TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

April 17, 1979

Prefatory Note

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

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

Staff Statements Appended to the Transcript

Mr. Holmes, Manager of the System Open Market Account
Mr. Sternlight, Deputy Manager for Domestic Operations
Mr. Kichline, Economist
Mr. Axilrod, Economist

Meeting of Federal Open Market Committee

April 17, 1979

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, April 17, 1979, beginning at 9:30 a.m.

PRESENT: Mr. Miller, Chairman
Mr. Volcker, Vice Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Kimbrel
Mr. Mayo
Mr. Partee
Mrs. Teeters
Mr. Wallich

Messrs. Guffey, Roos, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. Baughman and Willes, Presidents of the Federal Reserve Banks of Dallas and Minneapolis, respectively

Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. Petersen, General Counsel
Mr. Oltman, Deputy General Counsel
Mr. Mannion, Assistant General Counsel
Mr. Axilrod, Economist

Messrs. Brandt, R. Davis, Ettin, Henry, Keir, Keran, Kichline, Parthemos, Scheld, Truman, and Zeisel, Associate Economists

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

Mr. Coyne, Assistant to the Board of Governors
Mr. Kalchbrenner, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Gemmill, Associate Director, Division of International Finance, Board of Governors
Ms. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. McIntosh and Smoot, First Vice Presidents, Federal Reserve Banks of Boston and Philadelphia, respectively

Messrs. Balbach, Boehne, J. Davis, and Eisenmenger, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Philadelphia, Cleveland, and Boston, respectively

Messrs. Burns, Danforth, and T. Davis, Vice Presidents, Federal Reserve Banks of Dallas, Minneapolis, and Kansas City, respectively

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

Mr. John Morton, Economist, Division of International Finance, Board of Governors

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CHAIRMAN MILLER. Ladies and gentlemen, thank you for posing [for the group picture]. It's nice to be here with all you celebrities. And I hope by the time the pictures are published the same members will still be on the Committee! I would point out that Frank Morris and Dave Eastburn are not with us this morning and [representing their Banks] we have Jim McIntosh and Dick Smoot. We are delighted to have you, and we assume that you will be independent of your Presidents and give us some really good advice to help us out! I want to remind you about the structure of the meeting; I think the procedure we have been using recently has been very helpful. Once again, I would suggest that although I am personally impressed with the eloquence of your statements, I would be even more impressed with crispness and brevity in making your very powerful points to which through our mental process we'll be able to add the eloquence.

MR. PARTEE. Silence is golden!

CHAIRMAN MILLER. At least promptness is worth something. Accordingly, we will proceed with the agenda. The first item of business is to approve the minutes of the last meeting. I believe they have been circulated. Are there any corrections or comments? Hearing none, we will report those as approved. Turning to foreign currency operations, Scott has been taken suddenly ill and Alan, therefore, will report on the foreign currency operations.

MR. HOLMES. I'm sorry Scott can't be here to make this report because it's very near and dear to his heart. It's rather historic. [Statement--see Appendix.]

CHAIRMAN MILLER. Thank you very much, Alan. Questions or comments? Chuck.

MR. PARTEE. Alan, had there not been all this intervention, do you believe that the dollar would have been substantially higher?

MR. HOLMES. Substantially higher, yes indeed.

MR. PARTEE. That is, it wasn't supply bringing forth its own demand?

MR. HOLMES. The fact that we were there and willing to [intervene] probably increased the flow. But I think we would have had a substantially different exchange rate effect if we had not been intervening at all and if the Europeans had not been intervening at all.

MR. PARTEE. So speculators against the dollar might have been squeezed in the absence of this intervention, I suppose.

MR. HOLMES. Yes, they might have been squeezed more if we had not intervened.

CHAIRMAN MILLER. Henry.

MR. WALLICH. Alan, in terms of the possible magnitudes of these movements, you remember what happened to the United Kingdom a couple of years ago: There was a tremendous inflow into sterling and they held the rate [for a time]; eventually, after taking in $10 or $15 billion in reserves, they had to let the rate go. Do you see any possible parallel for the United States?

MR. HOLMES. Well, there's always a possible parallel. If we try to put a complete lid on the rate, one or two things will happen: Either we will have to acquire a lot of currencies or we will so convince the market that there is no upside risk in the dollar that the flows will stop. I'm not quite clear which would happen; it could well be a combination of the two.

CHAIRMAN MILLER. Bob Black.

MR. BLACK. Alan, what do you think the reaction would be in exchange markets if the aggregates should come in weak and we nudged the federal funds rate down a little?

MR. HOLMES. I think the market has been quite favorably impressed by the fact that, despite weak aggregates, the System has stayed steady in the boat as far as the funds rate is concerned. I think a change in that pattern would have a negative effect on the exchange market. How big it would be I really don't know.

MR. BLACK. You think they would pay more attention to the federal funds rate, though, than the behavior of the aggregates?

MR. HOLMES. I think they would. The market is more geared to interest rates than it is to aggregates because interest rates have a real meaning for currency flows.

CHAIRMAN MILLER. Phil Coldwell.

MR. COLDWELL. Alan, what theory of intervention are you working under now? Do you just buy back enough to pay off [foreign currency debt], peg the rate, or bend with market forces? What sort of strategy are you working under?

CHAIRMAN MILLER. Let me tell you what strategy Alan is working under. It has been a consistent one from November 1 [of last year], which is that we would move in depth in both directions to avoid disorderliness in the market. That's what we have been doing consistently, despite people who pressure us from time to time to do something else.

MR. PARTEE. Would you say that there would have been disorderly strength in the dollar?

CHAIRMAN MILLER. Yes.

MR. HOLMES. Yes, I think it would have been a disorderly market on the up side, which is clearly possible.

MR. PARTEE. Well, it's a breakthrough then.

CHAIRMAN MILLER. Yes, indeed. Notice what happened when the Bank of Japan raised its discount rate. The yen weakened against the powerful dollar. I'm sorry to interrupt but I wouldn't want Alan to have to defend his own posture because it's one that he has been working under in coordination with us. And this is what we have been trying to accomplish. Other questions or comments?

MS. TEETERS. Mr. Chairman.

CHAIRMAN MILLER. Yes, Nancy.

MS. TEETERS. Where do you think the dollar is going now? Do you expect it to stabilize or do you expect the upward pressures to continue?

MR. HOLMES. Well, in the last week or so the flows slowed. There has been no new impetus to it. Part of the reason was the fact that the market got the perception that the Germans didn't want to see the dollar appreciate any more against the mark. That may be overcome, depending on what happens, and we may again get a reoccurrence of very large flows back into the dollar. But it has slowed down in the last week.

CHAIRMAN MILLER. Thank you very much. We now need to ratify the transactions since the last meeting. I believe you all have the reports. Are there any comments or questions or objections? Hearing none, we will record the ratification of those transactions.

Now we will turn to domestic operations. Of course, we have had great drama in this area since the last meeting. We've come as close as the nation could come to defaulting on its debt. So Peter undoubtedly will likewise have an exciting report.

MR. STERNLIGHT. I don't know if I will live up to the excitement of that billing, Mr. Chairman, although the delay in [raising] the debt ceiling certainly did have an impact on operations and on Treasury financing during the month. [Statement--see Appendix.]

CHAIRMAN MILLER. Thank you, Peter. Questions or comments? Henry.

MR. WALLICH. With the new wider distribution of Treasury bills, do you feel that the dangers of inadequate collateral for RPs are substantially reduced?

MR. STERNLIGHT. At the moment there is certainly ample collateral around, but some of those bills will be maturing later this week and next week, so we could get back into a situation of scarce collateral.

CHAIRMAN MILLER. Nancy.

MS. TEETERS. Was the heavy sell-off of foreign holdings for the swap operations or was it also to provide funds for that market?

MR. STERNLIGHT. Both were going on. There were swap repayments, but also foreign countries were undertaking intervention

and, as I understand it, they had to liquidate holdings of Treasury bills to raise the dollars they needed.

MS. TEETERS. Most of the $5-1/2 billion was for the intervention?

MR. STERNLIGHT. The greater part of it was for intervention, yes.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Peter, after these fluctuations over the last six weeks or so, how would you characterize the short-term markets--the short-term government market and the short-term private market--in relationship to the funds rate? That is, do you think the relationship is about normal or are rates high or low relative to the funds rate?

MR. STERNLIGHT. At the moment there's a temporary bulge in dealers' holdings of very short-term issues, particularly of Treasury bills, so I think the day-to-day financing costs are toward the high end of some range of variation. But I expect that to be transitory; those rates will probably come down in the next couple of weeks.

MR. PARTEE. So the government rates may be a little high relative to the funds rate, but the private rates--those on commercial paper and CDs and so forth--are low, aren't they?

MR. STERNLIGHT. CDs have been under some special influence because banks have been willing to pay off CDs, and they have obtained more of their financing recently from Eurodollar takedowns. The commercial paper rate seems to me to be about in a normal relationship to the funds rate.

CHAIRMAN MILLER. Thank you all. Again we need a vote to ratify the transactions. The reports have been circulated. Are there questions, comments, or reservations? Hearing none, we will record those as approved. We will turn now to the staff report on the economic situation. Jim Kichline.

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

CHAIRMAN MILLER. Thank you, Jim. Let's take a few moments to see if there are any questions about this before we turn to Steve. Yes, Phil.

MR. COLDWELL. In the forecast of federal and state expenditures, Jim, would you give me a little more explanation than I have seen on the negatives and positives in the first and second quarters? Are there some offsetting jumps of sizable magnitude?

MR. KICHLINE. We think the developments in the state and local area reflect largely a weather effect related to a slowdown in construction expenditures and capital outlays. Employment in the state and local sector declined, or was very weak at least, in the first two months and picked up in March. So I think what is happening here is a transitory factor that will shift activity out of the first quarter and into the second. On the federal side, I must say I think

we're talking about these miserable CCC payments, which tend to accelerate federal purchases in one quarter and disappear in the next and get revised away. So, we are not talking about anything that is a major factor; it's largely the sort of thing where we have higher expenditures in the first quarter and then a sharp drop in the second quarter, which is a paydown of CCC loans.

MR. COLDWELL. Just looking at your pattern, you have a positive on federal expenditures in the first quarter and a heavy negative on state and local [spending] and the reverse of that in the second quarter, with a heavy negative on the federal side and a pretty heavy positive on [state and local]. They just happen to cancel out.

MR. KICHLINE. State and local is weather-related and federal reflects CCC payments.

MR. ZEISEL. There was a big CCC payout in the fourth quarter--I'm sorry.

CHAIRMAN MILLER. No, go ahead Jerry.

MR. ZEISEL. This kind of sawtooth pattern drives us insane, but it is very common.

CHAIRMAN MILLER. Mark.

MR. WILLES. Thank you. I just wanted to ask how you treated the impact of decontrol of oil prices and how that fed through to the forecast for inflation. Was it any different than you would have treated it if the same amount of increase came simply as a result of an OPEC [price] increase? Is my question clear?

MR. KICHLINE. We did not treat it differently in terms of the price impact. On the real side, there are important differences. I believe I know what you are getting at. I think the question is what the percentage passthrough is and whether or not we are simply talking about shifting profits from refiners to crude oil producers, or how much do prices actually go up. And that's a major area of conflict. I might say we have treated it roughly the same; the Administration has treated it somewhat differently and assumed that only two-thirds of the costs get passed through.

CHAIRMAN MILLER. We show more inflation impact than the Administration does?

MR. KICHLINE. That's right.

CHAIRMAN MILLER. I have used 0.5, which is what you've used. They have used much less, I believe.

MR. KICHLINE. [They have used] 0.3.

MR. WILLES. Well, in addition to that, there is another factor and I don't pretend to know exactly how to [take it into account]. When OPEC increases its prices, it does so without an increase in supply. In the case of decontrol there's at least a hope that it is going to have a supply-side effect. When one works that

through the system, it's not clear whether in general--though clearly energy prices will go up--the inflation rate will go up.

CHAIRMAN MILLER. Yes, because of the lag effect.

MR. KICHLINE. One of the issues involved, which is very important, particularly as we get into the '80s, is that we have assumed some lag in the supply-side effects. We are talking about partial decontrol in 1979--it's very limited--and it's bigger in 1980. But by the end of 1980, decontrol in domestic prices is only about 55 percent completed. So I think the longer-run effects on the supply side are quite important.

CHAIRMAN MILLER. Willis.

MR. WINN. Jim, in the last three weeks we've been getting a little more evidence that disintermediation is starting to take place. We see it in terms of traffic in the Bank--direct purchases of [Treasury] securities--and we see it in looking at some of the institutional outflows. Parallel to that is the fact that long-term rates are starting to increase, particularly for the financing of office buildings and other such things. I get a reading that across the country for the first time [builders] are really starting to look very hard at costs and that a number of projects have suddenly been pulled back in April. Are we starting to see the bite of the policies that have been in train for some time? If that's true, then one gets a little different outlook than you projected for some of these things.

MR. KICHLINE. Well, on the thrift institution side, for mutual savings banks the numbers available through early April indicate a substantial decline in rates of inflow. For S&Ls, the March data show inflows up a little.

