Meeting of the Federal Open Market Committee

May 24, 1983

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, May 24, 1983, at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman
Mr. Gramley
Mr. Guffey
Mr. Keehn
Mr. Martin
Mr. Morris
Mr. Partee
Mr. Rice
Mr. Roberts
Mrs. Teeters
Mr. Wallich

Messrs. Boehne, Boykin, Corrigan, and Mrs. Horn, Alternate Members of the Federal Open Market Committee

Messrs. Balles, Black, and Ford, Presidents of the Federal Reserve Banks of San Francisco, Richmond, and Atlanta, respectively

Mr. Axilrod, Staff Director and Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield, 1/ General Counsel
Mr. Oltman, Deputy General Counsel
Mr. Truman, Economist (International)

Messrs. Balbach, T. Davis, Eisenmenger, Ettin, Prell, Scheld, Siegman, and Zeisel, Associate Economists

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

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

1/ Entered the meeting prior to the action to ratify System Open Market transactions.

Mr. Coyne, Assistant to the Board of Governors
Mr. Gemmill, Senior Associate Director, Division of International Finance, Board of Governors
Mr. Lindsey, Deputy Associate Director, Division of Research and Statistics, Board of Governors
Mrs. Low, Open Market Secretariat Assistant, Board of Governors

Messrs. Burns, Koch, Parthemos, and Stern, Senior Vice Presidents, Federal Reserve Banks of Dallas, Atlanta, Richmond, and Minneapolis, respectively

Ms. Arak, Messrs. Bisignano, Lang, and Soss, Vice Presidents, Federal Reserve Banks of New York, San Francisco, Philadelphia, and New York, respectively

Ms. Meulendyke, Manager, Securities Department, Federal Reserve Bank of New York

Mr. Stevens, Economic Advisor, Federal Reserve Bank of Cleveland

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

CHAIRMAN VOLCKER. Open to questions.

MR. BOEHNE. I have a broader question than just exchange rate conditions. I detect among bankers in my District a rising level of nervousness about these [foreign] debt problems, with talk of moratorium and things like that. Is there anything you can share with us about that?

CHAIRMAN VOLCKER. Well, I don't know what I could say that's very meaningful. I agree with you. There is a rising sense of nervousness underneath the surface and I think a lot of it is related to a perception that Brazil is not doing very well. That perception has some foundation; I certainly [don't have] any confidence in the Brazilian situation. If they need more money, they are out of compliance with the [Fund requirements. They] must be able to make a Fund drawing on May 31 and aren't going to be able to make it through [unintelligible] and the question is [unintelligible]. There is some feeling that the Brazilians may not be the most avid people in the world in following through on the strong program. I think that's a lot of it. But it's also true that Venezuela is stumbling around doing nothing [about] their big problems. Other countries in Latin America pretty generally have a problem. On the more positive side, Mexican payments are proceeding on schedule. One sees reports that they're going to need some more money. I don't see any indication of that, assuming that the oil price doesn't go down again. And while I think production is still declining in Mexico, there is a possibility that they have a little money in the bank and may begin to bring in some more and we may begin seeing some improvement before long. There seems to be a little more confidence in exchange markets in the Mexican situation doing a little better.

VICE CHAIRMAN SOLOMON. I think part of the better Mexican performance is due to the enormous disorganization. The agencies have not been spending the money. In the second half of the year [Finance Minister] Silva Herzog is expecting that they're going to be under more pressure and it's going to be much harder for them to hit the Fund targets on the public [sector and public expenditures].

CHAIRMAN VOLCKER. Well, we shall see. But at the moment if there is any room for confidence, it's in the Mexican situation; for the rest of them the situation is deteriorating. Yugoslavia is not doing all that well. And, obviously, the interest rate level in the United States [unintelligible] with all our debts is one factor [unintelligible] the situation. Brazil is the focus of concern at the moment.

MR. PARTEE. Sam, I didn't quite follow on the swaps. Are you talking about the special swaps with the extension to August 23? This is not our regular swap.

MR. CROSS. No. This is a special swap, which is a part of the BIS-U.S. facility including [the Federal Reserve] and the U.S. Treasury.

MR. PARTEE. Our maturity date is supposed to be the 23rd of August?

MR. CROSS. Yes.

CHAIRMAN VOLCKER. The indications are that they can meet that; they may need a little help in August because they do have to make up each payment they didn't make in August. How big is [the payment] in August?

MR. CROSS. It's $1.85 billion less what they pay next week. It would be $1.5 billion.

MR. TRUMAN. They have another drawing on the Fund at that time too. It's about $1.2 billion over and above what they have [unintelligible] in the meantime.

MR. MARTIN. Lloyds Bank had indicated a substantial cutback in their overseas committing process. Is that shared by National Westminster or other British or European banks? That's a pretty big bank.

MR. TRUMAN. I wasn't sure how to interpret that report. In fact, I was told the report indicated that they were cutting back not in Latin America but in other parts of the world, including North America. [Unintelligible] it's relatively small. A 25 percent cut isn't going [unintelligible]. It applies to new lending but I think that includes rollovers, so it includes as new lending what would in effect replace loans that have matured on the bank's books. Put against the context of the fact that new lending to developing countries in 1982 meant [decreases] in lending--[loans to] developing countries in 1982 dropped by 50 percent--that cut is a pretty modest cut. That comforts me.

CHAIRMAN VOLCKER. [Unintelligible]. Unless there is some objection, we will roll over the [swaps] as needed in the context that Mr. Cross described. We haven't anything other than that, do we?

SPEAKER(?). No.

CHAIRMAN VOLCKER. Mr. Sternlight.

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

CHAIRMAN VOLCKER. Questions?

MR. WALLICH. You refer to variations in the level of borrowing and in the demand for excess [reserves]. Can you say what the market tends to think is our present target? Do they think it is any part of the money supply or do they think it's the funds rate or the level of borrowing or free reserves?

MR. STERNLIGHT. I tend to believe that they think of it as a free reserve target, Governor Wallich. And they probably think of it as centering around zero or very slightly plus.

MR. WALLICH. So they attach more importance, apparently, to excess reserves than the FOMC technique seems to give them.

MR. STERNLIGHT. Well, in fact, they do. Yes.

MR. BLACK. Peter, why don't they think it's a federal funds rate target?

MR. STERNLIGHT. Well, I don't think they regard it as a federal funds target in the sense of pre-October 1979. I think they would feel, with some reason, that if we are aiming at free reserves or borrowing we are aiming at something that has a likely range of variation in the federal funds rate but not a federal funds target in that very narrow sense where the Desk pin-pointed within 1/8 point or so a particular funds level and intervened every time that there was ever so little a variation from that.

MR. BLACK. But, given the variation in the apparent borrowing target every time the federal funds rate threatened to deviate, I am beginning to think that we are putting more emphasis on the federal funds rate than on anything else.

MR. STERNLIGHT. I think they see it as a federal funds range [once removed] but not a tight target.

MR. BLACK. Yes, I can see that distinction: that they wouldn't think it was as tight as it was before October 1979. I am rather surprised by the answer.

CHAIRMAN VOLCKER. When is this debt ceiling [issue] supposed to be cleared up?

MR. STERNLIGHT. The Senate should be taking it up in the Finance Committee today. I think the Treasury desperately needs them to finish and then Congress can finish action by the end of this week. They will literally run out of money early next week.

CHAIRMAN VOLCKER. Then we are going to get a whole bunch of offerings.

MR. STERNLIGHT. Then we could get a whole bunch, yes.

CHAIRMAN VOLCKER. Any other question?

MS. TEETERS. I have just one minor question on the [repayment of] the German marks. Was that under the debt ceiling?

MR. STERNLIGHT. The Carter bonds. Yes, I think they were.

CHAIRMAN VOLCKER. We need to ratify the transactions. [Without objection.]

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

MR. BALLES. Mr. Chairman, Bill Ford and I both happen to have the same question, we just found out. Jerry, you referred to the fixed weight deflator. The Board staff forecast officially, at least in the version I see here, uses the implicit deflator. Just referring to the first quarter of the year, with that implicit deflator rising to a 5.8 percent annual rate and the CPI and the WPI either flat or declining, we are getting major different signals now on what is really happening on the inflation front. So, our technical question to the staff, Jerry, is: Which of these different indicators of price movements do you consider to be the more meaningful?

MR. ZEISEL. Well, the lower one, always the lower one! The deflator for the first quarter was distorted by very sharp swings in net exports, particularly the importation of fuels, which was down sharply. We expect that figure to move back into line in the second quarter. We think the CPI and the fixed weight price index are a better measure of what was happening to fundamental price movements in the first quarter. And those were quite good indeed; they were in the 2 to 3 percent range.

MR. FORD. What about military procurement prices? Procurement is picking up. Is that captured in any of the other indexes or is this the only one that really captures what the government is paying for all this defense [spending]?

MR. ZEISEL. Theoretically, both capture it.

MR. FORD. The WPI ought to capture some of it.

MR. ZEISEL. Yes, it should. The attempt certainly is made to capture the actual increases in prices. The deflator is a bit more sensitive to shifts in weights. The rising increases in the proportion of defense spending would affect that index somewhat more. But actually over the last half year or so defense spending has lagged. There has been no increase since the third quarter of last year, and we are rather expecting a surge in outlays because this was supposed to be the big year for procurement.

MR. FORD. What I'm hearing is that the government is really paying up for spare parts and things like that because capacity to produce has been run down in a lot of specialized activities. Do you hear anything like that--that now's the time to be selling nuts and bolts to the government?

MR. ZEISEL. It seems sad that when capacity is way up prices run up sharply and when capacity is down prices run up sharply. It sounds like a Catch-22 situation. I hadn't heard that particular argument.

MR. BOEHNE. I don't have any fundamental disagreement with Jerry's forecast. He has done his usual good job; however, it does seem to me that there has been at least a subtle shift in the direction of how the errors might be. At the last meeting I would have agreed with the Greenbook, but I was thinking that if the Greenbook were wrong, perhaps there would be less growth. But it seems to me now that the risks have shifted. I think the Greenbook is right but if it is wrong, then there will probably be more growth. There comes a particular point in a recovery where the dynamics of a recovery set in and it's somewhat greater than the individual sectors of housing, consumption, etc. I get the sense that these dynamics are now at work. One sign that I look for in a recovery is when business people stop complaining about high [interest] rates and they start saying: Why don't you just keep things the way they are? When they start saying that, it means things are getting better and they don't want anybody to rock the boat. And that has been the dominant theme of what I've been hearing. I think we are in that period where the dynamics really are beginning to take hold.

MR. RICE. Jerry, I think I heard you say that the expansion over the next year and a half through 1984 would be [at a rate] just below the median for previous expansions. Would you still say, in light of the present data that we have, that the strength of the recovery so far is below the postwar average significantly?

MR. ZEISEL. Yes. The first year is when we get a major kick in output and our projections fall short of the average for the first year of recovery; it's about 70 percent or so. Our projections make it up in a sense in the second year when on average recoveries begin to lose some of their steam and we are maintaining the same rate of increase in the second year as in the first. We have increases of 4-3/4 percent in both the first and second year of the recovery.

CHAIRMAN VOLCKER. That's through the year that you're talking about. I thought we saw some pictures yesterday that said the recovery so far is about average.

MR. ZEISEL. Well, we have [only] the first quarter; I'm addressing myself to our projections of the first year.

CHAIRMAN VOLCKER. Suppose you address yourself to the first six months, recognizing your projections?

MR. ZEISEL. The only thing we have to date, Mr. Chairman, is the first quarter and that was a rather modest increase of 2-1/2 percent, which is well below the typical rate.

CHAIRMAN VOLCKER. You have industrial production and you have auto sales figures.

MR. ZEISEL. Incorporating the first and second quarters together probably brings us fairly close to the average.

MR. PARTEE. Those monthly figures, you remember Jerry, were plotted against a shaded area. We were more or less in the middle.

MR. ZEISEL. For industrial production and employment--the figures for which we have monthly data--that's correct. They're really quite consistent with the average recovery at this point.

MR. BLACK. Jerry, if you exclude the CCC payments from the fourth quarter and also from the first quarter so that you get final demand of roughly the same magnitude in both quarters and make some allowance for the point that John Balles made about the possible overstatement of that implicit price deflator, wouldn't it look a good deal stronger? It would look somewhat stronger than average if it looked about average before you made those adjustments, wouldn't it?

MR. ZEISEL. As I recall, excluding the CCC gets you something in the neighborhood of 3 to 3-1/2 percent for the last couple of quarters. I don't have GNP excluding CCC; I have the final sales excluding CCC. That was 3.3 percent in the fourth quarter, 3 percent in the first quarter, and we're [estimating] 2.7 percent in the second quarter.

MR. BLACK. But if in fact the point that John raised has some validity, as we're inclined to think it does, and you made those adjustments, I would think real final sales may well be higher in the first quarter than they were in the fourth quarter.

MR. ZEISEL. Well, final sales certainly are stronger in the first quarter when one makes that adjustment and certainly weaker in the fourth quarter because CCC outlays were enormously high in the fourth quarter. So, you get a somewhat more stable pattern. Final sales trail off a bit in our projection in the second quarter largely because of the net export situation. Basically it's a situation, depending on what you take out, where we seem to get a pattern that's reasonably stable, excluding CCC, at around 3 percent over the last several quarters.

MR. GUFFEY. Jerry, part of your forecast beyond the second quarter is premised on the weakness of the dollar. What kind of factors are you taking into consideration to project that the dollar will indeed weaken later in 1983 and 1984?

MR. ZEISEL. I think I'll let Mr. Truman answer; it's his forecast.

MR. TRUMAN. I'd say right up front, Mr. Guffey, that there is clearly room for some skepticism about that element of the forecast. We are forecasting for the year a current account deficit of $35 billion, which would be more than twice the rate we've ever had before, and by the end of the year a current account deficit of $60 billion, which would be four times the [highest] annual rate we've ever had before. And our sense is that the market will look at numbers of that sort, which will start coming out in the latter part of the year, with trade deficits of over $70 billion per month at an annual rate, and say that that will be unsustainable and that there will have to be some corrections. We do not predicate this on much, by the way, in terms of trade in the United States falling relative to abroad or otherwise. One can argue that these kinds of forecasts, while they are high relative to market forecasts and to conventional forecasts, are not out of the range of what people talk about. The Administration has relatively similar forecasts and they have more or less made them public. Our sense in talking to people in the market, although they know that some economists are forecasting these numbers, is that they're not going to react to them until they in some sense see them. And as Sam noted in his report, the fact that the current account moved back not toward zero but something like $7 billion at an annual rate from something over $20 billion in the second half of 1982, largely because of oil which in many respects is a spurious factor, is one reason why the dollar at least in the short run has stayed quite strong. That factor has, if anything, moved in the other direction in the short run. I would make one other comment. Much of the change in net exports in the second quarter is the resumption of oil imports and, in fact, the two surprising things about the first quarter were the decline in oil imports, which we obviously did not fully anticipate, and the remarkable growth in non-oil imports. If you look at those numbers, which are really big numbers--and [sparked] by oil, which dropped to $20 billion at an annual rate--if anything, the outlook that we have now is more pessimistic for the current account than it was two months ago.

MR. MORRIS. I don't understand why the market is not anticipating this.

MR. TRUMAN. Well, if you talk to traders, they say: "Of course, our economists are forecasting X, Y, and Z (and those tend to be numbers that are smaller than ours) but I never listen to our economists anyhow."

MR. CORRIGAN. You have imports rising by $60 billion between the first and fourth quarters of this year. How much of that is oil?

MR. TRUMAN. Between the first quarter and the fourth quarter? Twenty-five billion or so. Of the increase from [$313] to [$373] billion, a little less than half of that is oil, which is a rebound. The price is there. You just add them up, price-adjusted a little lower than you would [otherwise] think in the second half. But most of it is a rebound in quantity as we had a mild winter and in addition they were running down inventory, if you believe the API number that reports a rebounding already in April.

VICE CHAIRMAN SOLOMON. My question has been taken care of by Roger. I just have a lot of skepticism about that projected decline in the dollar, if one assumes interest rates stay in this range, given the enormous interests on the part of foreigners in our securities markets and less confidence in European securities. A lot of the European bankers we spoke with talked in terms of a very high percentage of their portfolios staying in U.S. securities. Combined with the interest rate spread outlook and the safety haven aspects, we may very well see next year the same kind of disappointment with regard to the dollar value that we expected in the last year. The bulk of the market had expected a decline in the dollar in the last 12 months and it didn't materialize. Nobody can say for certain; it's just that I personally have some skepticism that we should count on any decline with any degree of certainty.

