TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

June 22, 1976

Prefatory Note

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

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

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

Meeting of Federal Open Market Committee

June 22, 1976

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, June 22, 1976, at 9:30 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Gardner
Mr. Jackson
Mr. Lilly
Mr. Partee
Mr. Wallich
Mr. Winn
Mr. Baughman, Alternate for Mr. Kimbrel

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

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

Mr. Broida, Secretary
Mr. Altmann,1/ Deputy Secretary
Mr. Bernard,1/ Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist (Domestic Finance)
Mr. Gramley1/ Economist (Domestic Business)
Messrs. Brandt,1/ Davis,1/ Hocter,1/ Parthemos,1/ Reynolds,1/ and Zeisel,1/ Associate Economists

1/ Entered meeting at point indicated.
2/ Left meeting at point indicated.

Mr. Sternlight,1/ Deputy Manager for Domestic Operations

Mr. Keir,1/ Assistant to the Board of Governors
Mr. Guenther,2/ Assistant to the Board of Governors
Mr. O'Brien, Special Assistant to the Board of Governors
Mr. Gemmill,1/ Adviser, Division of International Finance, Board of Governors
Mrs. Farar,1/ Economist, Open Market Secretariat, Board of Governors
Mrs. Deck,1/ Staff Assistant, Open Market Secretariat, Board of Governors

Mr. Fossum, First Vice President of the Federal Reserve Bank of Atlanta

Messrs. Scheld,1/ Eisenmenger,1/ Sims,1/ and Doll,1/ Senior Vice Presidents, Federal Reserve Banks of Chicago, Boston, San Francisco, and Kansas City, respectively
Messrs. Burns 1/ and Karnosky,1/ Vice Presidents, Federal Reserve Banks of Dallas and St. Louis, respectively
Mr. Kareken,1/ Economic Adviser, Federal Reserve Bank of Minneapolis
Ms. Greene,1/ Assistant Vice President, Federal Reserve Bank of New York
Ms. Tschinkel,1/ Adviser, Federal Reserve Bank of New York
Mr. Mullineaux,1/ Research Officer, Federal Reserve Bank of Philadelphia

1/ Entered meeting at point indicated.
2/ Left meeting at point indicated.

Transcript of Federal Open Market Committee Meeting of
June 22, 1976

[Executive session]

CHAIRMAN BURNS. Gentlemen, we have a special meeting, and our newest Governor David Lilly, I am glad to say, has joined us this morning.

MR. LILLY. There are many old familiar faces around this table. I'm glad to be with you all again.

CHAIRMAN BURNS. I might have said that, yes. Newest Governor, but an old Federal Reserve hand.

As members of the Committee have been informed, Henry Reuss has filed a suit against our individual District Banks and individual Bank Presidents. And I've asked Mr. Broida to make copies of Mr. Reuss's letter along with the civil action that he's brought and asked that it be made available to the Committee. I've written a brief note of acknowledgment merely saying that I received his letter and that I will make sure that members of the Committee are properly informed. Now, I've asked Tom O'Connell, our counsel, to tell us whatever he may be prepared to say about this lawsuit. Mr. O'Connell.

MR. O'CONNELL**.** Yes, Mr. Chairman. As an administrative matter you might wish to note that, on comments [to the press]--

CHAIRMAN BURNS. I might just say one word I have very much on my mind. We have had numerous inquiries from the press, and I've given strict directions to Mr. O'Connell not to comment in any way, and that is precisely what I'm going to do if anyone asks my view--I will say I have no comment. And I hope that each of you will do exactly the same. No good can come from a [public] discussion of this lawsuit. Mr. O'Connell.

MR. O'CONNELL**.** Mr. Chairman, I checked with the courthouse this morning. This civil action number is 76-1142. The case has been assigned to Judge Barrington Parker, who is the United States District Court Judge for the District of Columbia.

The complaint, of course, asks that a three-judge court be appointed for the purpose of determining a constitutional issue [raised] by the complaint. Mr. Reuss has challenged the provisions of the Federal Reserve Act, section 12A, which is the provision containing the constitution of the Committee. He asserts that this is in violation of the [U.S.] Constitution and the provision there in article II , section 2, clause 2, which is the so-called appointments clause, [which] provides basically that officers of the United States be appointed by the President with the advice and consent of the Senate.

Mr. Reuss charges that the members designated as defendants--and as the Chairman said, each Federal Reserve Bank President has been thus designated, or his alternate serving on the Committee at this time--the five members and their alternates as well as each Reserve Bank--are in every respect, insofar as they operate on this Committee, officers of the United States because of the import of their function and the impact of the actions of this Committee, and thus they should be appointed by the President with the advice and consent of the Senate.

He therefore, asks in his [unintelligible] that the members of the Committee be enjoined from functioning as members of the Committee and, secondly, that any action that is directed at the Reserve Bank of New York, namely the Desk, insofar as that action [was] participated in by any of the Reserve Bank Presidents, be enjoined. And he asks that the portion of section 12A of the Federal Reserve Act designating appointment be declared unconstitutional, and for such other and further relief as the court deems appropriate.

One final point, if I may, Mr. Chairman. There are several issues that we are going to have to explore very carefully. Among them, preliminarily, will be the standing of this plaintiff to bring this lawsuit. I think there is a significant question as to his standing to bring this suit. He bases his alleged standing on one of two pieces. One, that he is a member of Congress and as a member of Congress, as assigned by statute, has certain responsibilities. He is prevented from carrying out these responsibilities insofar as they relate to oversight of monetary policy formulation, credit regulation, the issuance of currency, etc.--that he is being deprived of this right as a member of Congress. He assigns identification in the complaint to himself as chairman, of course, of [his congressional] committee, but he doesn't particularly assert that role in the complaint.

In the alternative, he identifies himself as an individual who is the owner of government obligations, having a value in excess of $20,000, and that the action [of the FOMC], insofar as it's participated in by the Presidents named as defendants, jeopardizes that ownership, and he thus asks that their further action be enjoined. Mr. Chairman, without taking the time to give you the basis for the question of standing, I think it is an issue that we will hopefully [unintelligible] explore.

Quite apart from that are the constitutional issues that have been raised, among them a consideration of whether or not the Board of Governors as such is head of a department within the meaning of article II. Namely, if the Board is head of a department, its function in approving, as required by law, the appointment of the [Reserve Bank] Presidents designated to [serve on] this Committee may well meet [the requirements of] article II. This is an issue that we will be exploring with the Department of Justice. I contacted them last night, Mr. Chairman, and we gave them copies of the complaint this morning.

I was served this morning by the United States Marshall, with copies for each of the Presidents named as defendants. I raised no question of the service process. There could have been a technical question as to whether or not they can effect service on corporate Reserve Banks in the city. But certainly he, the Marshall, would have come into the [Board Room] without permission and served each defendant. So I accepted service on the part of the defendants, Mr. Chairman, but it does not preclude us from raising technical points later.

At this point, the Department [of Justice] is taking no position. All of the issues I've mentioned will be explored thoroughly. I believe the complaint gives the Committee members 20 days within which to respond. This has a technical meaning. Under the law, officers of the United States or officials of the United States government have 60 days within which to respond to a complaint filed in federal district court. Having been assigned 20 days on the complaint, it's clear that the plaintiff's position is that the defendants named are not officials or officers of the United States, even though the complaint says they should be so determined.

The petition for a three-judge court is, in the first instance, before Judge Parker. As a technical matter, it's possible that we will attempt, after further consultation with the Department [of Justice] and the advice of this Committee, to file a motion to dismiss this complaint for lack of standing. [If it] were to be filed timely, [it would] perhaps disenable the Federal District Court Judge from certifying the case to the chief judge at the Court of Appeals. It is the chief judge who assigns two District Court Judges, including Judge Parker, [who, along with] a Court of Appeals judge, constitute the three-judge constitutional court that is called to decide these issues. Mr. Chairman, I think that's all the information I have. I'll be glad to respond to any questions you may have.

CHAIRMAN BURNS. Thank you very much. Now, gentlemen, just one question. Our 12 Bank Presidents are going to be sued. They will need counsel. Will you serve as counsel along with some members of the Justice Department, or do you have enough to use?