MR. WINN. That's right, but the April data--

MR. KICHLINE. We have scattered reports for April and we have been picking up the same sort of thing. Our own forecast, however, is not for a sharp deceleration of inflows but rather a gradual slowing. We don't have any massive change there. I might note, though, that in the mortgage market on the financing side we have been picking up increasing reports of stringency in various parts of the country. So if one looks at the mortgage picture, it has been much tighter both in price and nonprice lending terms. On the construction side, I don't have any reliable information that I could point to regarding recent changes that may be under way.

MR. PARTEE. Willis, I might just say that it took a little while for this money market certificate change to take hold. There were various cut-off dates. The credit unions didn't [get] cut off until the end of the month. In one city in Alabama we let every [institution] go to the end of the month. It took a while to get all that adjusted out, but the intention--and the expectation--is to do away with that differential, which will shift some flows from the thrifts to the banks.

MR. WINN. I wonder if the flows are going to go into market investments?

MR. PARTEE. They might because, after all, the compounding effect was cut back, so there is also a greater disadvantage compared with the market than there was.

MR. WINN. I think we are going to see more.

CHAIRMAN MILLER. We'll just go [unintelligible]. Paul.

VICE CHAIRMAN VOLCKER. All I have is the GNP deflator in your forecast, which I think is 9.4 percent this year. What would that be in terms of consumer prices?

MR. KICHLINE. We don't forecast the CPI directly; we do forecast [the deflator for] personal consumption expenditures, which is a close approximation for the CPI. For 1979 we have them virtually the same--about 9-1/4 percent for personal consumption expenditures and the deflator.

VICE CHAIRMAN VOLCKER. We are going to have to have a pretty low rate of price increase in the second half of the year to make 9-1/4 percent, given this first quarter.

MR. KICHLINE. Yes, by the time we get into the summer, say July or August, if we don't begin to see substantially slower rates of increase in the CPI, then this inflation forecast is clearly at risk of being too low.

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

CHAIRMAN MILLER. Thank you, Steve. Yes, Larry, we'll have a time for questions.

MR. ROOS. I'd like to ask one clarifying question and also a question after that. Early in your statement I believe I heard you say, Steve, that the slower growth of the monetary aggregates reflects slower demand for goods and services. Then further on I understood you to say, if I understood correctly, that in an inflationary economy such as we have people tend to increase their demands or purchases of goods and services. Is there a conflict in--?

MR. AXILROD. There's a slight conflict, you're quite right. I said early on that the slower growth [in the monetary aggregates] we're now having is consistent with our staff projections of a slowing later on in economic activity. But then I went on to say that the slow [monetary] growth we're having was sufficient to finance this rapid expansion in nominal activity. And the rapid expansion in nominal activity mainly reflects, of course, the rate of inflation and only to a minor extent expansion in real output. Real output was low in the first quarter; it increased at only a 1-1/2 percent rate and the rate of inflation was up close to 10 percent.

MR. ROOS. Could I just ask one further question, Mr. Chairman? What factors mitigate, in your thinking, the view that there will be a rebound in the monetary aggregates in the period ahead? What evidence would there be to justify your point of view other than wishful thinking?

MR. AXILROD. We only have two [pieces] of evidence. One is that the most recent week's data show a slowdown in the [decline] in the outstanding amount of savings deposits at commercial banks. That decline has gone on for five months; savings deposits have been dropping very sharply since late last fall. I think that mainly [reflects] a shift of those deposits into other kinds of assets, maybe even into goods, and [that process] has slowed. Therefore, we possibly are reaching the point where the stock outstanding has been shifted and [the process] is ending. That in itself will increase rates of growth as [it is now] subtracting [from them]. It involves taking away a negative factor. And then there have been slight indications in very recent data of some uptick in M1. But, again, President Roos, I don't feel the least bit [confident] that I could guarantee the Committee that there's going to be a rebound in M1 growth this month, next month, or the month after that because I don't know how long this kind of demand shift is going to last. In history we have not had periods with such rapid rises of velocity as we've experienced in the [last] three quarters in a row, including this second quarter. So on that ground alone, one might think velocity is going to drop and money will rise.

CHAIRMAN MILLER. John Balles.

MR. BALLES. Thanks, Mr. Chairman. I always find it difficult to disagree with Steve, particularly after such a lucid exposition as the one he has just gone through. I do have to quarrel though, Steve, with the conclusion that Larry has already addressed. What is the evidence that money will rebound? Last month, you may remember, I called attention to the fact that for the five months running through February the Bluebook forecast has proven to be considerably over the mark month by month for both M1 and M2. To add a little interest to this debate--of course, it's always easier to be a Monday morning quarterback--I gave my own forecast in qualitative terms. And my guess was that given this consistent pattern the March figures would probably come in significantly below what you were then forecasting. And with apologies for sounding like "I told you so," your March forecast for M1 was an increase of 5.7 percent and, as you know, it came in at .75 percent. I consider that significant. There was a better record on M2; the forecast then was 4.9 percent and its growth now is said to have been 3.6 percent in March.

To try to get my arms around what seems to be the problem, I had my staff prepare a memorandum, which I have handed out here, and I would like to take just a minute, Mr. Chairman, to run through a few of the highlights. There has been this pattern now for six months in a row, October through March, of a significant overforecasting of money growth month by month. That is shown on table 1 by months for M2 and M1; those [variances] are in percentage points. The average overforecast for M1 for those six months was 5.1 percentage points and the average overforecast for M2 was 2.8 percentage points, as shown in table 1. Chart 1, which is on the next page, is rather revealing. These monthly errors are just bound to be big. If anybody asked me if I could do better than Steve, I'd say "no I couldn't." This is a darn difficult job. Usually what happens, though, is that large errors in any given month will be offset by errors in the opposite direction in the next month. As shown on Chart 1, about half of the time or in a good part of 1975 and 1976 that is what in fact happened. But when we got near a trough in interest rates in the latter part of 1976 and

into 1977, the errors were all on one side. The staff was underforecasting money, as shown by the black areas below the zero line. We got into a period of rising interest rates in 1978 and the errors shown in the black shaded part were pretty much random. From late 1978 moving into 1979 the errors have again been systematic; they seem to occur at or near troughs or peaks in interest rates.

Therefore, Steve, I must say to you again, as I did last month, that [I question] the forecast in the April Bluebook, which shows M1 growth coming in at 6.75 percent--this is assuming alternative B and an unchanged funds rate--in May after 3.3 percent [in April], for an average of the two months of 5.5 percent. I suspect that's going to be several points too high when we get the actual numbers. I'd say ditto on M2, where the Bluebook shows M2 growth in April at an estimated 7.5 percent rate and in May at a projected 5.2 percent, for a two-month average of 6.35 percent. I think that's going to be several points too high. Now, if that's what the Committee wants to do, if that's the outcome we're looking for, fine. But we shouldn't walk into it accidentally. I'm beginning in my own mind to make some mental adjustments in deflating these current [Bluebook] figures until I see evidence that money is in fact rebounding at current interest rate levels. I'm afraid the evidence in the last six months gives me little comfort on that [score], Steve, and therefore I suspect that we may be unintentionally, as it were, leaning too hard and getting aggregate growth that in retrospect may prove to have been our undoing. My fear of this risk is compounded by the fact that, contrary to the Board's staff, we expect at least a mild recession beginning in the second half of this year. Without throwing in any detail, I expect it will probably be the classic inventory-type recession, hopefully short and mild.

CHAIRMAN MILLER. I think we have "Balles rule number one" now: That near troughs and peaks forecasts of money are wrong in the wrong direction.

MR. BALLES. Well, in short, Mr. Chairman, those are my misgivings. And I say that with apologies to the staff because I know this forecasting is a tough job. But when we detect systematic errors that run on as long as these have, I for one feel that we've got to make some mental adjustments. This to me says that it would certainly be a mistake to tighten right now by raising the federal funds rate. I think we can overdo that restraint and actually bring about a recession, or exacerbate one that may be in the works in any event. I'm very leery about overdoing it on the monetary policy side. I think there are limits--and we've spoken of this from time to time, Mr. Chairman--about how much can be accomplished by monetary restraint. Therefore, without getting into details on the specifications for the current period, I have a very strong bias against tightening and possibly will make a case for a bit of easing.

CHAIRMAN MILLER. John, thank you for those inputs. Chuck.

MR. PARTEE. Well, I just want to comment on what John said. I have some sympathy with that, John. The fact is that I might admit that [what you talked about] used to be one of my inside devices for forecasting if we had extended misses in the staff projections. Incidentally, Steve doesn't really do those. In his position I used to find that if the extended misses were in one direction, it was an

indication of a change. But what one has to examine is the reason for that. Is it that the staff is assuming there will not be a substantial change in the relationship between activity and money growth? The issue right now, I think, is whether there has been a change in the relationship that is not indicative of the future but indicative of a change in the demand function. So when you point out that the staff has misforecast over the last six months, all you're pointing out is that there has been some kind of change in the relationship, which the staff increasingly has come to believe is a change in the demand function. So it doesn't really answer--in case this has happened and I'm inclined to think it has happened to a degree at least--the aggregate [unintelligible]. You would have to be a strict monetarist to believe that there can't be a change in the demand function of money and, therefore, [that money] must be a forecast of the future.

MR. BALLES. Well, I think your point is well taken, Chuck. I'm not a strict monetarist and I'm not a strict Keynesian either. I don't know what that makes me--a non-monetarist and a non-Keynesian. Eclectic is one word. I used that word recently to a friend and he said: Did you say epileptic? In any event, there is a plausible case, and the staff has made it well, for a change in the demand for money. I am still somewhat skeptical that the whole outcome has in fact been because there's been a change in the demand for money. That's because we looked pretty closely this past month at what has been going on in money market mutual funds--which have been rapidly accelerating--and at RPs, which have been practically flat for some months now. And the two of them together have not been accelerating. [But that's what] they'd have to do, I would think, to explain the very sluggish growth in M1 and M2. I have a hunch that we may have seen both the combination of some downward shift in the demand for money and also, because we have been on a federal funds target--for pretty good reasons starting November 1, given the international crisis--the shrinking effect of that on bank reserves. [So I think] the very sluggish growth in bank reserves, or in some ways even the negative growth quite recently, also explains some of the outcome.

CHAIRMAN MILLER. We'll have Henry Wallich's question and then start the go-around and see where we really come out.

MR. WALLICH. I wanted to ask Steve what his reasons were for placing much confidence on the existing relationship. As Chuck said, there is at least a possibility that that relationship has changed. It has changed, I think, for two years running and has led us to an overprediction of $30 billion in that time, if I remember. People are now looking at what they consider to be inflation of 10 to 12 percent and that is a tremendous incentive to hold down not only M1 balances but also lower-yielding savings and time deposit balances. I really think that under these conditions we have to assume that there is a change in the relationship and, therefore, I don't see much basis for predicting a rebound. I think this shift can go on at a substantial rate for a long time. If I were to look at any monetary aggregate now, it would be more nearly bank credit plus commercial paper plus finance company lending. In any event I am aware that the monetarists are divided now, with some taking the point of view that the aggregates are moving too slowly and others arguing that the relationship has changed. I'm trying to ask Steve: What is the reason for thinking we'll get back on track with the relationship?

MR. AXILROD. Well, Governor Wallich, I really don't know and I don't think anyone knows when exactly we'll get back on the relationship. As you said, in the early stages of this expansion beginning around the end of '74 it took us 2-1/2 years to so-called "get back on the relationship." We have always assumed that this demand shift is not going to last as long because so much [of it] had occurred earlier and there is just that much less cash to use up. It was because of the uncertainty about the aggregates, as you point out, that I tried to stress as much as I did the kind of analysis one would go through in assessing the restrictiveness or non-restrictiveness of the present level of market rates. In that way I think one gets down to what is going to be a very judgmental factor, and that is assessing what really is the expected real return on capital. That is, if inflation expectations are accelerating, that could be offset by declining expectations in the real return of capital. One just expects to make less profit on any given investment. And that would tend, in so far as [assessing] restrictiveness, to offset the impact of accelerating inflation. So I really do believe under present circumstances that that kind of judgment is critical to policy, more so than a judgment--if I may put it this way without meaning it prejudicially--about a mechanical application of rules with regard to the aggregates. That's the more critical judgment now; it's essentially a judgment about the future economic outlook.

MR. WALLICH. I agree.

CHAIRMAN MILLER. Well, ladies and gentlemen, I think it might be appropriate now to start on item six [on our agenda], which is a Committee discussion of the economic situation and policy implications. What we've been doing recently is asking for you briefly to give your views on the economy, if they involve any significant differences from the staff projection, and the monetary policy implications this might have in general terms. After our break then we'll come back and look at the details and the specifications that might go into a directive. Murray Altmann has straightened me out finally on my random walk theory and, based on his straightening me out, I think we will start with Larry today and come around clockwise from there.

