I look at it, particularly in the context of M1, which is the measure most people seem to want to look at, no matter what we do to the targets we're going to be looking at a rate of growth on a comparable basis that is going to be above last year. Indeed, if we ended up at the midpoint of the current range, M1 growth would be roughly 2 percentage points above last year's growth even though it is still within the tentative targets. I do recognize, as I said, that maybe something can be done with the base, although I'm not sure how to do it. Personally, I would have sympathy for the notion that maybe M2 is a little incompatible with M1 or from a presentational point of view maybe talking about an M1 range of 3-1/2 to 5-1/2 percent. Just changing the bottom and not changing anything else doesn't matter, and I wouldn't fight that to death. But anything that comes across as a systematic raising of these targets--raising them all, for example, instead of maybe raising the bottom end of just one--will cause us to run into some problems.

On this question of what growth is left for the [remainder of the] year, I am very sensitive to that as well. I would just observe that all these lines in the Bluebook are drawn more or less on the assumption that we will go through the year without having any negative months. I don't know when we're going to have them, whether it will be February or July or whatever, but the one thing I am sure of is that we will have some negative months. So, I don't think the situation is quite as bleak as the pattern one gets just by drawing those straight lines off of that January number. In a nutshell, I'd like to see us retain the targets either at or pretty close to where they are.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. Having established the preliminary targets that we did last July, I'd be very reluctant to make a change at this time unless there are good supportable reasons for so doing. And I'm unpersuaded by what I've heard today that, with regard to M1, a change would be in order. It seems to me that we are in an environment where absolutely everything we do is so carefully scrutinized that we'd have to have very supportable reasons for making a change. A change upward would be inappropriate, particularly given the economic forecast we have for 1982. Therefore, I'd be in favor of leaving the M1 target as we had established it. But with M2 it does seem to me that there are some supportable reasons for a change, namely, that we did not come in within that range last year and that from the figures that we have for this year [an unchanged range] would be very tight at best. And I think it would be too bad to go through the year having to explain constantly why we are out of the range on M2. Therefore, I would be in favor of making a change upward with regard to that target to, say, a 7 to 10 percent range, to give us a little room to operate.

MR. FORD. What base would you go for?

MR. KEEHN. Where we are now.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I have three points, probably none of which will prevail. The first is that I would raise the lower limit of M1 to 3 percent and I would put the top at 5 percent. I think 2-1/2 percent is too low and I have long favored narrowing that spread because I think doing so would give additional credibility to what we say we're going to do. But I sense that we'll go for 2-1/2 to 5-1/2 percent, so I would suggest that we ought to aim definitely at 4 percent regardless of which of those two routes we follow. The second point is that I wouldn't favor what the Bluebook called rebasing. I had some sympathy for it back when we had overshot our targets, but then I started trying to contemplate how difficult it would be to explain to the market how an aggregate was going to grow at a certain percentage rate from where it really wasn't at the moment and I decided that it was best just to adjust the rates. And now, since we've come in on the low side in the case of M1, I think we'd really catch a lot of flak if we tried to do that. Furthermore, with our shifting from M1-B to M1, which is going to be very difficult to explain, if we had to explain rebasing on that, too, I just don't think anybody would really understand what we're trying to do. My final point is that I'd really rather solve this problem of running over on M2 and M3 by not setting ranges for them. I realize we don't know all we would like to know about M1, but I think we know more about it than we do about M2 and M3. So, I'd get rid of these multiple targets and focus primarily on M1.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. I think it's important that we stick with our present targets. If we were able to achieve precise gradations, I would think that M1 should grow as in the strategy [2] scenario at something like 5, 5-1/2 percent. I'm not sure, with our present procedures, that we can hit our targets anyway much less achieve subtle differences between 4 and 5 percent. I would agree with [Bob Black] in that I'm not disturbed about [the behavior of] M2 or M3. Except for the cosmetic aspect of it, the defensive end, I think we'd clear the air by not setting M2 or M3 targets because they don't affect output or prices as effectively as M1, and I think it would be disastrous to start horsing around with the base again. People know what we're doing; they watch us like hawks. And I think it's important for us to say what we're going to do and then try our level best to improve procedures to accomplish our targets.

CHAIRMAN VOLCKER. Mrs. Teeters.

MS. TEETERS. Well, my problem is that I'm not satisfied with the forecast. If we stick to these targets, we end up with virtually no growth for the fourth year in a row and unemployment of 9 percent or above. I think that's politically very dangerous. We're courting a lot of trouble for the Congress, the Administration, and the American people [if we try] to hold unemployment at 9-1/2 percent. We said we were going to review these targets. We set tentative targets and that has turned out in my mind to be a major mistake because we are setting targets for the subsequent year when we're right in the midst of the formulation of fiscal policy for that year on the Hill. And then we don't have the courage to change them. I don't want to play around with the base because I think that is too difficult to explain.

We ought to look at this and ask: What gives us an acceptable level of real growth and some decline in the unemployment rate next year? And that leads me to say that we should go at least to last year's M1 target of 3 to 6 percent. The target proved disastrous and we undershot it. Instead of doing all this horsing around with the base, we should [set the ranges] straightforwardly the way John Balles has suggested and widen the difference between the M1 and M2 ranges, and then try to stay with that. Even with 3 to 6 percent, if we come out at the upper limit, we are not going to have a robust economy next year. But at least we might get some decline in the unemployment rate and in interest rates and I think that's what we're here for. Our major responsibility is to provide a healthy economy. We are getting considerable forecasts, at least, of a reduction in inflation; and if it turns out that we're wrong, maybe we can change the ranges again in midyear and do it in an honest way rather than just always have this problem of perception. One of the problems with sticking with the ranges that we have is that if we don't come within them, then we have an enormous credibility problem starting the end of the year. We can push, but there's just so much we can do with this. Sooner or later we have to face up to whether we made it within our ranges or we didn't. We go into an enormous amount of explanation to try to explain why we didn't. We may push off that credibility problem, but we don't avoid it. So, I would suggest raising the ranges on all of the aggregates.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. Well, I think there is still a very good chance that we will see in 1982 some of the downward shift in demand for holding M1 that we saw in 1981, and I don't think we should be mesmerized by a January bulge. We also should not be the least bit unhappy about coming in anywhere within the range and we shouldn't even be thinking in terms of midpoints given the shifting nature of these demands. We may very well come in at the upper end of the M1 range if we don't get a significant or even partial repetition of what we saw in 1981. But I have no reason to assume that we won't get that. In addition to money moving into money market funds and the substitution effect, we may also get a significant movement in the development of automatic sweep accounts, which also will tend to reduce the demand for M1 balances. Therefore, my instinct would be to stay with the ranges because it's not clear to me that we have as little room as the January bulge would indicate. Not only is there the possibility that part of it is temporary but there's also this other point that I just made. So, I'd be inclined to stick with [the tentative ranges].

As far as M2 goes, even this last year I was a little unhappy about the tightness of the M2 range. I pretty much come out the way Steve does in that I believe it's very likely that we are going to have less of a problem coming within the 9 percent [upper limit], although I agree with Chuck that we're probably likely to be at the high end of that range. On the other hand, it wouldn't bother me at all if we came out at the low end of one range and the high end of another. I think the midpoint stuff is absolutely nonsense in this imprecise world we're living in.

So, on balance, if I were presenting the targets, I would point out to the Congress and the country that we may very well come in at the upper end of the range for M1, given the strong growth in January, if that doesn't prove to be as temporary as it might be. But it's also true that if we get the kind of innovation and structural changes that we got in 1981 in M1, we could very easily come in toward the lower end of the range. And I think the M2 relationship to nominal GNP is close enough; I don't think one can read too much from that 0.3 percentage point movement. It's still very close and, therefore, it seems to me that we could come in on that. So that's why I would stay [with the tentative ranges].

CHAIRMAN VOLCKER. We're running late, but I think we are far enough advanced here that we may as well get this preliminary go-around out of the way. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I still feel that we're in a period now where we can no longer measure transactions accounts. And the problem, as Tony indicated, is going to get more difficult rather than less difficult in the future. If you look at what happened in '81, we had a reasonably predictable performance in terms of M2, M3, and bank credit relative to nominal GNP. But the real outlier was M1; the M1 number came in much lower than anyone would have forecast. It's very clear from the earlier discussion at this very meeting that we really don't understand what the devil is going on with M1. So, I still feel that we should abandon the M1 target and go with M2, M3, and bank credit. Beyond that, we ought to take a fresh look at how we're managing monetary policy because I think this whole concept of a transactions account, which is really the way the public focuses on what we're doing, is obsolete. The monetary aggregates are obsolete. We have to get some new models on the floor or the Japanese are going to take us over!

CHAIRMAN VOLCKER. We seem to have contrasting views on what to do with M1: Leave it alone or throw it out.

MR. SCHULTZ. We ought to put Messrs. Morris and Roos in the center of the table and let them go at it!

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I would agree with those who have spoken about the uncertainty that might come about by trying to rebase or to fool around otherwise with the numbers. As a result, I come out on the side of taking the ranges as we set them in July and trying to decide whether or not we want to increase or decrease those ranges, as the case may be. Let me just say that it's striking to me that one month's money growth--which we have talked about and the bulge that took place is totally unexplainable--has prompted this Committee to talk for another hour and a half or so as to how we should change the ranges for the period. That's a dramatic change, it seems to me, from what we talked about just one month ago at our December meeting. I mention that to make the point that because of the uncertainty that I suspect rests within everybody's mind and the unexplanability of the January numbers it doesn't seem to me to be very logical to start talking about rebasing or doing anything else with those numbers. There's only one [month of data]. As a result, I would reestablish what we set in July and agreed upon again in December without taking any formal action on it.

There's one potential [change] that has been mentioned before that might be acceptable as far as I'm concerned, and that is the movement of the lower end of M1 from the 2-1/2 percent that we originally set to 3 percent. And that is only because the January bulge probably has rendered that 2-1/2 percent lower limit ineffective unless we get some very big negative numbers in the next couple of months. And if moving the lower band from 2-1/2 to 3 percent would serve the Chairman's purpose when he testifies before the Congressional Committees to give a view that we are going to be a bit more expansive in 1982 than what we achieved in 1981, then I would opt to increase the bottom end of that M1 range from 2-1/2 to 3 percent. That produces a midpoint, if anybody worries about midpoints, of 4-1/4 percent as opposed to 4 percent, and that's some 2 percentage points more than we achieved in 1981. It tells a pretty good story.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. Well, it's getting on toward cocktail time wisdom and I wouldn't want to stand in the way of that, so I'll be brief. Rebasing strikes me as gimmicky and I feel that we ought not do that. I don't think we've done it in the past; we ought to drift up or down and go from the real base. I think we ought to stay with the 2-1/2 to 5-1/2 percent range for M1. Roger is probably right that the 2-1/2 percent end is obsolete but I don't see any reason to cut into our flexibility. I think we ought to be happy to be anywhere within that range, given the imprecision. There is a case on technical grounds to raise M2 for reasons we discussed last time. Some of the points that Chuck made are valid, so I would be amenable to that kind of adjustment.

CHAIRMAN VOLCKER. Mr. Rice and Mr. Winn haven't said anything. Do either of you want to add a quick word?

MR. RICE. Well, just quickly, my instinct is to agree with Fred Schultz, largely on the basis that to change the targets for the aggregates at this point would probably damage our credibility. I recognize the point that Nancy made that we have somewhat of a conflict here in that if we don't make the ranges again, that's a basis for reducing our credibility. But, on balance, I think we do more damage if we change the ranges or fiddle around with the base at this point than we do if we just stick with the current ranges. As you know, I've been one of the people who have been worried about the fact that the money supply, up until this month, has not grown fast enough. To me the ranges are basically cosmetic. This is what we tell the public we want to do. If we come in at the upper end of the range for M1 and if we exceed the range for M2 slightly, I for one will not be too worried about that.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Mr. Chairman, against the background of the behavior [of M1] in January, I think any changes we make would be subject to a misinterpretation regarding what our intentions are. Second, I'm really concerned about the thing we call M1 because it's going to become less and less of a measure of transaction balances. I watch [banks] in our District as they tool up for [changes in] cash management, and there are big, big, numbers here that don't show up at all as M1 numbers. The sweep accounts also are being tooled up in a big way and that's going to affect behavior, so I think we have a real case [for not changing the ranges] in terms of the changes that are occurring in the aggregates themselves in this period alone. Our concern should be to get a better feel for what these numbers really are than on this [unintelligible] that we play out here. I'd also focus on the ranges and not the midpoints because the midpoint overemphasizes our precision and our ability to achieve these things.

Third, it seems to me, with this uncertain economic background, that we can't just stay with this willy-nilly. And we ought to factor that into the report that is made at this time, saying that as things change, we too will reexamine what we're trying to achieve.

CHAIRMAN VOLCKER. I am tempted to make some observations but I think I'll let them go until the morning, considering the hour.

[Meeting recessed]

February 2, 1982--Morning Session

CHAIRMAN VOLCKER. We had a considerable go-around yesterday on the long-term ranges. There were some differences of view expressed, I think more on M2 than on M1. I don't believe we should try to settle this issue right at the moment until after we look at the short term because the two are interrelated in some respects. We'll go to the short-term [policy discussion] and then come back to the long-term [decision].

Let me just say in general terms, so far as the long term is concerned, that I am aware of and sensitive to all the concerns about confusion and market interpretations of what we say and of credibility and all that. More basic than that is that we ought to be doing what we think is appropriate, and we can live through the credibility problems. In the end, our credibility will be related more to making the right decision than to worrying too much about what the market says about it in the short run. Having said all that, I think we're in a peculiarly uncertain period simply because of this big jump [in M1 growth] in January. If this growth were going to carry through, it would begin to suggest that something is going on here that we haven't fully been aware of in NOW accounts or otherwise. If it were semi-permanent in some sense, given how little growth that leaves [within the tentative range] for the rest of the year, I would question whether we are not being too tight. But I think a very strong case can be made that that judgment is premature; we just don't know. Things will look quite different if we get a decline in M1 in February. My expectations are not the greatest in the world; I don't think anybody else's are. My [intuitive] expectations weren't very good at the last meeting, I'm sure, and they may not be any better at this meeting. But one would think with the kind of velocity decreases we're getting now, and particularly a velocity decrease with the kind of interest rate movement we have had very recently, that it just doesn't seem to hang together all that well unless there is something very peculiar occurring in NOW accounts. So, there's a pretty good chance of some relapse from that January M1 movement. If there is a relapse, then this box that we appear to be in will disappear or dissipate--to a very considerably extent anyway.

If we are going to change anything--and I thought about this for a considerable amount of time--I would argue that the advantages of rebasing rather than changing the targets are quite clear. I say that for two reasons. First of all, changing the targets in response to a sudden jump of the kind we have experienced--a short-term deviation or maybe a long-term deviation--may give the wrong impression. It could be interpreted easily as our not being interested in bringing down the money supply growth over a period of time and it could have implications for 1983 and 1984, which we do not want. Somehow, just psychologically, [it would appear that] we were off on a course of increasing the money supply. More important than that, it doesn't really go to what I conceive of as the problem. The problem is that we have a bulge right at the moment, which puts M1 above the target. We can change the target, but [under any reasonable target] we would still be above the target by a [considerable] amount, as we were before. And, if we leave the base the same, all the psychological and market freight of being above the target will be sitting there just as it is now, whether or not we change the range for the year as a whole.

If we move the base up, what we will be doing is recognizing that we are starting from the higher point and we will be immediately back much more within the range of where we want to be in terms of the targets without changing those numbers. I am constantly aggravated--maybe other people are less so--by the amount of importance put on the three months that happen to be the final three months of the year. I look at what happens over a longer period of time. I meant to bring the figures in, but Steve may have them. Starting where we're starting, unless we get a very significant decline in February or March, we're going to have a higher year-to-year growth in the money supply than we had last year, certainly if you look at the shift-adjusted numbers. If you don't look at the shift-adjusted figures it won't be true because we had a 7 percent growth I think year-to-year on the non shift-adjusted last year. That growth reflected the bulge of NOW accounts at the beginning of the year. So, if you look at the nonadjusted figures, we started high and that produced a high yearly average growth of the money supply for the year as a whole even though the fourth-quarter-to-fourth-quarter growth was not very high. The contour was a high [rate of growth] in the beginning of the year and then it leveled off for the rest of the year. I think that gave a false reading because of the shifts into NOW accounts that produced the bulge. If you look at the shift-adjusted numbers, what was it on a yearly average basis last year, Steve?

MR. PARTEE. 4.7 percent.

MR. AXILROD. 4.7 percent.

CHAIRMAN VOLCKER. It looks now that we would be no lower than 4.7 percent in 1982 and in all probability higher simply because we're starting high. Consistent with the present targets and growth anywhere in those targets except at the very low end and [in the absence of] a sharp early decline, we are going to have more monetary growth this year, looking at the period as a whole with the present target, than we had last year, if "reality" is a shift-adjusted number, without changing the target. And, of course, we would have more growth on a fourth-quarter-to-fourth-quarter basis, too. So, we have [more growth] both ways.

MS. TEETERS. Are you assuming a decline at any point?

CHAIRMAN VOLCKER. Well, I'm assuming it doesn't go down very sharply. That comment may not be correct. If we had a very sharp decline--and by very sharp I mean more than a $5 billion decline in February--

MS. TEETERS. Or over a couple of months.

CHAIRMAN VOLCKER. Yes, we would have to have a fairly sizable decline for a month or two for the yearly average to have any reasonable chance of not being significantly higher than it was last year. I can't predict every month but, just [extrapolating] on a straight-line basis, which may be unfair, it is equivalent on all these short-term alternatives except alternative A to ending up with 5 to 6 percent growth--I'm just going by memory, Steve--in the yearly average for 1982.

MR. AXILROD. That's right. If you hit the upper limit, it would be around 6 percent; at the midpoint it would be around 5 percent.

CHAIRMAN VOLCKER. That assumes that we don't have a great big decline in the short run. But, one of the peculiarities is this: Suppose October weren't there and suppose this increase had happened one month earlier. The fourth quarter would be very close to the fourth-quarter base and nobody would be arguing that that wasn't the appropriate thing to start with. [The bulge] comes a month later and results in a $5 billion difference in the base. Should that type of thing affect us? That's the kind of consideration that I've been struggling with. I have gone up and down on this, not knowing what is going to happen in the next 6 weeks. My feeling is that we will pretty much know the story then, although we never know for sure because there's always another week out there. But at least in 4 or 5 or 6 weeks, we will have a much better feel as to whether some of this has washed out or not. If it has, the current targets may not be perfect but, given the problems of fiddling around with them, they would look entirely appropriate to me. If that did not happen, I'd have a very serious question as to whether we were not being too tight--that something more basic and continuing may be going on here. That would imply, as a matter of judgment, given what is going on in the economy, what is going on in interest rates, and what is going on in the money supply, that we would have to think seriously about providing a little more relief. My tentative judgment is that that is a very hard decision to make right now and that maybe we should just say we are not prepared to make that judgment but will keep the matter under review and if we have to change it, we will change it. And we will change it as soon as [the situation] becomes more solidly apparent than it is today.