MR. O'CONNELL**.** At this point, Mr. Chairman, I would interpret this lawsuit against the individuals named as in reality constituting a suit against a portion of the FOMC, and with your approval, I think it appropriate that I represent these individuals, if that's satisfactory, together with counsel from the Justice Department. And we have asked [the Justice Department] for the assignment of a specific individual who has worked on a number of constitutional law questions under article II. They hope to provide a specialist in this area to be of assistance.

CHAIRMAN BURNS. Thank you. Any questions?

VICE CHAIRMAN VOLCKER. We could have counsel of our own, Mr. Chairman, and I would hope that they would be involved in this process.

CHAIRMAN BURNS. Well, let me say a word about that. Fortunately, of course, each of you has counsel of his own. And, of course, the opinions of your counsel should be transmitted, but this must not be regarded as a suit that is brought against anyone of you as an individual. It's a lawsuit that is really brought against the fuller concept of the Federal Open Market Committee. And therefore, a single unified legal defense, I take it, is essential. To draw upon the best legal ability that we can--that we do have--is only good sense. But I think it would be clearly wrong for individual members of this Committee to go off in individual directions. This must be a single unified legal approach, at least that's the way it appears to me.

MR. O'CONNELL**.** May I say, Mr. Chairman, that President Volcker's general counsel is also associate general counsel of this Committee, and because of that reason, I spoke at length on the phone with him last night to apprise him of the lawsuit and its basic character.

CHAIRMAN BURNS. Good.

MR. MACLAURY**.** I was going to ask, Mr. Chairman, if Tom could tell us anything about the case cited in the covering letter, of Buckley v. Valeo, or whether that's even worth taking the time to do now.

MR. O'CONNELL**.** I'd be glad to briefly comment, Mr. Chairman, if I may. Buckley v. Valeo is a suit that was decided in January of this year, and of course most recently has been cited as precedent for upsetting the [1974 Federal Election Commission act]. That statute was brought into question by the plaintiffs, [among whom] were congressional members and so-called political appointees, who had brought suit [in Buckley v. Valeo in January 1975] to have the Federal Election Campaign Act of 1971, as amended in 1974, declared invalid for a number of reasons.

Pertinent to [the Reuss] lawsuit is the portion of the [Buckley v. Valeo] complaint [concerning] the members of the [Federal Election Commission], who were then eight in number and two of whom were appointed by the President of the United States, two by the speaker of the House, and two by the president pro tem of the Senate, in each case with the advice and consent of both houses [of Congress]. The question raised was whether or not the appointees of the House and Senate constituted so-called [unintelligible] officers of the United States within the meaning of article II, section 2 [of the U.S. Constitution], the same article that is brought into question by [the Reuss] lawsuit.

The Court of Appeals and then the Supreme Court ruled that [the appointment process] portion of the [Federal Election Commission] act was unconstitutional [because] the functions and the duties of the election commission members were so substantive and of such far-reaching authority that [those performing them] had to be designated as officers of the United States. And the failure of the statute to provide for appointment by the President with the advice and consent [of the Senate] was a substantial failure to comply with the provisions of the Constitution. It was thus overturned. It is that case that they cite in parallel here, saying that the functions performed by this Committee are of such substantive nature that members performing those functions should be appointed by the President with the advice and consent of the Senate. That's the parallel for the case, President MacLaury.

SPEAKER(?). Recognizing the wisdom of our not commenting at this stage of the situation--obviously this is another act in the long-term effort of this man and his associates to challenge the way [the Federal Reserve System] functions. It is conceivable, I would assume, that as this evolves, this maneuver by Mr. Reuss could be made, in the minds of his colleagues in the Congress and the nation generally, to work against him. This is another frantic--so, somewhere along the line it's possible that we would be encouraged, I assume, to react in the public area to terms of this case. I mean, I think the man looks ridiculous in what he is doing.

CHAIRMAN BURNS. I think that the story in the *Wall Street Journal* this morning takes care of the matter for the time being, beautifully. Mr. Reuss tried to get this kind of provision through the Congress. He has [not been able] to do so even in the House Banking Committee. And now, being frustrated, he turns to the courts. And I would suppose Mr. Reuss would look rather ridiculous before his colleagues in the Congress. He has not been able to persuade his colleagues. He has emphasized the importance of larger congressional controls. So suddenly, he turns to the courts to resolve the problems that he could have resolved if he had had the support and backing of the total Congress. I think that, for the time being certainly, we ought not to comment on the case, and I would believe that others will do the commenting for us very effectively.

SPEAKER(?). My I say, sir, that the briefer story in the *New York Times* takes much the same line.

CHAIRMAN BURNS. It's hard for me to see how he can gain stature among his colleagues in the Congress by this [unintelligible].

SPEAKER(?). If pressed by reports, I would [unintelligible] is a point to be made that we cannot comment at this time in view of the legal proceeding, [which] we would complicate?

MR. O'CONNELL**.** That's perfectly valid. The matter is now in court, and I think, with good reason, at this time the pendency in court makes it wise to make no comment.

SPEAKER(?). I agree with you.

CHAIRMAN BURNS. I think that any comment runs the risk of igniting passions. And the calm attitude on our part, I think is only good sense. There is a lawsuit, it's before the courts, it isn't even proper to comment. Any other questions? Mr. Mayo.

MR. MAYO. Question for counsel. Tom, is there any legal risk that the decisions made by this Committee today will be overturned in the process of this suit?

MR. O'CONNELL**.** In my judgment, there is none, President Mayo. The complaint does not ask for a temporary restraining order. The case has been assigned as of this morning to Judge Parker. There is nothing in the request that asks it be taken this morning before that court or that he certify as a matter of emergency the appeal to the Court of Appeals for a three-judge court. I would think that today's actions by the Committee are clear of any impact from this suit.

MR. MAYO. Thank you.

CHAIRMAN BURNS. Mr. Balles.

MR. BALLES. Tom, you cast some doubt on whether Mr. Reuss really has standing to bring this suit. Is there any need to [unintelligible] to perfect his position to get standing, or if he doesn't have standing, who else might? That's the first question.

Second question, this may be premature, but if you care to express an informal tentative view, how do you think this thing might turn out--if you fail on the possible order for dismissal based on lack of standing--just on the merits of the case. Is there any reasonable clear possible outcome one way or another?

MR. O'CONNELL**.** I'll answer that very briefly. I can't answer it, President Balles. On the second question, the merits, the constitutionality, a lot would depend upon the composition of the court, the three-judge court. If the chief judge at the Court of Appeals, Judge Bazelon, assigns this to himself, together with Judge Parker and perhaps Judge Bryant, whom we've had in the earlier case, I'd say a decision in our favor is at question. There are judges in the Federal District Court here whom I would view with pleasure [if we were] to appear before [them] to argue this question on its merits--the constitutionality of this statute--because [those judges] would quickly pierce the allegation of unconstitutionality as it relates to this Committee, but I think favorably to the Committee. So a great deal will depend on the composition of the three-judge court on the constitutional issue.

On the earlier issue of standing, as to whether or not he can better perfect [his standing], we had a case in 1963 in which I represented this Committee. It was the Bryant case, in President MacLaury's District, in Montana, and the same basic issue of the constitutionality of the appointment process, although not exactly parallel, was then raised.

In that case, the plaintiff owned a Federal Reserve note, and he challenged the actions of this Committee that impacted the value of that note. We filed a motion to dismiss there. He asked for a three-judge court. The Federal District Judge, seeing that the Committee had substantially disproved the likelihood of his recovery or the substantiality of his allegations, granted our motion to dismiss and denied his right of recourse to a three-judge court. It is on that thesis that I would like to believe that Mr. Reuss's assertion of his status as a member of Congress on one hand, or his ownership of government securities on the other, [doesn't] sufficiently distinguish him from a total class of individuals as to warrant his standing to bring suit. Hopefully he couldn't improve [his standing], either.

MR. MACLAURY. Thank you, Tom.

MR. JACKSON. Mr. Chairman, what provisions do we have in the by-laws or incorporation certificates of the Federal Reserve Banks to authorize the Banks to defend actions of its elected officers in their official capacity? To commit the resources of the Banks to the defense of the officers totally or the indemnification of the officers?

MR. O'CONNELL. If I may, Mr. Chairman, I think the basic right of the Banks to act in behalf of the corporation is contained in the Federal Reserve Act, among enumerated powers of the Federal Reserve Banks.