MR. ROOS. Mr. Chairman, I think we're in an almost no-win situation today. We're in a posture that was of our own making, in that we're reaping what we sowed 2 or 3 years ago by refusing to face up to the fact that by stabilizing interest rates we were permitting the aggregates to grow much too quickly. I think concerning ourselves with the subject of demand shifts is somewhat of an exercise in futility because I don't think we, in our monetary policy function, can control shifts in demand. We're not able to do that. I think the problem is on the supply side. Whereas the aggregates have grown excessively for nearly three years, we're in serious danger of repeating mistakes we've made in the past--and this is at least a near monetarist speaking. For us to jam on the brakes to permit the growth of the aggregates to drop as abruptly as they have and to continue to tolerate that is almost certainly an assurance of a recessionary result. I would just like to emphasize again that at no time did any monetarist ever suggest that there should be an abrupt pulling down of the rate of money growth from a high level to a low level. That is what is happening. I think our main decision today has to be whether we are going to expand the growth of money temporarily in order to

ease at least the extent of the recession or whether we are going to knowingly--and if we do it knowingly, we have to accept part of the responsibility--permit monetary growth to continue to be quite low and, at least as we see it, assure the advent of a recession.

CHAIRMAN MILLER. Thank you, Larry. Bones.

MR. KIMBREL. Mr. Chairman, [after] listening to our own directors on Friday and [based on] our own testing of the activity and the sentiment in our District during recent days, we are more nearly attuned to the [analysis] by the staff this morning than we've been in some time. We recognize the enormous uncertainties about prices, the aggregates, and business growth, and I find it almost useless to belabor this since we are very close to the staff's [projections] this morning.

CHAIRMAN MILLER. Thank you very much. Jim.

MR. SMOOT. Yesterday in meeting with my own staff on this, I think I suffered an information overload. One of the alternatives that was presented to me was called "the pure ignorance theory." That is, we don't know how the economy got here and we don't know where it's going. And I must say that I felt embarrassingly comfortable with that view. Nevertheless--

CHAIRMAN MILLER. That is the most honest comment we've had today!

MR. SMOOT. Nevertheless, I have to agree with Bones in that we can find no major area of disagreement with anything the staff has said at this point; we have minor points of difference, but nothing dramatic. If one can abstract from this horrible inflation problem, things don't appear to be out of kilter. [The economic expansion is] slowing down--I think the way we would like--and, therefore, in general terms our view would be to stay roughly where we are.

CHAIRMAN MILLER. Thank you very much. Willis.

MR. WINN. I hate to see such unanimity over there. I don't want to be a counterforce today. The inflation situation is still very bad. It seems to me that any easing would be misinterpreted and could only be counterproductive. On the [plus] side, it seems to me that the transfer mechanisms really are at work, both from the budget side and the food side. [As for] the oil side, we really don't know what that means. I have a feeling that our policies are really starting to work; they've been slow to take hold, but [monetary policy] is not a quick fix. And to be impatient at this stage would be a mistake. So I end up right in the middle--[no change].

CHAIRMAN MILLER. Fantastic. I've never seen this happen at these FOMC meetings before! Bob, you must have some different view.

MR. BLACK. There has to be one in every group! I have more doubts than usual about the staff's forecast, which is really one of stagflation for eight or so quarters. I don't deny that there's a possibility that can happen, but to me the weight of past evidence suggests that we're more likely to get cumulative effects and slip into a recession [than to achieve] the kind of soft landing that the

staff is projecting. My own feeling is that we're probably near the end of the current expansion and fairly close to a turning point. Inflation has [contributed to] a pretty severe attrition, I think, of real incomes and wealth positions. We see some convincing signs of this in the behavior of consumer and residential outlays. Some people take comfort in the strength that appears to be developing in the investment sector of business, but that is a lagging indicator and I don't think we can take much comfort in that. I'm more impressed with the scattered signs that are reported throughout the Redbook of lengthening delivery times, of some anticipatory inventory building, and a strong current preference of businesses for short-term versus long-term debt. When one talks to those in the business community there is an unusual unanimity in their views. They all seem to say that things are very good now, but they are scared as the devil about the future. I suppose that translates, Steve, into a belief that the real rate of return on capital is probably dropping.

So, I think we've arrived at the point in policy where we have to be seriously concerned about the steepness of the deceleration that is taking place in the rate of growth in the aggregates. Some slowing of the excessive growth that we experienced in 1976, 1977, and a good part of 1978 was clearly needed in an effort to have an effective anti-inflationary policy. I hoped we could bring the rate of expansion down, but at a more gradual rate of perhaps 1 to 1-1/2 percentage points a year. I thought it was the best way in which to wring inflation out of the economy and I still think so. But the deceleration that we've experienced since September has not been gradual. Even after allowing for ATS, NOWs, and a likely downward shift in the demand for money, in my view this has been an overly steep decline. If this is allowed to continue, I think we risk aggravating any recession that may be impending. If my feeling that a recession is close at hand has any merit at all, then at this stage I think we have to face up to the question of whether we want to risk adding to its severity by reacting to the recent inflationary figures. I have doubts about [the wisdom of taking that risk] for two reasons. In the first place, I think we probably will see some abatement in inflation as a result of the past slowing in the aggregates. Secondly, I'm not at all convinced that a severe recession would add significantly more to the reduction of inflation than a mild recession. And as a matter of political reality, if the recession is more serious than it otherwise might be, I think the political system is such that we're likely to have the kind of fiscal policy fallout that will aggravate inflation rather than help.

CHAIRMAN MILLER. Thank you very much, Bob. Nancy.

MS. TEETERS. I would like to draw the attention of the Committee to the change in our perception of what has been going on out there. Three or four months ago we were looking at a projection for the first quarter--I'm not criticizing staff, my own perceptions have changed markedly as we've gotten more data--of a rate of growth in GNP of 3 percent. It's now under 1.3 percent. We were expecting to have 3 percent growth in consumption. It's now negative; purchases of goods actually turned down. A whole range of estimates have come in considerably lower than we thought they were going to. The only indicator that seems to be up in real terms is employment. And I would point out to you that employment is not a leading indicator; it

generally [comes] in fairly strong around the final point of a cyclical expansion.

Also, two major reasons that we have used in the past to increase restrictiveness were an excessively rapid growth of the money supply and the need to maintain the international value of the dollar. Now both of those reasons have apparently disappeared. In fact, both of those would almost suggest that we should ease monetary policy at the present time. However, I also feel that anything we do at this point would be mainly psychological. It will have its impact six to nine months down the road and [at this point it] will primarily be for show rather than for any real impact. Finally, I'm quite concerned that if we tighten, within two months we will have to turn around and undo it. In my view the economy is slowing down and it would be a mistake to tighten credit further. However, given the rate of inflation, I think it also would be a mistake to loosen at the present time. So I would come out for maintaining the present policy.

CHAIRMAN MILLER. Thank you, Nancy. Chuck.

MR. PARTEE. Well, I think the picture is mixed. It seemed to me possible that we could have one final surge of activity and I've been quite worried over the last six weeks or so that that might be developing in the business sector in business equipment and in inventories. Whether right or not, I've become rather more calm about inventories in the last couple of weeks. For one, the February numbers were better; retail inventories were down. For another, there do seem to be some explanations--Jim cited quite a list--for the inventory accumulation. The Teamster's strike, the possibility of a rubber strike, the automobile situation, and so forth may have accounted for the unusual inventory accumulation that was reflected in the Redbook and for the raw materials price figures in the first part of this year. So I'm prepared broadly to accept the staff's forecast except that I, of course, think that the economy is going to weaken further and we'll have a recession toward the end of this year and [into] early next year. But let me say that for the time being the staff's forecast looks reasonable to me.

Another problem that we're all struggling with is the aggregates and how to interpret them. It seems to me that it has almost reached the point where it may just be a matter of one's predilection. Some people say we ought to tighten regardless of the aggregates because they're no good anymore and other people say the aggregates are just as potent as they used to be and are terribly important. Trying to sort through all this, I've been looking at the various credit numbers. Bank credit, which had shown some strength, seems to have been weakening as the quarter progressed as have other credit numbers. M5, for example, has been weakening steadily. But that measure doesn't include RPs and money market funds and things like that. One of the difficulties we have at this time when interest rates are very high--we've had it before--is that there's a good deal of grossing up in credit flows. And it's easy to double count credit flows. For example, if a money market mutual fund expands rapidly in size and buys bank CDs, you can't count both the bank CDs in the bank sector and the money market mutual fund on the other side because that's double counting. That's not really demand for credit or a credit flow. If a savings and loan or a mutual savings bank issues a money market certificate and buys a bank CD, the same is true. There

is excessive grossing, which doesn't really have anything to do with the economy.

CHAIRMAN MILLER. They're netted out in M7 aren't they, Chuck?

MR. PARTEE. They are, but we don't really [track that]. I've found, for example, that our Bluebook doesn't have M7. But they are netted out in another way. That is, the flow of funds accounts have a line for funds raised by nonfinancial sectors. That is like final demand in the GNP, if you will. In looking at that and relating it to GNP, I think I have found something of significance for the Committee to focus on. That number has been quite high over the last six quarters. It was lower in the earlier part of the recovery and expanded sharply in the last half of '77 and the first three quarters of '78. Going through those five quarters, for example, the numbers were 20.4, 18.7, 18.8, 18.3, and 19.1 percent. The average is a high number; it's distinctly higher than it had been before. In the fourth quarter of '78 funds raised as a percentage of GNP dropped from 19.1 to 17.6 percent. And in the first quarter of this year the estimate of our flow of funds people is that it dropped further to 14.2 percent. That's a rather marked drop--almost 5 percentage points in two quarters--carrying it well below where it was earlier in the recovery phase. And I think it is indicative of the fact that for some reason the demand for credit isn't there. It may be [because of] interest rates, it may be nonprice terms, or it may be as Steve suggested that the expected rate of return on capital is dropping. But for some reason [that demand] isn't there. And I think it does indicate in a very real sense that in the financial sector of the economy a fading is occurring that is consistent with very slow growth if not a downturn in the economy shortly. And I believe we ought to keep that very much in mind as we talk about making these [decisions] that affect the demand for credit and make credit even more restrictive or less restrictive.

CHAIRMAN MILLER. Thank you, Chuck. Paul.

VICE CHAIRMAN VOLCKER. Let me make a couple of observations. I sit here listening to all this about the aggregates and it seems to me that the only reasonable conclusion is not to put much weight on the aggregates. We see relationships that go way out of the range of historical experience. We haven't any idea of the validity of the forecast [for the monetary aggregates], I'm afraid, and the combination of those two events does not make me want to linger over the aggregates. When I look at the outlook for real GNP, it does seem to me that the staff forecast of six quarters of approximately 1 percent growth in GNP per quarter is inherently improbable. I don't think that has ever happened.

CHAIRMAN MILLER. Plus or minus 3 percent.

VICE CHAIRMAN VOLCKER. That is precisely the difficulty. The reason they have come up with this forecast is that one doesn't know whether the 3 percent error will in fact be plus or minus. I must say in talking about projection errors that I am much more concerned about the persistent errors in the projections of the inflation rate than I am about the recent errors in the projections of the monetary aggregates. The inflation projections have been

consistently on the low side. And I'm not just talking about the staff's projections; I think that has been true of most forecasters. And [inflation] clearly remains our problem. In any longer-range or indeed shorter-range perspective, the inflationary momentum has been increasing. In terms of economic stability in the future that is what is likely to give us the most problems and create the biggest recession. And the difficulty in getting out of a recession, if we succeed, is that it conveys an impression that we are not dealing with inflation. I'm afraid that is the impression that we are conveying. We talk about gradually decelerating the rate of inflation over a series of years. In fact, it has been accelerating over a series of years and hasn't yet shown any signs of reversing. I devoutly hope that it will in the second half of this year, but I think the staff is probably being too optimistic on what it will show in the normal course of events. I think the economy is essentially at full capacity and there is a real chance that the concern about a recession will be justified. But I also think there's some possibility we will have more of a boom for a longer period of time than we hope. I think it's clear that real interest rates are falling and the rate of inflation is up.

MR. PARTEE. It depends on the expected rate of inflation.

VICE CHAIRMAN VOLCKER. That is right. My observation would be that the expected rate of inflation has increased somewhat in the last six months and the nominal rate of interest has not. Therefore, the real rate of interest has declined. I don't see any reason why the profitability of investment under present conditions would be declining in Mr. Axilrod's terms, so I think policy has probably gotten somewhat easier. We may be one month closer to a recession than we were last month and I think we are late [in tightening], but I still am of the view that some greater degree of restriction would be more appropriate than the reverse [and] more appropriate than standing still.

CHAIRMAN MILLER. Thank you, Paul. Henry.

MR. WALLICH. I think we are in a very difficult situation. The real sector points down. Inflation points up. And the question is whether we can do anything about the downturn of the real sector without aggravating the inflation. I think the answer is no. It is very probable that a slowdown is ahead after four years of cyclical expansion. It would be really astonishing if we didn't get a cyclical peak after such a long expansion. The circumstances we observe are not those we've seen at other peaks. Unemployment is still relatively high. Capacity utilization isn't all that high. But the economy has changed. Six percent [unemployment] is now what 4 or 4-1/2 percent used to be, and 84 or 85 percent capacity utilization is probably what 87 or 88 used to be after all the obsolescence in the capital stock that changing price relationships must have caused. So I think we have all the makings of a cyclical peak; we don't know whether we will descend into a recession or just a slowdown. I see no similarity, however, to 1974. There's no comparable buildup and there's no financial crunch. Meanwhile, inflation and inflation expectations are clearly mounting. I think something like 1/2 percent per month or every two months is being built into expectations. If I believe Art Okun, every 1 percentage point in the inflation rate costs $200 billion to remove by orthodox means, and I don't know of any other

good means. I think that's greatly exaggerated, but I'd like to alert you to the very high cost, in terms of an inflation correction, we're incurring if all we're doing now is postponing that slightly. It is in any event probably inevitable. Actually, I think the choice we have is between a mild turndown now, in the second half of 1979, or a more severe one later after having suffered some more inflation. I don't think the choices are an obvious or foregone conclusion.