MR. ROOS. Do we assume that it is impossible to pinch off this bulge through our open market operations? In other words, we did it in the middle of last year. What if we decided, instead of waiting to see what happens in a month or two or six weeks ahead, that we were going to instruct the Desk to sell securities out of our open market account in the amount necessary to pull down this bulge that has occurred. And, if that goes too far, then we'd reverse that performance. Can't we be the--

CHAIRMAN VOLCKER. Well, you are raising the question directly that I want to go to now Larry, and that is: What should we do in the short run? The issue on the table is how aggressively we want to move to, in effect, pinch the bulge off, as you put it. I'd like to turn to that now, but before we do, let's ask Peter to give us the normal background. But I think that is precisely the issue before us. The only thing I would note is that in the last week, inadvertently, we already have moved more strongly to pinch it off than we really intended. We moved some distance in that direction. So, why don't you talk, Peter, and then we'll go right to that point and then come back to the longer-run decision.

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

MR. ROOS. Peter, may I ask a question? In the Bluebook the staff usually gives us several alternatives for the short-run targets and also indicates an implied fed funds range for each of those alternatives. If my memory serves me, in the past as well as in this current Bluebook the most expansive alternative usually reflects lower fed funds rate projections and the more restrictive money growth projections are accompanied by higher fed funds ranges. Now, at our last meeting, if we actually had set targets for money growth that were what has happened--money growth exploded--would you feel that normally that would have resulted in a lower fed funds rate or a higher one? It seems--

MR. STERNLIGHT. Well, if the Committee had set the kind of money growth rates that actually transpired over the past month, it would have accommodated what has happened without getting the rise in borrowing and the rise in the funds rate that has occurred.

MR. ROOS. What I'm trying in a clumsy way to get to is this: Is it not possible that our whole concept of how the fed funds rate reacts to the aggregate targets we set is exactly the reverse of what really happens? When money explodes, it seems to me that the fed funds rates and interest rates rise, as they are presently. Is that not true? And if that is true, why do you continue under the alternatives that are suggested to imply lower fed funds ranges with aggregates that show a higher money growth?

MR. PARTEE. Do you mean we ought to reduce the funds rate range in order to choke off the money supply?

MR. ROOS. No sir. I'm suggesting that the relationship between money growth and the fed funds ranges is just the opposite of what our Bluebook shows us. The Bluebook usually shows a lower range of fed funds when we opt for the more expansive alternative and a higher fed funds range under the alternative where money grows more slowly, implying that that will bring rates up. And that's exactly the opposite of what happened, Chuck.

MR. PARTEE. Yes, but I think--

MR. WALLICH. It depends on supply and demand.

CHAIRMAN VOLCKER. Will you defend the Bluebook, Mr. Axilrod?

MR. WALLICH. One has to distinguish whether a movement is the result of a shift in the demand function or a shift in the supply function. We assume the demand is constant and, therefore, an increase in the supply of money--just as of potatoes--increases supply and reduces the price. Now, if it's the demand function that changes while the supply function is constant, then price--that is, the interest rate--and quantity move in the same direction. That is what you've observed and what you commented on. But the Bluebook targets are based on the assumption of constant demand and a change in the supply function.

MR. ROOS. Regardless of the theory that relates one to the other, Henry, if we see over and over again that when money grows the fed funds rate moves up, we're getting our theory--

MR. WALLICH. If the price of potatoes goes up and you know that there has been no change in supply, it must have been because of a change in demand. These markets work just the same as every market in the economy and one has to distinguish what is the source of the movement.

CHAIRMAN VOLCKER. Mr. Schultz.

MR. SCHULTZ. I don't quite understand this, but I gather that the argument is whether interest rates are the price of money or the price of credit. You are arguing that it's the price of money, and I have to agree with that; I think Larry's Reserve Bank would argue that it's the price of credit that's--

MR. ROOS. Fred, all I'm trying to argue is that if--

MR. WALLICH. Is that not accurate?

MR. ROOS. If you look at what happens today when money grows more rapidly than people anticipated, these rates move up. It's just exactly the opposite of the circumstances formerly, before we had inflationary expectations.

MR. SCHULTZ. But what Henry is trying to say is that if that is because the demand for money increased, then it takes place that way. If it's because the supply of money increases, it has quite a different result.

MR. AXILROD. President Roos, may I just make a comment? When you observe in the market that there is an increase in money and short-term rates go up, it is not in my opinion because people believe that there's going to be more inflation. In my opinion--and this is what is predicted in the Bluebook--it is because the market believes that the Federal Reserve is going to hit its longer-run targets and, therefore, will take action to restrain the growth in money that has bulged in the short run because of the [increased] demand. And with demand high relative to the supply, the price, as Governor Wallich says, goes up. And the price of money is the interest rate. Therefore, they realize that interest rates are going to go up in the short run and short-term interest rates are what we're dealing with.

MR. ROOS. But, Steve, regardless of what causes this--I'll buy any theory and I know you're both right--when money grows, rates go up. So it is just the opposite of the way we project these things in our thinking in the Bluebook.

MR. WALLICH. Well, all that says is that supply is pretty stable and demand is the source of most changes. This is what I and others normally say about the money supply and money demand. It's the demand that is the more unstable variable. And that's why we get movement of prices and quantities in the same direction.

VICE CHAIRMAN SOLOMON. If one were putting this is non-jargon, the way to explain it was just the way I think Peter started to do. When we project a more expansive money supply, the reason we project that rates will go lower is that we are assuming we will supply the reserves. But when it happens not because we're supplying the reserves but because the demand is going up, we don't supply those reserves because it's not in our path. Then, of course, we get a different kind of reaction. The rates go up instead of down.

MR. ROOS. But Tony if that's so--and I'll agree with you that it may be--still if we have an alternative that implies a higher rate of money growth, then we should project, regardless of the reason for it, a higher range for fed funds than if we're setting a lower rate of money growth. That is my point regardless of why.

MR. WALLICH. But, Larry, we're the controllers of supply; we're not the controllers of the demand.

CHAIRMAN VOLCKER. I think perhaps all of this will be made a little more concrete by examining what we want to do in the short run against all these alternatives, which have various demand and supply assumptions implicit in them. But we can have any questions about the market and dispose of those.

MS. TEETERS. I have a tentative question for Peter. I'm not sure I'm totally correct but if I add up roughly [the figures in] the footnotes in appendix 2 [in the Bluebook], you took $540 million out in the multiplier adjustment, which is greater than I've ever seen before. That must mean that you had a very unstable multiplier relationship in your initial projections that you were constantly adjusting. That also suggests to me that reserves were shifting between categories at a greater degree than is normal. When all the reserves went out last summer, they sort of disappeared. During this period did you have a shift of reserves from low reserve deposit categories to high reserve deposit categories?

MR. STERNLIGHT. I don't remember. It was a relatively large amount; whether that was a record amount of those technical adjustments, I'm just not sure.

MR. AXILROD. In large part, Governor Teeters, the [OCDs] were a lot weaker than we had allowed for in the path. So, if we hadn't taken out the reserves that had been allowed to support them, of course, they would have supported even more money growth. And for similar reasons, if we had left the reserves in, they would have supported more total deposits. Those were the essential multiplier adjustments, and they were larger than they normally are.

MS. TEETERS. Essentially, we had a reverse of the situation that prevailed over the summer? In a very technical sense, we had a reversal of that?

CHAIRMAN VOLCKER. I think that's probably right, isn't it?

MR. STERNLIGHT. Yes, we had to adjust upward, then, for the [OCD] growth.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. I don't know for sure, Peter, whether you or Steve ought to handle this question. I just wondered if you had given any thought to possibly changing this automatic reaction mechanism. The rule of thumb you have, when you force the banking system to borrow any total reserves above path, is on a one-to-one basis. Have you considered other combinations? Looking at this period, one would think running borrowing up from $300 million to $1.7 billion [in the most recent week], with the target of $1.5 billion, would be a whale of a move. Still, the money supply did spurt. Have you monkeyed with the idea of maybe changing that automatic part?

MR. STERNLIGHT. Well, as I said, some of the move up was a more or less automatic fallout of a strengthening in demand for reserves. We did, well along into the period, make a discretionary downward adjustment in the nonborrowed path of $190 million, I think it was, which added to that borrowing gap. There is continual consideration given to the size of those adjustments. And the factors bearing on it on this occasion had to do partly with trying to reach judgments about how lasting this bulge would be. If there had been a sense that this bulge was likely to be more lasting, and particularly if there had been a sense that it was occurring against a background of a strengthening economy instead of a still weakening economy, my view is that there probably would have been more of a discretionary downward adjustment made to build up that borrowing gap even further.

MR. BLACK. Well, you actually made two ad hoc adjustments, if I understand it. One was on the 4th of January and then one was on the 15th. What I was talking about, really, was not those ad hoc adjustments but whether you had considered making the automatic [response] a little stronger or weaker. I just wondered what you--

MR. AXILROD. One point, President Black--and this is somewhat subjective because I don't have the data laid out--is that we know for sure that, for one reason or another, the relation between borrowing and the funds rate has become a lot looser over the last year or two than it had been. Often we get a level of borrowing without as much pressure associated with it in the funds market as one might have expected. It could be that in this period when things are confused by year-end [pressures] and all that, and in addition it is early in a period of pressure on bank reserve positions--that is, it has only been three or four weeks or so of which the first week or two are uncertain, because it was the year-end period--it may simply take more time for those pressures to build up. The function may be somewhat asymmetric or something. The banks may have to be in debt for a longer period before we get as marked a reaction as we might have expected ahead of time. So, if they have these kinds of pressures for a more sustained period, we might see a more prompt reaction in market conditions than when they first get in debt by $1 billion or so.

MR. BLACK. Well, I think that's reasonable; I certainly can't suggest anything--

CHAIRMAN VOLCKER. This situation has also been complicated by the fact that in January we had some reserve misses that went in a rather perverse way. We didn't tighten up de facto as much as we thought we were doing earlier in January simply because we had more reserves in there than we thought we had. And then this past week it reversed. And while the market didn't tighten up particularly until the market [players] saw the figures, when they saw the figures they exaggerated how much we had tightened up. It gives us a bit of a problem; maybe it does or maybe it doesn't, depending upon what the future brings. But, statistically, we had much more but later tightening than we intended simply because of the way the reserve factors went.

MR. BLACK. And the way we construct the path, the timing of the first indication of the overrun determines the pattern of borrowing for the whole period.

CHAIRMAN VOLCKER. We ran over in reserves and short in borrowings and then had the reverse. That's--

MR. BLACK. Well, I was just expressing some hope that maybe somebody had some ideas on how we could try an automatic mechanism that might work a little better than this had. But I guess that's probably expecting too much.

MR. PARTEE. Go to contemporaneous [reserve accounting] and close the window.

MR. BLACK. Well, that's one way.

CHAIRMAN VOLCKER. That's one way of doing it; then we'd get a very strong one. Anybody else?

MR. BOEHNE. Yes, I'd just like to ask Peter how he thinks the market would react to either an increase in the surcharge or an increase in the discount rate.

MR. STERNLIGHT. Given the events of the last week or so, it wouldn't come as a total surprise, but I don't think there's a preponderant expectation of a move either. I think there would be some reaction to either of those, probably less so if a move were confined just to the surcharge. It hasn't been fully discounted; some people would say that they don't expect such a move because they still don't see the turnaround in the economy that they think would be part of the background of such a move.

CHAIRMAN VOLCKER. We have to ratify the transactions. Are there any other technical questions?

MS. TEETERS. So moved.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection, we will ratify them and turn to the immediate problem before us. In terms of what we were just talking about, Mr. Axilrod, is it fair to ask if all your alternatives, A, B, C, and D assume no great change in the demand for money? You're assuming that the money created is in there and it's not going to relapse on its own accord?

MR. AXILROD. We have assumed a sharp deceleration in money demand in all of the alternatives in that we don't think the high double-digit growth rates of the past three months on average will persist. We have not assumed in any of them a contraction in the outstanding amount of money over a two-month period. We could have a 1 percent [annualized rate of] increase--say, a -7 percent [annual growth rate one month] and a +9 percent [in the next month] or something. That is possible, but we have not assumed a contraction over a two-month period in any of the alternatives unless action is taken to make market instruments more attractive, which in effect means interest rates rising, which is the assumption of alternative A.

That is, we believe that a contraction could be attained but with interest rates rising substantially. Alternatives B, C, and D suggest much slower growth rates than we have had and alternatives B and C would hit the upper limit of the present long-run [range] later. Alternative D remains outside [the range] if the Committee were to vote for a continuation of the [previously set] growth rates over the rest of the year.

I might add, Mr. Chairman, that because of this problem we did suggest a second alternative in the Bluebook for the directive language on the thought that the Committee may not wish to squeeze the economy further in order to attain the contraction but might find such a contraction highly welcome if it were to develop without squeezing the economy further. The second of the two alternative languages presented, while it need not be different in the substance of the numbers, is somewhat different in the public posture it portrays about the Committee decision. It is meant to provide an alternative which would in effect welcome a sharp drop [in money growth], provided that the drop could be attained without squeezing the economy further.

MR. ROOS. Well, how would the economy be squeezed? What do you mean by that?

MR. AXILROD. I meant that if the Committee targeted on a drop of 7 percent, our suggestion would be that to attain that we'd need borrowing to start as high as $3 billion. But suppose the Committee said no, we don't believe that; our thought would still be that if you targeted on a drop as low as 7 percent and even if you started with borrowings where they are now, the required reserves would immediately come in higher than is consistent with that drop. And borrowing would tend to rise very sharply, so that you would get a sharp rise in short-term rates because the immediate demands for money would be in excess of the -7 percent that was targeted. If we're wrong about that--and we may very well be--then we would not get this rise in interest rates. So, what I meant by squeezing the economy was that the Committee may choose not to target on such a thing on the grounds that it runs greater risks of raising interest rates in the middle of a recession. But it may wish to target on something involving a slower deceleration into the long-run targets--a more gradual slowing on the grounds that that minimizes the chances of rising rates. On the other hand, the Committee might be quite willing to accept a sharp decline if that could be attained without further upward pressure on short rates at this time.

MR. ROOS. But the most--

CHAIRMAN VOLCKER. Did you want to say anything in a more orderly way, Mr. Axilrod, without my asking you a leading question?

MR. AXILROD. Well, I've just given the substance of the comments I had written out, Mr. Chairman.

VICE CHAIRMAN SOLOMON. Steve, since we don't know the January figures--and we have done this before--why aren't we basing from December to March rather than from January to March?

MR. AXILROD. Well, one could base it from December to March. The first alternative left that blank in case the Committee wished to retain November or December or whatever. The second alternative was designed just to make it clear that the Committee wants a deceleration from the very recent growth rates, which was January essentially. That was what was carrying the Committee beyond its tolerance point, so it just seemed natural to base it on January. We have full data through the 20th of January and partial data through the 27th; so there may be a change in the base but not as substantial a change as it appeared we would have in December because we had quite a bit less data for December when the Committee met last time.

MR. PARTEE. Page 10 has November to March.

VICE CHAIRMAN SOLOMON. Yes, I saw that, and I didn't understand why we would do November to March.

MR. AXILROD. That's what your base was before.

VICE CHAIRMAN SOLOMON. Yes, but to me [a December base] just seems a little more logical, since we really know only 2/3 of January and we do know December. And the numbers look more moderate if we go from December.

MR. AXILROD. The December-to-March numbers consistent with alternatives B and C, President Solomon, are 8 percent and 9 percent for M1. That's why in alternative I [of the draft directive language] we left it for the Committee to fill in whichever base it felt most comfortable with. Alternative II suggests simply [to base on] January, to make clear that with January behind us the Committee wishes to get money growth moving back toward the range. That's the essential reason for that approach.

MS. TEETERS. Steve, did you say what the borrowing associated with alternative A was?

MR. AXILROD. In our judgment, it could go as high as $3 billion because we believe that we can't get that kind of reduction for two months without a further rise in the funds rate, even though the economy is as weak as it seems. But I have a certain degree of uncertainty about that because our quarterly model does suggest, if you believe it, that given the amount of money that has already been produced and given the weakness of the economy, that that amount of money isn't in effect needed for transactions associated with GNP in the first quarter. But it might be needed for precautionary purposes, so you have to force interest rates up to get it out of there.

MS. TEETERS. The $3 billion on borrowing that you're tentatively estimating for "A" could go as high as $5 billion?

MR. AXILROD. Oh, it could go a bit higher; that's correct. We assumed that was consistent with a fairly high funds rate. But it could be anything.

CHAIRMAN VOLCKER. It could go as high as what?

MR. AXILROD. It depends on how hard you want to fight it.

CHAIRMAN VOLCKER. Let me try a common-sense interpretation of this--I hope.

MR. FORD. Of what?

CHAIRMAN VOLCKER. Of A, B, C, and D.

MR. FORD. I thought you were going to do alternatives I and II.

CHAIRMAN VOLCKER. I'll suggest a possible approach as a focus for discussion. I think you're saying, Steve, that either because of transactions balances alone or transactions plus precautionary balances--depending upon what model you look at--the demand should not continue to rise at the rate it has been rising, but it is going to rise a little anyway, or hold stable perhaps. Therefore, if we're going to get [M1 growth] down, we have to take some action to tighten up--well, for borrowings to be about where they are or higher, up to $3 billion. That's the number you just gave in terms of borrowing. Alternative A says, against the presumption which may be wrong--it may just relapse on its own--that if we really want to retrace January, we have to be aggressive in tightening up the market. And that's going to push the funds rate way up because of this demand factor. Alternative B says, if we stay more or less where we think we are--lower than where we were in practice last week and maybe this week, but where we were aiming--that we would get a leveling off, but that's it. Alternative C says, if we're a little easier in terms of pressure on reserve positions, measured by $1 billion worth of borrowing, that we probably would get a small increase in the money supply but we certainly cannot retrace the increase we had. And "D," of course, moves further in that direction. It says that even if we were quite easy on reserve positions, we wouldn't get much of an increase in the money supply compared to what we have had, but we would certainly add to what we have had.

MR. PARTEE. Because it has already occurred.

CHAIRMAN VOLCKER. Because it has already occurred, that's right. Now, the question is what we want to do. If we get any significant increase from where we are, I am suggesting that we have to resist it. I would accept that as a starting proposition. I think there is some chance it could happen by itself. But who knows? Tentatively, anyway, I reject something like alternative A, [which implies] that we're just going to whack off a big amount in an effort to get a quick reversal that we feel we otherwise would not get. One can take the view that it would tighten up the market very substantially in the middle of a recession. I am not proposing that. I do think we have to show some resistance, which means a tighter market than we now have, if the figures carry us up significantly from where we are. And I interpret something like "B" or "C"--either one or someplace in between--as saying we can ride along and we would be satisfied. It is not the happiest situation in the world, but we would be satisfied at riding along if we have to be someplace around where we are in terms--

MR. PARTEE. By "where we are" do you mean the level of the money supply?

CHAIRMAN VOLCKER. --of the money supply, yes.

MR. PARTEE. Not the rate of increase, but the level?