MR. JACKSON. What about the officers and their [unintelligible] capacity as such?

MR. O'CONNELL**.** Right. To my knowledge, there is no provision in law for indemnification. And some months ago, we instituted a form of indemnification that would assure indemnification for actions properly taken. As to the right of the Banks to defend individually the actions of their officers, I'd suggest that, in these cases, where it's alleged in a federal district court suit that their actions are those of officers of the United States, [those cases are] properly postured for defense either by this Committee as a body or by representation by the Department of Justice. Does that satisfy your question?

CHAIRMAN BURNS. Any other question? Yes, Mr. Mayo.

MR. MAYO. This may not be too relevant, Tom, but it raises a question in my mind that, if this is unconstitutional, wouldn't the fixing of the discount rate by our boards of directors be unconstitutional since that's one of our major tools of monetary policy?

MR. O'CONNELL**.** Well, by analogy, President Mayo, the substantive quality of that action, as it might be alleged in parallel with this suit certainly could be brought into question. I think any number of such actions might parallel and be brought into issue by a plaintiff. Which is why I think that it's critical that [we take] a very clear, careful approach to our response to this complaint.

CHAIRMAN BURNS. Any other question? Yes, Mr. Guffey.

MR. GUFFEY. Tom, with respect to Chairman Reuss's attorneys, did his Committee staff file this case

MR. O'CONNELL**.** Yes. I should comment, President Guffey, Mr. Crews was formerly in the legal division of the Board. He's a very careful and astute lawyer. At the present time, to the best of my knowledge, he is on the staff of Mr. Reuss. He visited me yesterday to advise me of the filing of the suit.

MR. GUFFEY. It raises a second question, Tom--you and I have had discussions in the past about the quality of legal work that may be tendered to us by the Justice Department.

MR. O'CONNELL**.** Yes.

MR. GUFFEY. And I guess I share some of Paul Volcker's concern that sometime down the road we might want to employ counsel to assist you rather than rely totally upon the Justice Department. You find that that quality of defense is not as great as we'd like, and what I'm suggesting is that it may be within the power of the Committee to [hire outside counsel]. I don't think we ought to lose sight of that fact.

MR. O'CONNELL**.** As I say, my conversation last night was with the assistant attorney general and then with the chief for the general litigation section [at the Justice Department], the latter gentlemen being, I think, a very high-quality lawyer. But the trouble is, of course, that Denis Lender himself won't actually pen the brief work. I don't know yet to whom it will be assigned. I'd like to believe that we can closet immediately with the Justice Department and begin the course of thinking with respect to the makeup, composition, and functions of this Committee so as to enable them to write the very, very [best] brief.

CHAIRMAN BURNS. I interpret Mr. Guffey's question to me as follows: Suppose that you reach the conclusion that outside counsel could be helpful and that some outstanding constitutional lawyer might join you in the defense. I take it that was the question, and I would assume that you would have the authority. Could you do that?

MR. O'CONNELL. I'd be both pleased and privileged to have such assistance. I would say, Mr. Chairman--

CHAIRMAN BURNS. We will have such assistance if you deem it advisable. That is, do you have the authority to do that or would you need authority from this Committee to empower you to employ a consultant if you reach the conclusion that outside legal counsel could be helpful?

MR. O'CONNELL**.** I would ask the Committee's authority to employ such counsel.

CHAIRMAN BURNS. Well, let's give Mr. O'Connell that authority now.

SPEAKER(?). So moved.

SPEAKER(?). Seconded.

CHAIRMAN BURNS. Any objection? All right. That is the authority, it's not to hire legal counsel--

MR. O'CONNELL**.** I understand.

CHAIRMAN BURNS. --the authority is to hire legal counsel if you, in your judgment, arrive at the conclusion that that would be helpful in defending the Committee, the individual members of [unintelligible] against this lawsuit.

MR. O'CONNELL**.** I understand, Mr. Chairman.

MR. COLDWELL. Tom, is there any possibility that the Justice Department runs into a conflict of interest in defending the Federal Open Market Committee against a congressman?

MR. O'CONNELL. I think the Department has first to answer the question, and I haven't yet explored it with them. Can the Department under title 5 represent individually named Bank Presidents where, at least at the outset, you don't have them constituting an agency of the United States?

Now, once I get over that hurdle, the second question you'd impose, perhaps, may be raised. I don't know of another instance in which the [Justice] Department has been positioned in representation of an agency against a member of Congress, or against the Committee itself, and so forth. I do know that, on occasion when a committee of the Congress officially made demands on this agency with respect to examination reports, and where the question of leakage of information from this Board became an issue, a representative of the criminal division of the Justice Department appeared before a committee of Congress and in effect represented the position of the Chairman and the Board in calling in the FBI.

So there have been instances in which they've apparently taken the position that was [unintelligible] to the thrust of the Committee. That's not quite where you're headed, but it may give us a sense of their willingness to do so.

CHAIRMAN BURNS. Yes, Mr. Gardner?

MR. GARDNER. Tom, the Reserve Bank Presidents, the members of the Committee, are defendants, along with the Banks. What does Reuss ask, considering the worst case? He asks simply, in my view--and I would like your comments--that the court enjoin the defendant from serving. That the court will enjoin the Banks from carrying out the order, that the court declare part of the Federal Reserve Act unconstitutional. That seems to me to be the most significant part of the [case], crippling our operations. On a worst-case basis, the court will--

CHAIRMAN BURNS. You say crippled--[but if that is] the decision of the court, then the powers of the Federal Open Market Committee would be taken over by the Federal Reserve Board, and the Federal Reserve Board could act five minutes after the court decision is handed down. So the [Federal Reserve] System, in its operations, would not be crippled. At least that is one interpretation.

SPEAKER(?). Well, Mr. Chairman, we get curious results if he enjoins the Banks from carrying out open market operations. Conceivably that stops all of the action of this Committee. The Committee itself does not conduct the open market operations, it must be done by the 12 Banks on the statute.

CHAIRMAN BURNS. It would have to be done on the basis of some understanding between the Federal Reserve Board and the Banks, and immediately with the New York Bank in its operations of the Desk.

SPEAKER(?). Well, I guess what I'm suggesting--

CHAIRMAN BURNS. All that I'm trying to say is that if the worst happens, we are not going to have a national financial crisis, as I see it.

MR. GARDNER. Mr. Chairman, I didn't mean to open Pandora's box. I was looking at the [plaintiff's] prayer for relief, and what I'm getting at is hopefully a comment from counsel on the fact that this appears to me to be a totally technical "principal" suit, in which the individual Bank Presidents do not appear to have any liability.

While we are discussing retaining counsel in assisting Mr. O'Connell, I'm just trying to point out that on a worst-case basis, the plaintiff has simply asked for an injunction that would prevent the defendants from [unintelligible]. And the cost granted to the plaintiff, and [unintelligible] what other and further relief may be proper--I don't read into that any liability or what have you [for the Presidents]. Do you?

MR. O'CONNELL. I do not. It's always possible that the named defendants could be asked [unintelligible] to share in any liability for loss of value in the so-called ownership of government securities by the plaintiff. But that is such a nebulous allegation that I think there is no possibility of personal liability of the named defendants. I agree with that--

CHAIRMAN BURNS. Not in this lawsuit.

MR. O'CONNELL. In this lawsuit.

CHAIRMAN BURNS. But let's say the court handed down the decision in favor of Mr. Reuss. Then another lawsuit may be brought against Bank Presidents because of early actions in which they participated--am I romancing?

MR. O'CONNELL. If I may comment--

CHAIRMAN BURNS. The court hands down the decision in favor of Mr. Reuss, and I bring a lawsuit on the grounds that my personal fortune has been hurt because interest rates went up. And this increase in interest rates and loss in capital value of the securities that are held was brought about by the Bank Presidents acting unlawfully in this Committee. Acting unconstitutionally. I couldn't do that?

MR. O'CONNELL. You could bring such a complaint. I would question even the possibility of recovery, Mr. Chairman, for the reason that prior to this suit, actions taken by the Presidents as members of this Committee were pursuant to lawful authority. And if the court should determine that, pursuant to Mr. Reuss's complaint, the provision of law is unconstitutional, there can be no direct attribution in that finding to the members' actions.