As far as the aggregates are concerned, I don't need the aggregates at this time to tell me that the economy may be heading for a slowdown. I think the aggregates have become very weak because of what seems to be a shift in demand. I see that as plausible because the equations by which we're guided don't really encompass expectations of inflation of the kind that we now see, where expectations have moved from the 8 to 10 percent range to the 10 to 12 percent range. I think Paul is right that real interest rates have declined. In fact, they're probably no longer positive. And in a situation like the present, the only halfway plausible guide is to aim at positive real interest rates. I'm not even talking about after taxes because after tax real interest rates are very demonstrably negative except for nontaxable holders. So looking at this combination of a possibility of a downturn, or even of recession, and almost certainty continued inflation at an accelerating rate if we don't act, I come out for some tightening of monetary policy.

CHAIRMAN MILLER. Thank you, Henry. Phil.

MR. COLDWELL. Mr. Chairman, I see no reason to prolong what you've heard from Paul Volcker and Henry Wallich. I agree with their positions. I would point out to the Committee that we've had several months now of status quo and in that several months we've had at least a 3 percentage point increase in the inflation rate. And I can see some more if we don't act.

CHAIRMAN MILLER. Thank you. Jim.

MR. MCINTOSH. Mr. Chairman, if one were to array the 8 or 10 most prominent forecasts, including the Greenbook forecast, clearly the Greenbook forecast with its rather heroic estimates of plus 1 percent real growth in six quarters would come up on the optimistic end of the array. Our own view is that we are heading toward a recession later this year, and that view is shared by most other forecasts. We don't see the case for tightening at this time, particularly since it doesn't buy us anything on the price front in 1979--and perhaps much of 1980--because of the lags. We think the choice is between easing or staying pat. Historically the Federal Reserve has had a tendency to overstay its policy at peaks and troughs, and it's our fear that we're about to repeat that performance. Therefore, we would argue in favor of a modest move in the direction of ease at this time in the interest of moderating the impact of the recession that we're [expecting].

CHAIRMAN MILLER. Thank you, Jim. Ernie.

MR. BAUGHMAN. Mr. Chairman, I have no particular quarrel with the staff forecast. It's interesting, however, that the discussion--with just a couple of exceptions--tends to suggest that the risk is on the down side rather than the up side. It seems to me

that the evidence is probably increasing that we have a fair amount of risk on the up side, at least for a temporary period here. Business conditions are very strong in the Southwest and labor markets are very tight. Even in that tight labor market there is heavy recruiting going on from rather distant areas. The only rationality I can see in that is that these out-of-area recruiters feel there's a significant element in that labor market that is familiar with the jobs in aircraft factories because certainly they shouldn't be attempting to pull people out of our market on the grounds of any significant amount of unemployment.

We're unable to see any indications of tightness in credit, with the exception of housing. And in that particular market the tightness in credit is a function of legal ceilings on interest rates. In fact it appears increasingly that what we're seeing in the monetary aggregates is the old [pattern] we saw under price ceilings on commodities in WWII. We found the price ceiling on the commodity disappears when there are alternative uses for the resources that will bring higher returns. And we've seen [such] alternatives develop with closer and closer characteristics of money. So if we keep the price ceiling on, it seems possible to me that M1 as we describe it at the present time is going to disappear.

Foreign investments continue to come into our area in significant volume. A natural disaster struck recently, which physically removed one bank. Other bank buildings in the area were not seriously damaged. But all the banks are operating. It is resulting in a substantial demand for currency. It did reveal, however, that a few people in the population still use the mattress. Reportedly one party brought in some $5,000 of $50 and $100 bills and said that he had decided the bank was a safer place than the mattress.

MR. PARTEE. Because of the tornado, that's true.

MR. ROOS. Was that a nonmember bank?

MR. BAUGHMAN. A national bank. I assume that it could be characterized as an involuntary member. Well, we immediately sent people to the area [affected by the tornado] to indicate that we were prepared to do what we could to assist. They reported that there were long lines of people drawing currency from the banks. One question I asked them was whether there were any indications that it was a run type of situation or simply a matter that in the circumstances people needed currency to continue doing whatever they were trying to do. And the report was that it was mixed. People had some questions as to whether the bank that was severely damaged--as I say, the above ground portion just disappeared--would survive. But other banks in town were accepting checks on that bank and I think that helped to reestablish confidence.

Coming to policy, the recitations by Mr. Volcker and Mr. Wallich, with which Mr. Coldwell concurred, captured my feeling of the present situation more closely than other commentary. I think we should at a minimum stand with present interest rates, but indications are that those rates are dropping behind other developments in the economy and, therefore, probably should be nudged up some.

CHAIRMAN MILLER. Thank you, Ernie. John.

MR. BALLES. Just to add briefly, Mr. Chairman, to what I said before, we should not have a dilemma, especially for those of us who expect a downturn, hopefully mild, sometime this year and going into early 1980. Intuitively, one is tempted, of course, to tamp a bit harder on the credit brakes because of the recent news on inflation. Having taken a good hard look at what we might get out of that, I doubt if an increase in the funds rate would really give us any quick fix. Certainly it wouldn't do anything that I can see in the foreseeable future to affect the things that have been especially important in [causing] the recent increase in prices--namely what has been going on in food and in oil. And if we did increase the funds rate at the moment, given the lag that I think exists between such an action and [when] it flows through to the real world, it would be some time in 1980 before that would have much of an impact. Secondly, any move toward a further slowdown in money--looking at the other side now--I'm afraid would simply exacerbate the recession that we probably are going to see in any event. The flattening out of retail sales for the past three months in my opinion suggests, as was said earlier around this table, that much of the growth in real GNP in the first quarter, modest as it was, was in the form of inventory accumulation. And while inventories don't appear to be out of line now, that picture, as I've discovered to my sorrow many times before, can change very quickly if final sales remain weak. The recent slowdown in personal income growth and the heavy debt position of consumers suggest to me that we can't look to the consumer sector for any real strength over the balance of this year. The trend toward austerity--if that's the right word for it--or less expansion in federal, state, and local government spending doesn't indicate that sector as a great source of strength in the year ahead. Although capital spending is now a source of strength, in my opinion it's simply too small and too volatile to support any broad-based increase in final sales. And I expect before this year is over [such capital spending will] be swamped by inventories going the other way.

So given the outlook on the real side, to tighten monetary policy further now would, I fear, seriously risk the repetition of 1974. In my view the Fed held interest rates too high, too long, and certainly exacerbated that recession. Finally, I would add that the case for tightening to support the dollar is much weaker now than it was several months ago in view of what we heard earlier in the report from the Desk. There was good reason starting last November to adopt the [policy] that we did and I have no regrets about it. Now that the dollar is strong, I think there is more freedom to consider what we ought to be doing in view of the domestic outlook. So where I come out is strongly against any tightening and with some leaning toward a little easing. That's because of my personal view, as I said to Steve, that his estimates of monetary growth will be too high on both M1 and M2 for the April-May period. That's too much restraint for me and I think it's going to make the recession somewhat worse.

CHAIRMAN MILLER. Thank you, John. Mark.

MR. WILLES. Thank you, Mr. Chairman. When economic theory and data appear to be in such disarray, it seems to me that we ought to introduce real factors. As exhibit A I would like to show the Committee the last shoe I was able to purchase, which cost me $559. It was made in Nebraska, which is someone else's District, I'm happy to say. But it's a clear demonstration of the fact that inflation is

a real problem and that when guidelines are imposed, quality just goes to pot.

CHAIRMAN MILLER. Well, I'm glad to get facts back into this [discussion]!

MR. WILLES. I would simply like to say, when I see all these arguments about real interest rates coming back to haunt me, that I'm beginning to wonder why I did that. Inflation numbers in the first half have been very bad; I don't think that should surprise any of us. They've been a little worse than we expected, I guess, but we did expect bad numbers. I think the second half is going to look better. Whereas last year I was anxious for strong and aggressive action, this year--two operations later--I'm painfully convinced that slow and steady as she goes is the appropriate policy.

CHAIRMAN MILLER. Thank you, Mark. Bob.

MR. MAYO. Mr. Chairman, I think the Board staff's forecast is a very good one though improbable. I agree with Mr. Volcker; it never happens that way. But to make it have jiggles is even more improbable. So let's keep our balance on the improbability theory. Like so many others, I feel that if anything the Board staff's forecast is too high on the real side and too low on the price side, unfortunately. But I am not saying that we are going into a significant recession. We may get awfully close to zero, though, before this calendar year is over.

In the Midwest, inventories are not excessive at the moment, although I grant the point that they can turn around very fast. I think the risk is still much greater on the inflation side than on the recession side. I am getting sick and tired, though, of hearing market analysts and the press blow up the fact that we are having so much difficulty at the Federal Reserve interpreting the monetary figures and, therefore, we feel we don't know what we're doing. It is getting ridiculous. As a non-monetarist to start with, I've been having trouble interpreting the monetary figures for the last ten years and I don't see that this is any worse. Really, I'm serious! I think the emphasis on the confusion has done us harm. We have tended to feed it and we should stop if we can, simply because our ability to be precise on the monetary aggregates--a precision that I feel was never [possible]--has been exaggerated. So I'd come out and say that we do know what is happening to the aggregates within the usual guidelines of our interpretation here. I might even go so far as to stick my neck out and say that I think monetary policy has done a good job in the last six or nine months in terms of achieving some slowing in the aggregates--not as exaggerated a slowing as the published figures on M1 show. But given the environment in which we had to work I think we have a [good] record. Having said that, I feel it would be premature to ease because of a fear of recession. It would exacerbate the inflation problem, so I would not like to see us ease. Any tightening we do should be no more than 1/8 point or so at the most. To change our basic [posture] from alternative B, or from where we are right now, would risk a very bad result. I don't want to cut off any strength in the dollar by easing at this point. I don't think we need to accentuate the strength of the dollar by tightening. So at this particular juncture I'm as much in favor of standing pat as I've ever been.

CHAIRMAN MILLER. Thank you, Bob. Roger.

MR. GUFFEY. Thank you, Mr. Chairman. I'm at the end of the table and perhaps everything has been said. I look forward to these meetings. [I was pleased] particularly this morning to learn that we have a new industry in Nebraska and they're apparently very persuasive if they can sell that shoe for $559 to Mark Willes!

As for the Board staff's Greenbook forecast, we agree generally with it, with a bit of exception to a couple of areas. If you look carefully at it, they have a [rebound] in GNP in the second quarter which, as far as our staff can tell, does not have any basis other than a hope that GNP will increase to a more acceptable level in quarter two of 1979. Also, we'd suggest that housing starts and consumer spending may not be quite as strong as they're projecting. Thus, we would say that their forecast is a bit on the optimistic side, but [the difference] is narrow; we feel the economy might be just a bit weaker.

Turning then to the aggregates, everything has been said about the aggregates. To be sure, all of them, including bank credit, have weakened measurably [even] with all the technical explanation that Steve has given. That, taken together with at least our outlook for the economy--and I think it would be true of the Board staff's outlook--the fact is that the restraint that has been put in place by monetary policy in the past is beginning to take effect. Looking forward to 1979, the risks certainly are on the down side. A recession--hopefully a moderate one--is quite likely sometime late in 1979 or early 1980. As for inflation, there's no question that it has been accelerating over the past months, but largely as a result of factors that we cannot control with monetary policy. That is, oil, food, and other such price increases will not be affected, at least in the short run, by anything we do here today. Thus, I would prefer that we stay where we are at the moment. I think a tightening would insure a recession. I don't think that's the way out.

As a result, I'd stay where we are and be prepared to move to a bit easier stance if we find that, indeed, the economy in the second quarter is coming in somewhat weaker than the staff is forecasting and if the aggregates remain weak. I'd give greater emphasis to M2 than M1 because M1 does not seem to have much value at the moment. [Unintelligible] all of the measures are weak [and] so long as M1 remains weak with the rest, it seems to me we can throw it out and probably focus on M2 and bank credit a bit more. And I'd be prepared to move to a bit easier stance if the economy does indeed continue to be weak.

CHAIRMAN MILLER. Thank you very much, Roger, and thank you all. Those were very interesting inputs. I would suggest that we take a 15 minute break and reconvene.

[Coffee break]

CHAIRMAN MILLER. While we're waiting, I'll merely say that my impression prior to joining this Committee was that it was just a social gathering of folks who enjoyed getting together once a month. But this meeting almost makes me believe that you've earned your pay--excessive though it may be! I'm talking of the Governors, of course!

I think we're all back; Jim will be here in a moment I guess. Let me make two observations. We've done a fast computer plot on your comments and it appears that we have a perfect bell curve. The Secretary was predicting to me that we'd have a 5 to 5 vote and for the first time in history there would be no new directive. That would mean that the Desk could go on doing whatever it is doing now, [even though] nobody knows what it is. However, just on the chance that we can break the 5 to 5--

MR. PARTEE. I wonder what would happen if we didn't have a [new] directive. I guess we would continue on the old directive.