CHAIRMAN VOLCKER. No, the level. We would be willing to ride along with that level without tightening the market further. We will wait longer and make another decision, obviously, in 6 or 8 weeks or whenever we meet again. But, in balancing off all these considerations, we would be content to see an eventual unwinding without any substantial changes in the level of the money supply with money market conditions more or less where we intended them to be, which is somewhat easier than they in fact are at the moment in terms of federal funds rates and borrowing levels. We are talking about something around $1.5 billion in borrowing, which is lower than it has been for the last 10 days. That seems to me a reasonable approach.

But I would feel rather strongly about the caveat expressed in that second version of the directive: That if the assumption of essentially unchanged demand for money proves to be wrong and, with that amount of pressure on the market, the money supply relapses, I would be delighted. I would not say that at that point we would put in money in order to keep the money supply at an unchanged level or a +1 or +2-1/2 percent or whatever. In other words, if we could accomplish that--. This may give too much weight to what we do in the short run, but if the dynamics of the marketplace produced a relapse in the money supply downward consistent with unchanged or even a reduced level of borrowing, we should just accept that and count our blessings and wait for the next meeting. If it doesn't happen, if maintaining these pressures produced a result like "B," let's say, we would be content with the situation. If the tendency of the money supply were to rise further, we'd have to act against it. And that would send the level of borrowings still higher--maybe not higher than it is now, but higher than what our target is at the moment. So, that is the approach that seems to me to make sense. And we would incorporate--I don't know what the precise numbers would be--something like 0 to 2 percent or whatever number we wanted to put in there for M1 for the next couple of months with a borrowing level where it is, or maybe even a little lower than that, depending upon what weight we wanted to put on the possibility of a decline arising spontaneously. And if M1 does decline, we would let it decline as a welcome reversal of what we had [in January].

MR. ROOS. I'd like to ask Steve to verify whether the following reasoning or these facts are right or wrong: If M1 remains at its current level of about $450 billion throughout the first quarter of 1982, would the estimated growth rate for the first quarter be about 12 percent? Is that correct?

MR. AXILROD. That's correct.

CHAIRMAN VOLCKER. That 12 percent assumes M1 is unchanged from now on.

MR. ROOS. Then if money grows at this 12 percent rate over the first quarter, if we do what the Chairman suggested and stay where we are, what does that imply for the growth of M1 over the rest of '82? In other words, if M1 growth in the last quarter of last year was 6 percent and in the first quarter of this year is 12 percent, doesn't that imply, if we're going to stay within the long-term range that we have been talking about, something like a 3 percent growth rate for the next two quarters?

MR. AXILROD. Yes, in general, it's right in that order of magnitude.

MR. ROOS. Okay. If we had a 9 percent average growth for M1 over the last two quarters and we're forced to seek a 3 percent growth rate of M1 for the next two quarters, wouldn't that have a very traumatic effect on output late in the year?

MR. AXILROD. Well, our thought at the moment is that something like what you described will develop more or less given demands at something like current interest rates. That is, we will get a sharp deceleration in money growth to a 1 to 2 percent monthly growth rate over the next couple of months--it's implicit in that--and a moderate rate of growth over the second quarter. Where we would see more of a sharp effect on output would be if that pattern required higher interest rates because there were bigger demands for money than are implicit there. Then we would see much sharper effects on output. But our projection for GNP is based on a pattern somewhat like what you were describing, on the thought that that will not be accompanied by substantially different interest rates than we now have.

MR. ROOS. Steve, your most expansive case, alternative D--and I promise I'll shut up soon, Mr. Chairman--has the lowest fed funds range of these four alternatives. Yet, with the explosion of money growth that we have experienced in the last few weeks, the fed funds rate is already above the top of that alternative D range. What makes you think that we aren't going to have increasing fed funds rates even if we go the more expansive route? That's what worries me about this whole thing.

MR. AXILROD. It all depends, President Roos, on one's assessment of the demand for money relative to the amount the Committee is willing to supply.

MR. ROOS. Can anyone accurately forecast the demand for money?

MR. AXILROD. It's very difficult.

CHAIRMAN VOLCKER. You've got us on that one!

MR. ROOS. The prosecution rests!

CHAIRMAN VOLCKER. The kind of consideration that you raise, Mr. Roos, is what I have in mind. If the demand were so strong that it turned out, let's say, that with the amount of pressure we now have, we were continuing to get increases in the money supply, I'd begin wondering very seriously about our targets for the year, because they wouldn't seem to hang together with what we know about the economy and all the rest. Now, we'd have to evaluate the economic situation, but just sitting here now it doesn't seem to hang together if the demand for money were that strong. But we don't know that yet. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. If I understood what you said earlier, the only quarrel I might have with you is what side of "B" we ought to end up on. You are on the right; I'd go a bit to the left.

CHAIRMAN VOLCKER. Well, I'm not sure. Let me just clarify that for a moment. As I sit here gazing at these numbers again, we're essentially talking about how we are going to act between now and the next meeting, of course. And given the great bulge that we've had, I'm not sure it's the right thing to say--we can have another discussion about what the borrowing assumption would be--but in terms of the right posture, maybe the right number to put in there is zero: The breaking point for us on whether to tighten or ease is whether we get any further growth beyond this great big bulge that we've had. What we would be doing is expressing some unhappiness with and some resistance to any growth above the elevated level that we now have.

MR. FORD. And that puts you between "B" and "A," not between "B" and "C."

CHAIRMAN VOLCKER. Yes, it's almost to "B." Of course, it is between "B" and "A" but it's a trivial distance from "B."

MR. GUFFEY. It's on the left side of "B." It's almost the same.

CHAIRMAN VOLCKER. It just looks to me a little funny, now that I look at it, to say we want 1 percent growth. That's just a fine [line] after this bulge. What's so magic about one percent? We're willing to accept, if we have to, what we already have but we wouldn't like to see it going up any further. [Zero] may make a little common sense.

MR. GUFFEY. That's coupled with the thought you also expressed that we would move against any evidence above zero and would tolerate or accept and be grateful for anything below zero.

CHAIRMAN VOLCKER. That's right. Precisely.

MR. GUFFEY. I think that's precisely what I'd like to see happen.

MS. TEETERS. We could fall off the cliff on the other side.

CHAIRMAN VOLCKER. Look, this is about degree. I'm saying we don't move very hastily if M1 begins falling. If we got a couple of weeks of decline--let's say in a few weeks it fell off $6 billion just to pick that number out of the air--the market would be easing because we would be quite satisfied with that and could afford to be somewhat more relaxed about it. I'm not making a fine judgment as to how much to let borrowing go down. I'm saying we wouldn't at the very least begin making discretionary adjustments and we wouldn't begin pumping more money in than the path said with a fairly sizable decline in M1. We'd say we were happy about that. We might let the automatic [response] that Bob Black was referring to work, but we wouldn't begin taking aggressive action to keep [borrowing] up while [M1] declined by $5 or $6 billion. We'd be delighted. If it began declining further, we might well [respond]. Now, just where the number is, I don't know. I have some figures that may not be out of the ballpark. The preliminary figures have been very poor in terms of indicators, but suppose it came out [as a decline of] more than $2 billion--say, $2-1/2 billion, which it could easily do. And suppose we had another decline of that magnitude the following week. One can always hope.

We would then have a $5 billion decline and a sizable decline may be in train for February and I think we just ought to be delighted. If that continued, then we would expect to see some easing in the market, but would not be aggressive in trying to offset the decline during this 2- or 3-week period. We'd welcome the decline.

MR. RICE. If we saw an increase of, say, 2 percent over the period, would you rush to resist that?

CHAIRMAN VOLCKER. I don't think "rush" is the right word but we would resist, yes.

MR. PARTEE. We would let borrowings go up.

CHAIRMAN VOLCKER. We would certainly let borrowings go up at least, in accord with the automatic [mechanism]. And we might have to do a little more than that.

MS. TEETERS. We have already signalled our displeasure to the market. We are at 15-1/2 percent [on the funds rate] and $2 billion in borrowing. When we say "stay where we are," are we talking about staying at $2 billion or $2-1/2 billion or $3 billion?

CHAIRMAN VOLCKER. No, a billion and a half dollars. I don't know how soon it would develop--we will want to discuss that explicitly--but I am talking no higher than $1.5 billion of borrowing, which presumably means an easier market than we have now even with zero [M1 growth]. Just to be explicit, on the borrowing one could argue that maybe it should be even lower. It depends on what kind of chances one wants to take.

MR. PARTEE. What were we seeking? I lost track.

CHAIRMAN VOLCKER. A billion and a half dollars as I recall.

MR. AXILROD. Right.

MR. PARTEE. It got up from $1.2 billion to $1.5 billion.

CHAIRMAN VOLCKER. Essentially, what I am suggesting is retaining that with a zero number [for the M1 growth rate]. If it began rising above zero, we would go above that. If for a while it declined below that, we wouldn't be very quick about moving; if it declined enough, obviously, we'd move; but we wouldn't be very quick about it on the down side.

MR. PARTEE. It's hard to imagine a negative between now and the next meeting that would be so large that we would think it was an excessive washout of the bulge. I guess there is such a number--25 or 30 percent--but it has to be awfully big because it was a 22 percent increase.

CHAIRMAN VOLCKER. Yes, but we would not be in too bad shape by the end of the quarter, or we'd still be high. But that's compared to where we are now. I don't think we should assume that we couldn't get a $5 billion decline in the money supply between now and March. And then if March were stable, we'd look in not too bad shape. We would still be high [relative to the long-term target].

MS. TEETERS. We more than washed out last April in the space of what--3 months?

MR. PARTEE. By the end of three months some of us were getting concerned.

VICE CHAIRMAN SOLOMON. If we get the washing out starting early in February, I don't think any of us has a problem. If it doesn't work out like that, though, it seems to me that we might want to build in a little extra protection by setting the initial borrowing assumption at, say, $1.3 billion rather than at $1.5 billion because otherwise we're going to get a rise in rates, I think. If we start with $1.5 billion for borrowing and don't get a decline, there's a greater risk that we're going to get a rise in interest rates. We would give ourselves a little margin if we start with $1.3 billion.

MR. SCHULTZ. Why would we do that if borrowing is already running above $1.5 billion right now? If we start out setting it at $1.3 billion, which is a considerable drop from where we are at this point, and even $1.5 billion is a drop from where we are--

SPEAKER(?). No, it isn't.

MR. SCHULTZ. Yes. Borrowing is running--

MR. STERNLIGHT. $1.5 billion is what we have been aiming for; the actual came in at $2.3 billion.

CHAIRMAN VOLCKER. One has to distinguish between the aim and the actual.

MR. SCHULTZ. Between the aim and the actual?

VICE CHAIRMAN SOLOMON. We're talking about the aim.

MR. STERNLIGHT. This week borrowing is [averaging] $1.7 billion so far.

VICE CHAIRMAN SOLOMON. The nonborrowed reserve path right now is based on the assumption of aiming for borrowing of $1.5 billion. At the moment I'm assuming that we don't want to see a 15-1/2 percent fed funds rate. I'm assuming that we're talking more about what we had hoped. which was that $1.5 billion in borrowing would produce a fed funds rate of closer to 14 or 15 percent

MR. STERNLIGHT. I would have said about 14-1/2 percent.

VICE CHAIRMAN SOLOMON. Right, about 14-1/2 percent. So, it seems to me--

MR. CORRIGAN. But doesn't that argue that if we stay with the $1.5 billion, we're going to get lower interest rates anyway?

VICE CHAIRMAN SOLOMON. Well, my instinct is based on our discussions in New York, to the effect that the psychology in the markets is such that if we aim at $1.5 billion and don't get any decline [in M1], we're probably going to end up with a higher funds rate than 14-1/2 percent. And, therefore, I think there's some advantage to starting with a modest safety margin in case we don't get the decline.

CHAIRMAN VOLCKER. Well, it depends upon what safety margin we're talking about. I view the difference between $1.3 and $1.5 billion as no big deal. But you're talking about a safety margin in terms of market reactions. Other people may think of the safety margin in terms of what happens to the money supply, so it depends on where you're looking for the safety. And that's what we're--

VICE CHAIRMAN SOLOMON. Right, but if we're living with the January bulge, and I certainly agree that that makes sense, we're not trying to correct it in the very, very short run. If we start off with $1.3 billion, basically what we're saying is that if all of the projections worked out exactly as projected, we would get back to the upper end of the target halfway between June and September. Now, if we start with $1.5 billion, what we're saying based on the staff's analysis is that we would get back to the upper end by June.

MR. SCHULTZ. I'm a little confused.

CHAIRMAN VOLCKER. Before we get off on this question, let me ask in general whether anybody is radically out of the ballpark I suggested. If people are, let's put it on the table and then dispose of that issue and then come back to the fine-tuning. Mr. Roos.

MR. ROOS. Well, I think it's obvious that we ought to do what we did last year and pinch out this bulge. If you recall, we had almost the same experience in the middle of last year; and when we took the action we did in April of last year, the fed funds rate did rise from about 13 to 19 percent. It stayed there a couple of months. But then it came down again and we were in a much more favorable position after we had taken the remedial action. So, that's obviously my point of view. I think we ought to do something sooner.

CHAIRMAN VOLCKER. Let's just put this on the table and dispose of it or not. You are just an advocate of an aggressive move at the moment in the hope and expectation that that will help in the long run. And you would take all the implications that that may have for substantially higher interest rates in the very short run.

MR. PARTEE. I just might point out, Larry, that when we moved in April, we moved in the context of the strongest quarter in GNP that we had seen for a long time--the first quarter. Now we would be moving in a context of the weakest quarter in GNP that we've seen since the spring of 1980. The economic circumstances are quite a lot different than they were then.

CHAIRMAN VOLCKER. Well, this is clearly an aggressive view on the table. It's a legitimate view. Does anybody want to support it?

MR. BLACK. Mr. Chairman, I think what you have more or less suggested is an excellent fallback position, and if it developed in that way I'd be just tickled pink about it. But looking at past experience, these trends that develop are so like runs in stockings: They sometimes keep going on. It's like trying to drive on the ice, as I have been recently. If you don't correct until you're way off toward the ditch, you sometimes have to make a pretty big correction. We have looked at this as carefully as we could and tried to find out whether this burst was an aberration or permanent, and I don't think we know the answer to that. So, I think it's safer to minimize the risk by assuming for the time being--though we may be dead wrong--that the bulge is permanent, and I would be inclined to move more strongly against it now, along the lines of what Larry was saying. But by the same token, if it comes out the other way, which is probably just about as likely, then we ought to be prepared to let the federal funds rate come down and use the whole range for it if [M1] comes in overly weak.

CHAIRMAN VOLCKER. It's hard to see it overly weak in my way of thinking, but I--

MR. BLACK. I don't think we could get that in one month, but if that persisted for a while it could cause--

CHAIRMAN VOLCKER. Oh, if it persisted for a while--

MR. BLACK. Until recently, I thought the economy was going to be much weaker than I now think it is. I've begun to wonder if it might not be bottoming out, which is something I never thought I would think at this point. But if you look at what happened at the bottom of the previous two recessions, the [M1] growth was not unlike what we've had, so I don't think we can rule that out. I don't know what probability we should attach to it, but I just believe that's the course of lesser risk, because I think further growth now is a little more dangerous than moving the rates up temporarily to try to bring M1 growth down.

CHAIRMAN VOLCKER. Well, these are difficult matters of judgment. The only thing I would say on the other side--without saying this view is wrong because we won't know until afterwards--is that we have had a pretty big tightening move in the market already and we haven't had much chance to see [the response] because it was delayed; in fact, to exaggerate, the market got no message at all almost until very recently. We haven't had a chance to see what kind of reaction that will bring. One can argue that being as aggressive as you're talking about, particularly against the business background that exists, takes too many risks. That's what I feel.

MR. BLACK. I think that's a good point, and it does add strong support to what you're suggesting. The only thing that keeps me from doing that is remembering that it is so darn hard to hit these short-term targets. And we have missed them so often, despite our best efforts, that I just shift a little in the other direction. But I think your position is a perfectly reasonably one and I would expect most people would think that's the better one to follow.

CHAIRMAN VOLCKER. Well, we've had some expression of view on the more aggressive side. I guess the next logic is to ask: Does anybody want to be considerably less aggressive? Let's get that view on the table if it has any support. Not hearing any, I think we're down to fine-tuning. Just to repeat the specificity so that we have something to fine-tune, the proposal is to use a zero in there for the M1 number and I guess we can leave the M2 number where it is [in alternative B]. And we have a $1.5 billion and a $1.3 billion borrowing assumption advanced so far. Mr. Guffey.

MR. GUFFEY. I would opt for the $1.5 billion. Although we've been above that over the past week or two, it seems to me that things are moving in the right direction. I believe Peter said that we had a $600 or $700 million [run-off] last week and a potential at least of some run-off again this week, which would bring the borrowing level back to about $1.5 or $1.4 billion. That seems to me to be the right place to start with a zero [M1] growth in the intermeeting period.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. I'm reasonably close to where you are, if I understand you correctly--that is, "B" with a slight tilt to "A," which would say--

CHAIRMAN VOLCKER. I would say a purely cosmetic one. That zero somehow looks more defensible than one percent in terms of what has happened.

MR. SCHULTZ. Now, wait a minute. I don't think "B" with a slight tilt toward "A" is accurate because that's January to March. The Chairman is suggesting zero [M1 growth] from now until the next Committee meeting. I think that's a different animal.

CHAIRMAN VOLCKER. Well, no, I meant it to be the same.

MR. FORD. I understood it to be the same.

CHAIRMAN VOLCKER. I meant it to be the same. I think that roughly is until the next Committee meeting.

MR. FORD. I would lean a bit toward the tighter end of what you're describing by saying that we ought to assume $1.5 billion on borrowing, especially given that the funds rate today, as it was yesterday, is coming in close to the upper end of this band and we ought to continue with the common sense notion of bracketing the funds range around where it is when we leave this room and allowing some leeway on the upper end of that range. I know that's not going to be real--

CHAIRMAN VOLCKER. Well, I didn't mention that but my instincts are against taking the last 2 days on the federal funds rate as the rate to bracket. I would say the 14 percent is probably what we ought to bracket on those assumptions.

MR. FORD. Alternative A shows 3 percentage points [of leeway both above and below the midpoint of the range]; the others show 2 points. If you are saying that you want to peg the fed funds and not hit 16--

CHAIRMAN VOLCKER. I didn't say that. I said I would worry if the federal funds rate were 16 percent now. I surely would.

MR. FORD. I can understand on an intra-day basis and it has been 16 percent or right--

MR. STERNLIGHT. It touched 16 percent yesterday. The effective rate yesterday was 15.68 percent or something like that.

CHAIRMAN VOLCKER. But we're not talking about an intra-day touching.

MR. FORD. Still, I'd go along with "B" and the zero growth rate for M1 and something like the [alternative B] M2 figure, but I'd want to give ourselves a little room to breathe on where the funds rate goes.

MR. PARTEE. I think we ought to do away with the funds rate range. I think this is the perfect meeting just to do away with it.

MR. BLACK. I second that.

MR. FORD. All right. I think that's a great idea.

MR. BALLES. I'd agree.