CHAIRMAN BURNS. I understand. Let me ask this question. Is Mr. Reuss acting as chairman of the House Banking Committee or as a private citizen?

MR. O'CONNELL**.** A little bit of both, Mr. Chairman. He alleges as a ground for standing that he is a member of Congress and is thus bringing this suit. He enumerates the fact that he's also chairman of the committee. The letter transmitting advice of this suit, addressed to you, to which we responded, was signed by him as chairman of the committee. It's a little bit difficult to sort out the position in which he purports to hold himself--

CHAIRMAN BURNS. Personally, I would think he'd be in some difficulty with his committee to the extent that he acts in this capacity as chairman of the committee. I assume that he hasn't consulted with his full committee.

SPEAKER(?). Is it not conceivable that his committee could disavow this action and remove him as chairman? In other words, when things start working within--

CHAIRMAN BURNS. I would think so.

MR. O'CONNELL**.** Well, except that I think that nothing in his complaint--if I may, he describes himself on page 2 of the complaint as, "plaintiff is a member of the United States House of Representatives, Chairman of the Committee on Banking, Currency, and Housing, which pursuant to rule 101D of the Rules of the House has jurisdiction over legislative matters relating to [unintelligible]." And he describes, of course, the rules' description of the function of that committee. [The text continues,] "The plaintiff is also Chairman of the Subcommittee on International Economics and the Joint Economic Committee, established" etc. And "The plaintiff is the owner of certain marketable bonds whose aggregate costs," etc. "$20,000."

This is his description of himself as plaintiff. It mixes his position as a member of the Congress, as a private citizen with ownership of government securities, and as chairman of two [congressional] committees.

CHAIRMAN BURNS. Well, I don't know if members of [his] committee would react, but a member of the committee might raise the question about the propriety of Mr. Reuss's acting in this manner without first consulting with the committee. That is, bringing the lawsuit, addressing such a letter to me, and using legal staff of the committee for the purpose.

MR. O'CONNELL**.** Now, I should say that, to the best of my knowledge, Mr. Crews, plaintiff's counsel, is an employee of that staff. I stand subject to correction. I'll try to ascertain that today. He may be outside counsel. The last I knew he was on the--

SPEAKER(?). He is on the Hill. He is not listed as a member of the committee's staff. Although I think what he said earlier, Tom, is probably that he is a member of Reuss's personal staff. I think we also should say that removing [unintelligible] as committee chairman--it appears that the final judgment on that rests with the Democratic caucus. The House Banking Committee as such would not remove the committee chairman, only the Democratic caucus could take such a position.

CHAIRMAN BURNS. Well, there is another dimension that I think you should bear in mind, Tom. The President of the United States is indirectly involved in this case, because what is being questioned is the exercise of his appointment power. And that may possibly have some bearing on how the Justice Department looks at the case, and that ties in with a question that Governor Coldwell raised before. All I suggest is that you keep this dimension in mind.

MR. O'CONNELL. I shall, Mr. Chairman. It could be asserted that the complaint in its deepest meaning is asserting the authority of the [U.S.] President and supporting that authority.

CHAIRMAN BURNS. And it's an authority that [U.S.] Presidents traditionally and constitutionally will seek to defend. That is the point of my comment.

MR. O'CONNELL. May I make one further comment, too, Mr. Chairman, a matter that we have touched upon before the Committee and as to which you counseled that it be treated with the utmost confidence. That relates to the Government in the Sunshine legislation.

If the language of the bill as now proposed with respect to the definition of agency were to be enacted into law, we have [stated] the possibility that this Committee could take the position that the law is not applicable to the Committee because the members of the Committee are not appointed to such a position by the President. Now, if that's the issue, I will want very carefully and gingerly to approach our defense in this case with respect to whether or not the members of this Committee are officers of the United States and should be appointed by the President, etc. I am merely advising in advance that I want to walk a very careful line, Mr. Chairman.

CHAIRMAN BURNS. Very good. Any other questions? I think we have probably gone as far as we can on informing ourselves about this lawsuit.

MR. O'CONNELL**.** Mr. Chairman, I apologize, I should advise that I've arranged at five o'clock this evening for a conference call to the counsel of each of the Reserve Banks merely to apprise them of the content of this complaint and its general makeup.

CHAIRMAN BURNS. Very good.

MR. WALLICH. If [we lose] the suit, would that affect any past actions taken by the Committee?

CHAIRMAN BURNS. I think Tom has already answered that question.

MR. O'CONNELL. In my judgment, Governor, I would argue that on the basis of the complaint itself, there's no necessary application to previous actions of the Committee, and it could be all futuristic in terms of its applicability, depending on what the Court of Appeals finally rules. I think it would not have any impact on past actions. Although as the Chairman has mentioned, we can't preclude citizen John, on the basis of the decision of the Court of Appeals, from filing suit, [unintelligible] past injury.

CHAIRMAN BURNS. Gentlemen, I need hardly say that life at the Federal Reserve is very interesting. We'll turn to our regular business.

[End of executive session]

CHAIRMAN BURNS. We would like to have the report of the Foreign Exchange [Trading] Desk.

MS. GREENE. Thank you. It is a pleasure for me to be here. Since your last meeting, the dollar continued [unintelligible] it tried to reach in early June at the highest levels against the major European currencies since late January. This latest advance had been triggered by the upward advancement in short-term U.S. interest rates; in addition, evidence of a further reduction in unemployment, generally favorable [unintelligible] performance, and a lower trade deficit for April underpin a generally positive [market] sentiment. Subsequently, the dollar eased fractionally from early June levels once the rise in short-term interest rates leveled off, but then it remained stable against many important currencies, especially the German mark, even as tensions deepened in the market for other currencies.

Meanwhile, the markets focused their attentions on sterling and the Swiss franc. Sterling continued its deep plunge as the market, now totally demoralized, took little notice of the recent and substantial increase in Britain's export sales or of a growing acceptance among trade union memberships of the need for an accepted constraint on wages. Instead, concerns deepened as [unintelligible] fall in sterling threatened to reignite union opposition to the government's pay policy.

At the same time, parliamentary debate over public spending [unintelligible] on the government's entire economic program. The Bank of England, which had earlier provided heavy support for the pound, eased up its dollar sales as reserves came close to being depleted. And with dealers also no longer willing to take sterling into their positions, the rate dropped without resistance to just about $1.70, some 15.8 percent below levels of just last March. This drop was far greater than any corrections needed simply to offset Britain's relatively high inflation rate; moreover, it had very serious consequences, not only for the British government's efforts to contain inflation at home but also on competitive relationships throughout Europe.

The announcement of a $5.3 billion dollar credit for England by the Group of Ten countries, Switzerland, and the BIS [Bank for International Settlements] consequently had a strongly positive and immediate impact and was followed up with simultaneous operations in sterling by the Bank of England in both London and through the Federal Reserve Bank of New York. It [unintelligible] a covering of short sterling positions and a sharp rebound in the [unintelligible] race. Since then the government pay policy has been accepted by the Trade Union Congress by an overwhelming majority. In addition, the Bank of England took advantage of the shortage of liquidity in the domestic money market to engineer an even greater squeeze on speculative positions [unintelligible] in the Eurosterling market.

Nevertheless, the market for sterling remains fragile. Many participants were disappointed that the government has not adopted further anti-inflationary measures, and consequently sterling does not yet have sufficient buoyancy to offset a continuing flow of commercial offers in the market. The Bank of England, therefore, has continued to provide supports for the crown, selling--since the June 7 announcement at around the $1.77 level--almost $550 million. The bulk of this will be covered by a requested [unintelligible] by the Bank of England on the Group of Ten standby of 10 percent of the total arrangement, hopefully valued tomorrow.

By contrast, the Swiss franc remained strong against both the dollar and the German mark during the period. To counter this trend, the Swiss authorities introduced harsh measures and cut the discount rate to limit new inflows into Swiss francs. In addition, the [Swiss] National Bank pledged to intervene massively if necessary; it also agreed that a German government borrowing denominated in German marks be placed with a consortium of Swiss banks. This renewed demonstration of determination to resist the Swiss franc’s persistent rise, together with Swiss bidding for marks before the paydown of the German government loan, helped for a while to relieve the upward pressure on the franc. But to the extent that the German mark was simultaneously nudged higher in the European community [unintelligible], it brought those currencies close to the band [unintelligible] such as the Dutch guilder, again under pressure.