CHAIRMAN MILLER. We continue with the old directive. I call your attention to page 5 of the Bluebook on which you see the three alternatives the staff has laid out. Having looked at that, hold your finger there and I call your attention to page 9. If one [starts] from the present position of M1 and M2 and plots out the ranges, in the case of alternative B the staff didn't update their charts. They changed their minds on this after they printed [the chart on page 9] so, instead of 2-1/2 to 7-1/2 percent, alternative B is actually 3 to 7 percent [in the table on page 5]. But that's all right; you get the point.

The new dotted line is an innovation that I thought would be helpful. It plots from the last data the trend six months ahead to get back to the midpoint--to show us how we're going to get back on track. This is known as the "Black amendment." Bob has been pushing us to do this--to try to give us a graphic way of glancing at it. So, M1 would need to grow at a 6-1/2 percent rate for six months to get back to the midpoint [of its long-run range]. Obviously, we can't get back on track in one month or two months without being too erratic but [this shows how] to trend back. On M2 the ranges for alternative B are 4-1/2 to 8-1/2 percent, and it would take a 9-1/2 percent trend [growth] for six months to get us back to the midpoint of the [long-run M2] range we established. Page 10 shows the same sort of thing for M3; we'd have to have a 9 percent rate [of growth to reach the midpoint] and an M3 range consistent with alternative B would be 5 to 9 percent. Bank credit of 6 to 8 percent is consistent [with alternative B], and there the midpoint of that 2-month 6 to 8 percent range happens to be consistent with getting back [to the middle of our long-run range] in six months.

Let me give you a couple of personal observations. One, I hope very much that we can develop a public view of the FOMC that we perform for substance and not for form: That we don't do things because they have some announcement value but because they have real effects on the economy. [Second,] I hope very much that we can establish the view that we're going to take action because it directs us toward where we intend to go and not because somebody this week or this month has some transitory idea. The more we get the idea [across] that we have ranges [and] we're going to get within them--if they're wrong we will change them--the more we do ourselves a service. That will diffuse the short-range idea that monetary policy can somehow affect the concurrent operation of the economy, which in my opinion it cannot do. It's false for us to think that it can and it's more important that we begin to educate the public that if there is monetary action, it will have an effect in subsequent quarters. It

should be looked upon as a leading policy direction rather than something that's going to affect today's activity.

I've been personally somewhat bemused by the use of the media to send us a message that there are those who would like us to take certain monetary policy actions. There are limits to monetary policy, limits to what we can do. There are frustrations in other parts of the government where their own policies have been disturbed by events that they perhaps cannot control, and that may cause them to look for monetary policy to do that which it cannot do. It cannot change prices this month or next month. It cannot change the real activity of the economy. Having looked at that and looked at our staff projections, I would say that I view these projections as consistent with the data I see on the general direction of the economy. The staff does not [pretend] that the quarterly figures can be achieved precisely. There's too much motion in the economy and the economy will bounce around from quarter to quarter. But I do believe their trend is correct--that is, that the economy is in a slowing mode. Whether it will slow into a recession or a low level [of growth], we'll see. The action we take now will influence that real activity six to nine months from now. That's what we're going to be doing today.

Looking at all of the factors, which you've recited so well, if we were really ready to bite the bullet [we could] say that the Federal Reserve knows what affects [economic] growth, we know how to measure [the effects of] our actions, and in our opinion the growth of money and credit has been restrained because of our prior action. To say we've done nothing about inflation is to overlook the fact that we went to considerable effort for a period of time to restrain the growth of money and credit through the actions that we took, which have resulted in those aggregates growing more slowly. Now, some of you say that's because of a demand shift. Well, that comes about because we got the interest rates to the point where demand would shift. [After all], how did it come about? It's just that we've gotten [rates] in a range where [demand] would shift; and having gotten them there, to say we're going to ignore it is rather peculiar to me because we are the ones who brought it about. We raised interest rates 3, 4 percentage points. And we are getting the restraint in terms of getting people to do something else with their money instead of buying things. We are beginning to get the impact, as Willis pointed out. So it would be rather peculiar if we should then begin, as we have often done historically, to abandon our own thinking and be affected by the transitory world around us and take an action [as if it would affect the economy] for today instead of the action [appropriate] for six or nine months down stream.

If we were really geared up to do it, we would probably fall in line with those who suggest that we begin to [consider easing] in order to fulfill our commitment to the public on the levels we expect these aggregates to be. If we really believed our own monetary policy recommendations, that's what we would do. We're not prepared to do that because we fear the expectations [effects]--the psychology--because we haven't yet educated the public to look upon us as doing something [now that will have an impact] in six months. We've tended to educate them, perhaps for our own egos, to think that what we do today [has a] powerful [effect] in the economy. And, therefore, we ourselves have made our task somewhat more difficult by giving the

impression that what we are is somehow the bulwark in the fight against inflation and we're going to change three price components that have been out of control--namely, the cost of food, energy, and housing. We're going to lower those by tightening. That makes no sense at all. We're going to lower them by bringing the economy down to a lower rate of growth and damping demand and letting that work itself through the system in the 6, 12, or 18 months that it always has taken. We're certainly not going to lower housing costs by raising mortgage rates; that's going to change them up.

So it seems to me that we would do ourselves a great service if we would ignore all the static and keep on what I think under all the circumstances is the wisest course. And that is to keep a steady hand, stay where we are, keep the aggregates under restraint over time. I do think that we have not prepared the public for the concept of easing at this point. And I think it would be a policy mistake to take action now that would exacerbate the economic slowness later; that in my opinion would only cause us to [face] a series of other transitory pressures to do something else equally as unacceptable. So I recommend to you that we follow alternative B and perhaps use a money market directive to maintain the funds rate about where it is now. With that recitation, perhaps we can go down the list and see how you all see it. John Balles.

MR. BALLES. Well, if we're expressing preferences for the first go-around, Mr. Chairman, I'd have to say I lean toward the specs of alternative A as far as M1 and M2 are concerned. I would not make the federal funds range as low as is shown under alternative A; I would suggest 9-1/2 to 10-1/4 percent. And I would like to see some easing within that range from where we've been for most of the past two months or so.

CHAIRMAN MILLER. Thank you very much, John. Bob Black.

MR. BLACK. Mr. Chairman, given my views of the economy and how I perceive monetary policy to work, strangely enough, I think all these aggregates ranges are really too low. I'd prefer for M1 a range of 5 to 9 percent--which would trigger action under a strict monetary aggregates directive if the rate came in under 6 percent--and perhaps 6 to 10 percent for M2, which would trigger action at 7 percent. I emphasize that strict monetary aggregates interpretation because I would not move initially. I would sit right where we are until we see something happening. If we adopted these specifications, we might well see the funds rate move down a little before the next meeting. I'm aware of the risks of that, but it does seem to me that the recent action proposed on reserve requirements might have at least some offsetting effect. Lest some of my more hawkish friends around the table think that I'm a late-hatching dove, I would hasten to add that if I'm fooled on this and the aggregates begin to grow rapidly, I would be just as quick to move the rate up a little, too. But I would sit still until we got some evidence.

CHAIRMAN MILLER. You'd keep the fed funds where it is. Yes, John?

MR. BALLES. Excuse me, I forgot to add that I would prefer the monetary aggregates directive. Excuse me, Bob.

CHAIRMAN MILLER. Bob you were finished, weren't you?

MR. BLACK. Yes, I was.

CHAIRMAN MILLER. Okay. Phil.

MR. COLDWELL. Mr. Chairman, the view of the world that you portrayed in your initial [comments] just doesn't happen to square with my view of what monetary policy can do nor with my belief in the desirability of public policy [moving] to restrain inflation. So I still would advocate that we put additional restraint in this package. I'd prefer ranges of 2 to 7 percent for M1 and 3 to 8 percent for M2, and a federal funds intermeeting range of 10 to 10-1/2 percent.

CHAIRMAN MILLER. And where would you put the funds rate now? Leave it where it is?

MR. COLDWELL. At 10-1/4 percent, the midpoint.

CHAIRMAN MILLER. Bones Kimbrel.

MR. KIMBREL. Mr. Chairman, I would much prefer at this particular juncture to see [policy] cast in terms of a money market directive. I have trouble with these [Bluebook] ranges. I personally would not like to see them change, so I'd like roughly 2 to 6 percent on M1 and 4 to 8 percent on M2. I would very much dislike having the fed funds rate drop below 10 percent during this intermeeting period. At the same time, I'm not very anxious to see it move up very much--maybe a shade to 10-1/8 percent with a range of perhaps 10 to 10-1/2. I'm not a subscriber to such a narrow range, but in this environment it may flow reasonably well. So I'd go with 10 to 10-1/2 percent with probably 10-1/8 at the moment.

CHAIRMAN MILLER. Okay, thank you. Bob Mayo.

MR. MAYO. Mr. Chairman, I would stick with alternative B. I would not object, however, to a tightening of 1/8 point or so, which would bring us closer to 10-1/4 percent [on the funds rate]. I think that could give a sign of resoluteness without getting us in trouble of over-reacting. Again, I would follow it as we go along and to some extent see what the market is telling us; I would accept a 10-1/4 percent rate if the market seemed to be telling us that. Otherwise I'd leave it where it is. I have no particular quarrel with the digits on M1 and M2, and I could buy either type of directive. A monetary aggregates directive might be a little better this time.

CHAIRMAN MILLER. Thank you, Bob. Chuck.

MR. PARTEE. Mr. Chairman, I think we really ought to be easing. It's past time. We've already gotten ourselves into considerable difficulty with respect to the behavior of the real economy. And I agree that there isn't much we can do to restrain the kind of inflation we have now other than to encourage moderate demand over the long pull. That's really the only instrument we have available to us to affect prices. The difficulty with easing now is that the public perception is wrong. In fact, all these newspaper articles and so forth have trapped us, or at least they have trapped me. I can't quite ease in the face of that. Also, I have a modest

concern yet about the March employment numbers--I'd like to see another month's figures--and the possibility of an inventory hump. I think the latter is still possible, but less likely than it seemed before.

So for the time being I would favor an unchanged policy but in an easing mode, one might say. And for that purpose we might as well have a money market directive because that certainly is what we've had all year. It doesn't make any difference what those aggregates have been. We've kept the funds rate unchanged and we ought to do it again. And if we are going to do that, it seems to me that [our decisions] ought to begin to reflect something of the longer-term strategy that you've indicated here--relating to these charts that have to do with our Humphrey-Hawkins pledge so to speak. I think 3 to 7 percent is too low for M1 if we intend to move back on track at all. I would make that 4 to 8 percent, as I think somebody else suggested. Well, there were a number of suggestions along that line. And I think we need to raise M2, which is going to miss the range even more. In that case, 5 to 9 percent would be a [step] on the way to that. That's within the context of the money market directive. That doesn't necessarily mean we would move, but we ought to try, to the extent that it is at all feasible, to have short-range target growth rates that are not inconsistent with moving back into the [long-run] bands that we have specified. Otherwise we ought to decide to change the bands and so inform the Congress. So, I would raise those two specs a little but with an unchanged funds rate of 9-3/4 percent. I'd be happy with a range of 9-3/4 to 10-1/4 percent. I don't know why the range needs to go up to 10-1/2 percent; we're not going to move there, I hope, in the period to come.

CHAIRMAN MILLER. Thank you, Chuck. Nancy.

MS. TEETERS. I would counsel that we stay unchanged. My [view] is that we should probably be easing. But again I don't think we're quite to the point where we should be doing it and [worsen] inflation. I think it would be the wrong move. I have no quarrel with the specifications of alternative B and I would go for a money market directive.

CHAIRMAN MILLER. Thank you, Nancy. Paul.

VICE CHAIRMAN VOLCKER. I think you were very eloquent, Mr. Chairman, and I agree with a good deal of what you had to say, but overlooked was the fact that inflation has tended to get worse and that the economy is very much at capacity and ought to slow down. So I find myself very much with Mr. Coldwell in terms of the specifications.

CHAIRMAN MILLER. Thank you. Henry.

MR. WALLICH. I share your views, Mr. Chairman, about what monetary policy can do with respect to the real sector; I don't think we can do anything that will affect it very much very soon. But monetary policy certainly can affect expectations and prices; prices can be changed overnight because of inflation expectations and I think that's what is happening now. So I think we can do something on inflation and we should. I'd go largely with alternative C. For M1 I'd have a range of 2-1/2 to 6-1/2 percent as in "C." I see no point

in trying to get back on track in six months. Chuck's thought that we should change the track and notify Congress might be one thing we can do to favorably influence expectations, because for M1 to grow over six months at that rate of speed we'd have to have--adding 2-1/2 percentage points for ATS--it growing at 9 percent for six months. I think that would be very inflationary and very alarming to the public. Continuing with the specifications, for M2 I'd say 4 to 8 percent. I would say 10-1/4 to 10-3/4 percent [for the funds range], go to the midpoint of 10-1/2 percent and not go below that without a telephone call. If the aggregates are very weak, then we should reexamine. And I'd go with a money market conditions directive.

CHAIRMAN MILLER. A money market directive. Ernie.