MR. FORD. We say we're shooting for zero growth in M1 and no rate restrictions.

MR. BOEHNE. Why is this a perfect meeting to do it?

MR. PARTEE. It's the first meeting of the year. We're totally at sea. We have a very simple suggestion from the Chairman, which is that we target for zero [M1] growth and we accept any shortfall. And we take the rate that comes up.

MR. GRAMLEY. As long as we're going to put out extremes, I'll suggest throwing out M1.

MR. PARTEE. So we throw out zero and we come up--

MR. WALLICH. Not using a funds range makes a lot of sense because that range is always misunderstood in the market. They all believe that it cannot be breeched, but actually it is a checkpoint at which consultation begins. I think we'd do ourselves a lot of good by removing it.

MS. TEETERS. You're willing to remove the bottom as well as the top?

MR. PARTEE. Sure. We opt to take it out; we don't want it.

MR. WALLICH. That doesn't mean that we can't consult under any circumstances, I take it.

MR. MORRIS. Well, I would be very upset if, without any evidence that the economy has bottomed out--I think the only evidence suggests the economy is still going down--we threw out any constraint on interest rates on the up side, as Mr. Partee suggests.

MR. BOEHNE. It seems to me that there are lot of people out there who think we're going nuts in the direction of the money supply anyway, and if we just throw out any restraint on the funds rate, given the economy where it is, it's going to convey the notion that we've lost our sense of balance.

CHAIRMAN VOLCKER. You can even leave off the "of balance" in that statement!

MR. GRAMLEY. And I don't think we ought to have a hidden consultation rate that we don't tell the public about. It seems to me we owe the public [information on] the way we're looking at things and the way we're operating and how that works. If we're going to use a 16 percent and 12 percent as the upper and lower limits for purposes of consultation, we should tell the public that.

MR. PARTEE. Well, I have great faith in the conservatism of our management.

MR. WALLICH. Now, if we use a borrowing assumption, which we don't publish, and which is a much more operationally important thing than the consultation ranges--

CHAIRMAN VOLCKER. Let us defer this particular argument and settle on the other dimensions. Mr. Corrigan.

MR. CORRIGAN. I have just one little anecdote here. We talk about all these statistics all the time, and I would note for the record that many of the people who are always telling us what to do tell us we should look at the monetary base. If you look at the monetary base for 1981, it's actually quite stable on a quarterly basis. But the most interesting thing is that the growth rate of the monetary base was slowest in the fourth quarter when the growth of the money supply was fastest. And I think there's a little message there.

As to the substance of the short-run decision that we will be making, I personally would have quite a strong preference for having something like the second alternative directive [shown in the Bluebook] as our basic marching order, with M1 at zero and M2 at 9 percent. I would be very comfortable with a funds rate range of 12 to 16 percent. I for one would feel very, very strongly that we should maintain a band on the federal funds rate for some of the reasons that have already been stated. I don't think there is a great deal of misunderstanding in the marketplace as to what that band means right now; most people know exactly what it means. So, I would be very uncomfortable getting away from having a federal funds rate band, and I would fix it at 12 to 16 percent. On the borrowings, again, I would feel fairly strongly that we should start at $1.5 billion. At least as I read the Bluebook and look at what has happened even since this Bluebook was written, I would interpret the staff's analysis as saying that over the intermeeting period as a whole a borrowing level of $1.5 billion should be compatible, from where we are right now, with both lower interest rates and a lower actual level of borrowing. That's how I would look at it, Mr. Chairman.

MR. ROOS. Mr. Corrigan, may I please just correct one thing, sir? The monetary base has grown much more quickly in the last quarter of--

MR. CORRIGAN. On a quarterly average basis, I think it is the slowest growth rate of the year.

MR. PARTEE. It was in the Bluebook.

MR. ROOS. No, not according to us. We'll have to put you on our mailing list.

MR. WALLICH. There's a different base in St.Louis; we know that.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. I'm about where Jerry is. I like your general ballpark specifications, Mr. Chairman. Zero seems right to me for M1 and 8 or 9 percent is acceptable for M2. I feel strongly that we ought to keep the fed funds range of 12 to 16 percent and $1.5 billion on borrowing. And I like the alternative II specification of the directive. I think that captures my sense of it.

CHAIRMAN VOLCKER. You pointed out something. I misspoke when I said 9 percent for M2. I was looking at the numbers down below which were for November to March. I just meant the same number as was in alternative B, which is 8 percent and not 9 percent.

MR. BOEHNE. Well, 8 or 9 percent would be acceptable.

CHAIRMAN VOLCKER. I don't think it's critical but I was just reading off a piece of paper and I read the wrong number. Mr. Keehn.

MR. KEEHN. Well, philosophically, I'm very close to what Ed has just suggested. I'd feel far more comfortable with alternative B. I would like a directive that would emphasize that we're trying to maintain the current level as opposed to being slavish to any particular number. I would be comfortable with the borrowing level of $1.5 billion. I would feel very strongly that we should not eliminate the fed funds range. I'd be in favor of maintaining that at 12 to 16 percent; given the current rate, that seems reasonable.

CHAIRMAN VOLCKER. Mr. Gramley.

MR. GRAMLEY. I'm very much with Jerry and Ed and Si on the specs. And I'm there because I am deeply worried about what would happen to the economy if interest rates go up again. I think Bob Black said, perhaps inadvertently, that we can't rule out a recovery. But we can't rule out the possibility that there won't be a recovery. I'm particularly worried about what may be happening to business fixed investment. I think that all the risks are on the down side as regards capital formation and that any inadvertent increase in interest rates now, with the aim of pinching this bulge in the money stock, would be a grave mistake.

I want to note what we're doing here around the table as we set specs for the short run. We say that we'll take M1 of zero and that for M2, well, maybe there's something to that aggregate but we don't really care much [about it]. I do care and I care a lot. That's because I think we're looking at a world in which M1-B or M1--or what we use for M1 now with other checkable deposits in it--is showing an enormous variation in response to changes in interest rates that very much parallels what has been going on for several years in savings deposits. If you look, for example, at the recent period you'll find that other checkable deposits had a turnaround; in terms of annualized percentage rates their growth was around 26-1/2 percent from October to December. Savings deposits had a turnaround in terms of annualized growth rates of roughly 32 percent. I think the parking argument is very much the reason for it. People are using their savings deposits as a vehicle for temporarily depositing funds that they're going to put back into other forms of financial assets later, and they're beginning to use their other checkable deposits for the same purpose. We're going to see a tremendous amount of variation in M1, I think, in response to changes in monetary policy and in response to changes in the economy that affect interest rates that we will not see in the nontransactions component of M2 to anywhere near the same degree. I think we get a more stable response to changes in policy, therefore, in a larger aggregate like M2 than we do in M1. I wouldn't push this to the point where Frank Morris is of throwing out all the aggregates altogether; I could perhaps be persuaded if you twisted my arm, Frank. But I do think it means that we ought to give more attention to what is happening to M2, not just for this meeting but more importantly for the longer term.

CHAIRMAN VOLCKER. I want any remarks of mine that you may have interpreted the other way stricken from the record because I agree with what you're saying. I just misread the M2 figures. It's not that I don't think it's--

MR. PARTEE. Well, M2 growth in January anyway was 11.2 percent, or that's the estimate.

MR. GRAMLEY. But what does that mean about the nontransactions component of M2?

MR. PARTEE. Well, do you believe that the parked money is going to move entirely out of the Ms? I think a lot of it will shift from M1-B or M1 into M2 components and, therefore, if we set an 8 percent limit, we would have a pretty tough policy.

MR. GRAMLEY. If you're that concerned, Chuck, about parked money moving from one component of [M2] to another, then focusing on the broader aggregate seems a way of dealing with that. If you look at the monthly growth rates in terms of the billions of dollars of nontransactions components in M2, there was a big bulge in November, but September, October, December and January were all very much the same order of magnitude. We did not have this tremendous burst, and a continuation of that burst, in the nontransactions components of M2. That's exactly my point.

CHAIRMAN VOLCKER. Let me suggest this. We're going to have a little time problem here; I'm going to have to do a little work during intermission. The German mark has been very weak and there's a question of whether we should intervene or not. I don't have any fixed view on this, but I want to talk to [the German officials]. And I have to talk to a few people here. So, I would like to wind up this portion of our discussion fairly promptly, if that's possible. Let's see where we are.

MR. SCHULTZ. I'm ready to vote on it, Mr. Chairman. I don't have anything to add to the discussion. I think we've settled in here. There seems to be a very general consensus.

CHAIRMAN VOLCKER. I just want to make sure that that's what we have. Mrs. Teeters.

MS. TEETERS. Well, I don't object to starting at $1.5 billion on borrowings because that's coming down from where we are. My only difference from the specifications suggested so far is that I think we should be prepared to move toward $1.3 billion. The language here does that, but I think it should be put on the table that we're not going to be rigidly stuck at $1.5 billion of borrowing if things--

CHAIRMAN VOLCKER. Well, if things really turn around. I find it very difficult to specify just where we would be, but I might be very reluctant on that first $3 or $4 billion [decline in M1] to make much change. If it went beyond that, some gradual response would begin to--

MS. TEETERS. The point I'm making is that we went from $300 million to $2 billion [on borrowings] in the last six-week period. So, if we're going to be that flexible going that way, we should be prepared to be equally flexible when we get--

CHAIRMAN VOLCKER. Well, certainly if this January [M1 bulge] washed out, borrowing would be down. There's no question about that. If it really washed out--I don't expect that to happen in that extreme form, but who knows, it might--

MR. PARTEE. Well, I think the only question Nancy is asking is: Will you let the usual arithmetic relationship show through in lower borrowings if in fact there is weakness below zero in the money supply?

CHAIRMAN VOLCKER. Well, I hate to get very specific about this, but I guess what I am saying is that I'm not sure I would react to the first $3 billion below zero. Beyond that, yes.

VICE CHAIRMAN SOLOMON. The way Nancy formulated it, it's basically a discretionary decision. It seems to me that the advantage of starting with $1.3 billion as against $1.5 billion is that then we have a carry-through during the entire period of the lower base. That's because we make the adjustments and the amount of change that results from the reality of the situation doesn't affect the starting point. So, you get the carry-through effect of the $200 million increase in the initial nonborrowed reserve path by starting with borrowings of $1.3 rather than $1.5 billion. I will live with $1.5 billion--in every other respect I agree with what has been put forward--but I'm just not sure that at $1.5 billion we will get 14 or even 14-1/2 percent [on the funds rate]. I certainly don't think 14 percent is what it is likely to produce; it probably will be 14-1/2 percent at best. And given the psychology of the market, we may not get that. I just wanted to have a safety margin to start with. If we don't build it in to start with, Nancy, then it becomes simply a discretionary decision at a later time. And I don't see that--

CHAIRMAN VOLCKER. Well, it doesn't have to be completely discretionary. Even in that first little margin we could take the position that we at least will let it go through to whatever extent it automatically shows through, which wouldn't be very much, unless we've got a big decline, right?

VICE CHAIRMAN SOLOMON. Yes, there--

CHAIRMAN VOLCKER. Mr. Balles, I skipped you completely.

MR. BALLES. Well, just very quickly, since we are still in a recession, I would go along with your proposal, Mr. Chairman, but with a strong plea or caveat as the case may be that we take such actions as are necessary to avoid the big overshoots that we had on the [monetary growth] paths we set at the November meeting and the December meeting.

CHAIRMAN VOLCKER. I wish I knew how to do that.

MR. BALLES. I wish I did too.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. I would be in agreement with the way you specified it and with the second alternative on the language of the directive.

MR. RICE. I'd go along with your proposal, Mr. Chairman.

CHAIRMAN VOLCKER. Does anybody else have any comments?

MR. WALLICH. I have nothing to add. I would go along with zero and 8 percent. I prefer not to mention the funds range, not because I think interest rates are unimportant, but because I think it's misleading. But 12 to 16 percent is fine as is $1.5 billion on borrowing.

CHAIRMAN VOLCKER. Anybody else? Let me try to repeat it and maybe we can vote on it. What happens during this coming period will reflect on our longer-range strategy, but leaving that aside, what we're talking about is zero for M1, 8 percent for M2, and $1.5 billion as the initial borrowing assumption. Allowing for Governor Teeters' and Mr. Solomon's comment, let me modify what I said and say we would let [an M1 decline] show through in the purely automatic way but we would be reluctant to make any discretionary adjustment without a really big decline. However, whatever presumably rather small adjustment comes through by itself, if we do begin getting any declines here, we let them show through. It's a slight modification from what I said before. And the funds rate range is 12 to 16 percent. Frankly, I feel rather strongly that 12 to 16 percent is as high as I want to go on that funds range. If we were going to go above 16 percent on the federal funds rate--maybe we'd do it--I'd want to scratch my head and have the opportunity to scratch my head pretty darn hard. I'd scratch my head at 15-1/2 percent, I tell you. At 15 percent, it's--

MR. BLACK. Mr. Chairman, in view of what you said earlier about being very anxious that we not go above that rate, would you want it to be purely automatic if we did get a continued spurt or would you want some discretionary adjustment in the nonborrowed path?

CHAIRMAN VOLCKER. If M1 goes above the zero?

MR. BLACK. Yes.

MR. PARTEE. I think we might well have an adjustment.

MR. BLACK. Would you want that to be an automatic adjustment?

CHAIRMAN VOLCKER. Well, we'd certainly do the automatic adjustment and we might have to do a discretionary one if M1 really is rising. It would call into question this federal funds range and if and as it does, we'd have a consultation. I'd be much more quick to make a discretionary adjustment on the up side, if we have to, than on the down side.

MR. BLACK. I thought that's what you meant, but I just wanted to clarify it.

CHAIRMAN VOLCKER. Is that clear enough?

MR. BLACK. That's fine.

CHAIRMAN VOLCKER. We might as well vote on this and have a recess.

MR. ALTMANN.

Chairman Volcker	Yes
Vice Chairman Solomon	Yes
President Boehne	Yes
President Corrigan	Yes
Governor Gramley	Yes
President Keehn	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Schultz	Yes
Governor Teeters	Yes
Governor Wallich	Yes

Unanimous.

CHAIRMAN VOLCKER. Well, let's have a recess and return to the other regulatory exchange.

[Coffee break]

CHAIRMAN VOLCKER. I think we ought to go to Mr. Cross at this stage and dispose of his report. It's particularly relevant in view of the question about intervention. I will just bring you up to date. The mark, of course, has gotten quite weak, with our interest rates going up; other currencies have moved to a lesser degree in the same direction; the mark had gotten to a rather high level. [The Germans] have pretty much given up doing anything. They made a great or semi-great stand two or three weeks ago, but they think this [weakness] so much reflects interest rates and the uncertainty about what is going on [in the United States], that it's hard for them to do anything through intervention alone. That's probably a correct judgment. We have come to a conclusion with the Treasury that if the mark did weaken this afternoon or tomorrow when they probably will be announcing some economic expansionary measures--the latest movement of the mark has been toward some strengthening--we would look kindly upon an intervention gesture. We are not talking about huge amounts but about moving in the direction that indicates some interest on our part. They probably have an interest, too, but they didn't want to do anything alone. And that's the way it stands at the moment.

VICE CHAIRMAN SOLOMON. That would be interpreted in the market as dissatisfaction with the level, not as countering a disorderly or a very volatile market, I think. Wouldn't you agree that that's the way the market would see it to some degree?

CHAIRMAN VOLCKER. Well, I think some mixture.

MR. WALLICH. I think we could do this on the grounds that there is an element of disorder when the market pays little attention to fundamentals like inflation and--

VICE CHAIRMAN SOLOMON. But that still comes back to a view about the level. I'm not unhappy about this because it's a beautiful [chance] to finally get a change and a perception of a change in the Sprinkel policy. I do think, though, that the market will be a little confused because when we've had these disorderly or volatile markets [before] we have not intervened and all of a sudden we are intervening in a situation--and this is a big movement--

CHAIRMAN VOLCKER. I'm not talking about doing it on a really trivial movement; I'm not talking about a couple of pfennigs anyway.

MR. WALLICH. But we have never said anything other than that we would fight disorder. Now, disorder is in the eye of the beholder.

VICE CHAIRMAN SOLOMON. And the beholdee.

MR. WALLICH. I think we can make our point in the market without giving away the statement that we do it for disorder.

CHAIRMAN VOLCKER. No, I don't think we give that away to any extent.

MR. BOEHNE. Does this reflect a slight movement toward pragmatism on the part of the Treasury people?

CHAIRMAN VOLCKER. Maybe.

SPEAKER(?). Maybe.

MR. GRAMLEY. Where will this all end--this pragmatism over there?

MR. SCHULTZ. Good common sense. We can't have that!

CHAIRMAN VOLCKER. Well, with that background, why don't you go ahead, Mr. Cross.

MR. CROSS. Well, Mr. Chairman, that comes close to the conclusion of what I was going to say. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Any questions or comments?

MR. WALLICH. Sam, do you observe that the yen is more sensitive to interest rate differentials now than it has been in the past?

MR. CROSS. It seems to have followed pretty closely, at least during these recent weeks, the changes in the interest rate differentials. I haven't looked back to compare that very thoroughly with earlier periods, but it does seem to have happened in this period. Mr. Chairman, I also do have a recommendation.

CHAIRMAN VOLCKER. Proceed.

MR. CROSS. [Secretary's note: Text of Mr. Cross's recommendation not extant. Staff notes indicate that he recommended a $1/4 billion increase to $3-1/4 billion in the informal limit on holdings of German marks and an increase of the same amount to $4-3/4 billion on the limit of holdings of all foreign currencies to allow for the accrual of interest on mark balances.]

MS. TEETERS. If you're going to be intervening, aren't these two--

MR. CROSS. If we intervene, then we will need to modify that further.

VICE CHAIRMAN SOLOMON. I think it would be prudent to increase that [informal limit] by even more than [the $1/4 billion that] Sam is recommending.

CHAIRMAN VOLCKER. I think we could live with--

MR. SCHULTZ. That gives us a little problem. There are three of us on the Foreign Currency Subcommittee and I'm leaving.

MR. CROSS. It's an informal agreement, I believe.

MR. SCHULTZ. Oh, I see. Okay, fine.

MR. TRUMAN. Maybe the Secretary can correct me, but in the past we haven't dealt with this in terms of a formal vote.

CHAIRMAN VOLCKER. It doesn't require a vote of the Committee. This is purely an informal understanding. I think we can just leave it the way you are proposing, Sam, and understand that if we do intervene, you are not going to exceed this [new limit] right away anyway.

MR. CROSS. We're very close to the [current] limit at the moment.

MR. PARTEE. [The leeway] is only $12 million.

CHAIRMAN VOLCKER. It's only $12 million at the moment?

MR. CROSS. Yes, $12 million.

MS. TEETERS. With $200 million of interest [earnings to be added] in there.

CHAIRMAN VOLCKER. When does that $200 million--

MR. CROSS. If you raise it now, then we have that much scope and we will be receiving those interest receipts over the next five months.