Thus, the situation on the Continent also remained fluid. During the period, the Federal Reserve was asked by several other central banks to intervene on their behalf in the New York market. As exchange trading has become more and more a 24-hour business, many central banks have found it useful to follow up operations in their respective markets with operations in our market after their close. On that basis we have sold since May 18 more than $170 million with the Swiss banks; with the Swiss National Bank we have purchased $77 million of sterling from the Bank of England; and we have bought over $35 million worth of guilders with the Netherlands Bank.

We did not intervene with the System account. Instead, we continued to acquire Belgian francs, buying about $26 million worth, and repaid $20 million on our outstanding swap debt in that currency. In addition, the System was able to add to its balances of German marks, which now amount to $53 million equivalent, and only began to buy small amounts of Dutch guilders, a currency which we have also used to intervene from time to time.

Our total balances apart from those held against outstanding swap debts now amount to $58 million, well below the $150 million figure that the Committee agreed last September would be appropriate. I have two points to raise with regard to recommendations.

CHAIRMAN BURNS. Are there any questions?

MR. EASTBURN. Do you have any idea where the British expect the pound to be?

MS. GREENE. I don’t have any information on that. I do feel--and it is just a feeling--that they do wish to have the beneficial effects of the package demonstrated in the market, and so they have wished to keep the rate higher than where it was at the time of the announcement.

MR. PARTEE. The first drawing, you are saying they will beat the mark?

MS. GREENE. That's right.

MR. PARTEE. And then there will be--

MR. STERNLIGHT. About $200 million of it would have a reserve impact.

MR. PARTEE. That is our 200 of the total 550.

MR. STERNLIGHT. And as it happens, it would fit rather well with other things that are happening to reserves. It presents no problem from that standpoint.

MR. WALLICH. From your observation of the market, when sterling was going down as you said--without resistance, I think--would you have said that was a disorderly market?

SPEAKER(?). I think by all of the attributes of disorderliness we have spoken of in the past, the sterling market would certainly qualify as being disorderly, yes.

SPEAKER(?). Would you call it a disorderly market, Governor Wallich?

MR. WALLICH. If I had to stretch a point in order to be able to intervene, I would, yes.

MR. COLDWELL. I presume this drawing you are talking about will be pro rata among all the members of the group?

SPEAKER(?). As the request went out in the cable we received on Friday, it would be pro rata against all central banks and governmental agencies. That includes all participants except the BIS. There currently are negotiations under way as to whether or not that pro rata situation should [include] or can exclude the BIS. The Treasury was under the assumption that the BIS would be included in a manner similar to other participants; however, the BIS was under a different impression, apparently, and the Bank of England will be going to the BIS to finance outstanding short-dated swaps, which would be outstanding over the month-end.

So the total participation of the BIS, if [unintelligible] to conclude the financing of short-term swaps, would be far greater than the $15 million that would [unintelligible] to a 10 percent draw. There are a variety of issues outstanding, and it is for those reasons that we have not been able to confirm the drawing or actually [unintelligible] on the takedown of this particular drawing.

MR. MACLAURY. I was just going to ask, to the extent that OPEC countries' sterling balances seem to have been a major part of the pressures on sterling before the package, whether they continue to be described as continuing commercial selling in the market following the package.

MS. GREENE. Well, undoubtedly there has been some OPEC selling of sterling, because there are some large sterling holders on the part of a few remaining OPEC members. But the most surprising source of pressure there has been the many countries, not OPEC, that have historically held large amounts of sterling and have been disinvesting their sterling holdings over a period of several months. Probably they are equally important in terms of the amount of sterling sold. Furthermore, probably quantitatively the most important has been adverse movements in commercial [unintelligible]. And the kind of continuing business we see in the sterling market on the sale side does appear to be largely commercial.

MR. MACLAURY**.** In the case of diversification of previous sterling holders, do we have any [unintelligible] as to whether they are diversifying into dollars or into a broader range of currencies or into marks, or yen, or is it unknown?

MS. GREENE. Well, those countries with accounts with us look like they are diversifying largely into dollars, but that would make sense from the point of view of the composition of their trade. There may be other countries who are also diversifying with accounts elsewhere whose activities we cannot so easily track.

CHAIRMAN BURNS**.** Any other questions? Thank you, Miss Green. And now a motion to approve would be in order. I take it that the transactions for the Desk are approved. I should have asked you this question, Miss Green. Is the Bundesbank participating in trading in sterling? Did it intervene?

MS. GREENE. As it turned out, the Bundesbank did not need to, although there had been some [unintelligible] into the weekend that the Bundesbank would join in the intervention on the day of the announcement. As it turned out--

CHAIRMAN BURNS**.** Did it not intervene at any time?

MS. GREENE. In sterling?

CHAIRMAN BURNS**.** In sterling, since the 5.3 billion standby [unintelligible]--

MS. GREENE. As I said, they did not need to. The day of the announcement was a holiday on the Continent, and the Bundesbank was closed, and the German market was closed that day, and by the second day there was no need for such a [unintelligible].

CHAIRMAN BURNS**.** All right. Thank you. May we have your recommendations, Ms. Greene?

MS. GREENE. Certainly. Two drawings on Federal Reserve swap drawings come due before the next meeting. The first is the $360 million Mexican drawing. So far this year, Mexico has made progress in bringing down inflation, while its current account position has improved in response to the economic recovery here. But inasmuch as the swap matures just after the July 4 presidential election date, we understood at the time of the drawing and also from more recent conversations that the Bank of Mexico might well wish to renew. In that event, we would recommend renewal for another two months.

CHAIRMAN BURNS**.** Very well. Any objection on the part of the Committee?

MR. COLDWELL. This is a first renewal?

MS. GREENE. This would be a first renewal.

SPEAKER(?). You do not know for certain whether they will renew, but you think they will.

MS. GREENE. As of a conversation yesterday, they think it very likely that they will wish to.

CHAIRMAN BURNS. Any further questions?

MR. JACKSON. Do we have any information about activities along the Southwestern border indicating a change in people's attitude toward the peso? That might be a more general question than the Desk would be informed about.

MR. BAUGHMAN. Mr. Chairman, Mr. Volcker, it may be irrelevant here. We continue to hear a very substantial amount of discussion relative to a probable devaluation of the Mexican currency. And we hear conversation on the part of U.S. businessmen conducting a substantial amount of business in Mexico in the context of a 10- to 12-month time frame. The San Antonio and El Paso Branches have not seen a reflow of the large volume of large denomination currency withdrawn prior to Good Friday, as normally would have been expected to take place by this time. We do see indications of continued demand for large denominations of U.S. currency. They are not pressing us for it when we say we are out at the moment; they say "we'll check elsewhere," which suggests that they may be finding such currency in commercial banks.

CHAIRMAN BURNS. All right, is the Committee of a mind to approve a renewal of the Mexican drawing?

SPEAKER(?). Moved and seconded.

MS. GREENE. The next is the Italian situation. As Mr. Holmes anticipated at the last meeting, the Bank of Italy did request a renewal of its second $250 million swap when it matures on June 27. And the Bank of Italy agreed to the same conditions we had imposed upon renewal of the first drawing. Now that first drawing, also $250 million, will be coming due for the second time on July 22. According to my conversation with the Bank of Italy last week, they do intend to repay, but so far the Bank of Italy has drawn on only $500 million of the total $750 million that we made available to them in February, and so they still have $250 million to be drawn as they need. I don't have a specific recommendation to make in this regard, but I think it very possible that there may be a third request in the near future.

CHAIRMAN BURNS. Are there any questions?

SPEAKER(?). Is this a renewal?

MS. GREENE. When the draw issue comes up in July, when it matures, that would be at the end of its first renewal period. As a condition of the drawing, they agreed to repay after a first renewal period. And they intend to do so. However, they have $250 million left, and they are obviously in an uncertain situation at the moment with the elections just completed, and so it is very conceivable that within the next month there might be a request for a third drawing. [If so,] that would, by the time of the next meeting, [leave] the total amount of their indebtedness into the [unintelligible] unchanged.

SPEAKER(?). You mean they might borrow from us in order to repay us?

SPEAKER(?). That's what it sounds like to me.