MR. BAUGHMAN. Mr. Chairman, my preference is for the specifications of alternative C except for the funds rate range. I would [lower] that down some to, say, 10 to 10-3/4 percent, with the idea that we would move during the first week to above 10 percent and by the end of the week probably to 10-1/4 percent depending somewhat on market developments.

CHAIRMAN MILLER. And which way [on the directive]?

MR. BAUGHMAN. With an aggregates directive.

CHAIRMAN MILLER. Alternative C and an aggregates directive. Thank you. Roger.

MR. GUFFEY. Thank you, Mr. Chairman. I would opt for alternative B straight down the line including the funds rate range. On the funds rate I'd remain where we are unless we see the aggregates moving outside the lower end of the ranges.

CHAIRMAN MILLER. Did you say an aggregates directive?

MR. GUFFEY. A money market directive.

CHAIRMAN MILLER. Thank you, Roger. Larry.

MR. ROOS. Mr. Chairman, I would opt for alternative A, for easing. If that were done, I would urge the Chairman to explain the rationale that this is not a permanent softening of our anti-inflation emphasis--that we are really doing it temporarily to try to reduce the impact of a recession. Sometimes our tendency is not to state our reasons publicly. I think we could probably counteract a certain amount of the inflationary expectations that this signal might cause.

Finally, I'd like to compliment you, sir, for your emphasis on establishing and announcing longer-range strategies and sticking with them, and abandoning our month-to-month fine-tuning over an 1/8 percentage point on the federal funds rate. That comes like a breath of fresh air. It's the best news I've heard for three years!

CHAIRMAN MILLER. Well, thank you, I think. Mark.

MR. WILLES. I'm afraid it comes too late, Mr. Chairman, since I'm no longer a voting member. But I like both your recitation and your specifications and I would go with those.

CHAIRMAN MILLER. I knew I'd get you someday! Willis.

MR. WINN. I have no quarrel with alternative B. I just wonder, in view of the discussion, if there's some symbolism that could be effected without really much change in market conditions, such as a 1/4 point increase in the discount rate. Reserve requirements might be expanded on some other items such as on Eurodollars and other [components where we know of] problems. I don't know whether this is the appropriate time--

CHAIRMAN MILLER. Those are certainly things we have to consider.

VICE CHAIRMAN VOLCKER. I meant to mention those, too. I think that is correct.

CHAIRMAN MILLER. Thank you, Willis. Jim.

MR. MCINTOSH. Mr. Chairman, we certainly agree with your comments with respect to adopting a policy that seems to be appropriate given the lags in our forecasts. We'd opt for either "A" as proposed or for the modification suggested by John Balles.

CHAIRMAN MILLER. Thank you, Jim. Dick.

MR. SMOOT. I don't know whether it's a fact of whom I'm sitting between today but I find myself in amazing agreement with them on certain points. We would prefer alternative B. We would not quibble about a 1/8 point increase in the federal funds rate although we don't think it's required. As far as [raising] the discount rate, that's another possibility we had considered. That might merit some consideration if the funds rate rises at all. But fundamentally, alternative B is fine.

CHAIRMAN MILLER. Okay, thank you all. Let's see what we have. Bob did you have a range for the fed funds rate?

MR. BLACK. I neglected to say it, Mr. Chairman. I had 9-3/4 to 10-1/4 percent, but I could leave it unchanged without much quarrel, really.

CHAIRMAN MILLER. What is it now?

MR. BLACK. It's 9-3/4 to 10-1/2 percent, but I wouldn't want to use the top quarter.

MR. PARTEE. I had the same specs as you did, Mr. Chairman.

CHAIRMAN MILLER. We have a very mixed bag. Paul, did you want a money market or an aggregates directive?

VICE CHAIRMAN VOLCKER. [Given] the fact that we've been operating with a money market [directive], I presume we would continue to do so almost regardless of what we say here today.

CHAIRMAN MILLER. We keep saying we're doing something else, but we keep going with a money market directive, don't we?

VICE CHAIRMAN VOLCKER. I think that would be appropriate, yes.

CHAIRMAN MILLER. Well, it's going to be hard to make anything out of this. Five have the bottom of the fed funds range at 9-3/4 percent--I told you it would be five to five--and one has it at 9-1/2 percent. John, you said 9-1/2 percent on the bottom side?

MR. BALLES. Yes sir.

CHAIRMAN MILLER. Could we get you up to 9-3/4 percent? Then we'll have six.

MR. BALLES. Well, I'm a reasonable guy.

CHAIRMAN MILLER. On the top side we have three at 10-1/4 percent and everybody else is at 10-1/2 save Henry, who is at 10-3/4 percent. Have I misstated anyone's views? I think Henry is the only one at 10-3/4. As modified, John, you're 9-3/4 to 10-1/4; Bob [Black] had the same, 9-3/4 to 10-1/4. Phil and Bones had 10 to 10-1/2. Bob Mayo had the "B" range, which is the [current one of] 9-3/4 to 10-1/2 percent. Chuck had 9-3/4 to 10-1/4; Nancy, 9-3/4 to 10-1/2; Paul, 10 to 10-1/2; and Henry 10-1/4 to 10-3/4. That would indicate that something like 9-3/4 to 10-1/2 percent might fly. Let's put that down tentatively. There are lots of 10-1/2s on the up side; we're bracketing everybody, you see. We have nobody below [10-1/2 percent] and only one over it. We're going to have very little room for dissent when we're through here!

MR. PARTEE. Henry's safe!

CHAIRMAN MILLER. We have one member for easing some and we have five for prevailing [conditions]. Now, if John Balles is a reasonable man, he'll stick with prevailing and we'd have six for that.

MR. BALLES. I'm sorry, Mr. Chairman, will you say that again?

CHAIRMAN MILLER. We have a range for the fed funds rate and now the question is, do we keep the present [rate] or move it up or down. You suggested we move down. Five other members of the Committee suggested the prevailing rate. And four others suggested going up, although Bones did not; he said 10-1/8 percent and that's where we are now, more or less.

MR. KIMBREL. Right.

CHAIRMAN MILLER. Where we are is 10 to 10-1/8 percent, so you are pretty much for the prevailing--

MR. MAYO. I'm for prevailing also.

CHAIRMAN MILLER. Well, we have [a majority for] the prevailing rate, obviously. Now for the ranges. For M1, there's a definite split. Let's put down 3 to 8 percent. We have two for 3 to 7, one for 4 to 8, one for 5 to 9, and a couple for 2 to 7 percent. Help me with my mathematics. It looks as if we need something lower

to catch some who are interested in that possibility and something higher to catch others.

MR. PARTEE. How about 3 to 9 percent?

CHAIRMAN MILLER. Well, we need two 3 to 8 percent ranges--3 to 8 on M1 and on M2. That's the answer! Actually, we need 3 to 8-1/2 percent on M2, don't we? Or 4 to 8-1/2 percent. You all wouldn't stick with anything reasonable. You had to have all this individuality.

MR. BLACK. We were reasonable; we just weren't persuasive.

CHAIRMAN MILLER. Eight are calling for that directly and one is near it. Put down 4 to 8-1/2 percent. There seemed to be a majority for a money market directive, which means it's all an exercise anyway.

MS. TEETERS. Is it 4 to 8-1/2 percent for both M1 and M2?

CHAIRMAN MILLER. Let me see if I can read what I have here. This is very hard. Let's say a fed funds range of 9-3/4 to 10-1/2 percent and maintain the prevailing rate, which now is 10 to 10-1/8 percent--is that correct, Peter?

MR. STERNLIGHT. Yes.

MR. BALLES. Would you repeat that midpoint?

CHAIRMAN MILLER. The midpoint would be 10 to 10-1/8 percent, the prevailing level. The midpoint is slightly off center--asymmetric if you want to be technical. The rest is: M1, 3 to 8 percent; M2, 4 to 8-1/2 percent; and a money market directive. How many of the voting members do we have for that?

MR. PARTEE. An indication?

CHAIRMAN MILLER. An indication only.

MR. ALTMANN. None.

CHAIRMAN MILLER. None. Zero. I knew we weren't going to get a vote today! I told you we were going to keep [the existing directive]. Let's go [through] this. How many are happy with the 9-3/4 to 10-1/2 percent [funds range] with the prevailing [funds rate initially]? We seemed to have 6 or 7 for that before. I don't know what happened. Because nobody likes the whole thing, I have to know what's wrong with it. That [funds range] seemed to have a majority. There were about 6 or 7 people who wanted that. Seven. Okay, that takes care of that.

MR. PARTEE. What about the aggregates?

CHAIRMAN MILLER. Obviously, it's the aggregates that are wrong. All right, nobody wanted any of the aggregates [ranges I cited]. Let's go back down the list. John, what do you want for M1 on a compromise? You didn't get your 5 to 9 percent the first time

around. You were [not] the only one who went as high as 9, because Bob [Black] outdid you--he went to 10 percent.

MR. BLACK. Mr. Chairman, I think I said the 5 to 9 percent.

CHAIRMAN MILLER. Oh, we got them mixed up here.

MR. BLACK. I don't want him to get the credit!

CHAIRMAN MILLER. What I have down here is that John had 5 to 9 percent. What did you really say before?

MR. BALLES. I said 3-1/2 to 7-1/2 percent.

CHAIRMAN MILLER. I'm sorry, I'm talking M2.

MR. BALLES. It was the specs of alternative A on M1 and M2.

CHAIRMAN MILLER. You had 3-1/2 to 7-1/2 percent, right?

MR. BALLES. Yes.

CHAIRMAN MILLER. And you don't buy 3 to 8 percent. Or do you? It's a half percentage point each way--very precise tuning.

MR. BALLES. Mr. Chairman, I would take the revised specs that you indicated of 3 to 8 percent on M1 and 4 to 8-1/2 percent on M2. I do it with great reluctance in view of the money market directive, however. That's my hang-up.

CHAIRMAN MILLER. Okay. Let's go down [the list] again. Bob, you had much higher ranges; you had 5 to 9 and 6 to 10 percent.

MR. BLACK. I could come down to 4 to 8 percent on M1. M2 doesn't make a lot of difference to me really.

CHAIRMAN MILLER. Could you live with 4 to 8-1/2?

MR. BLACK. Oh yes, I'd like that even better.

VICE CHAIRMAN VOLCKER. That's the M2 [you proposed].

CHAIRMAN MILLER. Yes.

MR. BLACK. I can live with that part of it, but I--

CHAIRMAN MILLER. You need 4 to 8 percent on M1.

MR. BLACK. If we have a money market directive, I would want it that high. If we have an aggregates directive, I could go with 3 to 8 percent, I guess.

CHAIRMAN MILLER. All right. Phil Coldwell, you had 2 to 7 and 3 to 8.

MR. COLDWELL. Well, what I think is important to look at here is the upper part of the M1 range. Seven percent is the peak for alternative B, and if we're going to maintain a steady directive I

think we ought to keep some balance. I lowered [the bottom of the M1 range] to 2 percent just to give a little balance, but I'm willing to go with a 3 to 7 percent range on M1.

CHAIRMAN MILLER. Okay. Bones, you had 2 to 6 and 4 to 8.

MR. KIMBREL. I like the 3 to 7 percent much better and, obviously, 4 to 8-1/2 percent is fine, particularly if we're going to have a money market directive.

CHAIRMAN MILLER. Okay. Bob Mayo, you had 3 to 7 and 4-1/2 to 8-1/2.

MR. MAYO. I'm flexible within a 1/2 point on those.

CHAIRMAN MILLER. Okay. Then you really can be bracketed. And you had an aggregates directive.

MR. MAYO. I had aggregates. But Paul is right: In effect, we're using a money market directive.

CHAIRMAN MILLER. That's what we've been doing, yes. Chuck, you had 4 to 8. You don't like 3 to 8?

MR. PARTEE. Well, I really do believe we ought to have something that brackets the path for getting back within the longer-run ranges.

CHAIRMAN MILLER. And 3 to 8 percent didn't do that?

MR. PARTEE. No. The 4 to 8 is close--6-1/2 percent is the midpoint that is specified on that chart over the six months--so even that's a little short. It really ought to be what Bob suggested, 5 to 9 percent. But, I, of course--

CHAIRMAN MILLER. Nancy, you had--

MS. TEETERS. I had 3 to 7 and 4-1/2 to 8-1/2.

CHAIRMAN MILLER. Yes, 3 to 7 and 4-1/2 to 8-1/2. Paul, you had the 2 to 7 and 3 to 8 that Phil had specified.

VICE CHAIRMAN VOLCKER. I don't feel very sensitive to these ranges when the figure bounces around plus or minus 5 percentage points. I can't worry about a half percentage point on either end.

CHAIRMAN MILLER. Henry, you had 2-1/2 to 6-1/2 and 4 to 8 as the ranges.

MR. WALLICH. I have a hard time because I add 2-1/2 percentage points to each of these and it gets very high for M1. M2 wouldn't worry me so much.

CHAIRMAN MILLER. All right, let's try it again. Where did we come out? Murray, you're supposed to do the rest! I think we can sell 4 to 8-1/2 percent on M2.

MR. COLDWELL. How about 3 to 7-1/2 percent on M1?

CHAIRMAN MILLER. With 3 to 7-1/2, you didn't pick up Mr. Partee, did you?