CHAIRMAN VOLCKER. All right. We can do it any way we want to, but I don't feel hard pressed [to change it]. If we say this [increase from $3 billion to] $3-1/4 billion is generally acceptable, the understanding would be that if we intervene [the limit] is going to have to be more. And the Foreign Currency Subcommittee would presumably review that. Maybe we can [raise] it $1/2 billion, if you want to do that.

MR. CROSS. The present overall limit is $4-1/2 billion. The Committee could raise it to $5 billion, which would give us a little scope just in case.

VICE CHAIRMAN SOLOMON. I think we ought to [raise] it $1/2 billion because sometimes the situation moves fast. And it does seem to me that there is no issue of principle here.

CHAIRMAN VOLCKER. I don't think there's any big issue one way or the other. Which do you feel more comfortable with?

MR. CROSS. I would recommend [raising the overall informal limit to] $5 billion and raising [the informal mark limit] by $1/2 billion [to $3-1/2 billion].

CHAIRMAN VOLCKER. Is that acceptable? With that understanding, we will proceed.

Now we can return to our long-run ranges in the light of the decision we just made. Let me describe one variable that if I were doing it today I'd do differently than I did a few weeks ago. I agreed to testify on February 10th, which isn't very far off. I wanted to do that in part because I just don't like the idea of a long lapse between our decision and the time that it's announced. I think we should try to get it out of the way as soon as possible. Then there's a recess of the Congress, long in this context, for Lincoln's birthday and Washington's birthday. The alternative, if I don't testify on the 10th or 11th, is that I can't do it until the 23rd or something like that. At this point, if I hadn't semi-committed myself otherwise, I'd just as soon wait until the 23rd and see what happens to these numbers over the next three weeks. I note that because it's not impossible to go back and change that if we want to. There's no point in changing it if everybody is happy with the decision today. But if there were a view that minds could be swayed strongly one way or another by what happened to the money supply over the next--. We would have three weeks more of data, Mr. Axilrod?

MR. AXILROD. Pardon?

CHAIRMAN VOLCKER. If I didn't testify until [later]--is Mr. Winn here?

MR. AXILROD. The 23rd would be the alternate date.

CHAIRMAN VOLCKER. The 23rd is the alternate date, which is a Tuesday, isn't it? We would know--

MR. AXILROD. We would have partial data for the 17th and the 3rd and 10th would be published.

CHAIRMAN VOLCKER. The 23rd is Tuesday. So we would have partial data for the 17th. What do we have now: partial data for the 3rd? So we would [know] two more weeks' data.

MR. AXILROD. Tomorrow we'll have partial data for the 3rd.

CHAIRMAN VOLCKER. We don't have partial data for the 3rd yet? So, we'd have three more weeks' data if we waited.

MR. AXILROD. That's right.

MS. TEETERS. There's also the delay in the [President's] economic report and the budget.

CHAIRMAN VOLCKER. Well, we'd use that as part of the excuse for delaying. I wouldn't delay unless there were a strong feeling that it would add a great deal. Before you respond to that, I'd note that in a more general way, as I suggested earlier--based upon what we know now and a feeling that there is some reasonable chance, though I don't know where I would put those odds, that a considerable amount of this January surge in particular will wash out--I would feel comfortable with essentially the same targets we announced before with the same base. I think that would minimize the difficulties all around. What I would be inclined to say is that we would feel quite comfortable as we see things now--I am issuing a nuance statement--[with growth] in the upper part of the range, if that's the way things came about on M1. That's not quite the same as saying we would aim there deliberately. I don't think we can aim that finely a year away but we could say that we find that quite acceptable based upon everything we know now. I think that is consistent with what I said overtly before--but I don't remember precisely the reason we put in a bottom [for the range] as low as [2-1/2] percent--that the only purpose for the lower part of the range was the concern that a technological change, such as the rise of money market funds and sweep accounts and so forth, might have such a depressing effect on M1 that we would want to allow for that. It wasn't a policy assertion; rather than being a sign of a real policy objective, it was a concern that [M1 behavior might reflect] a technological response. All other things being equal, we wouldn't have growth as low as 2-1/2 percent.

On M2 we have a set of projections, for what they're worth, that say as I understand them that the range is more or less adequate. In other words, even at the upper end of M1, we'd expect to be within the M2 range; that may be a good or a bad judgment. And if we were in the middle of the M1 range and were presuming implicitly all other things equal--technology and everything else--we would expect more likely than not to be in the upper part of the [M2] range. We would certainly be in the upper part of the range on M2 and maybe threatening the upper limit, which is where we've been all along. And I would say that. Now, one can obviously argue logically: Why not just raise the M2 range? I wonder a bit what we would gain by that as against the explanation that we have been running slightly above the upper end of the M2 range for recent years and as a result of that I think it's understood in the market that the operative part of that range is around the upper limit. One could argue that raising the range puts us nearer the middle, but I'm afraid we might get some interpretation that the operative part of the range remains the upper part. So, if we moved, let's say, to 10 percent as the upper end, people might say 10 percent or slightly above is what we're aiming for because that's where we've been in terms of that range. And that would give us a higher M2 [growth] figure than we have had in any recent year. We also have this pattern where we haven't had any real declines in M2 [growth rates] for a number of years as I recall. In fact, we've had increases I think. It has been fairly steady for three years as I remember, but if you go back to the mid-1970s, M2 growth was much higher. That was back when we had this large component of fixed deposits. It got high when interest rates went down; it got low when interest rates went up. And since basically a flexible rate [has been paid on M2 deposits], M2 has closely tracked GNP very well. I don't know whether that will last, but it has so far. It has been hanging roughly just above 9-1/2 percent, plus or minus every year for those three years. Now we have the staff telling us--for what it's worth and I assume it's worth a lot--that M2 growth should be lower, consistent, of course, with the lower nominal GNP that is being projected.

MR. AXILROD. Mr. Chairman, the staff's view is that the data would have suggested there were stronger arguments for raising the range for M2 in the previous two years than there are this year, given our [GNP] projections.

CHAIRMAN VOLCKER. I think that was reflected earlier when we were at this position. The staff told us we'd be threatening the upper end quite clearly and maybe would exceed it. That's not impossible this year, but as I interpret it you feel more comfortable about the range this year than you felt at any time in the past two years anyway.

MR. AXILROD. Yes.

CHAIRMAN VOLCKER. Now, there are these arguments that were presented yesterday, which I think have a degree of theoretical validity. There were two that I recall: One was that if we get more savings, we may get more M2 because that's a savings vehicle for individuals; the second is that if the IRA/Keogh accounts pull money out of what is [not] now encompassed in M2, we would get an upward bias--assuming that we continue to count IRA/Keogh deposits in M2, which is a doubtful proposition. But we'd have the opposite problem of a downward bias if we took [those deposits] out. I was thinking about that just last night and maybe somebody can confirm my off-hand judgment that either of those events would involve literally tenths [of a percentage point] because we're not talking about the whole increase in IRA/Keogh but only about the part pulled out of market instruments and into M2. If the saving rate went up 1 percentage point, let's say, it doesn't mean a one percentage point increase in M2 [growth] by the wildest stretch. The saving rate is first of all calculated against disposable income, which is much lower than GNP. A one percentage point increase in the saving rate isn't one percentage point against GNP, which is where we are measuring this. And it's not all going to go into M2-type deposits. It can go into housing equity or into many other things. So, I think we're talking about tenths in either of those things, although they probably work in that direction and they're theoretically correct observations as near as I can see. But it has struck me that they are not the kind of thing--and I'm just getting a staff comment on this--that would have a really large impact on M2, although, if they happen, they would tend to go in that direction. I don't know if there is any equally clear offset. One could argue that on technical grounds, but we'd be arguing about an adjustment in the nature of 1/2 percent or something of that kind to allow for those things. That is my feel for it, but I don't know whether the staff has any other view. Of course, the staff made an estimate. I don't know to what extent you consciously took these things into account.

MR. AXILROD. Not very consciously at all, Mr. Chairman. I don't know what one would say. One percent on M1 is about $18 billion, which is probably as reasonable an estimate as one might make if you consider 10 million people at a $2,000 maximum per person.

CHAIRMAN VOLCKER. Yes, but we're not going to get that. I don't know what your estimate is for IRA/Keogh deposits, but certainly a large proportion of what goes into IRAs and Keoghs already would have been in M2 anyway.

MR. AXILROD. Yes, that's right. I'm saying as an upper limit I would think 1 percentage point is not unreasonable. So, it would be small in practice.

MR. PARTEE. The saving rate could be more influential because presumably this would be money that otherwise would have been going into consumption. I don't know what a 1 percentage point increase in the saving rate would be--

MR. CORRIGAN. $25 billion?

MR. GRAMLEY. It would be about $20 billion.

CHAIRMAN VOLCKER. Yes, but how much of that would appear in M2?

MR. PARTEE. Most of it, I should think.

CHAIRMAN VOLCKER. Why?

MR. PARTEE. Well, you said more equity in housing. That seems to me extremely unlikely this year.

CHAIRMAN VOLCKER. People just don't borrow. We know one thing, which is that borrowing is going to be low in that area. I'm not sure I've thought this all through, but I think the major change there is how much new mortgage [financing] somebody puts on in exchanging houses and so forth.

MR. PARTEE. Housing is nonexistent.

MR. FORD. That's one way it would show up, but I would--

MR. PARTEE. But housing is not a personal consumption expenditure. Housing investment is an investment expenditure, not a consumption expenditure.

MR. FORD. That's not what he's talking about.

CHAIRMAN VOLCKER. When one increases the equity in one's house, it shows up in the saving rate, right?

MS. TEETERS. We're not adding housing next year anyway when we have a 17 percent mortgage rate, so why worry about it?

CHAIRMAN VOLCKER. Well, that's what I'm saying. I don't think this is a year in which people are going to be consuming by borrowing on mortgages and in effect running down the equity in their houses and building up consumption. They're going to be paying off those mortgages because they're stuck with them. And that shows up with an increased saving rate, I think. Right, Mr. Zeisel?

MR. ZEISEL. We were involved [in a side conversation] here. The answer, I think, is yes. If people don't spend money on consumption items, it shows up in the saving rate.

CHAIRMAN VOLCKER. What is the form in which that savings is lodged if one is paying off mortgage debt? It's a decline in indebtedness rather than an increase in--

MR. PARTEE. I think that's true. As Jerry said, if one takes cash income and pays off mortgage debt, then obviously that cash income isn't used to consume and, therefore, it raises the saving rate.

CHAIRMAN VOLCKER. And I'm saying it's not unlikely that that's going to happen because ordinarily we get some new borrowing, which people in effect can use for consumption. This year we're not going to get the new borrowing side of the equation.

MR. GRAMLEY. Well, we really didn't have it last year either.

CHAIRMAN VOLCKER. That's right.

MR. PARTEE. We didn't have any.

MR. GRAMLEY. The issue is that if there's some deliberate decision to consume less and save more, the logical disposition of the proceeds is to pay off debt or increase financial asset holdings. And I would think that for the average homeowner who has a mortgage well below 16 or 17 percent or whatever he could earn on money market mutual funds, he's not going to pay off his debt, he's going to add to financial assets. So, the counterpart of the consumer balance sheet would be an increase in financial asset holdings and it would likely go into M2--not the whole thing, but maybe 3/4 of [it].

CHAIRMAN VOLCKER. Some portion of it. We're just talking about the magnitude of this effect.

MR. GRAMLEY. It seems to me that the bigger [issue with respect to] what we want to do with M2 is not the fact that we have an additional bias or lack thereof this year relative to last year but that last year we were well over the upper end, or several tenths over. If what we want is an increase in nominal GNP of, let us say, between 8 and 9 percent, then we ought to be choosing a range for M2, given the recent velocity figures, that has a midpoint between 8 and 9 percent. And if we put out another 6 to 9 percent range, particularly if, as I hope, we will be giving increased stress to M2 this year relative to M1, then we would be aiming almost certainly at a target that we will tend to violate on the up side unless we're not going to get that kind of economic performance.

MR. PARTEE. That's right.

CHAIRMAN VOLCKER. I think we are to the presentational question: Is it worth it? If we were going to aim at the midpoint as you say, does that follow the record? I don't think that's the way it will be interpreted because people see that growth has been around the top of the range. And it just looks as if we're raising the target. I think we would have to say that we expect [M2 growth] to be toward or at the upper end of that range. I have no problem with that because it has been there for three years.

MS. TEETERS. But we used [the upper end] at least once as a constraint.

CHAIRMAN VOLCKER. I'm not saying we wouldn't use it as a constraint again. I'm not saying we will ignore M2. The relevant issue is where it becomes a constraint. I'm saying a constraint is someplace in the neighborhood of 9 percent. I'm not saying it's a constraint at the logical midpoint, which is 7-1/2 percent. I'm not saying that. And then we have a presentational problem.

MR. PARTEE. I would emphasize the incremental possibilities more than Lyle would. I think M2 has about an even velocity, which would suggest 8-1/2 percent. But then there probably is a bias on the side of getting a little larger increase. So, I think it's very possible that we will be over 9 percent this year. Now, if you say to me that you don't care if it's over by a few tenths, because it was over by a few tenths last year and the year before, then you're telling me that it's not a binding range. And then I don't care where we put it; we can put it at 3 to 5 percent or whatever!

CHAIRMAN VOLCKER. Well, I'm not saying that. There's a difference between being at 9.3 percent and being at 10.5 percent. That is a difference.

MS. TEETERS. Not if the range goes up to 10 percent.

CHAIRMAN VOLCKER. No. If the range goes up to 10 percent, I think it will be read that 10.5 percent [growth] is okay. And that's the issue. Obviously, we can we raise the range and say cross our hearts, hope to die, we're going to stay in it; we won't be [above] it. That's the alternative.

MR. BALLES. I'll vote for that.

MR. WALLICH. M2 is very hard to control in a direct sense; we can control it by controlling GNP essentially. Savings is a function of GNP and in that sense, if we get a good M2, we have done a good job on GNP. But I would not get too firmly ensconced on an M2 target precisely for that reason.

VICE CHAIRMAN SOLOMON. Given the imprecision of the numbers, it seems to me that we all ought to agree with the general proposition that we are doing our job well if we come in anywhere within the ranges. We should not give the impression that we are aiming for midpoints.

MR. PARTEE. I agree with that.

SPEAKER(?). I agree.

VICE CHAIRMAN SOLOMON. Therefore, I think there is a considerable disadvantage in raising the range for M2 because then [it would seem that] what we are really trying to do is to come in closer to the midpoint and we would be disturbed with coming in around the upper end of the range. So, in addition to the staff predictions that we probably will be more comfortable with the M2 range this year than in the previous two years, it seems to me that there is a pretty strong case for not raising the M2 range.

CHAIRMAN VOLCKER. Before we elaborate any more on M2, let me just complete my story and go back to the [presentation] problem. As I said earlier, I would feel very uncomfortable with this M1 target if I thought that this bulge were semi-permanently built in. I do not have the evidence for that now, but if we just go ahead with our targets on the same base, I would be inclined to say--and it is not a very easy thing to say and get it just right--that if it turned out that this bulge more or less stayed in, this Committee would be prepared to review that target rather promptly, particularly in terms of this basing problem that we have. And we would report back even before the normal midyear review if we have sufficient evidence that this is a more permanent kind of--

MR. PARTEE. Shift in [demand].

CHAIRMAN VOLCKER. A shift that we did not anticipate. With the passage of, say, a couple of months, one way of looking at it would be that on balance we would conclude that coming up to last year's target range right at the end of the year was a more meaningful [event] than the earlier declines, in terms of the basic outlook regarding the need for money. I'd just lay that out on the table and say that if that is the kind of evidence we get in the ensuing couple of months, we are prepared to review that target. We are not making that assumption with regard to the target right now, and that is why we are sticking with the convention.

Now, one thing we could do is to delay the testimony; it would give us three more weeks and maybe we would have a little more evidence one way or another. I guess everybody would feel more comfortable if [M1 in] those next three weeks showed a decline; then this target would look much more reasonable. If it showed no decline over those three weeks, I would feel more uncomfortable with it than I do today. We still would not know. It might decline in March, obviously, but I would have substantially more uneasy feelings that we are too low on the range. So, we could play around for another three weeks before making a judgment if you thought that added something. But the alternative--this is just the way I feel--is to go ahead on the present schedule but just say reasonably clearly that this is our feeling at the time based upon a feeling that there is a temporary element in that figure and that it does not reflect a lasting [phenomenon]. I don't think I would use the term "shift in demand" but some English that reflected that. And I'd say that if it does not wash out with the degree of pressure in effect that we judge is right in the market, we would sense that something more fundamental is going on here, which would suggest that we may be using the wrong base for this year's target. And we would be prepared, as I said, to report that.

MS. TEETERS. Does no one share my concern that the forecast is too low? If all our temporary problems get [unintelligible] in essence that we are negating the President's program. I find myself in the odd position of being the only supporter of President Reagan in the room here. Basically, [the staff is] projecting a major continued recession at very low rates of [activity]. And the overall policy may be too tight. Whether we have problems with the base or any of the rest of it, we are just making monetary policy too restrictive to get the sort of recovery that I think all of us want.

CHAIRMAN VOLCKER. Obviously, these questions are interrelated, and you raise the issue in a more fundamental way. Let me just say that, mechanically, the impact of changing the base is just a little over a 1 percentage point [increase] in the targets. In terms of the end of the year, the contour is different than raising the target, but mechanically it gives us the result of being up 1 percent at the end of the year, because we are up 1 percent at the beginning of the year and it just carries through.

MR. ROOS. If Mr. Meese's comment this morning that the President would want to consult with you turns out to be meaningful, would that have any effect on the timing or on any aspect of this scenario that you are talking about?

CHAIRMAN VOLCKER. Well, I do not know. I did not hear him, and I do not know what to answer to that question.

MR. FORD. He said--I saw him--that he is going to be consulting with you very shortly.

MR. PARTEE. Who, Meese?

MR. FORD. Yes, on the Today show, I think it was.

MR. ROOS. I just meant could that have an effect on your timing in--

VICE CHAIRMAN SOLOMON. On the timing question, you seem to feel that there are no disadvantages, particularly, in delaying for three weeks.

CHAIRMAN VOLCKER. Oh, there is a disadvantage in that we would have to change something that has been announced. I think that is a disadvantage.

VICE CHAIRMAN SOLOMON. I see. I just wanted to be sure.

MS. TEETERS. I think there is a disadvantage in going [to testify] as early as the 10th because [Congress] might come back and say that we did not give a proper evaluation of [the Administration's] economic policy.

CHAIRMAN VOLCKER. I do not think that is the excuse we would use.

MS. TEETERS. Yes.

CHAIRMAN VOLCKER. I am not sure how credible it is because they assume we know what it is anyway.

MR. GRAMLEY. When you say that something would have to be changed that was announced, are you talking about the date of your testimony?

CHAIRMAN VOLCKER. Yes.

MR. GRAMLEY. Or the decision itself?

CHAIRMAN VOLCKER. Well, the date of my [testimony].

MR. GRAMLEY. Allegedly, no one knows that we are making a decision on long-run targets today. That is always a big deep secret that is reported in the newspapers, but no one really knows for sure.