MS. TEETERS. Tony, how much of that is flowing into Treasury securities?

VICE CHAIRMAN SOLOMON. Not very much, because central banks have not been adding to their holdings. And [private] foreigners don't tend to hold a very large portion of U.S. Treasuries.

MR. MARTIN. We've had some Middle Eastern sales.

VICE CHAIRMAN SOLOMON. Yes, putting it all together, there was some reduction in some of the central accounts. Some of the OPEC countries have a big reduction. Of course, in France's holding, that famous surplus, it is not very clear where it is anyway. As I think Chairman Volcker said last week, our biggest trading partner is "errors and omissions."

MR. MARTIN. I'd like to join Tony in that caveat by adding the awareness I'm sure we all have of the continued interest in American companies by European and other investors who feel that either a stake in an American company or the acquisition itself has some great advantages, particularly when they buy in below book or at reasonable multiples of earnings. That's another factor, despite the strong dollar.

MR. TRUMAN. Foreign purchases of U.S. Treasury securities in volume at present are quite small, although they have been larger than usual recently. They were almost $6-1/2 billion net last year and in fact they were about $3 billion net in the first quarter of this year.

MR. PARTEE. It's really a question, isn't it, Ted, of how easy it is to finance the deficit from abroad? There can't be much question that there's going to be a large trade deficit and the longer the dollar stays high the larger the trade deficit will be. But what we don't know is how forthcoming the funds from abroad will be to finance this deficit. If they are very, very eager to come here, maybe we don't need a lower price.

MR. TRUMAN. For the last year we had an $8 billion current account deficit and that's a coincidence. But in the second half of the year when that turned into a $20 billion current account deficit, annual rate, we had some weakening of the dollar. I started out my answer to President Guffey by saying that obviously there is room for skepticism on this point. The other side, though, as you said Governor Partee, is that if the dollar doesn't go down, then everything else being equal [unintelligible] the growth forecast will be considerably less ebullient than we have it now, by something on the order of 1/2 percent, as Jerry said in his briefing.

VICE CHAIRMAN SOLOMON. I might make a general comment that some of you will not agree with, I'm sure. I think that one of the most disruptive forces in this whole question of a world recovery is the strength of the dollar. The LDCs are paying their interest on dollar-denominated debt in dollar interest rates while they earn in weaker currencies. It adds to their problem. For commodity prices, including oil, it's the same kind of situation. And I think it will continue to be a drag on our economy in terms of exports. It's certainly a drag on the other industrialized countries. We tend to be very asymmetrical in our view of monetary policy with regard to the exchange rate. We are perfectly willing to tighten monetary policy when the exchange rate is down to a point that concerns us and disturbs us. But for some reason, we have what I would perceive as a large measure of indifference to using monetary policy to restrain what is clearly a very damaging rise in the level of the exchange rate. This is a view, of course, that is common abroad. And I find probably a greater gulf in intellectual thinking between the foreigners and ourselves in this area than in almost any other area.

MR. WALLICH. I think one needs to factor into the exchange rate situation the possibility at least of another boiling up of the international situation and the impact on the banks. As things are developing, our banks are likely to be more vulnerable if something like that were to happen, partly because of the heavy involvement in Latin America and partly because they seem to have made less preparation in provisioning against losses than some European banks. So there might be deposit withdrawals in such a case. Now, whether that means also withdrawals out of the dollar into another currency or just a move into U.S. Treasury bills, that is what one has to try to think through as one tries to anticipate the effects of such a crisis.

MR. KEEHN. On the domestic side I can confirm that the good news is even arriving in the Middle West but with one caution. The capital goods side is still exceptionally weak. The people I talk to who are in the very heavy side of capital goods see no improvement now and they really are very discouraged about the outlook, particularly with low operating ratios. Some of the people who have never really been concerned about exports before--never relied on those markets--see this as an opportunity. And because of the exchange rate, they feel that they are precluded from any relief on that side. So, the people in heavy capital goods are still pretty discouraged about the outlook. But other than that, I think the general environment in the Middle West is significantly better than the last time we met.

MR. ROBERTS. I just wanted to ask a question about inventory change. My understanding is that the first quarter still had a significant drag from inventory liquidation. I see your numbers here change dramatically from the first quarter of 1983 on to, say, the fourth quarter 1984--$64 billion. If we took out the inventory reduction in the first quarter--to kind of pursue Bob Black's analysis--you'd have a still stronger picture there contrasting with the fourth quarter. And in view of your forecasted elimination of the liquidation of inventories, that suggests a lot of strength. Is that a valid assumption? Are you fairly confident about the change in inventories that you are projecting?

MR. ZEISEL. One can never be confident about a sector like inventories because there is so much of the visceral in it. What is a reasonable level of stock is very much in the eyes of the businessman and his expectations about the outlook. We are assuming a reasonably conservative inventory posture over the next year and a half, largely because we feel businessmen first of all have been badly burned in their inventory policies recently, and secondly because the cost of holding inventories remains relatively high given our assumptions about interest rates. Essentially, we're saying that inventory investment is not going to be a big force for expansion. The behavior of inventories recently, as typically, has been the major factor turning the economy around. We've had a rather typical deceleration of inventory liquidation, which gives us an increase in GNP. That was a big factor in the first quarter. Excluding inventory liquidation--that is, looking at final sales--it was a 1.3 percent increase. We now are assuming that inventories will stabilize beyond the second quarter and start rising but at a relatively moderate rate.

MR. GUFFEY. I'd just like to complete a thought that led to the question to Jerry with regard to the dollar. There is a potential that we will have just an inventory liquidation/consumer spending recovery without the capital expenditures coming on stream. Traditionally, I understand, those have been very short cycles. With the [possibility] that there isn't any strength that might come from exports, I just want to raise a note of caution about all the euphoria and the good numbers that have come out in the last 30 days. The potential for this being an inventory liquidation/consumer spending recovery that lasts only through the third or fourth quarter perhaps is a real potential. I don't think we should become all that euphoric yet that this is a sustainable recovery through 1984. I'm a little concerned and not as sanguine about the numbers that we've seen.

MR. PARTEE. I would agree more with Ed Boehne than anybody else who has spoken up to now. On inventories, Ted, I think we can't say precisely what path the inventory change is going to follow quarter-by-quarter, but it seems extremely likely that it's going to move up from a large negative number to zero or a small plus, and that's a big algebraic change in the GNP when it occurs. It might occur this quarter or it might occur next quarter; it's hard to know what the pattern will be, but it's ahead of us for sure. And it seems to me that consumer spending just has to be pretty strong, with the increase in the value of financial assets that consumers hold--it's hundreds of billions of dollars in improvement there--with the change in sentiment, which is one of the biggest that we've seen in years in the surveys, and with the tax cut coming on in another five weeks, which adds another $30 billion to the hopper. It seems to me all that has to mean a pretty strong consumer sector. I'm surprised the retail sales data are as poor as they are. Indeed, when you read the Redbook, where almost all of [the Reserve Banks] commented on retail sales, things don't look anywhere near as weak as the national statistics. That is, the year-over-year increases range from a low of 6 percent, as I recall, to up in the 13 to 14 percent area. I don't know quite what's wrong, but in any event I think there's bound to be that increase in consumer spending and the inventory improvement. And with those I think some capital spending will come along. That comes late in cycles anyway, Roger; it isn't one of the things that appears early. And by the end of the year I think we may be looking at a much improved capital spending situation. Maybe it won't help the Midwest so much because it seems to be in high tech and automated equipment and so forth. Nevertheless, if anything, I think our staff has been surprised by the strength in capital spending this early on. But it hasn't been a [heavy capital] goods kind; it has been computers and the like. So, I think the outlook is really quite good and I agree with Ed that whereas I might have been inclined to say the risks were on the low side of the staff forecast last time, I think they're probably now on the high side of the staff forecast.

MR. GRAMLEY. I would agree with Chuck and Ed too. I think what we are getting now are some of the typical internal dynamics of the business cycle process, with dynamism in one sector reviving confidence in another and the whole thing building up into a more cumulative cyclical process. And in this connection, I was interested in Jerry's comment in speaking of 1984. I don't think I can quote him exactly but he said something like this: That present high levels of real interest rates, which are assumed to be a consequence of the monetary policy we're pursuing, will be a major restraint on private demand. Another way of stating the whole idea is that if we follow a policy which keeps interest rates from rising during the course of the dynamic cyclical process and that's fed by additional fiscal stimulus as time goes on, we may well be fueling a much larger economic expansion than anybody is forecasting now. Those are two different statements, looking at the same phenomenon in a different way. None of us knows for sure whether we ought to regard present real interest rates as a major restraint on private demand or as a level of interest rates that will accommodate a substantial increase in private demand. And I think as one looks at what has been going on in the past six months one is inclined--or at least I'm inclined--to the latter view rather than the former. We are getting a very, very dynamic response, particularly in those areas that are most credit sensitive like housing. So, we may be seeing a revival here of the usual cyclical process, which will give us a much bigger increase at present levels of real interest rates over the next two years than we're now forecasting.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I share the view that the risks this time are for excessive boominess to the economy. I just want to make a very small point. In the Redbook--

CHAIRMAN VOLCKER. I haven't heard that word for a while!

MR. PARTEE. I didn't exactly say that.

MR. WALLICH. Well, I interpret this as a getting into the 5, 6, 7 percent range at some point and I would think that would be excessive. Now, what I wanted to ask is: The Redbook contains a special exercise on the construction industry. To me it showed the enormous diversity of conditions and how much of an artificial number, essentially, the average of all these different local conditions is. I was wondering whether it had been of any use to the staff.

MR. FORD. Don't push them!

CHAIRMAN VOLCKER. You don't have to answer that question.

MR. ZEISEL. I will. I think it was of use in the sense that while a diversity of opinions was represented, one did get a central tendency both about the residential construction activity and housing starts. The forecasts that were quoted appeared to range very closely to our own expectations for 1983 in terms of housing starts. And we got some confirming indication about expectations for commercial and industrial construction--that is, that they were turning down and that expectations were rather weak. We found them generally useful.

MR. MARTIN. Henry, let me comment on that, if I may. If we had gotten a different response from the disparate remarks District-by-District and metropolitan area-by-metropolitan area, we almost would have had to reject the survey results because housing markets nationally are a mosaic of little markets and submarkets. You must get this kind of result or someone is not doing his homework. This is a typical analysis and response of varying markets around the country with varying backed-up demand, different migration patterns, and different local economic base conditions. I found it quite a valid survey.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I've been skeptical for some time that this upturn was going to be as modest as I think most people were assuming, for a couple of very basic reasons. One is that a sharp downturn like we've had is typically followed by a pretty sharp upswing. And then we've added so much to the money supply that even if one assumes a pretty significant increase in demand for money, it seems to me that there is enough liquidity out there to finance a pretty good pickup. Chuck and Ed and Lyle and Henry touched on the recent burst of statistics, which lends further support to that. So, I am in agreement with them about the strength of the economy. I think the staff has made the revisions in the correct direction by raising the projections. Specifically, I think the second quarter may even be significantly higher than they're projecting. But the main concern that I would have is that if we're right in our supposition that this is a strong recovery, we may well find that those projections of price increase in 1984 are unduly optimistic.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I'm impressed at the breadth of the expansion that is underway. I'm not depressed about it, as Henry seems to be. I think we have plenty of room to get an awful lot of unused capacity on the scene; that decline in unused capacity is a very positive phenomenon. But in reference to capital goods, I think we've overlooked the fact that in the months of March and April machinery orders exceeded the level of shipments, which I think is rather unusual for this early in the cycle. As I read the numbers, I think the capital goods sector is doing better for this stage of the cycle than I would have expected.

CHAIRMAN VOLCKER. Mr. Boykin. How is your capital spending doing down in the oil fields?

MR. BOYKIN. In a general sense, we pretty well agree with the Board staff's forecast. Also, I think the risk is that it might be slightly low. Attitudinally I'm hearing much of what Ed Boehne said. In general there's a better feeling, but we still have a bit of a mixed picture. If you look at the middle corridor of our District--that is, through Dallas, Austin, and San Antonio--it looks pretty good. But if you get a little to the west or a little to the east, where you encounter the energy or energy-related activities, you still see the concerns on the coast in petrochemicals and refineries. While there is some improvement, there still are a lot of expensive rigs sitting there in the Sabine River. If you get out in the west Texas area, I think they have some very significant special problems and that is still going on. Of course, along the border of the Rio Grande, it's still pretty depressed, with unemployment up 25 to 30 percent and that sort of thing. But in spite of the special problems, I do feel that we are seeing a recovery. Part of our problem is that we find ourselves in a little different situation than we're used to. We're usually feeling good about everything. But I think energy is tempering our judgment a little.

MR. BLACK. I thought people always felt bad about west Texas!

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. This discussion is so different from our previous one. It certainly is gratifying to hear what I think is a well founded positive outlook. I won't call it optimism because it has some aspects to it that I don't think apply. So, let me be Dr. Doom here for a minute and remind everyone that Wachovia has raised its prime rate, that Bankers Trust has raised its broker loan rate, and that while one must allow for a good deal of difficulty the Treasury is experiencing because of Congressional inaction--if that's the correct term--on the debt ceiling, nevertheless, over the last few days there has been some upward pressure in the markets. Maybe this is very transitory as far as interest rates are concerned. But if we look at the LDC debt question vis-a-vis these firming rates and assume anything like even a 75 or 80 or 90 basis point increase in that burden, we are looking at countries with $90 billion or $84 billion or

$40 billion or whatever projections you'd like to use by the end of 1983. If we consider how much of that debt is nonsovereign debt but is private debt, how much of it is carried by our banks and how much is carried on a variable rate basis, [we see the impact] of the drift in rates on additional funds being advanced in those giant workout situations.

If we consider the vulnerability of those countries who are oil exporters--to shift my ground here a little--if prices decline on the petroleum products substantially more, these countries are paying on a weighted average basis higher interest rates. Yes, that certainly is offset to some degree by our ability to absorb some imports in some cases. The IMF constraints, as the Chairman and others commented earlier in this meeting, [impose] great difficulties on some of the countries--even those who are taking them seriously and attempting to comply. And then, of course, finally there are the political implications of compliance and the political implications of higher rates on the variable portion of the debt. It comes out to be quite cumulative. So, while I share the positive outlook with regard to our own economy--I have some reservations still in the housing area but share generally the outlook--I think we must inject into our discussions here, and we already have, the extreme complications and extreme sensitivities and vulnerabilities on the international side.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. Well, I think there's a good deal in what Preston says. We are not expecting, even without a financial shock in the international area, boom conditions. Certainly the second quarter growth may run as much as 5 percent or more, but we still would look for something more in the neighborhood of 4-1/2 percent growth over this year and well into the next year under the best of circumstances. Even though we're not getting into monetary policy discussions now, I want to take issue with what Bob Black said. I don't see that the money supply has increased that much. M2 and M3 are either in their cones or a little below. The credit aggregates, both narrow and broad, are in their target areas. The fact that M1 is behaving in the screwy way that we all expected and that there seems to be a permanent shift toward holding a large savings component in M1 balances in NOWs and Super NOWs should not [lead us to] generalize that there has been that big an increase in the money supply. I had the feeling that for good and rational and sufficient reasons we deemphasized M1. And now our psychology and our thinking as well as that of the markets seems to be creeping back to a situation where everybody is paying attention to M1 and these weekly numbers. I would just take exception to the generalization that, in terms of a stimulus to the economy, the money supply has increased that much.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Mr. Chairman, with regard to the near term, I'm inclined to the view that we'll probably do better than the staff forecast in terms of real growth and maybe even in terms of inflation. But I'm not nearly as sanguine about 1984, certainly. I think for some of the reasons Mr. Martin and Mr. Solomon suggested on the international front, we're by no means out of the woods there. But in addition to that, I must say in looking at the budget process and the body language that it is associated with, it doesn't seem to me that any real progress has been made on the so-called structural deficit--maybe some, but certainly nothing to write home about. But on top of that I do think we have to recognize that there is a lot of pent up pressure out there to raise prices. I think we're going to be able to avoid a manifestation of that pressure, perhaps for a period of time, simply because the productivity/unit labor cost phenomenon is working almost perfectly right now. That's not going to last forever. So, as I say, the near term looks fine, but I'm just not sure about 1984. And, looking at the staff's implied forecast, it gets a little hard for me to imagine out in 1984 how we really can keep those interest rates where they have them with underlying conditions what they are.

CHAIRMAN VOLCKER. Mr. Roberts.