MR. PARTEE. No, you certainly didn't. Of course, you're not looking with us on the money market-- [Laughter]

CHAIRMAN MILLER. Yes, we have to look at the 7 and who wants the--

VICE CHAIRMAN VOLCKER. I'll go with your aggregates if you go with my interest rate. You can go another half percent--

CHAIRMAN MILLER. We have to resolve this. How do I do it? I have to take some votes here on several options. Just on M1, I'm going to try 3 to 8, 4 to 8, and 3 to 7. Let's start with 3 to 7. How many of those who vote would buy 3 to 7 percent? One, two, three, four, five. I'll buy it, which makes six. Well, wait a minute; I may not. Count five. Who wants 3 to 8 percent? Anybody?

MR. MAYO. In preference to 3 to 7?

CHAIRMAN MILLER. Which one of the three--3 to 7, 3 to 8, or 4 to 8. We're going to use those three choices for a moment; take only one. At 3 to 7 percent, I had five hands up. All right now 3 to 8 percent. John.

MR. BALLES. I'll [change] to 3 to 8.

CHAIRMAN MILLER. All right, we'll change it; we have 4 for 3 to 7 percent. Right? And 3 to 8 percent suits me. That's two. Okay, let's try 4 to 8 percent. That's two. That adds up to 8, so two people didn't vote; two people want something different. All you folks at 3 to 7 go to 3 to 8, and all you folks at 4 to 8 go to 3 to 8. Okay? Now, 4 to 8-1/2 percent on M2 seemed all right. [Let's assume for M1] 3 to 8 percent--that everybody went in the middle. So now it's 9-3/4 to 10-1/2 percent for the funds range, maintaining the present rate of 10 to 10-1/8 percent, with an M1 range of 3 to 8 percent, an M2 range of 4 to 8-1/2 percent, and a money market directive.

VICE CHAIRMAN VOLCKER. Isn't that right where we started out?

CHAIRMAN MILLER. No, it's changed; it's absolutely changed. How many tentatively [can accept that], without voting [officially]. Paul.

VICE CHAIRMAN VOLCKER. No.

CHAIRMAN MILLER. John.

MR. BALLES. No, but for the other reason.

CHAIRMAN MILLER. Which reason?

MR. BALLES. The money market directive.

CHAIRMAN MILLER. Okay. Bob?

MR. MAYO. I agree with John, Mr. Chairman.

CHAIRMAN MILLER. Phil Coldwell.

MR. COLDWELL. No.

CHAIRMAN MILLER. Bones Kimbrel.

MR. KIMBREL. Yes sir.

CHAIRMAN MILLER. Bob Mayo.

MR. MAYO. Yes.

MR. PARTEE. Yes.

MS. TEETERS. Yes.

MR. WALLICH. No.

CHAIRMAN MILLER. So it's four and five. What if we change it to an aggregates directive? Let's try again with an aggregates directive.

VICE CHAIRMAN VOLCKER. No.

MR. BALLES. Yes.

MR. BLACK. Yes.

MR. COLDWELL. No.

MR. KIMBREL. No.

MR. MAYO. Yes.

MR. PARTEE. Yes.

MS. TEETERS. No.

MR. WALLICH. No.

CHAIRMAN MILLER. There we are again! I suggest we go to the next subject and have lunch. I knew we were going to have no directive today! Okay. The next agenda item is--.

I forgot to tell you that I have some information that will not be public until this afternoon so you're not to disclose it, but the housing starts for February have been revised to 1,384,000, and for March the number is 1,793,000. The staff had 2 million in their estimate, so the March number is lower than their estimate. The permits for March are 1,579,000. Jim, any comment?

MR. KICHLINE. No.

CHAIRMAN MILLER. No news to you.

SPEAKER(?). Maybe after that we can reach a consensus.

CHAIRMAN MILLER. Do you want to vote again?

MR. PARTEE. What would it take to get two aggregates directive people on line for the [money market] directive?

MR. BLACK. Four is the lower limit for me.

CHAIRMAN MILLER. What is? Four?

MR. PARTEE. That's certainly better.

CHAIRMAN MILLER. All right, let's try that one. I knew we'd get a compromise here. I threatened to leave it [and stay with the existing directive].

MR. PARTEE. You're going to try 4 to 8 percent on M1?

CHAIRMAN MILLER. Murray, we're going to take one more stab at a vote. Then we're going on to the next topic. We're going to use the same fed funds range, which is 9-3/4 to 10-1/2 percent and [initially] we're going to maintain the present fed funds rate of 10 to 10-1/8 percent; we're going to have M1 at 4 to 8 percent and M2 at 4 to 8-1/2 percent; and we're going to have a money market directive. Okay. Paul, you're just a constant no.

MR. ALTMANN.

Vice Chairman Volcker	No
President Balles	Yes
President Black	Yes
Governor Coldwell	No
President Kimbrel	Yes
President Mayo	Yes
Governor Partee	Yes
Governor Teeters	Yes
Governor Wallich	No

CHAIRMAN MILLER. I'll vote yes, so the vote is 7 to 3. It's sort of simple! Would any of the dissenters like to change their minds?

VICE CHAIRMAN VOLCKER. Do you have an April housing starts figure for me?

CHAIRMAN MILLER. This is the water shed. The fever has broken and next month we will have a unanimous vote. Now we will go to the next subject, which is consideration of the Manager's recommendation with respect to foreign currency operations. Alan Holmes.

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

CHAIRMAN MILLER. Thank you very much, Alan. Quite an unwinding job. Now we need to have a discussion of the question that was brought before the Committee previously and that is holding balances in foreign currencies. The Committee previously authorized the holding of up to $500 million in foreign currencies. But it was the desire of the Committee to have the question of whether we should hold larger amounts or none at all [studied by the staff]. Developed

for your consideration was a memorandum submitted jointly by Steve Axilrod and Alan Holmes, with supporting memos from the Board's International Division and from the New York Bank on possible recommendations. I might ask Steve and Alan to comment on this and we will open it up for discussion. Steve.

MR. AXILROD. Mr. Chairman, I believe the two supporting memoranda provide the Committee with the various arguments in some depth--with some differing points of view--and I don't feel it is necessary to review those arguments orally. Mr. Holmes and I have recommended raising the informal limit on balances to the neighborhood of $2 billion for the four reasons that we have outlined [in the memo]. One thing I would like to highlight is [something I've learned] in the relatively brief time I have been involved in this area. It's a rather practical approach. And that is, if you are going to play in the game, you've got to have chips. Playing in the game means not only with relation to the rest of the U.S. government but with foreign central banks. So, our holding balances [of foreign currencies] would seem to me very crucial in order to have a degree of flexibility in dealing with these groups. If the Federal Reserve is to have what I think will be a necessary input into the decisions that are made in this international game of affecting foreign exchange market operations, I believe we need to hold some balances. And I would simply stress that view, Mr. Chairman.

CHAIRMAN MILLER. Do you have a question for Steve, before we hear from Alan?

MR. ROOS. No sir, I'll wait.

MR. HOLMES. Mr. Chairman, I don't have very much to add. The only thing I would stress is that because we have been in the forefront of this activity for a very short period of time we were able to buy $2-3/4 billion in foreign currency. Now, that type of period may not repeat itself, yet it could. So to give us flexibility I would feel much happier if we had more than the $1/2 billion of leeway, of which we have already used half at the moment. Establishing a limit of $2 billion does not preclude us, in my view, from doing what we may eventually want to do, but I feel we have to wait for time, experience, and some testing of markets and other thinking. I believe the memos are fairly self-explanatory and I have nothing more to add.

CHAIRMAN MILLER. Fine. Thank you very much, Alan. Now, Larry, we will come back to your question or comment.

MR. ROOS. Mr. Chairman, I'm concerned about one bit of verbiage where reference is made to two possible policies. One says U.S. policy is aimed at countering short-run disorderly market conditions. Then there is explicit wording in the Morton-Truman memo which says that if U.S. policy is also designed to resist exchange market movements that carry the dollar's value beyond levels that are deemed to be reasonable in either direction, the United States might want to be prepared to accumulate substantial holdings. My question is this: In terms of the rules of the game that we are playing, are we contemplating going beyond just reacting to disorderly conditions and actually trying to peg [the value of the dollar]?

MR. HOLMES. I don't think anyone is suggesting pegging, but the whole November program was based on the thought that the dollar had gotten out of line, it had gone [down] too far. Now, that is a very rough judgment. It's not pegging.

MR. ROOS. Whose judgment is that, Alan?

MR. HOLMES. I think that was a collective judgment of the Administration, the Treasury, and the Federal Reserve.

CHAIRMAN MILLER. I might mention, Larry, that at Henry's suggestion the staff prepared some data on a series of currencies, looking from 1973 to date at price adjusted exchange rate indices. In other words, the weighted average [exchange rates] would be adjusted by CPI indices. It might be worth sending this to the members of the Committee just for their information. It's very helpful. One way to look at it is that the difference between inflation rates of two countries should be taken into account in terms of where those currencies ought to be over a period of time. One could also, in my opinion, look at it in relation to the opportunity [costs of] holding those currencies in terms of interest rate differentials. That would tell you whether the rates were being maintained in relation to [their respective] purchasing power. What will you be able to buy at the end of the year--or after two years--by holding one currency over 12 months as compared to holding another currency over that 12-month period? None of these ways is perfect, but they are indications. I think what Alan and Steve and others are getting at here is that if there were a real departure from anything that could be rationalized by inflation or interest rate differentials, we might want to say, well, there is just total disorder in the market. And we'd have to do something as we did on November 1 to get it back in line. We hope that doesn't happen again, but it can happen; basically it happens when we have failed to keep up with the situation for too long.

MR. ROOS. I see.

CHAIRMAN MILLER. Next [on my list of people who want to comment] is Chuck, then Bones, Phil, and Henry. Chuck.

MR. PARTEE. Mr. Chairman, I have real concern about the Federal Reserve holding substantial foreign currency balances. I don't think it's the appropriate thing for us to do. I've never liked the idea of U.S. institutions in general holding large foreign balances. [It means they] aren't financing their primary activity of spending or investment or whatever it is. I think we have a swap system that is perfectly adequate; it was developed over time. I found the reasoning in both memos very strained as to what the advantages would be in terms of being able to operate without the blessing of the Bundesbank or whatever. That's because, in fact, when we spend marks--whether we borrow and spend them or we [hold them and] just spend them--the Germans are going to have the same liquidity problem. We're going to have the same tolerance of their sentiments as we would otherwise. Also, let me mention that we seem to get a good deal lower rate of return on these [balances], at least in the case of Germany and I guess Switzerland and [Japan]. I was interested to see that apparently my concern was shared by the framers of the Federal Reserve [Act] because both memos specify that the Federal

Reserve Act says that it is against the law for the Federal Reserve to hold foreign currency securities. Then they go on to--

MR. HOLMES. Government securities.

MR. PARTEE. The one [reference] says government securities; the other doesn't. The other says foreign currency securities. Then [the memo] goes on to say that we can get around the law. I don't think that's an appropriate thing for the Federal Reserve to do--to find a way to get around the law. If we have a need for relatively small working balances, that's one thing. But if we're going to develop [a program for] large amounts of foreign currency holdings, that's another. I also noticed with interest that the memo from Messrs. Holmes and Pardee says on page 9 that a good cushion to begin with would be two or three days' worth of heavy intervention. That signals to me an intent here and a very possible threat of building up large balances. So I must say I oppose it.

VICE CHAIRMAN VOLCKER. Could we have some clarification of the legal point?

CHAIRMAN MILLER. What is the legal point? Paul is asking about the legal point of holding foreign currencies.

MR. HOLMES. We cannot hold foreign government liabilities.

VICE CHAIRMAN VOLCKER. Just government, right?

MR. HOLMES. We can hold private--

VICE CHAIRMAN VOLCKER. My assumption always has been that [the authority to hold foreign government securities] was not put in the Act originally because in those days there was not much deficit financing; there weren't many foreign government securities. What [central banks] held in those days were acceptances, deposits or some other form. Am I wrong about that?

MR. HOLMES. I am not a lawyer but my impression is that the Act described what was typically held by a central bank and it has not been revised over these many years.

MR. PARTEE. Well, why the prohibition on foreign government securities if it is--

MR. HOLMES. There weren't any.

VICE CHAIRMAN VOLCKER. It just wasn't listed.

MR. PARTEE. Did they prohibit everything that there wasn't anything of?

CHAIRMAN MILLER. They listed what we could hold. Is that what you're saying?

MR. HOLMES. That's right.

CHAIRMAN MILLER. It's the absence of a security that didn't exist. It didn't exist so it's not on the list.

MR. PARTEE. Oh, so they didn't prohibit it?

MR. HOLMES. It's not prohibited. It's just not listed as one of the assets that we might hold, primarily I think because none [existed] at the time the Act was written.

CHAIRMAN MILLER. That's quite different, I think. There was no expressed desire to prohibit. There were just no such securities around, so they didn't list them.

MR. HOLMES. I think it's that simple.

CHAIRMAN MILLER. Bones.

MR. KIMBREL. Mr. Chairman, maybe I'm [approaching] the problem from a slightly different angle but I think it may be prudent action to acquire some of these [currencies]. My question, though, is that I'm not sure I followed Alan when he was suggesting the dimensions. The numbers you suggested were $500 million and then $2 billion. I'm not sure what you're thinking now.