MS. GREENE. In effect.

MR. PARTEE. In any event, this particular drawing would--

MS. GREENE. I am not asking for a renewal. I am simply anticipating [unintelligible] of letting in a third drawing, which might be at a time other than the repayment date. But in the future.

MR. WALLICH. If that occurred, then [their debt] would never mature. Because they would extinguish one debt by creating a new debt.

SPEAKER(?). We would have to be a party to that.

SPEAKER(?). I agree.

CHAIRMAN BURNS**.** And we are not likely to. No action is required on the Italian [unintelligible]. Any further questions? We owe you thanks, Miss Green. We will now have Mr. Gramley's report on the economy.

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

CHAIRMAN BURNS. We're ready for the economics discussion, and let me just say one word before we turn to that. At the last meeting, the Committee decided to expand on the discussion in the Redbook, and particularly to gather information from our [Reserve Bank] directors concerning the rate of utilization of industrial capacity. Mr. Mayo took the responsibility of monitoring that effort, and this month's Redbook is a great improvement over the past. I have been very pleased with it, and I hope the rest of the Committee has found it of substantial benefit as well.

Well, we're ready for our discussion, and I think what we would want to do in the course of this discussion is to not concentrate on detail and technical matters but either reinforce or question the judgments that Mr. Gramley has expressed. Any comment?

MR. BAUGHMAN**.** Mr. Chairman--a speculative question, but I encountered in a number of places a possible explanation of the weakness of retail sales, particularly in soft goods recently. It is that, this year, people think there will be gas available for whatever kind of vacation travel they might wish to engage in, and therefore that is affecting their current spending. I was interested that this was not mentioned anywhere in the Redbook or Greenbook, and I was wondering whether you had any reaction to it?

CHAIRMAN BURNS. You mean that people are saving up a little money to spend on automobile travel in conjunction with vacation, etc.? That is the thought?

MR. BAUGHMAN**.** That's what I've been running into.

CHAIRMAN. Very interesting. I have not run into that. Mr. Gramley?

MR. GRAMLEY. I have not heard any such comment. I mentioned one thing in connection with this weakness in retail sales, which is that if you believe the weekly figures, we do now seem to be coming out of that. The weekly figures have been untrustworthy in the past, and I don't want to make too much of it, but since about the middle of May, the weekly figures have suggested a general upward course, and the auto sales figures have also improved. There could be all sorts of reasons for that, including what President Baughman and I think, which is that there just isn't any evidence at this point that this is anything other than a very temporary pause.

MR. EASTBURN. Mr. Chairman, I might follow up on Ernie's point with the comment that Bicentennial tourism has not proved to be as large as expected. Our hotels are running only 80 to 85 percent of capacity, which is lower than they expected. I understand that this is not confined to Philadelphia but it also applies to Washington.

MR. PARTEE. It's true of Washington. There have been reports in the press.

CHAIRMAN BURNS. Well, should this be the peak season? Or is not the peak season ahead of us? If 80 to 85 percent now, it might well be 95 percent for the first weeks in July.

MR. EASTBURN. Could be, and I think people are waiting to see [whether] their expectations have been fulfilled.

MR. GRAMLEY. Press reports in Washington have it that the level of its tourism in Washington is actually below last year's.

CHAIRMAN BURNS. Below last?

MR. GRAMLEY. Hotel occupancy is below last year's.

CHAIRMAN BURNS. Below last year's. That's very, very--

SPEAKER(?). Mr. Chairman, we had a conversation over the weekend with the May company people, headquartered in St. Louis, and they're normally quite sensitive to trends. They're still totally on dead center in terms of not having a real feel for which way consumer spending is going on the retail level. They're cautious. They're not pessimistic, but they're far from exuberant in terms of their analysis of the rest of the year.

CHAIRMAN BURNS. Mr. Partee.

MR. PARTEE. Well, let me say that, looking at this last chart that Mr. Gramley has distributed, I think it certainly fortifies my view that this is a temporary kind of a move in retail sales. I was fully expecting them to come back, too. Indeed, I would point out that the last couple of months of observations in this retail sales line are based on preliminary data. And if there was something of the kind that Ernie was mentioning going on, that is, a tendency not to spend in conventional ways at the department stores and so forth, but rather to spend in the course of vacations, that's a very hard thing for retail data to pick up--the restaurant sales in small towns and the motel rentals and that kind of thing. And so it could well be that what we're looking at here is going to largely disappear in the course of revisions. But I think that [unintelligible] personal income and unemployment certainly suggest that retail sales ought to be strengthening in the course of the summer as we go along.

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

MR. BLACK. Lyle, I think I come out about where the staff did on business spending on plant and equipment, but I can't find too many businessmen who feel that ebullient about it. They seem to be worrying about EPA and OSHA, and you might think that would add to their spending, but they seem to be having a reverse reaction. Of course, they're worried about the effects of inflation and the absence of a firm national energy policy and all sorts of things like this. In the oil industry, for example, one of our directors is a high official and says that the move to break up the oil companies is practically paralyzing the capital outlays by oil companies. And since fears of this type tend to be exaggerated in an election year, I'm wondering if we are giving enough weight to some of these feelings.

MR. GRAMLEY. I think that's a pretty good question, President Black. My own feeling is that we could be on the high side in our estimated increase in plant and equipment expenditures. Our estimated increase for the calendar year 1976 exceeds by a considerable margin what is projected in the Commerce anticipation survey. We have felt justified in [that estimate] for several reasons.

One, our model suggests that the sort of accelerator effect we should be getting from past increases in real consumer spending ought to be carrying through to the investment level in a rather vigorous way. Two, business profits have been very good and are still moving up, and it should induce some changes in planning. Third, new order figures have been unusually strong in the past five months--a 16 percent increase since the first of this year.

There are some signs of hesitancy. The expectations figures do not look all that strong in the first quarter. The Commerce survey does not show a particularly [large] improvement in spending plans from February to May. The construction contractors' work figures are weak. And we are concerned also about this problem of potential divestiture in the oil industry.

For the time being, I would want to stick with this kind of forecast on the general grounds that past cyclical experience rather strongly indicates that once you get a process of strongly advancing consumer spending under way, it does feed back to the investment level. But the next few months of information on plant and equipment spending could cause us to change our minds.

MR. BLACK. Well, I come out exactly there, too. The Redbook sort of reinforced what I was hearing in our own area on that, and I just want to know how much we ought to weight it.

CHAIRMAN BURNS. Any other question or comment? Mr. Wallich, please.

MR. WALLICH. I think you said, Lyle, that no reduction in the rate of inflation was likely during the present expansion, which makes me feel [that the projection is] rather ominous. Will it take another period of slowdown in order to get any improvement in inflation? How are our wages likely to develop with productivity that would permit some reduction in inflation, perhaps during the expansion?

MR. GRAMLEY. Well, what I said was, I don't think we can realistically expect any slowdown in the underlying rate of inflation--[although] I don't think it's impossible. What we have been projecting is an increase in compensation per man-hour in the range of 8-1/2 percent at annual rates. And an improvement in productivity of close to 3 percent, which would give us about a 5-1/2 percent increase in unit labor costs.

I think favorable surprises could come from several sources. For one thing, we have, generally speaking, been overestimating the rate of increase in wage rates this year. The rate of increase in wages has slowed more than we anticipated, and I think that the relatively favorable price developments have been importantly responsible. But the light collective bargaining schedule thus far has also been a factor, and maybe we are going to get better performance than we had thought.

But I think we would want to be conservative. I don't think we can offer much hope for a better wage rate performance than 8-1/2 percent in terms of compensation. We may get better increases in productivity, but here again, our estimates seem to us realistic. A 3 percent rise is a half percent above the long-term increase in productivity. A third source, of course, could be bumper crops, and again we can't forecast that. It could happen, but I don't think one can realistically hold out much hope for them.

MR. WALLICH. Imports is a possible source of lower prices?

MR. GRAMLEY. Gee, I would have a hard time imagining that all foreign countries taken together are going to do better than we do in terms of rate of inflation. Some perhaps will--Germany might. I wouldn't think that the world from which we import generally will show lower increases in prices than we do.