MR. ROBERTS. I think I'll wait for the monetary discussion. I want to respond to Tony. I disagree with him about 100 percent.

CHAIRMAN VOLCKER. Anybody else? Mr. Balles.

MR. BALLES. One more question, Mr. Chairman. I certainly share the feeling around the table here that the business outlook is clearly better this time than at the time of the last meeting. It's certainly true in the West. I'm getting a little concerned, though, about the inflation outlook and whether it will be as favorable as the staff forecast has it. I'd like to turn to you again, Jerry, on that one. Our staff is not as optimistic as your people are. I hope you're right. I understand that your forecast for the deflator as we get out into the balance of this year is dependent on some improvement in productivity which seems to be fairly significant--about 3 percent growth, if I remember the figures correctly.

MR. ZEISEL. About 3-1/2 percent.

MR. BALLES. 3-1/2 percent. Also, if my recollection is correct, that's pretty high in the range of historical experience; if not, tell me so. I'd like to know what makes you so confident that we're going to get this good accomplishment in productivity; I hope we do, but it's apparently essential to getting this good outcome on the inflation front that you people are predicting.

MR. ZEISEL. The productivity performance over this year--I think it's 3.6 percent that we are forecasting--is really a cyclical rebound in productivity that reflects the more efficient use of both capital and labor as output increases. And it's not an unusual performance. The underlying trend productivity that we have is not really much better than what we had been having recently. We've jacked up our trend productivity just a bit. We've been using a figure of about 3/4 of a point--a very, very poor productivity trend--until fairly recently. The underlying figures seem to suggest a little improvement. Now we're using something like one percent; that's really not very much better. And our forecast does not assume a large productivity increase in 1984. We get back down toward the trend of about 1-1/4 to 1-1/2 percent toward 1984. So, we're really not leaning on any very significant improvement in our fundamental productivity trend to get our inflation forecast. It's really a function more of the fact that we have a weak labor market, which we project will continue through the entire forecast period. We have had very good price performance. Wage negotiations have a tendency to be backward-looking and they are now looking back at very small increases in the cost of living. And we think that will be helping the overall performance of wages and, therefore, labor costs and prices over this period. In addition, of course, we have been and still are benefiting from the strength of the dollar and its implications for both imports and the competition of those imports with domestic producers. So, we have had a lot of things going for us and they are still going for us. And we think the inflation outlook is really very good, at least through this year, and we're assuming no deterioration in 1984 but no further improvement either. We stabilized our price projection at 3-1/4 percent in 1984 as well.

CHAIRMAN VOLCKER. I think you have a rather pessimistic productivity increase for next year.

MR. PARTEE. I think so too.

MR. ZEISEL. It's back fairly close to the long-term trend, which is a relatively poor trend performance. I hope you're right.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. I'll very quickly report on our region. We are fairly optimistic about the near term. I come out with an overall feeling much like Jerry Corrigan's that the next two or three quarters look fairly decent. Current performance is pretty positive all the way around on employment. Most people are starting to notice that we are really getting into a very heavy wholesale buying center role down in Atlanta. All the merchants for hundreds of miles around come down to our merchandise mart operation and buy, and one can really see what is going to happen in the next few months. At least the sentiment of the buyers is up; the buying of clothing for fall and winter and spring is way up over last year. And our taxable retail sales [gains] are well up into the double digit range, contrary to the national figures. As somebody said earlier, and I agree with it, the Redbook doesn't seem to agree with the national figures at all. Our District certainly doesn't. Two areas of great concern to us are the area that's adjacent to Bob's territory, which until the oil bloom came off was always one of our greatly optimistic areas and now that has reversed. There the drilling came down and all the people in oil and energy-related activities are very deeply concerned about the decline of drilling, defaults on the loans, etc. Relating to that is the banking stability picture. Most of the concern expressed around the table has been about the international concerns. We are still experiencing very severe difficulty. Governor Partee, I don't know why you're smiling up there.

MR. PARTEE. You have a couple of big ones coming up.

MR. FORD. Yes. You should all be aware of the fact that there is to be more excitement in Tennessee in the next few days, as Governor Partee and some of you may know, because the Tennessee banking situation really is quite desperate. There is a substantial number of banks--even a few beyond the Butcher bank empire--that look pretty shaky to us. And when you look at the national figures for banking--! We've just finished looking at the FDIC summary of the whole industry and I was amazed to see something like a 72 percent increase in write-offs in 1982. Write-offs for the whole industry net of recoveries went up from under $4 billion to $6-1/2 or $7 billion. I don't know whether any of the staff people really follow these numbers but usually the huge increase is the year after the recession. So, I'm beginning to wonder what the poor bankers are going to have to write off in 1983--if they had to go up from under $4 billion in write-offs to almost $7 billion in 1982--with the lags in recognition, if they are forced with all that's going on in the international area to put in bigger provisions for any of the Latin American and Eastern European [loans].

MR. WALLICH. German banks wrote off $4 billion and that's probably not including Luxembourg. Now, that's a [banking] system about 1/4 the size of ours.

MR. FORD. Yes. From the reports I've been hearing from Dresdner, Commerce, and so on, it sounds as if they feel that they've taken the heavy hit and really worked hard at cleaning up their books.

MR. WALLICH. Most of that is for domestic [loans]; 1/5 is for international and 4/5 for domestic.

MR. FORD. So, I'm as concerned about the condition of some of our banks as the rest of you are concerned about the condition of the international banks. I'm not sure [about the latter]. In the macro picture I come out where Jerry does. The next few quarters look pretty good to me. The big question is the one we were raising about whether the staff will be right. I've never wanted to pray harder that they're right. But I must say I share some of the skepticism that has been voiced about whether we can continue to keep inflation down as well as they say we will. I hope they're right, but that forecast is hard to visualize against the monetary and fiscal backdrop that we have right now.

May I ask one question? Someone was talking about counting on a $30 billion tax boost. Where is this fiscal [legislation]? Is that tax reduction in the bag now or is somebody talking about trying to recapture some of it?

MR. ZEISEL. Well, that's the third stage of the--

MR. FORD. I know what it is. The question is--

MR. ZEISEL. Yes, the tax reduction. There have been discussions of capping it or removing it and so on. It seems rather late at this point to accomplish very much.

MR. PARTEE. I assume the new withholding schedules have gone out to corporations.

MR. STERNLIGHT. The new withholdings schedules went out a few days ago.

MR. FORD. So it is in the bag.

MR. ZEISEL. Well, I would say certainly 90 to 95 percent.

MR. FORD. So, it's the indexing that's up for grabs now, the way you read it.

MR. ZEISEL. That's certainly one fairly large source of additional funds that is up for discussion. I think there will be some attempt possibly to replace the withholding of interest and dividends with some other kind of increase in taxes and so--

SPEAKER(?). Part of the banks--

CHAIRMAN VOLCKER. I think we have to move on here a little. Mr. Rice.

MR. RICE. Mr. Chairman, I don't have any additional insights to put on the table. I just want to say that I come out very much in the middle of this discussion that we've had so far. I'm impressed with the vitality that the economy has shown recently. And if things go the way they should go, I would expect that the expansion will continue at a healthy clip for the reasons pointed out by Chuck and Lyle and others around the table. It seems to me that that's the best bet for the present time. But I think that we ought to be prepared to be disappointed. The consumer it seems to me has every reason to be expanding his expenditures, but the consumption sector may not perform the way we would expect at the present time. We've been disappointed by the consumer before--surprised on both the up side and the down side, as a matter of fact. And I think we should remember that the consumer did not respond to last summer's tax cut the way we expected. Also, while I agree that it's too early to expect a big boom in the capital goods sector, the outlook for the capital goods sector is worrisome to me. I recognize that the most recent figures for capital equipment spending have been very encouraging, stronger than anybody expected. But we haven't seen any indication that capital expenditures for heavy equipment and so forth are going to perk up, and I'm just not convinced that they will. Also, we have to keep in mind the possibility that the dollar will not decline and that exports will not expand--the scenario emphasized by Roger and Pres and Tony. So, in short, I think we have to be prepared for the downside outcome. But I have to say that I come out in the middle and, therefore, I would tend to go along pretty much with the staff's forecast.

CHAIRMAN VOLCKER. I guess we can turn to Mr. Axilrod quickly for an interim review of the long-run objectives.

MR. AXILROD. Thank you, Mr. Chairman. I really can be very brief and give a short summary of where the evidence seems to lead. It's very hard to come to any conclusion that M1 is behaving more consistently with historical patterns than it has been in the past. We feel that it is very probable that the so-called interest rate responsiveness of M1 has gone up, largely because of the increasing role of NOW accounts, which have a savings component and probably a bit more interest sensitivity in relation to that savings component. But we have not seen any sign of a usual cyclical increase in the velocity of M1; and in fact we are thinking, of course, that in the second quarter we are still seeing a decline in that velocity. Looking at the range itself, the odds seem to favor M1 not coming in within that range. I would suggest that it may be a little premature, if the Committee were inclined to change the range, to do so. There will be a full review in July and a lot may depend on where we happen to come out in June--whether in fact we get a huge reversal of this May upsurge or whether it's beginning to tell us that we really are on a much higher track than we expect.

With respect to M2, it seems to me that the assumptions that the Committee made when it established the February-March base have held up. The bulk of the shifts do seem to be well behind us, though the increases in MMDAs recently have been running a little higher than we had assumed. But, of course, they are very far below the pace of January-February and even below the March pace. In some sense, the oddity in M2 now is the weakness of the non-transaction component. But assuming that does return to something closer to normal, there would seem to be little problem at this point in the longer-term M2 range. Thus, that too looks as if it is certainly sustainable pending the full-scale review that the Committee will be making in July.

CHAIRMAN VOLCKER. You didn't say anything about M3 and credit.

MR. AXILROD. Well, it's hard to read that [unintelligible], Mr. Chairman, which pertains particularly to M1 and M2. So we had interpreted that as the Committee's main focus of attention. M3 and credit are running well within the ranges. We wouldn't see any particular problems at this point with those ranges.

CHAIRMAN VOLCKER. Well, I would interpret your comments as saying that at least for technical reasons there is no need to review the M2, M3, and credit aggregates. There may be some reason to review the M1 aggregate but you're saying it's a little premature. I would say implicit in our activity so far is that M1 is getting relatively less emphasis; that does not mean no emphasis. I suppose we remain someplace in that vague area. That is what I am proposing. I see no strong need to change it [unintelligible] being consistent with that emphasis before the next meeting if you want. Maybe we can just leave it at that--that we don't change anything--unless there's some strong feeling otherwise. People are going to look at M1 and we're going to look at it, but it doesn't get the same mechanical emphasis that it had 6 months or 9 months ago or whenever it was.

MR. RICE. I don't think we ought to make any commitments to look at it even next time.

CHAIRMAN VOLCKER. Well, we will look at it automatically next time. And we don't need--

MR. RICE. I know it's the midyear review, but--

CHAIRMAN VOLCKER. I don't mean we'd necessarily change it.

MR. RICE. But I don't think we need to look at it with a [predisposition] toward changing it at this time.

MR. PARTEE. The comment has to do with both the range and the weight.

MR. MARTIN. We may not--

MR. PARTEE. That is, there is no need to change the range right now and no need for a [predisposition] to change the weight. That's what you're saying. That seems to be the staff's view.

MR. AXILROD. Yes. We have not seen any return to normal historical patterns yet, which is one of the Committee's criteria for giving it more weight.

MR. RICE. We're not likely to have any additional information on which to base a change.

CHAIRMAN VOLCKER. Well, I don't know. It will have to be judged at the next meeting.

MR. RICE. It's hard to [imagine] what new we could know about M1 between now and then.

MR. BALLES. I don't really disagree with what has just been said, Paul, but I am a little concerned--and I'd like to hear your view--about what the market's reaction is going to be if we in fact come in this month with a 24 percent increase in M1, as the Bluebook suggests. We're going to have a hard time convincing markets that we're not off to the races and an overexpansion of money. I think, Paul, that we will have to do something more than just sit.

CHAIRMAN VOLCKER. Oh, I'm not prejudging what our short-run decision will be. All I'm saying is that M1 does have the same weight that it had before and that we not bother to change the range now. It doesn't mean no weight. We have to decide that after the coffee break. If there is no strong objection to that, maybe we can just go along and [hear Mr. Axilrod's comments regarding our] immediate decision and then we'll have the coffee break.

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

CHAIRMAN VOLCKER. I don't know about the wording in the directive; we can worry about that later. I would only add one comment, for what it's worth. We had illustrated for us here the other day by some staff something that has been going on for some time. With the exception of Japan, the experience in almost all leading foreign countries looks like ours: rapid growth in M1 for the last 6 or 9 months, particularly rapid growth in currency for some reason or another, and relatively slow growth in broader aggregates. It's very strange. You could almost lay these sheets of paper on top of each other. Of course, other countries have had a different kind of business picture; it vaguely resembles ours, but they don't have a strong recovery.

MR. FORD. These are countries that aren't having all this deregulation business. So it's--

CHAIRMAN VOLCKER. Well, some of that is going on elsewhere too, but I don't think at the rate of speed it's going on around here.

MR. TRUMAN. That's primarily only in Canada.

CHAIRMAN VOLCKER. It's a very strange picture. They all look alike, although the figures aren't exactly alike.

VICE CHAIRMAN SOLOMON. Do you have a guess as to why?

CHAIRMAN VOLCKER. I guess any speculation one makes about the United States can be pushed off on M2, the disinflation process, relatively higher real interest rates--

MR. FORD. What do you make of it? I infer from what you've said that except in Canada it's not due to deregulation, so that would mean that the staffs of other central banks can't be telling them what ours is telling us about it all being due to shifts and stock adjustments, etc.

MR. PARTEE. The staff doesn't say that with regard to M1. And M1 growth in Germany is 14.7 percent; in Switzerland it's 14.9 percent; and in the United Kingdom it's 12-1/2 percent.

MR. FORD. Yes, but my question is: How are they explaining it? We're explaining it away as shifts in demand.

CHAIRMAN VOLCKER. I can only say what [unintelligible] for the future. If we don't have a great explosion of inflation in the next year around the world, the monetarists had better run for cover. If we do,--

MR. ROBERTS. If we do, there will be other people then heading for cover.

MR. PARTEE. At least nominal GNP ought to go up very sharply around the world.

VICE CHAIRMAN SOLOMON. But there has been a substantial amount of intervention by central banks.

CHAIRMAN VOLCKER. The Germans--

VICE CHAIRMAN SOLOMON. The Germans, EMS countries. And that does tend, depending on how they--usually they don't sterilize--[unintelligible].

CHAIRMAN VOLCKER. Well, the Germans think that that's part of the reason, but I'm not sure you can explain it that way in Canada or the United Kingdom or Switzerland. I don't know whether we have the low countries in here.

MR. AXILROD. One thought we had in reference to President Ford's question was that as you get into a noninflationary period or you become convinced that inflation is down, cash in some sense becomes more valuable. It's not going to lose its value as fast. And in any event, interest rates come down and the opportunity cost of holding it [declines]. And that would affect M1. On the broader aggregates, what I was trying to say here--and it may hold in Europe, though I haven't examined it closely--is that we could also begin to see people moving into longer-term assets before their rates drop too rapidly.

CHAIRMAN VOLCKER. One of the really curious things about this to me is why currency is going up around the world. That one little component has had a very strange experience here and [abroad].

VICE CHAIRMAN SOLOMON. There's more anxiety.

CHAIRMAN VOLCKER. Well, currency could be explained partly by anxiety about banks.

VICE CHAIRMAN SOLOMON. Steve, isn't the interest return on M1-type accounts in most European countries still very low?

MR. AXILROD. Oh yes.

VICE CHAIRMAN SOLOMON. They haven't changed the way we have.

MR. AXILROD. I'm not sure, but I think that's right.

MR. TRUMAN. Only in the United Kingdom is there an interest return on M1. The other countries don't have that.

MR. AXILROD. Ours is 5 percent or 5-1/4 percent on NOW accounts. I was not assuming Super NOWs as a very important factor.

CHAIRMAN VOLCKER. Well, let's have a break.