CHAIRMAN VOLCKER. I am saying that if we delayed the testimony, what I would do is attempt to arrive at a very clear tentative decision today but we would then confirm it [later].

MR. GRAMLEY. So there would not be any question of a leak because we would not have made any final decisions.

CHAIRMAN VOLCKER. That is right; we would not have made the final decision.

VICE CHAIRMAN SOLOMON. It is worth pointing out on the other side that there is an advantage in testifying on the scheduled day because then we would begin to accustom the committee, the Congress, and the public [to the idea] that we are willing, when there are technical or structural shifts, to be more flexible on midyear--or I should say intra-year--adjustments. If we wait the three weeks then you are somewhat less likely to put forward that point of view. So, it seems to me that there are arguments on both sides.

MR. PARTEE. I agree with that.

MS. TEETERS. We have been so flexible!

VICE CHAIRMAN SOLOMON. We have not. And that is why we should begin, when we have a good reason to support it such as when these technological changes and innovations result in shifts, to get people accustomed to our being flexible within the year.

MS. TEETERS. I learned 25 years ago that monetary policy was a flexible policy instrument, and we have been rigid for 2-1/2 years now, which is ridiculous.

MR. SCHULTZ. The world is a little different than it was 25 years ago.

MS. TEETERS. No, not that different.

MR. SCHULTZ. But I do agree very much with Tony Solomon that if indeed we do want to be a bit more flexible in the future, then the way to do it is to go ahead and testify--we have the best opportunity we are ever going to have--along the lines that the Chairman has just put forth.

MR. GRAMLEY. The counterargument is that if we are not willing to be flexible from July to early February, what makes anyone think that suddenly we are going to resolve to be flexible between now and, let's say, March?

MR. SCHULTZ. Because we say so. We say it and that does not--

MR. GRAMLEY. If we can agree that we are going to be flexible, let us start flexing. Let's not postpone this by notifying the public that we are flexible.

MR. ROOS. Of course, certain market participants are allegedly upset because we have been flexible--if you want to use that word--or volatile. They say that we have not really been able to stick with, on a rather inflexible basis, a set program. One can look at it either way. Does the press know the date that you are presently scheduled [to testify]?

CHAIRMAN VOLCKER. I presume they must. I do not think there is much public discussion, but--

SPEAKER(?). They may not.

MR. ROOS. Because there could be dangers in misinterpreting a delay as--

CHAIRMAN VOLCKER. I think they must know about it. I assume that if we change the date, it will be known that we have changed it.

MR. COYNE. Yes, they do.

MR. BALLES. Well, Mr. Chairman, what do you think could really happen between now and the next few weeks that would cause any tentative decisions today on ranges for the whole year to be changed?

CHAIRMAN VOLCKER. Just to give an extreme view: If I saw a continuing tendency for the money supply to rise despite the actions that we have taken to reverse it. It is hard to predict everything else that could go on, but if I see no sign of liveliness in the economy and we have rising interest rates and a rising money supply over the next three weeks, I'd be ready to change.

SEVERAL. Which way?

CHAIRMAN VOLCKER. I would rebase.

MR. PARTEE. You would add the 1.2 percent that rebases it?

CHAIRMAN VOLCKER. That is right.

MR. WALLICH. Well, it seems to me that if one is uncertain and later may have to say that we need flexibility because things have turned out differently, then one would strengthen one's position by showing this uncertainty a little earlier rather than coming in [firmly] early and then having to backtrack. I think we would have a harder time making that change.

CHAIRMAN VOLCKER. I am not saying that. If we go ahead right now and I testify on the 10th and then the same thing happens that I have just described, I wouldn't change it right then. I would wait another month or so, having already been on record, before I would make the change. But I might be prepared to make it if we had announced nothing at that point.

Let me just say, too, that there was some comment yesterday about rebasing being hard to explain. I do not think it is at all hard to explain. The explanation just flows as smooth as silk. Or maybe I am overestimating my capacities to explain. But I distinguish that very sharply from the market reactions and suspicions we would get. They would understand what we are doing; I do not think there is any problem with that. And we do have a logical explanation for it. That does not mean that there are not going to be people in the market who will say that we used this particular technique in order to ease [policy]. That is what they would say, but they would understand.

MR. BALLES. Have we ever rebased before? I am trying to recall.

CHAIRMAN VOLCKER. No, that is the problem.

MR. MORRIS. We have always had overshoots in the past.

CHAIRMAN VOLCKER. But this has always been discussed as a possibility and then we have not done it. So it is not a new concept.

MR. BALLES. It is not a good idea.

MR. GRAMLEY. Look, how many times have we been accused of base drift? We hear "You people always have base drift," to which we are going to say now "By Jove, no more!"

CHAIRMAN VOLCKER. The criticism that we would get is that we did not adjust for the base drift when we had it on the up side but now when we have it on the down side we are adjusting for it.

SPEAKER(?). [Unintelligible] be the other way.

MR. FORD. That is right.

CHAIRMAN VOLCKER. It is not that they would not understand; it is that they would say there is a bias.

MR. FORD. They would say it is a one-way deal and we are faking it. It comes across as being dishonest.

MR. CORRIGAN. This is a reversal of Nancy's problem.

SPEAKER(?). Imagery.

CHAIRMAN VOLCKER. Some people will say dishonest, but the explanation is--

MR. PARTEE. Visually.

CHAIRMAN VOLCKER. When we set these targets, we say we expect [growth] to come in around the bottom of the [range]. We just say we would like to be around the bottom and that's what we're assuming. That is what we assumed when we set the target and we did not change our mind. That is what we say.

MR. FORD. Well, of the two approaches you have described, I would very strongly prefer the one you described when you started talking a few minutes ago of implicitly leaving the base unchanged the way we have been doing and taking the hit on the [range]. Then, if we need to come back, I'd overtly state what we are doing, which is that we have decided for good and sufficient reasons to raise the band. I'd be up front with [it].

CHAIRMAN VOLCKER. Even there, my inclination would not be to raise the band. It would be to change the base and say we think we are operating off the wrong base.

MR. FORD. Well, I would say change the band. We would be doing the same thing either way. It is just a question of which is--

CHAIRMAN VOLCKER. I don't think it is [the same]. That is my point. If we raise the band, we are saying that from now on we want a higher growth rate. If we change the base, we are saying we do not want a higher growth rate from now on; we have forgiven what happened. I think that is saying two different things.

MR. PARTEE. Yes.

MS. TEETERS. It comes to the same thing.

CHAIRMAN VOLCKER. It comes to the same thing for the number at the end of this year.

MS. TEETERS. That is right. And either way it is an easing of monetary policy.

VICE CHAIRMAN SOLOMON. There is a difference in the implication for 1983.

MR. GRAMLEY. That is the important point.

CHAIRMAN VOLCKER. I think that is right. It is the implication for the trend that we are on, not the--

MR. GRAMLEY. Only the expansionists want to change the range.

MR. FORD. It is not going to do much for our credibility.

VICE CHAIRMAN SOLOMON. After all, the short-run decision that we just made early this morning does logically lead to what Paul said. I don't think it will happen, but if we find that the money supply is strong in February, then we have to do something to give ourselves more room. As I say, I don't think that is going to happen, but it does seem to me that we are better off sticking with the scheduled date for testimony and going on record and preparing people the way you indicated. I would point out that the uncertainty also exists because of the question of whether the innovations that we saw in 1981, which tended to depress demand, will continue in 1982. There is uncertainty not simply on the up side but also on the down side.

CHAIRMAN VOLCKER. To exaggerate a bit, it may be that what the Federal Reserve Board does on sweep accounts for money market funds and what the DIDC does on a new short-term instrument may have more to do with what M1 does this year than any decision we make.

SPEAKER(?). Sure.

SPEAKER(?). I would second that.

MR. GRAMLEY. Unfortunately, if we are not careful, we will end up with targets so low that we really have no option as a regulatory body but to permit sweep accounts to save the economy! I am not entirely joking. I just don't think that we can possibly have anything like a well performing economy unless two things happen: One is that this bulge proves to be very temporary; and the second is that we have more innovations that are pushing down the money demand function. That is built into the staff forecast. And if both of those do not come along, we are going to be in tough shape.

CHAIRMAN VOLCKER. There has been an element of that in our targets right along, because that kind of change has led to this persisting increase in velocity. And we are assuming it is going to continue.

MS. TEETERS. Have you thought through the implication of these interest rates for the savings and loans institutions? [Their representatives] were here the other day asking us if we were deliberately putting them out of business. And I would say that, yes, we are deliberately putting them out of business.

CHAIRMAN VOLCKER. No, I want to reject that. I think the implications for savings and loans are very important, but it is not all that clear--I will join Mr. Roos to some extent here--whether the savings and loans would be better off by greater or lesser expansion in the money supply and what that means for interest rates over a period of time. That is a dilemma we are fighting all the time. If we literally believe the savings and loans that it takes a bill rate of 8 or 9 percent to save them--I do not know about that but we will have to redo these estimates--then the only way to save them is by putting the economy in a real--

MR. PARTEE. Well, it is a question of how many we want to save. I think then--

MS. TEETERS. Or how many we want to put out of business.

MR. PARTEE. I think we may lose another few hundred as a result of policy, but we would not lose them all. On the other hand, I cannot think of any way we could save them.

CHAIRMAN VOLCKER. [How to] save them, that is the problem.

SPEAKER(?). When the FDIC--

MR. PARTEE. I would say they are one of the many casualties of monetary policy, but we did not intend it.

MR. SCHULTZ. Well, I'm not sure I agree with that either. I still contend that long-term interest rates are the key. And they are not going to come down until the deficit comes down. I think Governor Gramley is making the assumption that we by monetary policy are going to make these changes in what happens to the economy. I do not happen to believe that that is the case because if we give up, then the inflation problem is just going to explode again and the economy will be in terrible shape. We are in a box. I do not think we have the opportunity to move. We have to stay where we are and do our job. We cannot control the economy; we cannot control what the Administration does. You say, [Nancy], that you are supporting the President. It seems to me that the President has to support his program, which he is not doing right now.

MS. TEETERS. But he is.

MR. PARTEE. Well, I do not think the key to the thrifts is long rates; I think it is short rates. But in general I agree with what you have said.

CHAIRMAN VOLCKER. Let me make one other rather psychological observation; Bill Ford raised it yesterday. If we are going to rebase --and I do not think we would do this--it would look nicer if we rebased both M2 and M3. M2 does not make that much difference, but it happens to go in a direction that a lot of people are uneasy about anyway. It is only what--a .4 difference? That is not terribly important; it would not be important except for the concern of overshooting there anyway. And since that concern exists, it is important. That would make it more logical in some sense.

VICE CHAIRMAN SOLOMON. But then we would tighten the M2.

CHAIRMAN VOLCKER. Yes, slightly.

MR. PARTEE. But we are talking about liberalizing the M2 range.

CHAIRMAN VOLCKER. I know; that is what I am saying. People are concerned about whether it is too tight to start with, so it runs against that grain. And that is why we presumably would not do it even though it looks better.

MS. TEETERS. We could rebase the top.

CHAIRMAN VOLCKER. Well, we would rebase at the top of the range; that is what to do. But even rebasing at the top of the range costs .4 percent.

VICE CHAIRMAN SOLOMON. If we offset the tightening by raising the M2 range--

MR. PARTEE. Because we were above the range.

VICE CHAIRMAN SOLOMON. --and we rebase M1, we are in real danger of getting a major reaction by the market, the press, and the public that we are definitely easing monetary policy very significantly.

CHAIRMAN VOLCKER. I will make one more comment and then get some other comments. All this worry about our credibility is there, but at some point if we think we should change, we have to change. We do not build up credibility for the sake of building up more credibility. We build up credibility to get the flexibility to do what we think is necessary. If I were convinced now--more convinced than I am that this change is appropriate--I would say the heck with that point. My trouble is that I am not convinced [the bulge] is going to stay. And if we rebase and then find [M1] falling on us, we would have [allowed for] quite a lot of growth--too much in my judgment--between now and the end of the year. We would have a possibility of growth of a little over 6-1/2 percent, which seems a little too much to me, if M1 declines [and the bulge is washed out]. And since I think there is a good chance it will decline, I would hate to present that now.

VICE CHAIRMAN SOLOMON. What I am saying--I think you are misunderstanding me--is that I think we could get away with rebasing M1. But to rebase M2 and then offset it by raising the target range another 1/2 point I think is overkill.

CHAIRMAN VOLCKER. Well, I agree with you on that.

VICE CHAIRMAN SOLOMON. We are better off, if we are forced into rebasing M1, not to rebase M2.

CHAIRMAN VOLCKER. No, I agree.

VICE CHAIRMAN SOLOMON. And there are some arguments on why it does not have to be symmetrical.

CHAIRMAN VOLCKER. I do not disagree with that.

MR. SCHULTZ. I disagree with your comments on credibility. I think there is an enormous sense out there that we are still the only game in town in the fight against inflation. If we do something to change that, we are going to do something very important. To me that credibility question is really critical. We are right back in the situation we have been in before, particularly now that the

President will not do anything about the deficits. We are in this uncomfortable, improper, nasty situation that we have to deal with, which is that the central bank of the United States has far more responsibility than it ought to have. But the fact of the matter is that we have it because of the way the political system works. And this credibility question is just absolutely vital. We have not yet changed those inflation expectations because everybody thinks that we are going to cave in to the political pressure that is going to be on us. They do not understand all these nuances about demand shifts and linkages and all this other stuff; all they see is that the Fed is the only inflation fighter we have in the country. If we give an indication that we are caving in and if we start making some changes, there are some really serious costs in terms of credibility, Paul. I think that credibility factor is more important than you just gave it credit for.

MR. WALLICH. The central banks that have the most credibility, such as the Swiss National Bank and the Bundesbank, are pretty relaxed with respect to their targets. Sometimes one of them even abandons its targets. And yet they do not lose credibility because there is that basic belief that they will achieve better stability.

MS. TEETERS. More people perceive that we have 15-1/2 percent interest rates and 17 percent mortgage rates than whether we are [fostering growth of] the money supply at 1 percent or 2 percent or 3 percent.

VICE CHAIRMAN SOLOMON. The trouble is that everything we say here is true.

MS. TEETERS. Yes.

VICE CHAIRMAN SOLOMON. Even when we say different things.

MR. MORRIS. Fred Schultz's comments suggest that we should not make a change unless it is clear that if we don't, we are going to be following a policy that we really do not believe in.

CHAIRMAN VOLCKER. I believe that.

MR. MORRIS. That would lead to not making a change until midyear. If we find that we have to, fine, we ought to change the targets at midyear.

MR. SCHULTZ. Well, it could be earlier.

CHAIRMAN VOLCKER. It depends upon how things go, but I could well see circumstances where we would want to do it before midyear.

MR. MORRIS. Well, that could be.

MR. ROOS. You will be subjected, I am sure, to further questioning about our procedures and whether we just assume that we are doing this in the most satisfactory way, technique wise. That is where we are going to get some flak, I think. I assume that nobody around this table really would welcome or advocate any major changes, such as targeting on total reserves or taking the step that we have heard over and over again, which is going to contemporaneous reserve accounting.

CHAIRMAN VOLCKER. Well, the contemporaneous reserve accounting issue is going to be on our desks very quickly. I will tell you my view of contemporaneous reserve accounting very simply. I do not think it is going to make a lot of difference in and of itself. There is a certain logic in doing it. And if we were living on Neptune, I would do it because I think there is a certain logic just in terms of being consistent with our present techniques. My concern is that people will read into it more than it is worth and we would get more flak rather than less. But that is a psychological point and not a technical point. They will say: "Now that you have contemporaneous reserve accounting why isn't everything perfect?" And since I do not think it is going to change things very much, we may end up even more on the defensive. Now, that may not be persuasive as a reason for not doing it because just looked at as a purely technical matter it may well be desirable but marginal. So, my main concern in doing it is only that it will get over-interpreted. If we do that and combine it with some other things, such as closing up the discount window, that would be an entirely different kettle of fish. I am just prepared to argue against that.

MR. PARTEE. Well, at least change the conditions [for access to the discount window]. We do not let them close it altogether.

CHAIRMAN VOLCKER. To make it very much tighter. Yes, obviously, it is [an] extreme view to say close it altogether.

MS. TEETERS. I would say to Larry Roos that having gone to the reserve targeting and monetary aggregates targeting with a great deal of reluctance and skepticism, and having all the troubles and criticism that we have had, I am getting more and more to the point that I do not think it is the right way to [conduct policy]. We ought to be moving back toward interest rate targeting combined with aggregates targeting, knowing that we are not going to achieve either perfectly, but we would have a better monetary policy than we have had and a better economy. We have bounced this economy all over the mat for three years with no growth.

MR. ROOS. Of course, Nancy, what disturbs me--and I say this with humility--is that I fear that what is being done may not produce the results we sought. Procedurally, I don't think we really are doing what ought to be done to conduct monetary policy in the way that those who wanted to target on reserve targets had sought initially. What I think will happen in the real world--I am not going to be around--is that this will not work. And everybody, broad-brush, will say that the monetarist approach failed when I really do not think that we have conducted a true monetaristic experiment here. But we could argue that for forever and a day.

MS. TEETERS. I have a much more practical point. I do not like what we have done to the economy in the past three years. I do not like 9 percent unemployment rates and I do not like interest rates in the 17 to 20 percent range.

MR. ROOS. But, Nancy, I think a lot of people could say they did not like what happened when we were concentrating on controlling interest rates. That record is a very poor one and probably led to these high rates. Anyway, I do not mean to be cantankerous.

CHAIRMAN VOLCKER. Well, we are not going to resolve that problem this morning.

Let me just put this question on the table and dispose of it one way or another: Do we want to try to delay the testimony and delay the decision? Do people think that is going to help them enough so that it is worth whatever public question that arouses?

MR. BOYKIN. I vote no.

SEVERAL. No.

CHAIRMAN VOLCKER. All right. Let us dispose of that option then. We are left with making a decision today, essentially. What I would put on the table is what I said earlier--we can skip to the fine-tuning--that the basic decision would be to keep the targets the same as we already said, or very close to that, with a statement that we are prepared to relook at this, particularly M1, in the relatively near-term future, meaning probably a couple of months, in the light of the concerns I expressed.

MR. CORRIGAN. With it being clear that if something were to change, we would be making the base adjustment?

CHAIRMAN VOLCKER. We do not actually have to commit ourselves to that, but I would throw that out as the logical possibility without committing us to it.

VICE CHAIRMAN SOLOMON. You would do it in an even-handed way in the sense that you would mention the possibility of a shift in demand due to the innovations and to technology? If so,--

CHAIRMAN VOLCKER. Well, I would not do it in an even-handed way in that I do not visualize any possibility that I would say we would come back in two months and lower the [ranges].

VICE CHAIRMAN SOLOMON. Yes, I understand that. But you would mention that there is this--

CHAIRMAN VOLCKER. Well, I would distinguish between two things. In describing the range, I would say that the lower part of the range is basically designed to take care of the innovations that might appear and that we would not be at all unhappy, as we now see things, to be in the upper part of the M1 range and, indeed, we would expect to be toward the upper part of the M2 range. Okay, that finishes that discussion. Then I would go on to say that if this [bulge] in M1 is more permanent than we think, we would come back to Congress with a new M1 range--presumably rebased, but not committing ourselves to that--in the space of a couple of months. If it became clear on the basis of the evidence that accumulated over this period, that the November-December-January spurt was more indicative of the underlying demand relationship than the August, September, and October low levels--

VICE CHAIRMAN SOLOMON. I would vote yes.