MR. REYNOLDS. But you may have in mind the rise of commodity prices that we already had. But a lot of that, I think, may be a once-for-all adjustment. For example, the rise in coffee prices and adjustment to a very [small] crop ought not to continue, it seems to me. And even the rise in metals prices seems to owe something to cost increases and the fact that there's been a very sharp turnaround from inventory liquidations to [unintelligible] liquidation. But I don't think we are headed for a runaway boom situation.

SPEAKER(?). Given the determination of the recent EPC meeting, the country showed not to have a runaway boom. That's helpful.

MR. COLDWELL. Mr. Chairman, let me go back to the question of retail sales. Lyle, if you take as an assumption that we have had a run-up in retail sales that was at least partly attributable to price increases, do we have anything in our data which would indicate that price increases [are easing], particularly for GAF [general merchandise, apparel, and furniture] stores, which I gather are showing further weakness in the last month or two. Any evidence indicating a slowdown in the price changes with that type of commodity?

MR. GRAMLEY. Well, I don't think we have data relating specifically to GAF stores. If you were to look at apparel prices, though, I don't think you would see any significant evidence of a longer-term slowdown in prices. The increase in apparel commodities during May was half of 1 percent. And it [was] running about 2 or 3 tenths in previous months.

CHAIRMAN BURNS. Lyle, what does the Federated Department Store price index show?

MR. GRAMLEY. I haven't looked at that recently, Mr. Chairman, and I haven't--

CHAIRMAN BURNS. I haven't either, and it would be interesting to check because that may provide an answer.

SPEAKER(?). At least a partial--

MR. GRAMLEY. From what we have heard--

CHAIRMAN BURNS. A partial answer to Mr. Coldwell's question.

MR. GRAMLEY. From qualitative reports about the situation in retail stores, we could see some price cutting. We've understood that nondurable goods inventories are sufficiently high at the retail level as to generate some concern, and we have been told that there may be some price concessions to help move some of this merchandise. They would presumably show up in the June CPI.

MR. COLDWELL. In other words, there's an element here, too, Lyle, in the question of the kinds of commodities or goods which the public is buying. If there has been a shift in that toward upgrading or something like that, which might be reflective of a kind of commodity that is not growing at a price rate [unintelligible], you might be having an effect here on your total retail sales.

MR. GRAMLEY. That's a possibility, but from our discussions with people in the retail industry, there just isn't any doubt that sales overall slumped in April and stayed at relatively low levels in May. They were quite discouraged, and they were looking at increases in inventories that they found unacceptable.

CHAIRMAN BURNS. Mr. Partee.

MR. PARTEE. I don't recall that you said anything about housing, Lyle, but would you read the recent data as being rather disappointing?

MR. GRAMLEY. Yes, I would. The increase in starts in May was only a little over 2 percent. The permits figure was up around 5. What we are seeing is a smaller rate of rise in the multifamily area than we had hoped for. The problems there are proving to be more deep-seated and more intransigent than we had hoped for. And we have trimmed down somewhat our increase in projected housing starts over the remainder of this year, mainly in the multifamily area.

In the single-family area, I think we can look forward to some further gradual improvement. But here the discouraging factor is that sales seem to have leveled out. We just are not getting any further increases in sales in either new or existing homes through April, which is as far as the data go, and we did check qualitatively to see what May changes might have been. And generally speaking, the market doesn't seem to have shown any further improvement other than the normal seasonal rise.

CHAIRMAN BURNS. Well, the homebuilders and realtors I've talked to on that subject--I was surprised at the optimism that was being expressed by this very unscientific sample of mine. Do you have any observations on that subject, Mr. Jackson?

MR. JACKSON. I think generally they're optimistic. But there's no question about the figures Lyle talked about, that for the last three months the index of sales of existing homes is down and has not come back up. The number of single-family units sold is down, and has not come back, which tends to support everything, except, perhaps, the permits figure, which is up. And although they are still generally optimistic, there's no question about this.

CHAIRMAN BURNS. The permits figure is up, and multifamily starts were up rather sharply last month.

MR. JACKSON. Up from a very low level--a less-low level I guess is about the best way you could say it.

CHAIRMAN BURNS. Mr. Winn?

MR. WINN. Two things, Mr. Chairman. One, there is perhaps more seasonality in retail inventories than we recognize, and to the extent that they get caught with spring merchandise, particularly in the nondurable things, they can't always have price sales to get rid of it in summertime. So it takes a little time to work some of these things off, and price cutting just doesn't always do it.

Second is a remark on commodities. I think the tremendous pickup in the volume of commodity transactions, particularly in copper, lead, and zinc, would lead you to believe that maybe there's more than just consumption in that area, but perhaps we have a new international payments mechanism hedging against gold, which is no longer so attractive to many people, and also foreign exchange, with its greater fluctuations. And more people are turning to copper, lead, and zinc as a way of protecting themselves in terms of international transactions, as well as inflation and other things. I think the tremendous pickup in volume in that area is rather significant.

CHAIRMAN BURNS. Very interesting point. Any other comments on the economy? Well, we are in position to move ahead, and perhaps we will take a coffee break and resume our deliberations after.

[Coffee break]

CHAIRMAN BURNS. We are ready to start Mr. Sternlight's report.

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

CHAIRMAN BURNS. Thank you, Mr. Sternlight. It's generally true that the operations at the [Domestic Trading] Desk are carried out with considerable skill, and I thought that during this past month it was especially true.

MR. EASTBURN. Peter, I was [unintelligible] pleased to see the analysis in the Bluebook about the nonborrowed reserves and how they work. Do you have any feeling at this point as to how realistic the [nonborrowed reserves] simulation is now that you've seen this?

MR. STERNLIGHT. Well, we are attempting this simulation according to certain guidelines that we have set out. The guidelines could be somewhat different. I think it could be done along the lines that we are describing here, and the general result would be as we have described for each period, on balance. It seems to me we would have tended to move [more firmly] on the [federal] funds rate than we actually did and would have had more variation in the funds rate. I remain doubtful that this would really serve the longer-term purposes of policy, but it's still rather early to judge the exercise.

MR. AXILROD. If I may comment on that, Mr. Chairman. As you know, we're running at each interval, and the time before this [the simulation implied] somewhat higher [actual than targeted growth] rates for all reserve measures, and in this case, [a] higher [actual growth rate] for nonborrowed [reserves] but much lower [ones] for total [reserves and] the base.

The point I'd like to make in addition to those Mr. Sternlight made is, if the Desk had achieved the [lower] rates two months ago, we have no way of putting into the simulation what actually could have been the case with regard to deposits in the current period; maybe rates would have been somewhat [higher], for all I know, or unchanged. It doesn't necessarily mean that they're [lower] and again [lower], because we're not able to get the feedback effect in.

MR. EASTBURN. May I comment also on that, Mr. Chairman? [Unintelligible,] the recommendations of the Subcommittee on the Directive, we did, after all, have in there a federal funds constraint [unintelligible] so that it is a little difficult--in fact, it's impossible, I guess--in a simulation, to really tell what would have happened, because if we had a fed funds constraint to live with [unintelligible] reserve operating target, the outcome that we were talking about wouldn't necessarily have to come about. That is, it is not completely clear to me if we would have greater funds rate variability [with] that nonborrowed reserves target than we do now. Is that wrong, Peter?

MR. STERNLIGHT. Well, again, I think it depends on what constraints we set ourselves. We were working with kind of an internal rule that we would not want to see the average funds rate change by more than 25 basis points per week. We were permitting some backing and filling of the funds rate as we went through the period on these hypothetical scenarios. If, early in the period, it looked as though we were going to come out substantially above path, and we assumed that we would be moving up in the funds rate, and the later evidence had us much weaker against the path we were assuming, then we would be more generous in the reserve provision and let the funds rate come down.

No one can revise those internal rules so as to screen out those short-term residuals. One could just construct a different exercise than the one we went through, so I think you are right, we wouldn't necessarily have had to have greater variability, but I think we would then have been in a sense less faithful to the attempt to achieve the nonborrowed target.

MR. BALLES. Mr. Chairman, one other observation. I would certainly echo your remark that the Desk carried out the operations with great skill in this period. I was on the morning call for a good part of the period since the last meeting. One very definite impression I'm getting as a result of having paid close attention in this past month to the daily operations, and I would like to put this especially to Mr. Sternlight, is that the market sometimes overreacts to our direct purchases or sales in the market as opposed to purchases or sales to and from foreign accounts. They seem to read into it when we do direct market transactions [unintelligible] move on our part to change the level of the funds rate.