[Coffee break]

MR. ROBERTS. [Unintelligible] discussion, I have a feeling that it is time to do something about the excessive rate of growth in M1, which I happen to feel is still an important measure of what is happening in the economy. I believe, based on the contacts I have in the marketplace, which I am sure are not as extensive as others, that the market is quite conscious and sensitive to this excessive rate of expansion. As I look at the situation, we have M2 conveniently within a band only because we conveniently redefined the base. It might be interesting to redefine the base for M1 and thereby get it in the band and growing at about a moderate pace from here on out. That probably would be appropriate in view of the strength of this economy that we all have commented on. I just think that if we have to face some modest adjustment here in interest rates, we ought to face up to it earlier rather than later. We have an economy that is walking along very well through the so-called real interest rates that are believed to be too high; I don't think that some modest adjustment here would be bad. And if it begins to contain some of the excessive rate of expansion in M1, I think that probably would be productive as we look ahead for either holding the interest rates in the long term or leading us to some reduction, as against having to face up to this a few months later after short-term interest rates have already gone up with the rise in the private sector and long-term rates have gone up perhaps because of changes in inflationary expectations.

CHAIRMAN VOLCKER. Let me make one preliminary comment and then ask you a question relative to others. I don't think these numbers on page 8 [in the Bluebook] mean a great deal, except as a forecast, in terms of the operative decision as to what we are going to do in open market operations. It is now May 24th. Whatever numbers come out, growth is pretty much in the bag now for May and June. I think we ought to keep that in mind so that we don't put undue emphasis on a number a half percentage point higher or lower than another number used.

MR. ROBERTS. June is projected at a very low rate; it may not be in the bag.

CHAIRMAN VOLCKER. I don't mean that we know what it is. I just mean it is going to be what it is.

MR. ROBERTS. We can't change it at this point. Yes.

CHAIRMAN VOLCKER. I don't mean at all that we know what it is. I know that the staff has projected a low number in June. And I would just remind you, looking at the quarterly figures, that what we set forth the last time, reading down, was 9, 8, and 6 to 7 percent. We're below for M2 and M3 [and above for] M1. Credit, as near as we know is running around 9-1/2 percent; we didn't have a quarterly target for it but it's within the annual target as nearly as we know anything about credit. Now, having said that, do you want to quantify your comment in whatever way you want to quantify it? As I say, I don't attach much significance to a half percentage point difference in these numbers, but are you talking about some borrowing level or--

MR. ROBERTS. I would like to see us raise the borrowing level from $250 million to something like $500 to $750 million, if that would be the amount that would curtail the rate of growth in bank reserves that's accommodating this big expansion in M1. And if that raised the fed funds rate to 9 percent, I don't think that would be anything that would prevent this economy from continuing to expand at a sustainable pace.

CHAIRMAN VOLCKER. Just to inject a quick comment, I think that probably would raise the federal funds rate just above 9 percent. At what point would you be happy, if I now ask you to quantify it the other way? If [growth] got below that in alternative C, would you not go that strongly?

MR. ROBERTS. Alternative C is about right, as I see it. I am thinking in terms of about 6 or 7 percent incremental money growth from this point forward.

CHAIRMAN VOLCKER. I'll make one other comment and then I'll go to Mr. Morris. I am not sure that it is quite right to say we redefined the M2 base. Obviously, we did in a technical sense but I think that it's largely an element of judgment. If you put in the January-February base for M2, with the kind of adjustments that the staff took a stab at, you wouldn't get a much different trend for M2 during January and February than you got in the surrounding periods.

MR. AXILROD. It would be a little higher if you went from the fourth quarter. It would really be within a 6 to 9 percent range; I think it is somewhere around 8 or 8-1/2 percent. If you went from QIV to May making those adjustments [rather than from] January-February, it would be a bit higher.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, you may not find it surprising that Mr. Roberts and I differ rather dramatically.

CHAIRMAN VOLCKER. We're establishing the outer limits!

MR. MORRIS. I think the staff paper on the behavior of M1 was very good in that it pointed out that not only is the velocity of

M1 not currently predictable but we have no basis for assuming that it will be predictable in the foreseeable future, because we have had a changed concept--one which blends transactions balances with savings balances in unknown proportions. And I think our current posture of telling the market that we are not targeting M1 but are watching it is creating instability in the marketplace, which is counterproductive to our objectives. I think we have seen responses in the marketplace to M1 numbers which, while they are not of the magnitude of earlier years, are certainly not very productive. And it seems to me that the time has come to tell the market that, at least for the foreseeable future, we don't have any basis for confidence that we can predict the velocity of M1 and, therefore, we are abandoning M1 and are not going to watch it. We will publish it weekly for historical interest only. It seems to me that the time is right. I thought it was right in February to get rid of M1 but it seems to me that the evidence since February should lend some weight to my case that we ought to start moving away from consideration of M1 as a target or as something that we watch--whatever that means.

CHAIRMAN VOLCKER. Well, we have a difference of opinion. You say it's high, so abandon it; other people say it's high, so we better give it some weight. What would you do operationally?

MR. MORRIS. Operationally, we have target ranges for M2 and M3 and we can operate on those.

CHAIRMAN VOLCKER. What would you do on borrowings?

MR. MORRIS. At the last meeting I didn't have any confidence that the current level of interest rates would support a broad-based expansion but I think the evidence of the last month or so is that, at least for the time being, we can produce an expansion at the current rates. I would design the instructions to the Manager to say maintain the current level of interest rates. And if the $250 million borrowing level is what the staff says [would do that], I would accept that.

CHAIRMAN VOLCKER. Mr. Wallich.

MR. WALLICH. I think we have to distinguish between giving different weights to the different aggregates and watching them. If we give different weights, we say that each of them is potentially misleading. So we give more weight at the present time to M2 and M3, put a little weight on M1 and, therefore, are saying that we are not going to trust M2 and M3 and the debt variable fully either. They are all slightly wrong and the most likely right number seems to lie somewhere in the weighted average. This doesn't seem to me a very logical procedure when you have specific reasons to distrust one of the aggregates such as we have, I think, to distrust M1. There are reasons why people will hold more of their money [in M1], whether in demand deposits and currency or even in NOW accounts, than they would at much higher rates of interest and higher rates of inflation. And I would be willing, while watching M1 and not ignoring it, nevertheless not to give it any weight.

CHAIRMAN VOLCKER. That's a semantic distinction.

MR. WALLICH. No. I think the time may come when the argument that now leads to ignoring M1 loses some of its strength; and then if M1 still continues strong, one would have to say one had made a mistake and that there was something to it. But at the present time I think that the more reasonable argument is that there is something amiss with M1 and that therefore, while watching it, one is not acting on its signals. The strongest reason for proceeding that way, it seems to me, is the high level of real interest rates. If M1 were effective in the usual way of generating expansion, it would be by driving down interest rates. It hasn't done so. So I conclude that the usual transmission mechanism from M1 to aggregate demand somehow is not operative at this time. There is a further very minor point to be made on that same side. The divisia aggregates, which compute money on the basis of the moneyness of the aggregates rather than just adding up demand deposits and savings deposits and calling it all money, in the last few months universally seem to have shown a lower rate of growth than the unadjusted regular aggregates. I have no particular faith in this technique, but it is an interesting device in that, since it seems to support what I think reasonable for other reasons, it is something worth factoring into this.

CHAIRMAN VOLCKER. What would you do operationally?

MR. WALLICH. At the present time I would follow Bill Poole's old rule that when the aggregates are not very clear follow interest rates. That rule, of course, leaves open the question of which interest rate--the one that happens to prevail or a different one. At the present time I wouldn't change interest rates, so I would go with the same borrowing assumption.

CHAIRMAN VOLCKER. Ms. Horn.

MS. HORN. I want to start with M2. M2 is growing quite in line with a number of our expectations and with my expectations, and if it is growing a bit slowly, I think that has to do with the precautionary components [unintelligible]. So the signal that I read from M2 is a fairly good one for staying on the current course. However, I do read M1, although I can't explain why it is doing what it is, as giving a signal. [It influences] the direction of my uncertainties in dealing with policy matters so, because of the signal we might be getting from M1, I would like to see a little tightening up from the current position. I suppose, although I am not willing to argue over $50 million, that takes me from $250 to $300 million [on borrowing]. But the point I want to make is more that that is the direction in which I think we should be erring because of what M1 might be telling us.

CHAIRMAN VOLCKER. Mr. Gramley.

MR. GRAMLEY. Well, I come out somewhere near Karen, although I start at a different place. I don't know what in heaven's name to make of these money supply numbers. I have read the staff document with great interest and I think it does point out an important reason why we have had so much growth in M1 here--that is, we have a much higher interest elasticity of [money] demand, almost twice as high as the model suggested for the period 1959 to 1974. So, I assume from that that we aren't anywhere near as expansive as the 9, 10, or 11 percent growth rates in M1 would indicate over the past year or so.

But I don't know how much expansion we have had on the basis of the money numbers, so I tend to retreat to basics under uncertainty of this kind. I start with the proposition that if I could shape the recovery in any way that I would want to, I would like to have economic growth come out just the way the staff thinks it's going to, at somewhere between 4 and 5 percent both this year and next. If we get that, we will have improvement on the employment front, we will reduce excess capacity, we will get an investment process started but we will have, I think, continuing progress on inflation. My worry is that we are going to get more than that for reasons I have already indicated. And I add one more factor, and that is that I think fiscal policy is much more likely to be more stimulative than we are now talking about rather than less. I think we are not going to get a budget resolution; we are going to end up with lots of appropriation bills and they are not going to be easy to veto. But I am in a horrible dilemma, in terms of deciding what we ought to do as regards policy. I think that the international debt situation argues very, very strongly for not letting interest rates rise. Unfortunately, that international debt situation is still going to be here a year from now. And so, if I am right and at some point down the line we will need to think about raising interest rates, I guess it would be easier to raise them a little now, rather than to let the internal dynamics of the cycle begin to take hold and then raise them a lot more later. So, in terms of operational procedures for the moment, I would be inclined to argue for something like "B minus"--I think "C" is much too tight--with initial borrowings at maybe $350 to $400 million or somewhere around there. I don't care whether the federal funds rate range is 6 to 10 percent or 7 to 11 percent. And I would continue to use M2 as our principal target.

CHAIRMAN VOLCKER. Governor Teeters.

MS. TEETERS. I would tend to go along with $250 million in borrowings, which presumably would keep the interest rate where it is. I have many of the [worries] that have been expressed, particularly in the international scene. And I don't think we can get a sustained recovery with 8-1/2 percent rates of interest and 10-1/2 per cent in long-term rates. I think rates should be lowered in order to sustain the recovery; I can stay where we are at least until July, but my presumption is that sometime over the next several months we are going to have to lower the rates in order to keep the economy going. The other thing that I think is probably going to happen is that with the reduction in the first-quarter GNP we are going to have a quarter--probably the second or third, as Chuck said--in which the inventories will go in the other direction, and we could get a very strong one-quarter [expansion]. If that happens, I hope that we won't panic and then raise the rates in order to offset something which is a perfectly natural development. If anything, I would like to see the borrowings around $200 million rather than $250 million.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, to give my conclusions first, I would lean toward snugging up a bit now. I also think that we are going to have a couple of good quarters in GNP; the dynamics are such that I don't know what might come from that in terms of later on and, therefore, I think a little precautionary snugging would be in order. I would also point out that M1 is very much a fact, whether we want to look at it or not. The only way that we can really deal with this would be to stop publishing M1--suppress the numbers on the basis that M1 has no information content--and I don't think anybody would propose doing that. It is something that people look at. I am also impressed by this world-wide increase in M1 that has occurred over the last six months and it may be telling us something after all, as M1 was telling us something three or four months ago about a recovery that was stronger than almost anybody expected. Now, it didn't come in anything like as strong as normal relationships would have predicted, but in fact the economy acted more like M1 would have suggested than most judgmental forecasters would have expected three, four, or five months ago. And this may be now a world-wide event.

I also have a problem because I don't trust any of the other aggregates. M2, I think, is very much affected by the IRA/Keogh accounts, which are a direct substitution in the short run for tax-exempt savings balances. M3 reflects the pattern of demand on the markets, and I think it is a simple reflection of the fact that corporations are trying to do some restructuring. I have always been more comfortable with total credit but what I am not comfortable with about total credit is our estimates. Just a couple of months ago we were told that, by golly, total credit is running very low--well below the lower end of our range. Now, somehow, in the last six weeks, we learn that no it isn't; it is 9-1/2 percent, which is up in the range. And by the time we get another iteration of that, when the July national income numbers come out, we may find that it is at the top of the range. It is a very unstable figure from the standpoint of estimation even though it is a pretty stable figure from the point of view of its relationship to the economy. So, I don't think we can disregard M1 and I don't think we can disregard the fact that the economy seems to be pretty strong under foot. Therefore, I would snug up without changing operating procedures--which I think is what Ted Roberts was really proposing in taking M1 [into account] as a driver on providing reserves again. I'd snug up to maybe $300 million [on borrowings] and try to come in on the low side of alternative B on the aggregates.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. I would keep the borrowing level at $250 million, for what it is worth. It isn't worth very much, obviously. I would use the M2 and M3 targets under alternative A; in fact, if I had my druthers, I would round them on the up side and make them 8 and 7 percent. We have a strange situation where we are running short of our March-to-June targets by about 2 points and we have not been offered an alternative that comes closer to returning to the original targets. For March to June we had put M2 and M3 at 9 and 8 percent, [respectively].

CHAIRMAN VOLCKER. They're running lower.

VICE CHAIRMAN SOLOMON. I can't [bring] myself to pay that much attention to M1, as I believe some of you do, when I contrast that monetary aggregate, whose meaning we all seem to agree we don't understand these days, with the reality of the international situation that we're living with. I think it's just sheer irresponsibility on our part [to use] crystal ball wizardry to have our decision influenced so significantly by what is happening to this famous M1. I come out quite clearly for no tightening, no snugging up, and staying where we are in terms of borrowing levels. I do not see any evidence yet that a boom is going to materialize where we would have to say: Well, it's a question either of tightening now or tightening three or six months from now. I don't see that the choice is between them.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. I think we are getting ahead of ourselves on the case for snugging up. It just seems to me that that is entirely too premature. The only real argument for doing it is what we are seeing for M1 and that does seem to me an awfully thin reed on which to base snugging up. Our sentiments have changed about the economy. It does look better than six weeks ago, but there is considerable room for it to look better without our worrying that we have a boom. We still have lots of unused capacity even if one allows for all the structural problems; we are still in the very early phases of the recovery. It is broader-based, but I don't see any evidence that it is running away from us in any way that is going to prove to be a problem. Add to that the international situation, which I think if anything argues for lower rates. Even though there may be a case down the road where we would have to raise rates for domestic reasons, it seems to me that we would want to be pressed to do that rather than anticipate it. If we look at the various measures of monetary policy that we have--real interest rates, M2, M3, and credit--and add all those up, everything is on the side it seems to me for at least staying where we are. The only thing that is on the other side, for snugging up, is M1 and that just isn't much to base it on. So, I come down for staying where we are. Operationally, I would keep borrowings at about $250 million; I would carry forward in about the way that we have been conducting policy in the last several weeks.

CHAIRMAN VOLCKER. A comment on the case for snugging up: It probably is [unintelligible] rest on M1 alone. Mr. Corrigan.

MR. CORRIGAN. Mr. Chairman, I started out where a lot of people are. Internationally, the case is overwhelming that we would be better off with lower interest rates and a lower exchange rate. But looking at this domestically, I must say that I do get some sense that there may well be a case for some snugging up or whatever you want to call it. I would lean in that direction not because of M1 as much as I would because of the economy. I do think that the risks are on the side of the economy being stronger rather than weaker than the staff's forecast. And I am very much inclined to the view that a more moderate and balanced recovery right now works in the direction of making that recovery more durable and more sustainable, partly because I do think it works in the direction of minimizing the risks that some of those pent up pressures on prices, that I at least sense are there, could be unleashed. In some very practical ways the question that we face right now is: If we do snug up a bit, does that assist in [achieving] our longer-range objectives for the economy? In part I try to answer that by asking myself the question: What will happen to bond rates if we do snug up a little, recognizing that they have already increased 50 basis points in the last two weeks? On the other hand, what would happen to bond rates if we didn't do anything? In some ways I think that is the $64 question. My instinct is that in the current circumstances a gentle move in the direction of snugging might well produce the result of helping to stabilize long-term interest rates; and we have had experience in the past to suggest that some increase in short-term interest rates early on in a business recovery can be reversed. I think that happened in the mid-1970s in a way that did not inhibit the early phases of recovery. So, I would come out in the direction of, say, putting borrowings around $400 million in the expectation that the federal funds rate might move up toward the 9 percent range--again, not because I'm paranoid about M1 but because of the way I'm looking at the economy and the way that over time I think that might help us rather than hurt us in terms of our long-term objectives for the economy.