MR. HOLMES. As you recall--I think it was at the February meeting--we had been running with an informal limit of $150 million. There was nothing formal about that [limit], but it was an informal one that we had always respected at the Desk. In February I noted that we were making some progress in repaying [our swap debt] and I suggested that the Committee might want to consider [acquiring] $500 million and the Committee [approved that]. Now we're suggesting, since we have made such tremendous progress repaying swap debt and since there may be opportunities to acquire some more [foreign currency balances] in the future--heaven knows if there really will be--that $2 billion does not seem an inappropriate amount. I would note that at the peak of our swap borrowing we had risks on the other side of several times that amount.

MR. PARTEE. That, of course, was built up when the dollar was weak. Now we're going to build up a risk when the dollar is strong.

MR. HOLMES. That's right. We're trying to be a little more symmetrical on our asset and liability sides.

CHAIRMAN MILLER. Phil Coldwell.

MR. COLDWELL. Mr. Chairman, I don't resist the idea of building up a small kitty. I do have some resistance to the idea of an excessive amount in a single currency. So I think we ought to limit the amount in a single currency to a billion dollars, partly to limit potential exchange losses and partly to avoid pressures in terms of the currency status of some of these countries. Also, we ought to limit our holdings to major currencies. I'm certain that the Desk isn't going to play in or something like that, but I think we ought to have that well understood. I believe we need political and Treasury clearance and I assume that that will be done before we jump into any major stockpiling. We ought to have a slow rate of accumulation, assuming we don't have masses dumped on us, Alan. Then finally, I'm a little disturbed about what I hear in terms of intervention policy. [Under] the first of November ground rules,

we're going to try to resist further downward movement [in the exchange rate of the dollar]. Well, now we have upward movement. Theoretically, I guess that first of November policy was established by somebody believing the dollar to be undervalued at that time. I don't know whether the dollar is valued correctly, overvalued, or undervalued now. But it seems to me that we ought to have some sort of policy that permits some rate increases along with increases in balances. We do not attempt to peg or limit changes in exchange rates. Those are my comments, Mr. Chairman.

CHAIRMAN MILLER. Thank you, Phil. Henry.

MR. WALLICH. Well, I believe we should think very carefully about what we're doing here; $2 billion is not a large amount and can be a perfectly good means of enhancing our operations. It could be the first step into a totally different world. If we ever got to a very bullish dollar situation, which is not inconceivable, and we wanted to restrain the dollar from going up very sharply--not peg it--[because] we would lose our trade competitiveness, we might find ourselves authorizing $5 billion a week. And after a few weeks of that we might throw in the sponge, as the British did. If that were to happen, I don't think we should do that. We still have to think about what the reactions of other central banks will be; we don't want to promote countries into reserve currency status if they don't want that. We don't want to get them in the frame of mind where they throw all the burden of intervention on us. We've already attracted to ourselves more of the burden of intervention. The New York market has increased in scope; I would guess it has become a better market because there is a strong supplier of D-mark in it and we will be attracting an increasing burden. I'd like to be sure that what we do here remains small unless we carefully consider what we should do in the other direction. If we do go in the other direction, I hope we could find some way of using SDRs and not individual foreign currencies. There are technical difficulties but we might overcome those. Meanwhile I'd convey to foreign central banks as we accumulate [these balances]--provided they agree--that we by no means intend to make a total change in our predominant use of the swaps. We don't intend first to use the reserves and then the swap lines; and we don't want to expose ourselves to their saying that when we've drawn on the swap we pay that off out of reserves that we've accumulated rather than give us the money outright as we have done sometimes [in the past]. These are some of the market strategy considerations that I think will come to [unintelligible] and we ought to lay [the ground rules] out with foreign central banks very cautiously.

CHAIRMAN MILLER. Thank you, Henry. Paul.

VICE CHAIRMAN VOLCKER. Well, what I have to say is more or less along the lines of what Henry was just talking about. Let me state it perhaps slightly differently. I don't see this as an issue at this point. It may be a nice issue but I assume we're not being asked now to go out and acquire a substantial amount of foreign currencies to hold more or less indefinitely. What I see as a problem here, which is a byproduct of intervention, is that when we run out of indebtedness--if that's the way to put it--if we don't hold any foreign currencies, we can't intervene on the side of the market in which we are now intervening. That may be inconvenient if we're not prepared to hold foreign currencies. I don't think intervention

policies should be controlled by an inability to hold foreign currencies. Also, it makes sense to be symmetrical. If we're willing to go into debt, we ought to be willing to go long on the other side. And something like $2 billion may allow us a reasonable amount of leeway around zero, but [I don't see that] as a permanent holding. That's the way I view this and on that basis I would support it. I am not ready to support a permanent massive holding at this point.

CHAIRMAN MILLER. It seems to me that what has been recommended is by no means a suggestion that we become symmetrical. When we were talking about going short we were talking about some $20 billion dollars--more than that actually [including] the Treasury and ourselves--that we would borrow and have to pay back. If we were being symmetrical, we would want to authorize a $30 billion package on the [long side].

VICE CHAIRMAN VOLCKER. Between the Treasury and the Federal Reserve--

CHAIRMAN MILLER. We would have $30 billion on one side and $30 billion on the other side, a $60 billion band. No one would want to do that. I don't have a strong feeling on this, but the question before the Committee is: Do we at least want to deal in what is less than one swap line--in a series of currencies on the long side--as a way of continuing the operation of moving in depth to counter swings in the dollar, which is very strong again today? And we're not trying to peg it. As I say, we have had static occasionally from our [counterparts] about pegging or whatnot, but we have not tried to do that. Alan has consistently taken the view--sometimes with a few bruises--to let [the dollar] go a little and move in as it goes up and cushion it. So it probably wouldn't mean the end of the world today whether we approve this or we don't. I think some of the things Phil said are very worthwhile. If we do this, we might well want to put a limit of a billion dollars for any currency and we certainly want to list the currencies we're talking about [acquiring], which would be only the major currencies. At the moment we're only talking about three currencies but we might want to add to that. I don't know that we even need to add guilders or anything else at the moment.

MR. AXILROD. Mr. Chairman, our suggestion was that at the moment we would be contemplating three currencies. But we would assume that the possibility of the Desk holding minor amounts of other currencies would not be excluded.

CHAIRMAN MILLER. But it wouldn't be the world's mix of currencies, I take it.

MR. TRUMAN. Mr. Chairman, it would be the currencies that the Desk is now authorized to hold, i.e. the currencies of our swap partners.

CHAIRMAN MILLER. They are all listed here. It's a limited list of about 10 or 12--

MR. TRUMAN. It's [14].

CHAIRMAN MILLER. They include the Austrian shilling, the Belgian franc, the Canadian dollar--

MR. TRUMAN. I'm not saying we'd hold them all but--

CHAIRMAN MILLER. No, no. But this is the list: Austrian schillings, Belgian francs, Canadian dollars, Danish kroner, British [pounds] sterling, French francs, German marks, Italian lire, Japanese yen, Mexican pesos, Netherlands guilders, Norwegian kroner, Swedish kronor, and Swiss francs.

MR. WALLICH. These are our swap partners.

CHAIRMAN MILLER. Yes. That's the list. We could do anything else we want. I think the point of limiting it to a billion dollars in any one currency is a wise one. And I [agree] that even if we want to do this, we would be very wise to have consulted with the Hill and with the Administration before we [proceed]. I think those are very good comments.

MR. WALLICH. Let me say something about that. It may not fit the market situation; it may make no sense, for instance, to accumulate yen.

MR. COLDWELL. I was assuming we'd accumulate marks.

MR. WALLICH. We would probably, predominantly. That is the big intervention currency. I see your point of limiting risk but I think it would be better to limit risk by limiting the overall amount and then leave it to the Manager [to decide] what is useful in these relatively small amounts. I'd prefer that rather than have the Desk get to the limit of marks and say now we can make the market orderly by working in yen even though it's really the D-mark market that isn't orderly.

MR. COLDWELL. Well, can't we work around that through BIS and some other procedures to get hold of--

CHAIRMAN MILLER. We could limit it to $1 billion without prior permission from the Committee.

MR. COLDWELL. Well, I just think we have a possible exchange loss and we would be putting on some reserve currency pressure and ought to be very careful about that.

CHAIRMAN MILLER. John Balles.

MR. BALLES. On balance, without going through all the arguments, I have to join Chuck in opposing this. I think the disadvantages outweigh the advantages. I'm really concerned about the point of departure being one which could fairly easily get us away from countering disorderly conditions and into imposing an official view of what the dollar "ought to be worth." That's a pretty risky game and I don't think we're ready for it.

CHAIRMAN MILLER. Bob, did you want to comment?

MR. MAYO. I find myself supportive of it, Mr. Chairman. It seems to me that it does give us another tool. And I certainly trust this Committee and even more I trust the Manager that in the intermeeting periods the spirit of this would not be violated.

CHAIRMAN MILLER. We lose Managers if the spirit gets violated!

MR. MAYO. I agree with John that I don't want to see this used as a super intervention tool or--well, he didn't say this--as a way to throw our weight around or something like that. But I think it can be quite supportive of additional flexibility in monetary policy in a broad sense. Like Phil, I think we have to be very careful in how we do it, not only with the Hill and the Treasury but also in our relations with other central banks. But that's why we have such a capable Manager and that's part of his job. So I would vote for this.

CHAIRMAN MILLER. Thank you. Ernie Baughman.

MR. BAUGHMAN. Mr. Chairman, I don't have a voice in this matter today, but if I did it would be on the negative side. It seems to me the potential disadvantages tend to outweigh prospective advantages.

CHAIRMAN MILLER. Thank you. Chuck.

MR. PARTEE. I just want to make one additional comment on another aspect that perhaps Committee members haven't thought of. I have agreed to talk to the farmers who circled the building a few weeks ago and who want to borrow from the Federal Reserve at a low rate. I will tell them that we can't use Federal Reserve credit for that purpose because it's used to run the monetary system and all we do is invest in government securities and try to provide the right amount of reserves. A few years ago we took the same position with New York City when they wanted to borrow--that it wasn't a proper use of Federal Reserve credit. But we are talking about using up to $2 billion of Federal Reserve credit to support the mark or the yen, or the Swiss franc at a low rate of return. And I think that reduces our ability to resist these other demands for the use of--

CHAIRMAN MILLER. I thought we were doing it so the crops would sell better abroad and maybe get more money on the farm. That's what I thought we were doing. That's what Henry has been teaching me.

MR. PARTEE. It's pretty hard to do that with the agricultural bloc they have in Europe.

CHAIRMAN MILLER. It's still our biggest export.

MR. HOLMES(?). Well, I would not view this as supporting the mark or other currencies at a low rate but as maintaining an appropriate rate for the dollar if we can agree that there is such a thing.

MR. PARTEE. Oh, so it isn't disorderly conditions. It's an appropriate rate for the dollar.

MR. HOLMES. I think [it's helpful] if we can accomplish an appropriate rate for the dollar. For example, suppose this afternoon the mark goes to 2-1/2 marks per dollar. Is that good for the United States? I'm taking an exaggerated--

CHAIRMAN MILLER. I have exactly three minutes to wind up this meeting so we can get across the street for lunch. I hope we will have time for discussion, particularly of the monetary improvement program, at lunch.

MR. WALLICH. May I make just one comment? There is no government or central bank in the world that doesn't have this power. We are the only one; we have gold.

CHAIRMAN MILLER. Let's quickly check [via] a tentative vote on this proposition to indicate an agreement in principle--not on the details. If there is a sentiment in favor holding up to $2 billion, let's come back at another meeting with the details worked out and some specific proposals. We don't need to work on that proposal if there is no sentiment for it. So tentatively, Paul, how would you vote?

VICE CHAIRMAN VOLCKER. Yes.

CHAIRMAN MILLER. John Balles.

MR. BALLES. No.

CHAIRMAN MILLER. Bob Black.

MR. BLACK. Yes, Mr. Chairman, up to that [$2 billion] point.

CHAIRMAN MILLER. Phil Coldwell.

MR. COLDWELL. With the intervention limits and limits per currency.

CHAIRMAN MILLER. If those details came in to your satisfaction. Bones.

MR. KIMBREL. Yes.

MR MAYO. Yes.

MR. PARTEE. No.

MS. TEETERS. Yes.

MR. WALLICH. Yes.

CHAIRMAN MILLER. And I think I would favor it. That means we have 8 to 2 [in favor]. And we can have a unanimous vote if we can get John and Chuck to straighten up and fly right! How about those who are not voting members? I'd just be curious because I would like to know what the general feeling is. Ernie?

MR. BAUGHMAN. I'm negative.

MR. GUFFEY. Yes.

MR. ROOS. No.

MR. WILLES. No.

MR. WINN. Yes.

CHAIRMAN MILLER. And we have First Vice Presidents McIntosh and Smoot.

MR. MCINTOSH. Yes.

MR. SMOOT. Yes.

CHAIRMAN MILLER. I think there is a sentiment, then, to come back with a specific proposal, Steve and Alan. Thank you very much.

Unless there is further business we will confirm our meeting on May 22 when the fever will have broken, everything will be cool and you will vote unanimously for sound monetary policy!

END OF MEETING