MR. BOYKIN. I would be in agreement with that, provided that--. Well, you said something about the ranges as specified or close to it. Do you mean as specified?

CHAIRMAN VOLCKER. Well, I am leaving that question until we get to the precise part. I presume we are going to have a [detailed discussion] on exactly what those numbers will be, so I am just talking generally about something the same as or very like what we have. That is the next thing I will take up.

MR. BALLES. I would be concerned, Mr. Chairman, about the boomerang effects of creating that [specter] of further possible change and all the uncertainty that may [foster]. The Fed watchers will be going right up the wall and looking at us every minute instead of every hour. If, when we first talk about those ranges, we say they may be subject to near-term change, somehow that does not strike me as a very stabilizing influence in terms of expectations.

MR. PARTEE. I do not think we are saying that the range would be subject to change, John. What we would do is rebase the range. In a way we would consider January a part of last year to a degree.

CHAIRMAN VOLCKER. That is a--

MR. WALLICH. We have rebased every year through base drift only we do it nondeliberately rather than in this way.

MR. MORRIS. Using the Federal Reserve calendar rather than the standard calendar!

CHAIRMAN VOLCKER. Well, whatever we say other than that these are the ranges and come hell or high water we are going to be within them, we are going to raise some questions in some people's minds. There is no question that people will be talking about it, for two weeks anyway, if we say anything but that. But the problem is: Do we want to say that? We also may get ourselves in so deep that we can never change the darn things and we may be doing things substantively that we do not want to do. So, we have to balance that off. The fact is that there are going to be a lot of people out there who would heave a sigh of relief if we said that, because a lot of people think policy is too tight.

MR. GRAMLEY. May I question what it is we are assuming about the behavior of M1 from here on out which would give rise to a change in the targets? Do we, for example, decide that if what we have voted on this morning for our short-run targets materializes, which would get us essentially zero growth between now and March, that we can breathe a big sigh of relief and live within our targets? Making some very rough calculations, that seems to me to imply at most a 3 percent annual rate of growth from March on out to get within the upper limit of the range. So, are we going to say then that we made it and now we can supply 3 percent money growth and that will be enough?

CHAIRMAN VOLCKER. I think that depends on what has happened. You cannot just give me the figure on money growth. What is happening in the markets? What is happening in the economy?

MR. GRAMLEY. Well, let's say the economy begins to show signs of a modest recovery along the lines that the staff has forecast. But the staff forecast was built on the assumption that there was going to be a big drop in M1 during the course of the first quarter. Given the policy targets that we set this morning, we are saying that is not happening; we are saying it is going to stay level. So, from March on we are going to be applying a tighter monetary policy than was built into the forecast, which means that if we want to stay within the range, we will be opting for a weaker economy. Do we want less than 1.3 percent real growth from the fourth quarter to the fourth quarter?

CHAIRMAN VOLCKER. I cannot answer your question precisely. But if you say zero growth from now on and that is accompanied by interest rates as high as we have them now and a weak economy, yes, I would question whether we might not want to ease up on the range. I would begin getting pushed on that. I already have the question, and I would have more questions then.

MR. GRAMLEY. I would opt to wait a couple of weeks, if I thought I could get anyone else to go along with me, on loosening the reins. But I doubt very much--no matter what happens over the next two weeks--that this Committee is going to be willing to loosen up the ranges. Maybe they are, but I suspect that your suggestion has appeal because I do not think this Committee realizes yet how harsh a monetary policy it is imposing on the economy with the kind of targets we are looking at now, given what I think is going to happen to money. Maybe we will be lucky and money growth will turn negative and we will have a lot of room from then on. But I doubt it. So, I think we are looking at a situation, if we are not awfully careful and if we do not stay really flexible, where we are going to be opting for a still worse economy than what the staff is forecasting.

MR. AXILROD. Governor Gramley, if I might say, believable or not, the staff forecast is based on the scenario you described--that is, virtually no growth in money over the next couple of months and then three quarters of growth averaging 1.3 or 1.4 percent quarterly. And as you have pointed out, that requires, if you believe the models, a resumption of the downward drift in so-called money demands after this quarter at a rate almost as rapid, but not quite, as we had all of last year. So, if that does not develop, then we would get much higher interest rates, at least in the short run.

CHAIRMAN VOLCKER. That is certainly true in your assumption of velocity. But let me put it the other way around. If I understand those staff forecasts as best judgments, if in fact we sat here now and said we were content with being in the upper part of that M1 range, we would have a better business outlook than you have.

MR. AXILROD. That is right, on that assumption of a--

CHAIRMAN VOLCKER. With all the other assumptions you are making. And that is reflected in these alternatives that you give. It is scenario 2 instead of scenario 1. We would get a 1 percent or whatever it is higher nominal GNP.

MR. AXILROD. That is right, but with some further downward shifts in [unintelligible].

CHAIRMAN VOLCKER. Yes, I know. That assumption may go wrong, but just holding that assumption.

MR. CORRIGAN. But if we have Governor Gramley's situation now and we did end up rebasing, say, in March or something like that, the combination of rebasing and being in the upper part of that M1 range produces a couple of percentage points at least in terms of the money growth that is implied just by looking at the midpoint for the period from March through December.

MR. BLACK. Well, we must not forget that that forecast implies a certain assumption about inflation. If we are lucky enough to do better on that, we can do still more on the real side.

CHAIRMAN VOLCKER. I thought you were going to say if we are unlucky enough to do worse, we would have a bigger problem.

MR. BLACK. Well, I agree with that too.

CHAIRMAN VOLCKER. Both statements are true.

MR. BLACK. Expectations of which way that will go depend on what we decide to do, presumably.

VICE CHAIRMAN SOLOMON. At the risk of being mischievous, may I point out that this process or line of presentation--namely, getting a decision sequentially on this particular issue--[may prejudice the decision]. You are asking for a decision on that and saying that you are going to inform the [Congressional] committee and prepare the ground that under these conditions we might be willing to make an adjustment and that it would be logical to do it in the form of rebasing. If you get an affirmative decision from this Committee now on that and then go on to ask if we should fine-tune on the target ranges, then the answer I think becomes clearly no. We will look silly, it seems to me, if we make minor adjustments in M1 or M2 even, and then on top of that say we are prepared to take another look at this and do some rebasing. So, if you do not want to prejudice the decision on the last point, it seems to me that you really have to ask for a decision on both.

CHAIRMAN VOLCKER. We will get to it in good time.

VICE CHAIRMAN SOLOMON. I see. I am just pointing out where it logically leads.

MR. PARTEE. Well, we are only talking about rebasing M1, I believe.

CHAIRMAN VOLCKER. I think so, yes.

MR. GRAMLEY. I wonder how we lose credibility the fastest: By saying, in effect, that we are going to go back to the base we had for the fourth quarter of 1980 and use the same target range that we had for 1981 and now a lower target range for M1 for 1982, explaining in the footnotes what the numbers are; or by going out in March or April or thereabouts and saying we give up, money is running too fast and we cannot hold it within those targets, so we are going to raise them and retroactively change the base. My feeling is that we are less likely to upset the public and give rise to those concerns Fred Schultz was talking about, if we tell them right now that money growth very recently has been rapid but the fourth quarter was very, very low and, therefore, we are taking a longer-range point of view and still reducing the growth of M1 but basing it from the fourth quarter of 1980. I think we could sell that point of view.

CHAIRMAN VOLCKER. Yes, I think we could sell it. The problem is that it may be the wrong decision. We would have committed ourselves, then, to the decision. I have no problem with that if this [bulge] is going to be semi-permanent. But suppose it does wash out in February and March? Then I think we have too high a target.

MR. GRAMLEY. With 2-1/2 percent as the lower end?

MS. TEETERS. With 9 percent unemployed?

CHAIRMAN VOLCKER. People would be looking at the upper ends.

MR. GRAMLEY. Taking the 1.2 percent or so that we are raising it by the implied base shift, then we are talking about 3.7 percent growth in M1 after this shift. And that is not likely to give rise to a new wave of inflation.

MR. ROOS. Whatever adjustment is made in March or April, especially if you have a meeting with the President, anything that can be construed as being more expansionary at that time of the year will be interpreted immediately as the Fed caving in to political pressure in view of the November elections. They are going to be watching us. The question I hear is: Are you fellows going to be able to stand the heat from the politicians during an election year? And I think we have to be awfully careful that we do not fall into that trap and do something that may be better but that will be interpreted, in effect, as our climbing into bed with this Administration or any other--

MR. SCHULTZ. I think we have that problem right now, Larry.

MR. ROOS. Even now I think we do.

MR. PARTEE. Well, I think Larry is right: It will be worse in the spring.

MR. ROOS. It will be worse in the spring.

MR. GRAMLEY. It will be worse if, in fact, the quotation from Mr. Meese that Bill Ford mentioned is correct--that the President is going to pull you over for a little conference. We have not heard that officially yet. We would be better off as a Committee to make our decisions before that occurs.

MR. BALLES. Absolutely.

MS. TEETERS. Exactly.

MR. BLACK. Did Meese say he or the President?

MR. GRAMLEY. I did not see it.

MR. ROOS. It was just a passing remark in which he said he felt that the President was going to get together with [the Federal Reserve Chairman]--

MR. GUFFEY. --for the purpose of coordinating monetary and fiscal policy.

MR. RICE. It really was not an announcement; it was just a passing remark.

MR. BLACK. I thought it was Meese who was going to do the talking.

CHAIRMAN VOLCKER. It probably is going to happen anyway. Senator Baker has been saying it is going to be done all along. So, there is going to be a natural response to that. I would not read anything more into that than when people like Senator Baker are all over the paper saying it should be done. I see him sometimes anyway and there is going to be a certain amount of hullabaloo about it.

MR. SCHULTZ. We have real costs in terms of credibility if we change the targets. We ought to change them only if we have good, strong reasons. And I disagree with Larry Roos; I think if we have good strong reasons to change them, we are better off changing them in March or April than right now.

CHAIRMAN VOLCKER. But the problems that Larry mentioned are, of course, there. It just depends upon the setting. If we came out of the clear blue sky and said we are going to change them, that is one thing. If people saw the economy in bad shape, interest rates at 18 percent and so on, we have a different setting. It is awfully hard to predict these things.

MS. TEETERS. What are the consequences of being--

CHAIRMAN VOLCKER. Ordinarily I would agree with you that it is better now. But then, better now in which way?

MS. TEETERS. The political consequences of being the sole cause of a continuing 9 percent rate of unemployment can be greater than anybody is talking about around this table.

MR. SCHULTZ. But I do not believe that at all. I just do not believe that the monetary policy that we have carried out has been the sole cause or even the primary cause. I think this country was in for some real economic problems. Inflation was just shooting up like crazy. And I do not think that we can be held responsible for all of this. It is clear that if we are going to change inflation, we have to go through a painful period. There was never an easy way out of this. I refuse to accept the view that monetary policy has to take credit and I do not think it is correct to say that if we change monetary policy, everything is going to get better all of a sudden. I just do not believe that that is going to be the case.

SPEAKER(?). Hear, hear!

MR. WALLICH. It seems to be a pretty widespread view that it is the budget that is responsible.

MS. TEETERS. Not this year. Our problem is 1983; it is not this year.

MR. WALLICH. I think the market looks ahead; and interest rates went up for no particular reason other than the budget.

CHAIRMAN VOLCKER. Well, let me come back and see whether we can resolve this. We have a proposal on how to present this on the table. There obviously are pros and cons. There are problems with it, as expressed by Larry Roos and others; they are clearly there. There are also, obviously, some advantages. If we contemplate that approach, to some degree it is going to affect how people look at the precise decision, which I want to get to next. Do we proceed on the basis of making that decision against that kind of background or not? What is the consensus?

MR. PARTEE. What are the options?

CHAIRMAN VOLCKER. [The issue is] whether we open the possibility of coming back at midyear or before and in effect confess that we have some question in our mind about whether the range is too tight on M1.

MR. PARTEE. Or whether we rebase now?

CHAIRMAN VOLCKER. Well, whether we rebase or not, we just exclude that point and we do not express any doubt about our target. That is the only question on that. Then we get into an argument about whether to rebase now or not.

MR. ROOS. Paul, would it be possible, without tipping our hand, to say that we might come back if it were tight? Can't you build a case that there are a lot of imponderables and that it may be necessary to change the targets without saying in which direction--just signalling that we are always flexible.

MR. PARTEE. Our record shows that.

MR. SCHULTZ. We are always flexible; we just haven't flexed yet.

MR. WALLICH. We do expose ourselves to [heavy] pressure if we say we are flexible. And one has to take that into account. I really prefer the flexibility, provided we can resist [the pressure].

MR. BALLES. Our problems remind me of a definition I recently heard of diplomacy: It is usually the choice between the undesirable and the unacceptable.

CHAIRMAN VOLCKER. That is, I think, precisely where we are. I am just asking for people's judgment on this. One is going to be affected by the next question, so all we can do is ask for a preliminary view on whether that generally makes sense and whether for the moment that is the way we want to approach the other decision.

MR. GRAMLEY. I am not sure what the other decision is.

CHAIRMAN VOLCKER. Where the target should be precisely.

VICE CHAIRMAN SOLOMON. There are two alternatives: One is rebasing; the other is just to stick with the targets.

MS. TEETERS. Or change them.

CHAIRMAN VOLCKER. Or we can change them. We have three alternatives; that is right. Can we pass on to that decision, operating on the presumption for the moment that there will be in the statement something to the effect that upon further examination of this recent bulge and depending upon developments, we would be willing to consider the possibility that the M1 target might be too low?

MR. CORRIGAN. And it would be rebased.

CHAIRMAN VOLCKER. Presumably. I am not committing ourselves to that, but I would refer to the base question.

MR. WALLICH. The target is not too low; the base is too high.

MR. PARTEE. You want to be pretty specific about it, because the way you just stated it, it sounds as if we have flinched.

CHAIRMAN VOLCKER. All right. Well, I just did not want to prejudge the Committee. I am willing to state it as the target, with the base the [fundamental] question.

MR. PARTEE. Yes, that is the analytic argument.

MR. GRAMLEY. Well, I prefer to rebase now, but I do not think I have much [support]; not too many people are with me.

MS. TEETERS. I would prefer to rebase now.

CHAIRMAN VOLCKER. Well, I am sure some have that preference, but I take it that it is not the prevailing preference. So, let's go to the targets. We have 2-1/2 to 5-1/2 percent [for M1], 6 to 9 percent [for M2], and 6-1/2 to 9-1/2 percent [for M3]. I must say regarding that 6-1/2 to 9-1/2 percent: What is your projection for next year?

MR. AXILROD. For M3? For M3 we would have growth of around 9 percent.

CHAIRMAN VOLCKER. And there we probably have the clearest technical reason for saying something; there's just more [financing] running through the banking system. Why were bank credit and M3 so divergent this past year?

MR. AXILROD. Well, we have in M3 many things that are not in bank credit, such as the money market funds and Eurodollars held overseas. I think that is a good part of the reason.

CHAIRMAN VOLCKER. We had a big differential between M3 and M2, and one would think that that would reflect the banking component.

MR. AXILROD. That would be the large CDs, the long-term RPs, and Eurodollars other than overnight--those maturing in more than one day.

CHAIRMAN VOLCKER. Well, I know what it is statistically. Why are large CDs, Eurodollars maturing more than overnight and so forth going up so much more rapidly than bank credit?

MR. AXILROD. I stand corrected on the Eurodollars, which are in L.

MR. PRELL. Mr. Chairman, there are a number of factors involved here. Arithmetically and I think analytically, one is the way the banks financed their asset growth. It was much more through the issuance of large time deposits and much less through Eurodollar borrowings and the--

CHAIRMAN VOLCKER. Well, that is what I assumed was the answer, as a matter of fact.

MR. PRELL. That is one factor. Another factor--

CHAIRMAN VOLCKER. Eurodollar borrowings are not in M3, right?

MR. PRELL. That is right.

CHAIRMAN VOLCKER. And they went down, in effect, or rose slowly. That is the answer, I guess.

MR. PRELL. The money market funds are another factor contributing to the divergence.

VICE CHAIRMAN SOLOMON. What are your latest data on L?

CHAIRMAN VOLCKER. I have already said this but just to get other responses, assuming what I took as the consensus: The argument seems to me pretty strong not to horse around with the figures.

MR. PARTEE. That is one view. There is a minority--

MR. BALLES. Well, some of us had a different view yesterday. I have not changed my mind, but obviously those of us who felt that way appear to be in a minority.

MR. PARTEE. I don't know; there were quite a number on M2, I think. I did not distinguish between voting members and other presidents.

CHAIRMAN VOLCKER. I think there was a majority for not changing it, but there was quite a difference. A number of people did suggest changing it; that is true. At least five of the whole group and some [voting members] did not address themselves to it directly.

MR. SCHULTZ. Why don't you have a show of hands?

CHAIRMAN VOLCKER. Let's just take the whole proposition that we say we do not change any of the targets. Who would have a preference for that?

MR. PARTEE. That we are not going to change anything?

MR. ROOS. Voting members or everybody?

CHAIRMAN VOLCKER. Well, let's take voting members first. Six. This is all against the background of admitting that we might change later. I do not know how the nonvoting members feel about it. That adds a little weight here when we--

MR. ROOS. If we went with the present M1 target, would you consider saying that we would seek something at the upper [end of the] range?

CHAIRMAN VOLCKER. Well, I prefer not to say it in terms of seeking that, which just implies a degree of fine-tuning that I think is beyond this. I have no trouble saying that the upper end is perfectly acceptable and that it may well come out that way, as we see things at the moment. It is just a subtle distinction from saying we actually will aim at the upper end. But I have no problem at all saying that as we now see things the upper part of that range would be perfectly acceptable. I think the open question may be what arguments people want to make for changes and we'll see whether that can command any more people than we now have. What would be the nature of [any proposed] change in the ranges for M1 or M2 or M3?

MS. TEETERS. Well, I have stated my argument before. I do not like the outlook.

CHAIRMAN VOLCKER. You want them all higher?

MS. TEETERS. I want to change the ranges and I want to give more opportunity for growth and some opportunity to reduce the unemployment rate, some opportunity to reduce the interest rates, and some help to the savings and loan and the housing industries.

CHAIRMAN VOLCKER. No matter what we say about the future, you want to increase everything?

MS. TEETERS. Yes. I think monetary policy is much too tight for the state of the economy.