MR. KEEHN. I would be in substantial agreement with what Jerry has said. It seems to me the last time we established the directive based on a reasonably uncertain economic environment--though the news looked good at the time--and since then it certainly has gotten a lot better. I think we now have a reasonably broad-based economic recovery in place, with certain cautions, and on top of that we have a highly stimulative fiscal policy that's going to get more stimulative as the year goes along. Certainly that will be the case next year as we get closer to the election. And though all the papers I've read support the thought that M1 has changed, nonetheless, nothing persuades me that it is no longer useful in any way. I think we have to begin to establish a framework in which we are focusing slightly more attention on that. I'd be in favor of some modest snugging up, and alternative B or B+ in terms of the percentages would be reasonable. But I would be inclined to establish a borrowing level of, say, $400-$450 million as a way of establishing a higher level of focus on it and beginning to snug up a bit.

MR. GUFFEY. Mr. Chairman, I take alternative B with a $250 million borrowing level as being maintenance of the current conditions. And although I recognize the concern of some about M1, it seems clear, at least to me, that the informational content of M1 gives very little guidance for policy in the period ahead. That does not suggest that I want to join Frank Morris to bury M1; rather, I think it will become an important guide sometime in the future, but certainly not between now and July. Having said that, I still have a concern about the sustainability of this recovery over the long haul and I think the international situation suggests somewhat lower interest rates. Neither of those [considerations] seems to me to be persuasive enough to ease in the period ahead. Thus, I come out with a $250 million borrowing level from now until July and I hope that we get some more good news that we can react to in July. I'd like to say that I have some real questions about what kind of directive we may adopt, but I guess that's for later in this discussion.

MR. RICE. Just operationally, Mr. Chairman, I agree with everything that Roger just said. I would support alternative B and a borrowing level of $250 million, and I take that to be consistent with maintaining the situation substantially as it is at the present. I would not want to take any action that would have the effect of raising interest rates at the present time. I think it's too early to start pushing up interest rates.

MR. BALLES. I think the case for a touch of snugging up has been pretty well set forth here already by, among others, Chuck and Jerry. And I won't take the time to repeat those arguments. I do fear that if we let this upswing in the economy get too far ahead of us in terms of regenerating inflationary pressures or expectations, we will live to regret it. I don't think we've ever made mistakes, or many mistakes at least, in the past by being too easy during recessions. I think our mistake historically has been to hang on to ease too long after the upturn is underway. I would be concerned about just plain market reactions to the announcement of a 24 percent increase in M1 in May; I think we might get a bigger case of bond yields rising than we did after that little flurry following last Friday's announcement. We may not think that there is much content in M1 but I'm afraid the market may not be as convinced as we are. That's one of the psychological problems we're dealing with. And for those who are hasty to condemn M1 as having no informational content, I would raise the same question about M2. It too is a different animal than we used to have and we'd be ill advised to forget that. Coming down to the bottom line, my snugging would be defined in terms of perhaps a borrowing assumption of $300 to $350 million, just leaning a bit in the direction of "B minus" but certainly doing nothing very drastic.

MR. FORD. I'm with the group that wants to snug moderately for one reason: I'll confess to paranoia about M1, especially when it's happening on a global scale and in countries which don't have the institutional problems that we have to explain it away. I do think the worldwide expansion of money as conventionally measured is of enough significance to warrant conservative action on the part of our central bank. With regard to the timing, I think we have to remember the lags related to what we do now. If we wait until we can see the real economy exploding in front of us, then we're doing what we always do--we're too late. What we do today basically affects what will happen in the economy one year into the recovery. And that's why we should do it now, not later. So, I'm for a slight snugging, with perhaps a borrowing requirement of somewhere around $400 million--enough to let short-term rates go up to give a signal to the market that we are not going to ignore completely all of what is going on in the monetary area and in the real economy.

MR. MARTIN. I would join those who would oppose abandoning M1. I don't believe the market makers will abandon that measure. I don't think they'll take it off the tape in their offices because we say we are abandoning it. Even it they were convinced we were abandoning it, they may not abandon it. Some Wall Street types think they are a good deal smarter than we are anyway. I don't think the commentators will abandon discussion [of M1] in the media. Once a newspaper reporter learns something--and they only learn a very limited number of somethings--he or she will continue to work that story or alleged story of what will be seen as a conflict between the monetarists' analysis of markets and whatever analysis prevailed within these walls. I myself feel we should give M1 some weight aside from the media considerations. When it varies as much as it is now, I don't think we can ignore it; a 24 percent growth rate in May is pretty hard to ignore.

One comment I would like to make with regard to the recovery: I am just as encouraged as anyone else. I am a natural born optimist, but I did pick up on Jerry's comment that we are talking about a percentage increase and we started at a very low level. Those bankruptcies that occurred in the recession--the four-year recession or whatever it is being called--are rather permanent removals from the business population. If we seem to be forthcoming with regard to recognizing that a sustainable recovery requires lower long-term rates and we continue to express our view with regard to irresponsible fiscal policy, it seems to me that we can make a reasonable case for actions in the direction of less accommodation now, if these are modest moves. The kind of move I would support is perhaps raising borrowings to a $350 million level; I am a "B minus" type here. If we indicate that we recognize that long-term rates may be positively affected thereby, if we admit our awareness that autos, housing, and consumer credit are all vulnerable to high rates, knowing that consumer credit rates have been so sticky in coming down, and if we couple that with public statements that our longer-run goal is to avoid overcreating credit or money, however measured, at this time, it seems to me that a modest move in this direction might be salutary in terms of long-term rates and in terms of our credibility out there in the market.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Mr. Chairman, I came to the meeting pretty well convinced that the policy should be steady as it goes. I will have to confess that I have had a change in attitude in listening to the debate. I think those who are arguing for some snugging or some leaning against what is happening probably make sense. And having come some distance, I would continue on that line and I would argue for about $400 million on the borrowing assumption rather than $300 million.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I deliberately waited until Bob Boykin had spoken before I made a statement, because not very long ago he made a glowing compliment about my statement by saying he would have agreed with it all until he heard you speak. And that sort of wiped me out, so I thought I would wait this time! I suppose it won't come as a real surprise to anyone that I think we ought to continue to give greater emphasis to M1. One of the reasons we abandoned M1 is that we felt MMDAs and Super NOW accounts would affect M1; I think that was proper. But the growth rate has fallen off pretty sharply in recent weeks and the original reason for shifting away from M1 to M2 seems to me to have largely dissipated. There remains the argument that the demand for M1 balances may have increased because the OCDs introduced an element of elasticity in the demand and also an element of savings. I think there is some substance to that, but we are not really going to know the answer to that for many, many months down the road. And there's a risk that it might not have changed that significantly. In view of that, I think we have to weigh the risks in deciding what policy ought to do. To me there is some risk that if we do not move somewhat now, we may have some unwinding of this good effect we have had on inflation. And I would be particularly concerned about the adverse effect on long-term debt markets. So, I would favor going back to the old procedure, of course, where we adjusted our borrowing target automatically as M1 varied off the target. But I know we are not going to get that. I would next fall back to "C," which I also know we are not going to get. So, if I were voting, I guess you all would probably push me up to maybe "B minus." But I definitely think we ought to make some move now.

CHAIRMAN VOLCKER. Well, we obviously have a difference of opinion, but for the most part the difference of opinion is not numerically huge. I am impressed, domestically, by the actual and potential strength [of the economy]. It's moving pretty fast now, with inventory still negative in the last figures; I don't know whether they were negative in April or May, but we've had a lot of inventory liquidation and some increase in final demand. We'll get a shift in inventories at some point and consumers are very confident, if one believes these surveys at all. Ordinarily, I don't give them much weight, but they surely are going through the roof right now with a tax cut of some size coming up in thirty-six or thirty-seven days.

The conflict is quite clear in all the comments people have made. I don't think there's much question about the short-term outlook, which I take to be six months or so, for the economy. There's a question of its sustainability or certainly its balance. There are questions about investments and questions about exports, which are very real. And I think that's partly a reflection of the budgetary problem. We have a straight-out conflict between the domestic and international considerations. I don't know that we could have much more of a pronounced conflict there. That is clearly fed by the budgetary situation. We cannot control the budgetary situation; therefore, we have no satisfactory policy by monetary policy alone. We have problems in the credit structure that have been mentioned and would be eased by easier money, but that also creates a conflict. I am left with no answer in monetary policy except a compromise in an unsatisfactory situation. I am not so bothered by this M1; whether we count it or not, I think we weigh it a little--more than a little. I don't ignore it myself; I don't know that I'm pulled by it. But when the movement gets large enough, I don't see how we can totally ignore it. It lends a little weight to whatever decision we make.

I come out on the side of a little snugging up, which we should be prepared to reverse if things come out satisfactorily in terms of the aggregates or if there are any real signs that it is intolerably--that is a strong word--or even less than intolerably aggravating the international situation, or the business situation looks as if it has much less momentum than it appears to have at the moment. I don't know how to quantify that. But if we do anything, we have to go to $350 million, I suppose; we've practically been there recently by accident and $250 million is rather a minimal level of borrowing. I think all we are talking about is putting some very marginal pressure on the market. How the markets will react, I don't know. The danger is that they will overreact. Rather, that is a danger but there's a danger in the other direction, as Mr. Corrigan mentioned. I would suggest that we just compromise somehow.

MR. PARTEE. Peter, what kind of funds rate do you expect to be associated with a persistent $350 million of borrowing--if the borrowings were put up to $350 million and kept there rather than just accidentally being there?

MR. STERNLIGHT. Well, as you said, we've been there but to be aiming at it [is a distinction]. Whereas I felt aiming at $250 million was associated with funds of 8-1/2 to 8-3/4 percent, I'd expect to see funds trading more toward the 8-3/4 percent side and maybe edging above that on occasion.

MR. RICE. Funds have been up to 9 percent. I don't know if you directly associate it with--

CHAIRMAN VOLCKER. They were only up to 9 per cent, I think, during the statement period.

MR. STERNLIGHT. Well, for a weekly average, it only got up there in the week in early April when there were those special end-of-quarter pressures. Other than that, I think the highest it recently reached was 8.80 percent.

MR. RICE. And that was associated with the temporary movement to $350 million?

CHAIRMAN VOLCKER. I think the borrowing was all fouled up there; it was much higher, wasn't it? We had the statement date and the aftermath of the statement date.

MR. AXILROD. The funds rate/borrowing relationships have been quite variable. One week in late April we had borrowing of $678 million and the funds rate averaging 8.58 percent; the next week we had lower borrowing, of $435 million, and the funds rate was averaging 8.80 percent. And then last week we had $550 million borrowing and a funds rate averaging 8.59 percent.

CHAIRMAN VOLCKER. I didn't realize the borrowing levels had been quite that high.

MR. RICE. It doesn't help to snug up.

MR. AXILROD. Well, there have been lower weeks of borrowing. To make it a complete story, Mr. Chairman, we had $232 million of borrowing with a funds rate of 8-3/4 percent and $252 million with funds at 8.70 percent.

CHAIRMAN VOLCKER. A perfect inverse correlation!

MS. TEETERS. What interest rate are you aiming for? If you snug up, where do you want the rate to go?

MR. MARTIN. Maximum 9-1/2 percent.

MS. TEETERS. That's too much.

CHAIRMAN VOLCKER. I think it would be unlikely to go that high and stay that high with the kind of borrowing we're talking about. I wouldn't say it wouldn't touch there on occasion but I think we're talking more 8-3/4 to 9 percent. But I don't have any particular objective in mind. I don't want to shock the market.

MR. GUFFEY. Mr. Chairman, I would object to a directive that would get the funds rate in the 9 percent range. I'd go to 8-3/4 percent maybe--ranging above and below 8-3/4 percent. That's a pretty small range, obviously. But when it touches 9 percent, there is some magic to it, it seems to me, particularly if it touches 9 percent and remains there for any period of time.

MR. FORD. Yes, the market might understand what you're trying to do if it got to 9 percent! Seriously, isn't it slicing the bologna a little thin to say we're going to snug up 1/4 percentage point or less than 1/4 point if we average it?

MR. GUFFEY. There was a time when we used to do it in 1/8 point [increments], Bill, as you may remember.

VICE CHAIRMAN SOLOMON. I think there's going to be a strong market reaction if the fed funds rate gets to 9 percent. The prime rate would definitely go up. There will be loud cries from abroad.

CHAIRMAN VOLCKER. I'm not so sure the prime rate would go up with a funds rate of 9 percent.

MR. ROBERTS. The prime rate may be going up anyway.

MR. PARTEE. Well, I don't know that Wachovia--

SEVERAL. [Unintelligible.]

MR. BLACK. It was a half point lower?

MS. TEETERS. I thought the $250 million was associated with 8-3/4 percent. You're definitely pushing it over 8-3/4 percent, it seems to me.

MR. FORD. You're back to adjusting by eighths, Mr. Volcker.

CHAIRMAN VOLCKER. I don't know exactly what it will be. Mr. Axilrod just gave you a swing of one half percentage point, which seemed to be inversely correlated with the level of borrowing.

MR. AXILROD. Well, borrowing in the week to date is averaging $350 million and funds are trading at 8-5/8 to 8-3/4 percent generally. Who knows? The relationship to borrowings has been quite variable, so I don't think one can really be extremely precise.

VICE CHAIRMAN SOLOMON. Even though the numbers are small, we should not ignore the fact that there will be significant reaction, I think, in the dollar exchange market. There may or may not be some reaction in the bond or stock markets; I don't know about those. One can't be 100 percent certain, but the probabilities are that the prime rate would go up if the funds rate is moved up as much as half a point, and it just seems to me that we're going much too far.

MR. BOEHNE. What are the expectations in the markets about what the Committee is going to do, Peter--snug up or stay the same?

MR. STERNLIGHT. Well, I think they're debating that very point with probably a majority thinking no change. But there would be some who would expect some snugging.

MR. RICE. The market seems to be expecting no change at all. I think Tony put his finger on the main risk. When the market senses that we are snugging up, they will help us; they will conclude that that is what we want and will add impetus to it. We're going to get an upward bias, which I think is the wrong thing at the present time.

CHAIRMAN VOLCKER. I don't think one can say the market expects no change. A straightforward reading of the market says they already anticipate it.

MR. ROBERTS. And with respect to the exchange rate, it has been going up while rates have been going down.

MR. RICE. Henry Kaufman put out the word: No change.

MR. BOEHNE. I would think that a prime rate increase that could be linked, rightly or wrongly, with a snugging up by the Fed would have a definite detrimental effect on these expectations of good things to happen. I think things are sort of at an even keel and if business and mortgage markets thought that the low rates were over and that rates not only were not going to stay about where they are but were going to back up, that would have a major negative impact on psychology.

MR. ROBERTS. It doesn't follow that the prime would automatically go up, though, because there has been a big swing away from negotiable CDs to money market deposit accounts as a source of money. The spread can change between the funds rate or the CD rate and the prime and in the meantime business loan demand is very soft.

CHAIRMAN VOLCKER. Where is the CD rate this morning?

MR. AXILROD. It was at 8.80 percent yesterday. It's on this sheet; I'll give it to you in a second. It's 8-3/4 percent, roughly.

MR. ROBERTS. Is that 9ish reserve adjusted?

MR. AXILROD. Yes.

MR. ROBERTS. So, it's [a spread of] 150 basis points. That's not uncommon.

MR. AXILROD. Mr. Chairman, as a technical comment on market reaction--and, of course, no one can assess market reaction with any precision--if $350 million were where the Committee wanted to put borrowing, I'm not sure that would be noticeable at all in the market. We've been running very close to it. We hit it exactly. The free reserves number that's implied after you take out seasonal borrowing, which the markets tend to do, is slightly positive. [Unintelligible.] The odds on missing it on the high side are somewhat lower than when we're working with a minimal number because with a minimal number it's hard to get below it and it's easier when we miss to be on the high side because banks' borrowing tends to be higher. So, technically, I'm not sure with $350 million that hardly anything would be noticed.

MR. GUFFEY. Then what's the point in doing it?

MR. CORRIGAN. That's why we should go to $400 million.

CHAIRMAN VOLCKER. I doubt that we ought to be easing right in the face of all this.

MR. MORRIS. Well, the real issue is what level of the funds rate we should be shooting for.

SPEAKER(?). Sure.

MR. MORRIS. Given the instability in the relationship between the funds rate and borrowing, that's the issue. That's where the action is going to come from in the marketplace.

MR. GUFFEY. I'd certainly hate to go to Williamsburg after snugging up!

MR. GRAMLEY. They didn't invite you!

MR. FORD. You don't have to go!

MR. BALLES. I don't know, but there might be some who would view this snugging up as a way of either heading off further increases in long-term rates or helping to bring them down. That has to be the key thing. Let's not kid ourselves that the funds rate is going to make or break the economy. What's going to make it or break it is the trend of long-term rates.

MR. ROBERTS. Which are going up now.

SPEAKER(?). It depends on what you think--

MR. BALLES. That affects foreign borrowing--the whole business.

VICE CHAIRMAN SOLOMON. We're going to be perceived as going against the consensus view of all the governments, including our own, to encourage a worldwide recovery, because people judge that the inflationary problem is considerably reduced--that there's no immediate prospect for that in the near-term future. We are also going to be perceived as discouraging recovery because of the impact on the international debt burden. And I just think the symbolism of this is wrong. It's out of all proportion, I would admit, for a lousy $100 million difference in the borrowing level.

MR. WALLICH. There's a certain inconsistency between saying we want to snug up because the economy is strong and then saying moreover that that's going to hold down the long-term rate or bring it down. That isn't going to slow the economy that needs slowing.

MR. BALLES. I don't view it as inconsistent, Henry, because I happen to believe that long-term rates are heavily influenced by expectations of future inflation.

MR. FORD. It could be perfectly consistent.

CHAIRMAN VOLCKER. Well, I'm afraid Mr. Axilrod is correct that if it's below $350 million, it will be perceived as an easing.

MR. GRAMLEY. I would want my own prescription in that case to be reinterpreted as pushing a level of initial borrowing that would get the funds rate up to somewhere in the 8-3/4 or 9 percent range. I'd like the market to notice it. I can certainly understand why people who look at the present unemployment rate, excess capacity, and so on are saying: No, this is not the time to do it. And I can understand Tony's concerns. But I think we're going to be faced with these same concerns a month from now, 3 months from now, and 6 months from now; and they're going to be worse then they are now.

CHAIRMAN VOLCKER. Well, we have to write a directive. I'm not crazy about the one that's in here.

MR. PARTEE. I really think we ought to look at alternative II, Paul. It has more promise.

CHAIRMAN VOLCKER. I agree with that but I don't like alternative II either. I wrote something here but I don't know whether people will like it: "The Committee seeks in the short run to increase slightly the degree of reserve restraint, recognizing that while M2 and M3 are expected to remain somewhat below the rates of growth of 9 and 8 percent established for the quarter and within their long-run ranges, transactions balances have been increasing substantially more rapidly than desirable. The action was taken against the background of evidence of some acceleration in the rate of business recovery."

MR. ROBERTS. Excellent statement, Mr. Chairman.

MR. PARTEE. I like it.

SPEAKER(?). I do too.

VICE CHAIRMAN SOLOMON. I think it has two serious problems.

MR. GRAMLEY. [You think] the "increase" should be "decrease."

VICE CHAIRMAN SOLOMON. [It] puts more importance on the fact that we're giving attention to M1.

MR. PARTEE. Well, how could we fail to--

VICE CHAIRMAN SOLOMON. You go out of your way to comment on transactions money. And you're making M1 respectable again.

MR. ROBERTS. It's never been otherwise in the market, Tony.

VICE CHAIRMAN SOLOMON. Look, after Paul's initial Humphrey-Hawkins testimony, the market reaction was that they were paying a heck of a lot less attention to the M1 figures. That changed when Paul made a couple of remarks that gave the impression that we were paying more attention to M1 than the market thought. And that attitude has now come back. It is completely controllable by what Chairman Volcker says and the way he articulates his view on transactions money or M1.

MR. ROBERTS. That may or may not be true. The recent behavior, the very large increases, may overwhelm comments.

MR. GRAMLEY. But this won't get published for 45 days and meanwhile he can bail us out.

VICE CHAIRMAN SOLOMON. I think he's going in another direction.

MR. BLACK. I think it's reasonable to assume the elasticity of demand for M1 may have increased to some extent and the demand for M1 also may have increased. But it strains credibility, it seems to me, to assume that that can explain all the burst. It's just too large for me to think that it could be all of it.

MR. MORRIS. I think the use of "transactions balances" as you proposed is misleading in the sense that it assumes we can measure transactions balances. Part of the problem with M1 is that it's now a blurring of transactions balances and savings accounts. And how do we know transaction balances are up?

CHAIRMAN VOLCKER. We can refer to M1.

MR. MORRIS. Sure. Say that because that's what you mean.

MR. WALLICH. I find it troublesome to chase a number that we can't have confidence in. It seems to me the weight should be on real interest rates. If the inflation continues to come down, real rates are going up anyway at constant [nominal] interest rates. And to have a rise in interest rates at a time when the whole world hangs on whether these rates can be kept down I think really incurs a very large international risk.

CHAIRMAN VOLCKER. Well, there's no question that there's an international risk. The question is whether it's more now or later. We get more international risk if the economy gets a bit out of hand on the up side.

MR. PARTEE. Then we really will have to deal with it, which will mean significantly higher rates.

MR. RICE. The risk that the economy is going to get out of hand immediately is not--

MR. PARTEE. Well, I agree with Lyle when he says the problem with Brazil, Mexico, and so forth is going to be with us a year from now just like it is now.

VICE CHAIRMAN SOLOMON. Yes, but if we can get through 1983, there's going to be a big difference. I don't see why a slightly stronger recovery, if it's accompanied by continued low inflation, is going to cause us to raise interest rates later in the year.

CHAIRMAN VOLCKER. If it's slightly stronger and accompanied by continuing good news on inflation, it won't. Maybe interest rates will come down.

MS. TEETERS. I think you're pushing them up a quarter at a time.

VICE CHAIRMAN SOLOMON. They're not going to come down if the Fed is tightening.

CHAIRMAN VOLCKER. Well, we're talking about what we're doing over the next three or four weeks.

MR. RICE. We will not be lowering interest rates in the next three to six weeks no matter what happens.

VICE CHAIRMAN SOLOMON. If we tighten now, I doubt if we're going to end up changing our position six weeks from now or whenever the next FOMC meeting is. We'd have to see some major change in the economy, a weakening, which we're not going to see.

MR. RICE. Sure.

MR. WALLICH. Insofar as the economy is influenced by these increases in interest rates or the absence thereof, it'll give a little more stimulation to the rest of the world if we keep rates where they are, and to that extent the international situation is eased a little.

VICE CHAIRMAN SOLOMON. I think there will be a lot of reaction. It will look as though we're trying to spoil the recovery basically. It will be out of proportion to the modest amount of rise. If there's a clear perception that we are snugging up, people are just not going to understand.

MR. ROBERTS. The long rates already have started to rise without our snugging. My guess would be that snugging would be positively interpreted, particularly in the long markets, and that we would more likely get a decline in rates than an increase.

MS. TEETERS. I have never seen the short-term rates go up without the long-term rates going up. I've heard your argument many times around this table and it has never happened.

MR. WALLICH. Well, for the short run, I think they move together. But then we see that after the short rate has been established at some level, long rates may be drifting down; we've had quite a bit of that.

MS. TEETERS. If we want the long rate down at this point in time, we need to lower the federal funds rate, not increase it.

MR. GUFFEY. It seems to me we may be taking a risk reacting to the May M1 figures. If we look at the pattern of April at minus 3 percent and May at 24 percent and June projected--whether right or wrong--at only less than 5 percent, we're talking about snugging up in reaction to one month of very high M1 numbers. And we're not certain of what they mean.

MR. BLACK. Roger, the staff says 24 percent for May but if I'm not mistaken, that assumes no further growth in M1 during May. Doesn't it, Steve?

MR. AXILROD. Yes.

MR. BLACK. And if we have a reasonable amount of growth, it might well be above 30 percent.

MR. GUFFEY. Well, looking at the projection, I see [M1 growth of] 4.7 percent for June.

CHAIRMAN VOLCKER. I think whether May is 24 or 30 percent is irrelevant.

MR. PARTEE. I do too.

CHAIRMAN VOLCKER. The fact is that it comes after six months of very high growth that we thought might be slowing down and there is some doubt that it's slowing down.

MR. PARTEE. It makes April look like the aberration. Before we were thinking that maybe April was establishing a new course, and now it doesn't look that way.

MR. FORD. April was clearly the aberration. It's not 6 months; it's 8 months. Since last August we've had double digit growth every month except January, which was 9.8 percent and April which was -3.1 percent. So, the trend is clear for M1. You can't say [May] is a one-month observation. You could say you don't believe in M1, but you can't say there has only been one month of abnormal growth. We've had essentially 9 months with one [exception]; if anything, April is the freak month.

MR. GUFFEY. But it is coming down.

MR. CORRIGAN. I think the key thing, Roger, is how one reads the economy rather than how one reads M1.

CHAIRMAN VOLCKER. That is correct.

MR. MORRIS. But I read the economic numbers and I was pleased. Apparently some of you were displeased. You have the idea the economy is roaring ahead in such an uncontrolled--

CHAIRMAN VOLCKER. That's a bit of an exaggeration.

SPEAKER(?). It's out of hand, though.

MR. MORRIS. So you're really making a move based on M1; you're not making a move based on--

SPEAKER(?). No, that's wrong.

MR. GRAMLEY. That's not fair. That's not fair at all. The argument that I think people are laying out here is that we now have a good cyclical recovery underway. It's not out of hand at the moment. But I think past cyclical processes strongly suggest that recoveries tend to gain momentum as time goes on. That's not what the staff has forecast, but I think Jerry would agree that the risks at this point are on the up side and not on the down side.

MR. MORRIS. But we want it to gain some momentum, don't we?

MR. GRAMLEY. It depends on how much we want it to gain. And the question is--

MR. MORRIS. We have more slack than we've had since the 1930s.

MR. GRAMLEY. Everybody recognizes that too.

MR. MORRIS. I'd like to see us use up some of that slack for--

MR. CORRIGAN. Frank, I wasn't here; you were. But I have a hunch that exactly this same discussion probably took place sometime around 1976. And I think it's very apparent where we came out, partly on the grounds that we didn't have to worry about inflation.

SPEAKER(?). I think that's pretty unfair.

VICE CHAIRMAN SOLOMON. I think that's really an unfair conclusion. Lyle, let's accept the fact that there is some possibility that a stronger recovery than what we want may materialize later. At the moment you say it's going along on track okay but you're worried that later on it may materialize. Does that mean that you anticipate that now, given the situation? It can only--

MR. GRAMLEY. I always think that monetary policy has to work on a forecast, Tony. I don't believe that we operate just on what we see in the past 3 months or past 1 month on M1 or anything else. You have to ask yourself where you want to go and where you think the economy is going. If I thought the economy were falling off a cliff now, I'd want to drop interest rates a ton. But I don't. I think the evidence has been accumulating month-by-month that this recovery is gaining a lot of strength. Let's cite some numbers. The industrial production index has gone up at a 17 percent annual rate since December.

CHAIRMAN VOLCKER. In the midst of a lot of inventory reduction.

MR. GRAMLEY. That's right. We had private final purchases, residential construction plus personal consumption plus business fixed investment, going up at a 5-1/4 percent rate in the first quarter. This is not a weak recovery. We've had an increase in new orders for total durable goods at a 24 percent annual rate since December and at a 39 percent annual rate of increase for nondefense capital goods. Now, this is a recovery that's gaining momentum. I grant you that if we could be assured that we're going to get 4 to 5 percent growth and no more for the next two years, then I would be happy just to sit right where we are. But I don't think that's the outcome that is going to happen, so I think we need to take the precautionary move now. And if we go up 1/4 percentage point or 1/2 percentage point on the fed funds rate, it isn't going to end the world. It's not going to be the fact that dumps Brazil off the edge of the precipice. If we have to go up 200 basis points next September because we didn't go up 50 basis points now, Brazil is going to have a lot worse time of it. Obviously, there are risks in going in either direction. But I think the cautious and prudent thing to do now is to snug up just a tiny bit.

MR. BALLES. I strongly support Lyle's diagnosis, which I think is first-rate. We do have internal dynamics of a business expansion going on here; and part of the history is that when that goes on, we get price movements associated directly with it. And that's my fear--that we may be in the process of getting a greater inflation rate than the Board staff has forecast, even though they have a lot of logic and plausibility on their side. History would argue the other way. And that's what I would like to see us heading off at the pass by a little snugging up starting now.

MR. MORRIS. I think the analogy Jerry drew of 1976-77 is far from correct. We are now in the middle of 1975 in terms of that.

MR. PARTEE. We snugged up in the spring of '75.

CHAIRMAN VOLCKER. That's right. And by September it was going down in the other direction and interest rates were going down for a few months and the economy was rising.

MR. GUFFEY. But we also had an inflation rate of 7 percent in the CPI in March of '75. In other words, we were then starting at an inflation rate that was much higher than where we are in this recovery.

VICE CHAIRMAN SOLOMON. Well, if you want to make a snugging gesture, make it $300 million.

MR. ROBERTS. How about $500 million?

SPEAKER(?). [Unintelligible] going on.

VICE CHAIRMAN SOLOMON. I could live with that; any more I couldn't.

CHAIRMAN VOLCKER. Well, I'm disturbed by the fact that we're probably already de facto, by the results, at $350 million. If we literally came out below that, it will look as if the economy is getting better and M1 is going through the roof and we're easing up.

MR. BLACK. In the interest of conciliation, after Tony's offer, I'll come down from $600 to $500 million.

MR. MARTIN. You're all heart!

CHAIRMAN VOLCKER. Well, it may depend on how we word the directive. I don't know whether anybody has any better idea on how to word the directive. I look at mine and it says "increase slightly" and we haven't had that small an increase in which we--. How about "The Committee decided in the short run to increase reserve restraint invisibly."

VICE CHAIRMAN SOLOMON. I'll go for that.

MS. TEETERS. I'll go for that too; it's not saying--

MR. FORD. By a statistically deviant amount!

MR. WALLICH. We could say that we will keep it at the level at which on average it has been in the last few weeks.

MS. TEETERS. No, we don't want to do that. At one point it was $1-1/2 billion.

MR. WALLICH. On average.

MS. TEETERS. It still would average out well above where we are now.

CHAIRMAN VOLCKER. I haven't heard any promising suggestions.

MR. ROBERTS. Stick to your guns.

MR. PARTEE. I think the "increase slightly" is what the majority of the Committee is inclined to do. In fact, some would favor a little more than slightly, I gather. It sounds reasonable to me. I like your whole paragraph, Paul.

VICE CHAIRMAN SOLOMON. Including the "transactions" [part]?

MR. PARTEE. Yes, I think it's time to recognize them.

MR. GRAMLEY. Well, I think it's important for us to keep a facade up that we're using all the monetary aggregates.

MR. PARTEE. Yes.

MR. GRAMLEY. I don't want us to say we're deliberately pushing up interest rates. That's not the kind of indication that's going to be easy to deal with later on. So, I'd like to use that M1 as a cover.

VICE CHAIRMAN SOLOMON. Yes, but that's--

MR. PARTEE. And he has the stronger business--

VICE CHAIRMAN SOLOMON. Yes, but I don't understand. You argued very strongly that the reason for your position is not M1.

MR. GRAMLEY. That's right.

VICE CHAIRMAN SOLOMON. It's the strength of the economy. Why not say so, if that's the majority view here?

MR. GRAMLEY. Oh, I would want to.

VICE CHAIRMAN SOLOMON. I can dissent. But if that's the majority view here, then why not say so?

MR. GRAMLEY. Well, his statement does that.

VICE CHAIRMAN SOLOMON. It doesn't say that. He emphasized transactions balances.

CHAIRMAN VOLCKER. It says both. It says that the action was taken against the background of evidence of some acceleration in the rate of business recovery.

MS. TEETERS. And what's the rest of it?

MR. PARTEE. The second sentence?

CHAIRMAN VOLCKER. That is the second sentence.

MS. TEETERS. What's the first one?

VICE CHAIRMAN SOLOMON. What's the part about the transactions [balances]? We don't have copies of it; we can't see it.

CHAIRMAN VOLCKER. I'd take out the last phrase.

MR. PARTEE. "Some acceleration" seems to me a little weak, a bit of the wrong tone.

MS. TEETERS. Don't forget they keep revising the GNP down.

MR. PARTEE. "Evidence of a strengthening in the rate of business recovery."

MR. WALLICH. We can't really say transactions balances because we don't know what is in M1.

CHAIRMAN VOLCKER. I have no problem with changing that to M1, if that makes people feel happy. I don't like the word "M1."

MR. PARTEE. "Narrow money stock."

MR. WALLICH. It just may not be in M1.

CHAIRMAN VOLCKER. There may be some way of writing this to put more emphasis on the fact that M2 and M3 are expected to remain--

MS. TEETERS. Well, if they are expected to remain somewhat below their rates, why are we raising interest rates?