MR. GRAMLEY. I would like to argue the case for raising the range for M2. Given the fact that we are postponing any decision on rebasing, changing the range for M1 would make no sense at all. We would lose any credibility that we might otherwise hold by sticking with this postponement. But for M2 the most persuasive case seems to be the fact that in the past two years growth has been running over the upper end of the target range. I grant that there may be some arguments to the effect that that problem will be a little less in the future. But, as Governor Partee pointed out, we do not know what these IRA accounts are going to do to the magnitude of M2; and more importantly we do not know what will happen to M2 growth if in fact we get a one point or thereabouts increase in the saving rate. That could add [to M2] considerably. And I would much prefer a target range that had some realistic hope of being realized within the context of a growth in nominal GNP in the 8 to 9 percent range. Therefore, I think a persuasive case could be made for raising the M2 range to 7 to 10 percent.

MR. BOEHNE. I second Governor Gramley's comment.

MR. BALLES. I third it.

MR. PARTEE. I fourth it. I think we could [present] this, Paul, as being consistent with the President's program. The President is after more savings and more investment, and we have major changes in tax policy that are designed to bring that about. Therefore, we anticipate that we might have a somewhat higher M2 because that is the form in which it would show up. In addition, we have been high on M2 anyway because it is so closely related to the nominal [GNP] increase and expenditures in the economy and, therefore, we are raising it.

MR. MORRIS. Wouldn't it make more sense to take the IRA accounts out of M2?

MR. PARTEE. Well, that is going to be very hard to do I'm afraid. They are in a bunch of different deposit forms. They are not just in--

CHAIRMAN VOLCKER. We are going to get statistics on it, though.

MR. PARTEE. I anticipate real difficulty.

MR. MORRIS. But they are not liquid assets. Are you saying we cannot identify them?

MR. PARTEE. A lot of them are in small saver certificates and--

CHAIRMAN VOLCKER. We cannot identify them, as I understand it, without collecting more statistics.

MR. AXILROD. We will be collecting data to the end of getting the aggregate instead of just the various subcomponents that we now have.

MR. MORRIS. But an IRA is not a liquid asset unless one is 59-1/2 years old or older.

CHAIRMAN VOLCKER. There is a good logical argument for taking them out. But, of course, then we have the opposite problem. I think one could say flatly that in taking them out there would be more distortion in the trend--but we could adjust for it--than in leaving them in. But it moves in the opposite direction.

MS. TEETERS. I received a solicitation this weekend from Sears to establish an IRA account.

MR. PARTEE. That probably would not be in M2. If you were prepared to say that we would take account of growth in IRAs and Keogh accounts and any change in the saving rate that occurred in response to the President's program, then I guess I could live with 6 to 9 percent, because I think that would be saying that we would accept something higher than that.

MS. TEETERS. How would you feed back the change in the saving rate?

MR. PARTEE. Just take account of it. All we do is conclude that it would be higher if we say--

VICE CHAIRMAN SOLOMON. I think Chuck's suggestion opens up an interesting area of compromise.

MR. GRAMLEY. Well, from my standpoint, I am inclined to give more explicit weight to M2. I do not regard that as a--

MR. PARTEE. It is very fuzzy.

MR. GRAMLEY. It is very fuzzy and it says, in effect, that we really do not give a damn what M2 does; we are really concentrating on M1. It says: If M2 goes up above the upper end, so what?

CHAIRMAN VOLCKER. There is an implicit tradeoff in your proposal, as nearly as I can understand it. You want a little higher number but you would make it more rigid, in effect, than it has been.

MR. GRAMLEY. Yes. I would like to pay more attention to M2. I think it is important for us not just to do that internally but to communicate that because I believe the volatility of M1 is giving rise to a great deal of misunderstanding--and indeed misunderstanding on our part as to the effects on interest rates and the economy of our decisions, which I think is unfortunate. We have to be more tranquil about these short-run movements in M1. And if we do not develop that attitude ourselves, we are going to be building increasing problems for the future.

MR. CORRIGAN. I don't know; frankly, I am very troubled at the prospect of opening up this rebasing issue and changing the M2 target. I think Governor Schultz is right on the mark on this question. The issue, as Governor Teeters suggests, is getting unemployment down and all the rest, but not for a quarter or two. The issue in some sense is trying to be supportive of a sound approach to fiscal policy. But we are sitting here looking at a fiscal situation that is just untenable. And one of the concerns I have--and maybe it is tilting at our windmills a little--is that if the perception is that we really are easing, any prospect of being able to do better on the fiscal side is weakened as well because that creates the impression that we are going to sit here and monetize all that debt. I am under no illusion that we are going to have a magic wand come over fiscal policy in the next six months; but if we are perceived as easing, I think fiscal policy will go in the direction of further ease rather than the other way around. So, I must say I would be troubled at the prospect of doing both of these things, because for the long term it does not produce the result of lower unemployment and healthier thrifts and all the rest. I think it works the other way.

MR. BOEHNE. I wonder if there is a common ground here with what Chuck Partee has proposed. It seems to me that the allowances he has spelled out do give us some flexibility on the up side. I think there is some merit in that in terms of bridging the gap here.

CHAIRMAN VOLCKER. I have no problem with that. Maybe that is the practical alternative on the table. Let me leave M3 and bank credit aside for the moment. Let's not get into those; whatever we do with them is literally almost insignificant. I think what I have heard, obviously with the exception of Nancy Teeters, is that if we have this note of reservation, nobody wants to argue about fiddling around with the M1 range. Do I hear that correctly? I will proceed on that assumption.

Quite clearly, there are people who want to raise the M2 range. Let me give you two alternatives that I see now. One, consistent with this idea that we open up the possibility of rebasing and review, is that we stick to the targets we now have with the comment that Governor Partee made about M2. What concerns a lot of people about fooling around with any of these is whether we are going to rebase. The alternative is to go ahead and change M2 and not make the comments about rebasing. Would anybody prefer that? Let me put it this way: We stick basically with the M1 range; we raise the M2 range by 1 percentage point; and we do not say anything about the possibility of rebasing. Does that seem preferable to anybody?

MR. ROOS. That is a lesser of the two--

CHAIRMAN VOLCKER. I saw three people saying yes; I did not see any others.

MR. GUFFEY. I would join those three to make it four.

MR. RICE. I would too.

CHAIRMAN VOLCKER. Okay.

MR. MORRIS. Not saying anything about rebasing, I think, would be the sensible thing. That raises the imagery of manipulation. It might cause some people to remember that we have not rebased in the past and this selective rebasing charge could be [unintelligible]. It seems to me if we are going to--

CHAIRMAN VOLCKER. We are not going to do anything about it today. We never do anything about it because we never consider it until we get there. But what we do now seems to me rather silly, frankly. We do it all the time because we get trapped into it; I just regurgitate every time we have to put all this emphasis on what happened in a particular three months of the year. We get locked into that. We say: Well, that is what we did before, so we have to do it again. But that is where we are. There is some sentiment, though I do not detect a consensus, to go that way, which is a possibility. That leaves me with the degree of consensus we have on the other [alternative], which is basically leaving these ranges and making a specific comment about M2 and the savings connection and that we think it is quite likely M2 will be near the top of that range. We say that is perfectly acceptable and, in any event, M2 could be over [the range] if the savings and the IRA and Keogh accounts turned out to be significant. Thus, we are putting you on due warning. That is what we say on M2. On M1, based upon what we know now, we think this range is appropriate. We do not exclude the possibility that, if this recent development seemed to be of a more permanent character, which bears upon the basic demand for money, we would come back to you at midyear or before and change that. That carries some connotation, but I think it is consistent with the decision that we just made that we are not going to fight tooth and nail to reverse January. We already decided that, so I think it is perfectly consistent with what we have already decided. What is the degree of consensus as to how acceptable that is? I want to put it in terms of acceptability at this point. It seems we have the voting members. I guess what I hear is that it sounds pretty acceptable,

MR. GRAMLEY. We are doing it with words not deeds.

CHAIRMAN VOLCKER. All right, I do not detect any other course that is more acceptable at this point. In the absence of any comments that [some alternative would be] more acceptable, let me just describe it again so there is no doubt in people's minds. This is what would appear in the record: We reviewed these targets; considerable concern was expressed about the recent developments in M1 which suggest that some relationships could be developing that we did not anticipate. We think it is too early to make that judgment. We want to reaffirm the continuity of policy, but if we get further evidence that the presumption upon which we established this target is wrong, particularly considering the fact that we ended up below the target last year, we would be prepared to reconsider this matter. But we think it is more likely that we will have some relaxation here, which would make the present target appropriate. On M2, we say we think it is likely and desirable that growth be toward the upper end of the range; it is possible that a higher saving rate combined with the impact of IRA and Keogh accounts would introduce an element here that has not been there in recent years, which would change this relationship somewhat. If that were a discernable influence on M2, we would be satisfied with being somewhat above the upper end of that target. I think that is about as clearly as I can state it. And we just leave the M3 range [unchanged]. Does it make any difference to anybody where M3 and bank credit are? What do you have for bank credit [growth]?

MR. AXILROD. 8 percent.

CHAIRMAN VOLCKER. That is your projection?

MR. AXILROD. That is our projection.

CHAIRMAN VOLCKER. And what is the range you are suggesting?

MR. AXILROD. I think the Committee might as well stay with the range it has of 6 to 9 percent.

CHAIRMAN VOLCKER. A very small wrinkle: If people wanted to raise the range for M3 on the very simple argument that we expect more financing to be done through the banking system and that affects M3--

MR. PARTEE. Then we almost have to raise the range for bank credit, don't we?

CHAIRMAN VOLCKER. We might raise the bank credit range slightly, too, then.

VICE CHAIRMAN SOLOMON. But suppose we get a switch from large CDs to Eurodollar financing?

MR. GRAMLEY. Well, nobody pays any attention to those targets.

MS. TEETERS. We have yet to--

CHAIRMAN VOLCKER. Well, I guess it is not important to me one way or the other.

MR. CORRIGAN. Suppose interest rates come down and we get some bond financing?

MR. FORD. Why not drop [those two targets]?

CHAIRMAN VOLCKER. I do not think it hurts anything to have [them]. So, forget about M3 and bank credit; we just take what falls out. Leaving the ranges unchanged is the preliminary suggestion.

MR. AXILROD. We will make the proper adjustment for the bank credit base because of the IBFs. We either have to go from December-January or the fourth quarter, properly adjusted, because of the IBF shifts.

CHAIRMAN VOLCKER. Well, maybe it would be a good idea just to change the base on that to get in the idea of changing a base. Here we have such a clear technological change that hardly anybody could question it.

MR. AXILROD. It would still be 8 percent [growth] from the December-January base. That is how our estimates fell.

VICE CHAIRMAN SOLOMON. It would still be the same target, but we would rebase [bank credit]?

CHAIRMAN VOLCKER. Yes, because of the introduction of IBFs. Okay. If there are no other questions, we can vote.

MR. ALTMANN.

Chairman Volcker	Yes
Vice Chairman Solomon	Yes
President Boehne	Yes
President Boykin	Yes
President Corrigan	Yes
Governor Gramley	Yes
President Keehn	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Schultz	Yes
Governor Teeters	No
Governor Wallich	Yes

Eleven for, one against, Mr. Chairman.

CHAIRMAN VOLCKER. Thank you very much. You wanted to say something, Governor Schultz?

MR. SCHULTZ. Yes, everybody has heard enough from me already, and I guess you are going to hear a little more. But just to make you feel better, I would remind you that this will be the last day that you will have to do this.

CHAIRMAN VOLCKER. We might have an emergency shortly.

MR. SCHULTZ. I wanted to sing a little swan song today. You understand that swans do not sing very prettily but they generally sing a long time, so you will have to indulge me. Just remember that I am very shortly going to turn into an ugly duckling!

There are a couple of points that I wanted to make before I leave. You people are going to be under a lot of political pressure this year and a lot of outside pressure, and I have a little political advice for you. You understand that you have to be careful about political advice from a losing politician, and I fall within that category, but that is not always true. It is my belief that over time what is right is the best politics. I believe that if you do what is right and you are steadfast and consistent in your policies, the political pressures will ease and you will not be in great danger from them.

You are also going to have considerable internal pressures. I know I felt enormous internal pressures about whether what we were doing was right and whether what we were doing was the best way to go about it. Clearly, there are costs to this technique that we are using; we have all kinds of problems. But when the question is asked of me: If you were going to do anything differently than you have done over the past 2-1/2 years what would you do? I say that I did not like the credit controls and that I think we might have reacted a little better to the increase in 1980, but I honestly believe that the technique we are using now is considerably better than what we were doing. It is like Winston Churchill's comment about democracy being the worst form of government ever devised except for all the others. I think the operative question is not whether this technique we are using now is better than some other technique in an ideal world but whether it is better in view of what we have had to face. It just seems clear to me that it has enabled us in a time of great volatility to adjust interest rates more quickly and to adjust them far enough to have some market impact. I am with Tony Solomon on this. I do not know what these linkages are; they are getting looser and the demand shifts are coming more and more often; I don't know what the heck is money; all of these kinds of things are very difficult. But the real question is: What alternative do we have at this point in time? And it seems to me that what we are doing is the alternative that is best at this point.

I read the other day that somebody criticized us for playing to history. I would certainly hope that we do indeed have a sense of history. It strikes me that with the political system we have in this country and an election every two years, it is impossible to take a long-range view in the political sphere. We are the only organization that seems to have the opportunity and the ability to take a long-range view. Again, I think the pressures are going to be enormous because, whatever you do, the economy is not just going to get better very quickly. And the question that is going to be asked of you is: How much pain are you willing to inflict on the economy? I do not happen to think that it is [the Federal Reserve] that has been inflicting the pain on the economy, but that is the question that you are going to get asked. And the answer is: What is the alternative? If you stop now in this fight against inflation, if you do not carry it through, what kind of pain are you going to inflict on the economy then? It is an issue that just has to be faced and I believe it is a lot easier to face it now and overcome the problem now than it will be later on.

Finally, I would urge you to remember that you have a remarkable degree of support out there. Nobody is going to love a central bank; and heaven knows, nobody loves high interest rates. But the fact is that the Federal Reserve has built up an awful lot of respect out there. People in this country want to believe in something and you are about all there is to believe in at this time. I think there are a lot of people ready to come to your defense; you have been seeing some comments recently in the news magazines and the newspapers in response to the current criticism. A lot of people out there want to support you. I think you really do need to try to keep in contact with those people and marshal that support when it becomes necessary, because the fact of the matter is that you are still the only game in town. And good luck to you!

CHAIRMAN VOLCKER. Well, Fred, without prejudging any comments anybody may want to make later, I think your contribution on this Committee has been immensely important to all of us and I think we can acknowledge that around this little circle now before we go to lunch where, prejudging it, we can do you a little honor. We appreciate very much those comments on what has been a variety of experiences in your life and your full devotion to this one in the past 2-1/2 years. We ought to adjourn to lunch but I am reminded that I have forgotten two things that we ought to do in the nature of cleaning up.

I mentioned Mr. Reuss' proposal to you yesterday and I understood from the reactions that you did all consider that in your minds and did not choose that as a desirable course. I just want to be able to report that to him. Can I take that as a--

MS. TEETERS. Not me.

CHAIRMAN VOLCKER. Your position is clear and I can report that his proposal was considered and that one person rendered rather strong support to his point of view, but it did not command the support of the group. I think that is a fair representation of what I have heard.

The other thing to clean up relates to the short-term decision. I assumed that what we were talking about was the second version of the directive. Mr. Altmann has a slight revision, which I have not seen. It says: "...for the January-to-March period no growth in M1 and growth in M2 at an annual rate of around 8 percent." That is a slightly different way of saying it.

MR. PARTEE. Why don't we say "no further growth"?

CHAIRMAN VOLCKER. "No further growth;" good. Maybe we can just stick in a phrase "Considering the size of the recent growth, no further growth...." Maybe this is better: "Taking account of the recent surge...." And then the next sentence is about as he has it: Some decline in M1 "would be associated with more rapid attainment of the longer-run range and would be acceptable in the context of declining market interest rates."

MR. PARTEE. Would it be acceptable without declining interest rates? It would be acceptable period, wouldn't it?

MR. GRAMLEY. If this happened to be a movement along the function instead of a downward shift in the function, we would get real trouble. If, for example, the economy started to collapse--

CHAIRMAN VOLCKER. Well, one could catch a nuance here which might not be in the sentence; but if it declined in the context of rising rates, we would presumably ease.

MR. PARTEE. It struck me as being an inconsistency.

CHAIRMAN VOLCKER. I do not know whether there is a technical word or not. I guess it is not a full description of what we mean. It certainly would be acceptable in the context of rising rates, except then we presumably would move to ease. I do not know whether there is a better way to say that. This is basically a phrase we have used before, isn't it, Steve?

MR. AXILROD. Well, the last time it was used was in December 1980. We said "In the light of the rapid growth of money and credit aggregates in recent months, some shortfall [from what had been specified] would be acceptable in the near term if that developed in the context of reduced pressures in the money market." That is what the directive said in December 1980.

CHAIRMAN VOLCKER. Why don't we say "in the context of reduced pressure in the money market" instead of "declining interest rates." I think that is a little more polite way of saying it. Okay, then we are agreed and we can go to lunch.

MS. TEETERS. Wait a minute, we have the date of the next meeting. That is eight weeks away. Do we want to wait that long? It is a long time.

SEVERAL. It is a long time.

MR. PARTEE. I think we probably do, but [we can] have conferences [by telephone].

CHAIRMAN VOLCKER. Well, I guess I would just leave it. It is a long time, but if we want to have a meeting in between we can obviously do it on the telephone. I do not think we need to decide this, but if we felt like having a meeting in person four weeks from now, would that be welcomed?

MS. TEETERS. It is a matter of clearing our calendars or keeping them open.

MR. SCHULTZ. It makes no difference to me!

MR. MORRIS. I think eight weeks is a long time in the context that we are in.

CHAIRMAN VOLCKER. Well, what we can do is just pick out a date. Maybe I will send you two dates or something and ask you to make sure your calendar is clear. We will not call a meeting, but if we want to call a meeting, you would have kept a clear calendar.

SPEAKER(?). Four weeks would be around March 1st?

CHAIRMAN VOLCKER. Well, presumably it would be approximately four weeks from now. I will look for some dates about four weeks from now if that is desirable, but I do not know what my calendar is.

MR. SCHULTZ. I will be in Hawaii.

MR. GRAMLEY. You can come back. There is a place for you. We will give you another lunch if you come back!

CHAIRMAN VOLCKER. Why don't you look around March 1st. I will not call a meeting now, but I will not be allergic to calling one if it seems at all desirable.

MR. BOEHNE. Would you think in terms of a one-day meeting?

CHAIRMAN VOLCKER. Yes, I do not know about my own calendar, but I do not see any reason why--

MR. ROOS. A meeting on March 1st or coming in then for a meeting on March 2nd?

CHAIRMAN VOLCKER. As close to March 1st as I can make it. I may say March 1st if it looks all right from my standpoint.

MR. BALLES. That happens to be a Monday.

MR. PARTEE. March 2nd then.

CHAIRMAN VOLCKER. March 2nd, I think. When is the next meeting?

SPEAKER(?). March 30th.

MR. AXILROD. If that were an updating meeting, Mr. Chairman, I assume you would not need the full panoply of staff presentations.

CHAIRMAN VOLCKER. No, I think we would have a more informal meeting than usual. More precisely, we would not have the full panoply.

END OF MEETING