CHAIRMAN VOLCKER. Because M1 has been increasing substantially more rapidly and because of the business [picture].

MR. GUFFEY. Aren't you elevating M1 to a target again?

MR. RICE. Yes, we are.

MS. TEETERS. Yes.

MR. BLACK. Gosh, I hope so.

MR. FORD. I think there's no danger that the market will think that's what we're doing now when we adjust the rate by 1/8 or 1/4 of a percentage point.

MR. BOEHNE. Do we really want to convey the notion that M1 is re-elevated and also that somehow it's not good that it looks like the business recovery is getting in line with the average of postwar expansions and that we ought to raise interest rates because of the business recovery? Somehow that doesn't have a good ring to me.

CHAIRMAN VOLCKER. I would leave out that part about the average postwar expansion.

MR. PARTEE. Yes.

SPEAKER(?). Right.

SPEAKER(?). Do I have a notion that the--

CHAIRMAN VOLCKER. I put that in there to answer Mr. Moynihan.

MR. BLACK. I think we ought to have--

CHAIRMAN VOLCKER. There is no indication here of going back again if these things drop or the economy dropped. I don't know how we get that thought in very simply.

MR. MARTIN. Is there any comment on federal funds?

CHAIRMAN VOLCKER. I would leave in the boiler plate.

VICE CHAIRMAN SOLOMON. The way I would write the directive would be "The Committee, recognizing that M2 and M3 are expected to remain somewhat below the rates of growth of 9 and 8 percent established for the quarter but recognizing that this is in the context of a somewhat stronger economic picture, decided to maintain roughly the degree of existing reserve restraint but permitting some modest changes."

MR. MORRIS. In either direction.

MR. GRAMLEY. That you're offering in the spirit of compromise?

VICE CHAIRMAN SOLOMON. We don't have to have a money market directive; we can go back to an M2, M3 target. I think, though, that we wouldn't begin to agree on the numbers for the rest of this period.

MR. GUFFEY. Is this upsetting to you?

MR. BOEHNE. What if we move up "the evidence of some acceleration in the rate of business recovery" to replace "transactions balances have been increasing" And then the last sentence would be "The action was also taken against a background of substantially more rapid growth in M1." That would seem to be more consistent with recent directives.

MR. GRAMLEY. What if we put the two together? "The action was taken against the background of evidence of some acceleration in the rate of business recovery and continued rapid growth of M1."

MR. MARTIN. That gets the business recovery first.

MR. BOEHNE. Yes.

MR. MARTIN. Which is where we all put it.

MR. BOEHNE. Right; that's the point.

MR. MARTIN. Not the M1 first.

MR. BOEHNE. That's what I'm trying to get at.

VICE CHAIRMAN SOLOMON. A surge in M1, to which we don't pay much attention--

MR. MORRIS. Well, we say we don't pay much attention.

MR. WALLICH. We're very close to targeting on real growth.

VICE CHAIRMAN SOLOMON. And we don't want to--

MR. BOEHNE. Which we say we don't want to do.

CHAIRMAN VOLCKER. Mr. Axilrod is pointing out to me, in the area of truth in packaging, that in the last 6 weeks borrowing has averaged $392 million. This is a terrific snugging up we're talking about!

MR. FORD. At $350 million, it's minus $42 million; at $400 million, it's plus $8 million.

MR. GUFFEY. But in part of that period the funds rate was 9 percent or thereabouts.

MS. TEETERS. Yes.

MR. BOEHNE. Well, I don't think it's the actual level of borrowings that matters at all. It's what happens--

MS. TEETERS. It's time for me to have--

CHAIRMAN VOLCKER. The federal funds rate was above 9 percent the week of April 6, which Mr. Axilrod left out of this tabulation. The federal funds rate averaged in no week above 8.80 percent during [the rest of] the period.

MS. TEETERS. If you put in the first week of April, the funds rate averages out to exactly 8.75 percent. And if you put in the borrowing--

CHAIRMAN VOLCKER. In the first week of April the borrowings were $1.4 billion.

MS. TEETERS. That's right.

VICE CHAIRMAN SOLOMON. If we increase the borrowing assumption $100 million, we are still reducing the nonborrowed reserve path by $100 million and it depends simply on banks' variable holdings of excess reserves. We still are snugging up in intention. Whether it's manifested or not would depend on the excess reserves level.

MR. STERNLIGHT. Mr. Chairman, even leaving out that week of April 6 that had the $1.4 billion borrowing, that average that you cite is still affected by a couple of weeks where we had a wire breakdown or some special event that pulled that average up. Aiming at $250 million, there's just more room for misses on the up side than the down side and I think that's the result that emerges.

MR. WALLICH. Well, it seems that we maintained a higher level of restraint than we were aware of or than we decided last time.

Why can't we say that we accept the level of restraint that has developed for the last few weeks?

MR. RICE. I think that's a good suggestion.

MR. PARTEE. Yes.

SPEAKER(?). It's also offered in the spirit of compromise.

MR. BLACK. Our error has worked out better than we thought!

CHAIRMAN VOLCKER. Well, Mr. Axilrod is suggesting that we go back to the language somehow or another that he suggested in the first place--I'm not crazy about it--about anticipating that growth rates of M2 and M3 will accelerate. That's not very meaningful to me when they are below where we said we were satisfied before. That's--

MR. AXILROD. I was mainly trying to change your M1 to an "anticipation" instead of "desirable."

CHAIRMAN VOLCKER. Well, that's an easy change, changing "desirable" on M1 to "anticipating," but I--

VICE CHAIRMAN SOLOMON. I think he's right. I think alternative II comes closer--

MR. MARTIN. Certainly "anticipation" takes a bit of the weight away from M1. Rather than say we've done it because M1 is running higher to say we anticipate M1 to have certain behavior takes a little--

VICE CHAIRMAN SOLOMON. Well, what is his first sentence in alternative II? What's the verb, "maintain" generally or "increase" or "decrease"?

CHAIRMAN VOLCKER. Oh, I'd suggest "increase slightly." We can change it but I think the operative question, however we explain it, is whether we say "increase slightly" or whether somebody else has some other words.

MR. GUFFEY. The alternative is what appears: "the existing degree of restraint."

CHAIRMAN VOLCKER. Yes, that's the argument.

MR. GUFFEY. And if $350 million is what we have, I think that's a little high. The existing degree of restraint is what we have and what we maintain.

MR. WALLICH. Well, the question is whether "existing" means what we decided last time or what we actually have.

CHAIRMAN VOLCKER. In the context of reading these things, it reads--whether we aim at something a little tighter than last time or not and can't make it--

MR. ROBERTS. Why don't we just say--

CHAIRMAN VOLCKER. The changes have been so modest that--

MS. TEETERS. Well, where are you going to start our arguing: between increase or existing? Isn't that just--

CHAIRMAN VOLCKER. I think that's right. We can explain it differently but that's the substantive thing. [Unintelligible] and in my mind what this is missing is any recognition, if this is what you want to put in there, that if these aggregates came in low we might reverse it, or if business came in less than we were anticipating, we might be inclined to reverse it.

MR. BALLES. That's in alternative I, Paul, if you just want to borrow the language in the middle sentence there. It's the part in brackets.

MR. AXILROD. I don't mean to press it, Mr. Chairman, but there is some advantage to having the expectation of a pickup, or some such wording, because then if it doesn't occur, we could say it implies something.

VICE CHAIRMAN SOLOMON. But the M2 and the M3 which are referred to in alternative I are running low now.

CHAIRMAN VOLCKER. It would have to be still lower.

VICE CHAIRMAN SOLOMON. The advantage of the alternative II draft, I think, is that the sentence on M1 is handled better than in what you read earlier, Paul.

MR. MARTIN. That I agree with. We're really--

VICE CHAIRMAN SOLOMON. It doesn't have to read that we put M1 back on a pedestal or as a target.

MR. MARTIN. Well, it's forward looking rather than ex post.

MR. WALLICH. And it still bases the action on accelerating M2 and M3.

CHAIRMAN VOLCKER. Yes, but I think it's ridiculous when you look at it. It says we're going to tighten up because M2 and M3 are going to be more than 3 percent in the next two months.

MR. PARTEE. And it doesn't have the strength in the economy.

MR. MARTIN. It seems to me that if we take your language and move the business conditions comment ahead of the M1 comment and add that "lesser restraint will be acceptable in the context of..." we at least begin to have something to work with. It's not completely consistent; now we've got to reconcile--

MR. CORRIGAN. That might be the way to do it.

CHAIRMAN VOLCKER. Well, I don't quite have that operatively. What are you suggesting?

MR. MARTIN. After the language in your draft "for the quarter and within the longer-run ranges," why not move up "and against the background of evidence of some acceleration in the rate of the recovery." Then make your comment with regard to transactions balances in the anticipatory way that it's done in alternative II. And then close with the lesser restraint sentence. That is, we would have: "The Committee anticipates that M1 would remain above its long-run range," as in the alternative II language, "but that its growth would be substantially reduced in the period immediately ahead." And then close with "Lesser restraint would be acceptable...." Now, that isn't completely consistent; it needs a little editing once you tack it all together like that.

CHAIRMAN VOLCKER. Well, my problem is that I lose sight of just how it--. I understand adding this other sentence; I don't think there's any great problem with that.

MR. MARTIN. The lesser restraint?

CHAIRMAN VOLCKER. Yes. The fact is we haven't got much restraint.

MR. WALLICH. Well, the case for adding that increases, I think, as we shift to increasing the degree of restraint.

CHAIRMAN VOLCKER. The only problem with that sentence "Lesser restraint would be acceptable in the context of more pronounced slowing of growth in the monetary aggregates relative to the paths...." is that it's fine for M2 and M3 but it's hard to pronounce a slowing of growth in M1 relative to the path.

MR. MARTIN. You're right. So it should be "M2 and M3" instead of "monetary aggregates."

CHAIRMAN VOLCKER. Maybe we could just do that.

MR. GRAMLEY. That's a rather unusual construction no matter what, if we have lesser restraint if M2 and M3 slow further but we don't say what we're going to do if M1 slows.

MR. MARTIN. That's the beauty of it.

VICE CHAIRMAN SOLOMON. I think there's a very serious problem with your formulation, Paul, which is not true of alternative II, which is this: In effect what you're saying in the first sentence of your formulation is that while M2 and M3 on the one hand are growing below the rates established, since transactions balances have been increasing substantially more rapidly than desirable we therefore are increasing slightly the degree of reserve restraint. In effect you are telling the market that M1 is now more important than M2 and M3. Do you really want to go that far?

CHAIRMAN VOLCKER. I don't think it says that. It says that M1 is increasing at a rate of 24 percent and I give it some weight.

VICE CHAIRMAN SOLOMON. It doesn't say that. It says that M1 is more important than M2 and M3 in terms of the bottom line.

CHAIRMAN VOLCKER. I don't think it says that. That's your reading of it; it's not my reading of it.

MR. WALLICH. Two are going down; one is going up strongly.

CHAIRMAN VOLCKER. That's right. And there comes a point when the one going up strongly outweighs the two. When the two are 1 percentage point below where they should be and the other is 18 percentage points above where it should be, my weighting says, yes.

MR. MARTIN. So here we are to the central bank money as the German--

VICE CHAIRMAN SOLOMON. Well, that's not my view of deemphasis.

CHAIRMAN VOLCKER. [It is] straightforward. I'm not sure it's going to solve any of these problems; I'm perfectly happy to try it out. "The Committee seeks to increase slightly the degree of..."--I don't know about that "seeks to"--"taking account of expectations that growth of M2 and M3 will remain within their longer-run ranges, recognizing the recent strength of M1, and against the background of evidence of some acceleration in the rate of business recovery. Lesser restraint would be acceptable in the context of...."

MR. PARTEE. String them altogether.

CHAIRMAN VOLCKER. What's missing here, but I hate to say it, is that the Committee seeks to increase <u>only</u> slightly.

MR. MARTIN. Well, if you put in the reversal language, you'll get some of the members.

MR. ROBERTS. I think your first draft is better than any of these suggestions.

CHAIRMAN VOLCKER. Well, I'm not sure if I read anything that people are going to like better.

MR. GUFFEY. To be clear, Mr. Chairman, I would join Tony Solomon in opting for alternative II and lifting the bracketed language out of alternative I with respect to the downside risk on M2 and M3. It seems to me we're really adopting a money market conditions directive and the initial borrowing level is the important factor. If that's $350 million, that's consistent with what we've had in the past. And I don't see any reason to include language in a directive that will be made public after the next meeting, 6 weeks from now, which says we're going to snug up slightly or we're going to have slightly greater restraint or any other such language. I don't see where we [gain] anything from it. It seems to me that $300 million or the $250 to $350 million range of borrowing is what we ought to be focusing on without any language about snugging up. Alternative II, with the lifting of the language on the down side, seems to me to do that. And it doesn't elevate M1 to some target level for the Desk to shoot at.

CHAIRMAN VOLCKER. I suppose it will make nobody happy to say: "The Committee seeks in the short run to increase"--or maybe to increase only slightly--"the degree of reserve restraint, recognizing that, while M1 has been increasing substantially more rapidly than anticipated, M2 and M3 are expected to remain below the rates...." That explains why it's only slightly.

MR. PARTEE. I can accept it.

MR. MARTIN. Would you add the lesser restraint?

CHAIRMAN VOLCKER. We're talking about such narrow ranges.

MR. MARTIN. [Unintelligible.]

MR. PARTEE. But you would add the sentence on business?

CHAIRMAN VOLCKER. Yes, I'm not quite sure what I said. All right, let's try this: "The Committee seeks in the short run to increase slightly"--I'd put in "only" before that but it sounds a little [unintelligible]--"the degree of reserve restraint, recognizing that, while M1 has been increasing substantially more rapidly than anticipated, M2 and M3 are expected to remain below the rates of growth of 9 and 8 percent established earlier and within their longer-run ranges. The action was taken against the background of evidence of some acceleration in the rate of business recovery. Lesser restraint would be acceptable in the context of more pronounced slowing of growth in the broader monetary aggregates relative to the paths implied by the long-term ranges and a deceleration of M1 or indications of a little weakening in the pace of economic recovery."

MR. BALLES. That sounds good.

MR. PARTEE. That's a lot of words for $100 million.

MR. GUFFEY. May I ask you, Mr. Chairman, what you believe to be the advantages of making public 5 or 6 weeks from now the language "to increase slightly the degree of restraint"? What advantage enures to the System by publishing that language after the next meeting?

CHAIRMAN VOLCKER. I guess that question is not on the top of my mind. My first [objective] would be to try to say something that halfway accurately reflects what we think we're doing.

MR. BALLES. If I may be so bold, Mr. Chairman, to answer that question: You may not agree with it, but let's not forget, Roger, that this directive will be released right after our July meeting but before the Chairman's testimony and hence the Fed watchers will be really studying that directive to see what nuances they can draw from it. I think it's a particularly important statement.

MR. GUFFEY. Well, I don't tend to agree with you, obviously.

MR. PARTEE. It's a suggestion that we're not oblivious to what is going on.

MR. GUFFEY. On the other hand, you've also incorporated in this that we want to increase interest rates, or restraint if you will, because the economy has just come out of an episode where we had two recessions in three years.

MR. MARTIN. But it suggests we are moving in a way that would avoid the excesses that sometimes have characterized a certain stage of the recovery and overcreating the--

MR. MORRIS. And it also place more emphasis on M1 than on M2 and M3.

CHAIRMAN VOLCKER. No, I disagree with that. I just think that is a plain misreading. It says here we're placing some emphasis on it; we are not ignoring M1 when it's huge. We've never said anything different.

VICE CHAIRMAN SOLOMON. What you're saying is that even though we have deemphasized M1, when it's this large we have to take it into consideration.

CHAIRMAN VOLCKER. I think that's precisely what we're saying.

VICE CHAIRMAN SOLOMON. I don't agree with that.

CHAIRMAN VOLCKER. I don't know how you can read it any other way.

SPEAKER(?). For one month.

MR. MORRIS. Well, we're increasing reserve restraint when M2 and M3 are falling below their--

CHAIRMAN VOLCKER. That's right. They're falling 1 percent below. They're expected to fall 1 percentage point below and M1 is growing 10 percentage points above.

MR. FORD. I don't see, unless you don't want to snug at all, how we can snug with any less vigor than that statement. If I had a girlfriend that snuggled like that, I'd fire her!

CHAIRMAN VOLCKER. I think that is an empirically correct statement.

MR. PARTEE. Well, I think it read all right.

CHAIRMAN VOLCKER. To me, the only thing we could debate here is whether we put in the word "only" before slightly. It just sounds a little--

MR. PARTEE. No, I don't think so, because to snug only slightly in the short run suggests that a little later you're going to do more. "In the short run we will increase only slightly" seems to have a little trend.

MS. TEETERS. That's right.

CHAIRMAN VOLCKER. Or we could take out the words "in the short run."

MR. PARTEE. You'd have to take out "in the short run."

CHAIRMAN VOLCKER. Well, let me read it once again and see whether I've got it straight and see whether anybody can do any better.

MR. BLACK. Don't give them a chance at it!

CHAIRMAN VOLCKER. "The Committee seeks in the short run to increase slightly the degree of reserve restraint, recognizing that, while M1 has been increasing substantially more rapidly than anticipated, M2 and M3 are expected to remain below the rates of growth of 9 and 8 percent established earlier within the longer-run ranges. The action"--we could say the modest action--"was taken against the background of evidence of some acceleration in the rate of business recovery. Lesser restraint would be appropriate...."

MR. WALLICH. We seem to be saying that we're tightening because M2 and M3 are expected to remain below the rates--

CHAIRMAN VOLCKER. That's why the word only would help in that context.

MR. WALLICH. It seem to be putting all the weight there on M1.

VICE CHAIRMAN SOLOMON. Well, you could say marginally, so you avoid Chuck Partee's--

MS. TEETERS. Slightly marginally?

MR. CORRIGAN. Could we put a phrase before M2 and M3 there and say "in the context in which M2 and M3 are only slightly below their..."

MR. GRAMLEY. I think we'd need to drop the "while," though. The Chairman's point is correct. The argument seems backwards--

CHAIRMAN VOLCKER. It is backwards.

MR. GRAMLEY. --if we say we're doing this while M1 [is high] although M2 and M3 are falling below. We ought to drop the "while recognizing that."

CHAIRMAN VOLCKER. Like the way I said it originally.

MR. GRAMLEY. Or leave the order the way it is but take out the word "while" and just say "recognizing that [M1] growth...even though M2 and M3 are below."

CHAIRMAN VOLCKER. I think the result of that is that it gives a little more emphasis on M1, but I--

VICE CHAIRMAN SOLOMON. A more honest directive would say that.

CHAIRMAN VOLCKER. It's pretty honest as near as I can see.

VICE CHAIRMAN SOLOMON. I don't think it is. I think a more honest directive would say we are worrying about too strong a recovery and even though we don't pay too much attention to M1, when it gets to be this big we would pay some attention to it.

CHAIRMAN VOLCKER. That's what we're saying.

MR. BLACK. That's all it says.

MR. PARTEE. We're going to take a little precautionary snugging.

CHAIRMAN VOLCKER. That's comes as close to saying that as I can devise.

VICE CHAIRMAN SOLOMON. Well, I'll be glad to back off.

MS. TEETERS. A more honest way of saying it is when the economy shows some--

CHAIRMAN VOLCKER. I don't see anything dishonest about this. It says as plainly as I can say it what I think we're going to do. I just reject that entirely. It can't be much more straightforward.

MR. GUFFEY. What level of borrowing are we talking about?

CHAIRMAN VOLCKER. Well, that's a nice question. I'm assuming we're talking about $350 million.

MR. GUFFEY. Well, I thought that you had assumed before that that's the existing degree of restraint.

CHAIRMAN VOLCKER. I think it is about that, de facto.

MR. GUFFEY. Then the statement is dishonest in the sense that we are not going to snug.

MR. PARTEE. We're going to try for it this time, though.

MR. BLACK. Hitting it intentionally is snugging from hitting it accidentally.

MR. KEEHN. If we went to $400 million, I think that would represent an $8 million snugging, which is fairly modest.

MR. BLACK. Do you think we ought to put that "only" in there?

MR. MORRIS. Why aren't we talking about increasing the funds rate to 8-3/4 to 9 percent? Isn't that really the issue?

MS. TEETERS. That's what we're really talking about; that's right.

MR. PARTEE. We usually don't say it that boldly.

MR. MORRIS. Yes, but that's the understanding. That's what we're voting for.

MS. TEETERS. That is a 1/2 point increase in the funds rate over what we thought we had.

CHAIRMAN VOLCKER. I continue to welcome any suggestions as to how to word this, but I do not think the issue is honesty.

MR. MORRIS. It's to snug or not to snug.

SPEAKER(?). It's under 9 percent or--

CHAIRMAN VOLCKER. What we're trying to say here, assuming we snug however infinitesimally, is that, yes, we'll give a little weight to M1 when it's way above and we'll give some weight to the economy looking stronger.

MR. BLACK. I think it's as close as you're going to get.

MS. TEETERS. But the decision is whether to raise the interest rate or not.

CHAIRMAN VOLCKER. The decision is where to put the borrowing level.

MS. TEETERS. That's raising the interest rate.

MR. WALLICH. In a sense the snugging is already behind us. We're now going to aim at what we accidentally hit.

CHAIRMAN VOLCKER. I think what the market--

MS. TEETERS. Henry, it was clear last time--

MR. RICE. Not in this directive.

MS. TEETERS. --that we were to go to an 8-3/4 percent interest rate. We made that decision 6 weeks ago; now we're going to go to 9 percent.

MR. WALLICH. Not if we keep borrowings at $350 million.

MR. CORRIGAN. Would that language you have there, Mr. Chairman, perhaps be a bit more acceptable if it said "...increase slightly the degree of restraint. The action was taken in the context in which M2 and M3 were slightly below their paths for the quarter but M1 was well above and the economy was stronger." Does that help at all in terms of how--?

MR. GRAMLEY. I think it helps the syntax of it.

CHAIRMAN VOLCKER. I think that's what we're trying to say. It's very close to what I said originally.

MR. CORRIGAN. Well, I think it pushes M1 a little further off into the wilderness.

MS. TEETERS. But interest rates went up. If the two of them are below and we raise interest rates because they're below, and when one goes up we raise interest rates--

MR. CORRIGAN. Well, it's saying two things. It's saying M2 and M3 are just in a statistically insignificant way below where we want them to be and, on the other hand, M1 is very strong and the economy appears to be strong.

MS. TEETERS. So we raise the interest rates.

MR. CORRIGAN. Yes, but I think it says it in a slightly different way than the way it's there now. It pushes M1 further into the background than it is now.

CHAIRMAN VOLCKER. Not much.

MR. MORRIS. Not very much further.

MR. CORRIGAN. I myself would be willing to put it on the economy but that gets us into the trap of saying we're going to run policy more generally on the economy. I'm not ready for that either.

VICE CHAIRMAN SOLOMON(?). You're going to frustrate the Administration and Congress for the rest of the year?

MR. MARTIN. The Administration [unintelligible] frustrate the Congress and not the economy. You could drop them both and frustrate both.

VICE CHAIRMAN SOLOMON. Did Regan say 6 percent for M1?

MR. MARTIN. He won. Poole said 5 percent; we can't get them to agree on how far down.

SPEAKER(?). For the year, you mean.

MR. WALLICH. Anyone who names this M1 number should mention the associated funds rate.

MR. GRAMLEY. To Poole, the lower the money number the lower the funds rate, I think.

SPEAKER(?). In the long run.

MR. GRAMLEY [Unintelligible] talk about Poole?

CHAIRMAN VOLCKER. What did you suggest for M1, Mr. Corrigan?

MR. CORRIGAN. Well, it's--

VICE CHAIRMAN SOLOMON. Statistically insignificant.

MS. TEETERS. Statistically insignificant.

MR. CORRIGAN. Basically I said you have the operative sentence--

CHAIRMAN VOLCKER. I understand that part.

MR. CORRIGAN. "This action was taken against the background in which M2 and M3 were slightly below their targets for the quarter, while at the same time M1 was growing very rapidly and the economy appeared to be picking up."

MR. BLACK. That will eliminate the dangling participle too.

MR. CORRIGAN. If there is one thing we've got to do it's eliminate the participle, even if it--

MR. WALLICH. Well, only slightly below--

VICE CHAIRMAN SOLOMON. Couldn't we say "While M1, which we normally deemphasize, was growing unusually rapidly"?

MR. PARTEE. "And the economy, which we pay no attention to, was strengthening"!

CHAIRMAN VOLCKER. "The Committee seeks in the short run to increase slightly the degree of reserve restraint." I think at this point I'd be inclined to put in "only slightly." "The action was taken against the background of M2 and M3 remaining slightly below the rates of growth of 9 and 8 percent respectively established earlier for the quarter and within their long-term ranges, M1 growing well above the anticipated levels for some time, and evidence of some acceleration in the rate of business recovery. Lesser restraint would be appropriate in the context of more pronounced slowing in growth of the broader monetary aggregates relative to the paths implied by the long-term ranges and a sharp deceleration of M1."

MR. GUFFEY. Why put in that last part about deceleration of M1? That again is raising its importance.

MR. ROBERTS. You have to put it in because that's the only reason we're talking about snugging.

MR. GUFFEY. No it isn't.

MR. GRAMLEY. Oh, no!

SPEAKER(?). But then we have a lot of--

MR. BALLES. You've muddied the waters.

SPEAKER(?). Making him another God.

CHAIRMAN VOLCKER. Does anybody like "marginally" better?

MR. PARTEE. To seek "marginally" instead of "slightly"?

CHAIRMAN VOLCKER. Yes.

MR. PARTEE. "Increase only marginally the degree of reserve restraint."

CHAIRMAN VOLCKER. I'd put the word only in. I guess we're as close as we're going to get.

MR. CORRIGAN. We have to put something in now that says the action was taken because the Committee was getting hungry!

CHAIRMAN VOLCKER. The first question will be what the borrowing level is and the second question will be the directive. "The Committee seeks in the short run to increase only slightly the degree of reserve restraint. The action was taken against the background of M2 and M3 remaining slightly below the rates of growth of 9 and 8 percent, respectively, established earlier for the quarter and within their long-term ranges, M1 growing well above anticipated levels for some time, and evidence of some acceleration in the rate of business recovery. Lesser restraint would be appropriate in the context of more pronounced slowing of growth of the broader monetary aggregates relative to the paths implied by the long-term ranges and deceleration of M1"--

MS. TEETERS. I think you contradicted yourself in the last sentence.

MR. PARTEE. I don't think so.

VICE CHAIRMAN SOLOMON. Would it be sufficient in the last sentence, Paul, simply to say "slowing of the aggregates" and not say anything about the broader aggregates or deceleration of M1?

CHAIRMAN VOLCKER. Well, we can't say "more pronounced slowing of M1." What it says now is "relative to the paths implied by the long-term ranges [and deceleration of] M1."

MS. TEETERS. It sounds as if you're heading for the bottom of the range.

CHAIRMAN VOLCKER. Let me go to the borrowing level. How many people want to hold it at $350 million?

MR. PARTEE. I'll buy $350 million.

SPEAKER(?). It's $392 million.

MR. GRAMLEY. I'd prefer $400 million, but I'll buy $350 million. I'm getting hungry too!

CHAIRMAN VOLCKER. One, two, three, four. We didn't get six votes for $350 million.

MR. PARTEE. [Unintelligible.] I'm not sure we're going to have six votes for anything.

CHAIRMAN VOLCKER. I don't know where all the missing votes are.

MR. BLACK. I'd be willing to vote for one that won't hold.

MR. PARTEE. $400 million?

CHAIRMAN VOLCKER. Do we pick up any [votes] at $400 million?

MR. PARTEE. No.

MR. BLACK. No, we didn't.

VICE CHAIRMAN SOLOMON. Now try $300 million.

CHAIRMAN VOLCKER. $300 million isn't going to have enough votes here.

MR. FORD. You can't vote twice!

MR. MARTIN. Sure you can. Put your right arm up.

SPEAKER(?). You just did; now we're getting ready.

MR. FORD. At least use the left hand and the right hand.

MR. PARTEE. Well, in some ways $350 million is the weighted average.

CHAIRMAN VOLCKER. It's pretty obvious: $350 million is the weighted average. We have to reach a decision. I'll promote $350 million again. Any votes?

VICE CHAIRMAN SOLOMON. You've got $250 million over here.

MR. PARTEE. $350 million again?

MR. GRAMLEY. Again as a consensus.

CHAIRMAN VOLCKER. One, two, three, four, five, six. It would be nice to have another, but I guess it doesn't make any difference. We'll have dissents on both sides.

MR. PARTEE. Are you counting yourself?

CHAIRMAN VOLCKER. We've got to get a ruling from the chair.

MS. TEETERS. In a split, do we have any change from the last policy?

MR. GUFFEY. Mr. Chairman, I would go for $350 million if we're talking about a [funds rate] level of approximately 8-3/4 percent.

CHAIRMAN VOLCKER. I don't think anybody can predict [the funds rate] that precisely. It will probably be 8-3/4 percent sometimes and above that sometimes and--

MR. GUFFEY. I understand, but I--

CHAIRMAN VOLCKER. It sure isn't much different from where we are. And I can't promise you it wouldn't go to 9 percent.

MR. GUFFEY. We can operate policy so it won't go to 9 percent in the intermeeting period if that's the consensus of this Committee.

CHAIRMAN VOLCKER. You get lots of chances to consult.

MR. ROBERTS. Did we have six for $400 million?

MR. PARTEE. No.

MR. GRAMLEY. We had six for $350 million.

MR. FORD. Can those who are not voting not be starved into submission?

SPEAKER(?). No.

SPEAKER(?). Sorry.

MR. PARTEE. It's one of the disadvantages of attending!

MR. BLACK. The thing for you to do is go for $350 million and then dissent.

CHAIRMAN VOLCKER. Well, let's go for $350 million and see where we come out. Let's have a vote.

MR. BERNARD.

Chairman Volcker	Yes
Vice Chairman Solomon	No
Governor Gramley	Yes
President Guffey	No
President Keehn	Yes
Governor Martin	Yes
President Morris	No
Governor Partee	Yes
Governor Rice	No
President Roberts	No
Governor Teeters	No
Governor Wallich	Yes

Six to six.

CHAIRMAN VOLCKER. Well, someone's going to have to change the vote. We're going to have to go with a split vote, since there apparently are people on either side.

MS. TEETERS. I don't think so; there's only one on the other side.

CHAIRMAN VOLCKER. I don't see how--. Well, it only takes one to [unintelligible]. There's no higher number of votes for any other alternative that I see.

MR. BLACK. Would you vote for [$350] million, Ted? It's better than the alternative.

MS. HORN. At least there's a focus on M1.

MR. FORD. I'll verify that you're a snugger.

MR. BLACK. I'll put a sentence in every one of my talks!

VICE CHAIRMAN SOLOMON. [Unintelligible] get you to vote on $300 million?

CHAIRMAN VOLCKER. I don't know what that means. If it means we start out at $350 million, it's all right with me.

MR. FORD. The legal counsel is--

MS. TEETERS. Six [to six] leaves it where it was the last time.

CHAIRMAN VOLCKER. You know, for a $50 million difference, it's ridiculous.

MS. TEETERS. That's not what [I'm] against. That's not what we're voting for; we're voting to raise the interest rates or not to raise them.

CHAIRMAN VOLCKER. Well, I'll convert my statement; if you think there's a great relationship, you're voting for an eighth of a percentage point on the federal funds rate.

MS. TEETERS. That's what you told me last time too.

CHAIRMAN VOLCKER. Well, we will sit here until somebody has a better idea.

MR. ROBERTS. Okay, Mr. Chairman, I give in. I prefer a higher number but if we can't get any more, I'll go with the $350 million reluctantly.

CHAIRMAN VOLCKER. So we know what it is, we will vote for a directive that says "The Committee seeks in the short run to increase only slightly the degree of reserve restraint." We're going to have seven votes for this. "The action was taken against the background of M2 and M3 remaining slightly below the rates of growth of 9 and 8 percent, respectively, established earlier for the quarter and within their long-term ranges, M1 growing well above anticipated levels for some time, and evidence of some acceleration in the rate of business recovery. Lesser restraint would be appropriate in the context of more pronounced slowing of growth in the broader monetary aggregates relative to the paths implied by the long-term ranges and deceleration of M1, or indications of a weakening in the pace of economic recovery."

MR. BERNARD.

Chairman Volcker	Yes
Vice Chairman Solomon	No
Governor Gramley	Yes
President Guffey	No
President Keehn	Yes
Governor Martin	Yes
President Morris	No
Governor Partee	Yes
Governor Rice	No
President Roberts	Yes
Governor Teeters	No
Governor Wallich	Yes

CHAIRMAN VOLCKER. Now we can go eat, if we don't have any other business.

END OF MEETING