I wonder if we would get away from this, to some extent at least, if we were targeting on, say, nonborrowed reserves rather than targeting on the funds rate itself. I think the market is kind of overshooting in its reactions to your direct operations in the market as opposed to operations with foreign accounts, and the market, I think, has to look on the defensive operations.

MR. STERNLIGHT. I think you are certainly right that the market focuses more on overt operations that they see from us, and it's natural because that's what they are seeing directly. When the weekly statistics are published, they learn that we may have acquired bills from foreign accounts or sold to them. I'm not sure that there'd be very much difference in that regard if we were working on a nonborrowed reserve target. It seems to me we'd still be conducting operations either with overt entries into the market or operations that the market did not see as directly, and they would very possibly still exaggerate the significance of whatever they saw overtly from the Desk.

MR. JACKSON. What problems would you have if, when you had mechanical failures like you had recently, you were operating on nonborrowed reserves versus fed funds. Fed funds information is something you get externally, whereas the nonborrowed is internally generated.

MR. STERNLIGHT. Well, I think there could be delays in getting the information together when there were mechanical failures.

CHAIRMAN BURNS. Without implying any preference [unintelligible] operation over against another, if he had mechanical failures, you'd fall back on the federal funds rate because you had nothing else.

MR. AXILROD. In addition, Mr. Chairman, a mechanical failure recently did also affect the fed funds rate because banks didn't know their position or thought they had the wrong position, [which] actually caused the fed funds rate to be higher probably than otherwise it would have been.

CHAIRMAN BURNS. Any other question or comment on the Sternlight report?

MR. WALLICH. I'd like to hear a little more--the comparative observability of our objectives under the two techniques--the fed funds rate, how early they can feel us out with nonborrowed reserves, how early can they figure out what the objectives are.

MR. STERNLIGHT. I think that it is probably easier for the market to try to track us closely with the fed funds rate objective. That's something that they can read immediately from the market just as we can, whereas with a reserve objective, it would be a little more difficult for them to track us.

MR. MACLAURY. On that same point, I think the answer would obviously depend upon the extent to which we were prepared to follow the nonborrowed target regardless of day-to-day variations in the funds rate. The answer you gave, it seems to me, implied that we would certainly be giving less weight to day-to-day stability of the funds rate and therefore [creating] greater difficulty in tracking exactly what we had in mind.

I think that likewise has a bearing upon what so-called experts or professionals in the market can read from early disclosure of our decisions here. Will we be following a nonborrowed reserves target and allowing the funds rate to move in a wider range than we now do, day to day? It seems to me [that then] it would be much more difficult for the professionals to follow what we were doing or benefit or profit thereby even if we were to release our targets quickly.

SPEAKER(?). I think that's a good point--

CHAIRMAN BURNS. I think these [simulation] operations are useful. If there's going to be any change in the method of operating at the Desk, I think we need a little more experience, and I think the observations that have been made here are helpful to the Committee in thinking about our method or techniques of operating the Desk, but I don't think we can decide, or should try to decide, on a change in operating the Desk at this time. We need a little more time to observe what has been happening and to study the simulation exercises a little more for a longer period. If the members of the Committee are ready to change or want to discuss a change now, of course, we can do that. I doubt that we could--

MR. WALLICH. Mr. Chairman, I would think that at most it's a question of putting the nonborrowed reserves target where the RPDs [reserves available to support private nonbank deposits] used to be, in other words as a subsidiary element, not as a change in operating--

CHAIRMAN BURNS. Are we ready for that? If we are ready to include nonborrowed reserves as one of the factors to follow directly in the Desk's operations, let's indicate that by a show of hands. Well, the majority of the Committee clearly wants a little more time to--

MR. COLDWELL. I would suggest, Mr. Chairman, it might be helpful, though, for either the next meeting or the one following, to have a recap of the past four months that we have been tracking this and where the Desk thinks it might have to come out with these.

CHAIRMAN BURNS. Well, I haven't kept precise track of the period, but let's make it a six-month period.

MR. WALLICH. May I just verify a point in case I misunderstood it. We can use nonborrowed reserves in two ways. One is as one of the aggregate targets; that's what I understand we discussed tonight. The other is a more ambitious step--to replace the funds rate by nonborrowed reserves and have the [System Open Account] Manager look at that and not look at the fed funds. That I would not propose at this time.

CHAIRMAN BURNS. Anything else to be said on that subject? Any further comment on Mr. Sternlight's report? If not, a motion to approve operations at the Desk would be in order. Motion made and seconded.

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

CHAIRMAN BURNS. Thank you, Mr. Axilrod. Any questions to Mr. Axilrod?

MR. COLDWELL. Mr. Axilrod, what is there in the situation now that [supports] the staff's estimate of strengthening business demand? We haven't seen this for some time. The latest figures that I see coming out of the economy [suggest], perhaps, even some slowing in rate of progress. If we get some continued slowing in retail sales, you have a dampening influence on inventory accumulation. What is it that brings you to the idea of a stronger business demand over [unintelligible]?

MR. AXILROD. Well, Governor Coldwell, we do have increased business spending on capital expenditures in the second half of '76 compared with the first half of '76, and we have a larger increase in inventory accumulation in the second half of '76 than in the first half. These are somewhat larger than the increase in internal funds that's occurring in that period, so on balance, we have a somewhat greater need for net external financing on the part of nonfinancial corporations. We believe that virtually all of this additional moderate external financing will take the form of short-term business loans rather than a further increase in the relatively large amount of long-term corporate borrowing that has now occurred.

Of course, we could be wrong on several counts. We could be wrong on the added inventory accumulation or the added spending; we could be wrong on the extent to which businesses are going [to borrow short term]. We don't believe they're going to want to lock themselves into relatively high long-term rates any more than they are now doing. We may be wrong on that count, but the increase in business loans that were projected is really rather moderate, well below the rates of increase of '73 and '74. But it does represent a turnaround from the net declines that we were seeing in the first half of this year.

MR. COLDWELL. If you keep your level of internal cash generation without any increase but keep the current level of long-term issues, isn't that going to supply most of what you're going to need to meet this inventory and capital expenditure requirement?

MR. AXILROD. Well, as I say, we have some increase in the net external need, so if you keep the level of bond issues, you need something else to finance the increase in net external need. We are assuming much of that comes in business loans. In addition, we are permitting businesses as a group to add a little more to liquid assets, so some of it gets absorbed in the liquid assets. As a matter of fact, we really are projecting a slight decrease in corporate bond issues, so it stays pretty high but not a significant [unintelligible].

CHAIRMAN BURNS. Any other questions? Yes, Mr. Black.

MR. BLACK. Mr. Chairman, Governor Coldwell raised pretty much the sort of question I had in mind about cash flow and the continued restructuring of debts. I guess I come out with the belief that short-term rates will go up, but probably not as much as you think, from all that he indicated, and I was just going to try to elicit the sort of comments you gave him.

MR. AXILROD. Well, President Black, I would be the last person to claim that I feel 100 percent confident that rates will rise as much as we have in alternative B in the Bluebook, and if I were going to put an error around it, I would put a plus 1/2 on the top and a minus 1 on the bottom, something like that.

CHAIRMAN BURNS. **I** think we'd better stop at this point--we might become a little more precise. Any other question or comment? Yes, Mr. Wallich.

MR. WALLICH. In thinking about rates toward the end of the year, one has to look at the [unintelligible] levels of M1 and alternatives A, B, and C for early '77, and those are so low, ranging from 2.8 under alternative A to 4.0 under C, that one wouldn't be very surprised to see those produced [unintelligible]. That's, of course, the consequence of having moved up much of our gross leeway in the second quarter.

MR. PARTEE. Well, I think that's quite right. The staff is caught by the assumption of policies that they must take. But, as in the first quarter, when we forgave an undershoot, we might well forgive an overshoot in the second quarter, in which case there would be some relief in that first-half growth in 1977, which would modify attitudes toward great--

MR. WALLICH. Yes, all I'm trying to say is, these projections of high short-term rates are partly the result of an artificial constraint.

CHAIRMAN BURNS. I think that's right. Any other comments? Well, if not, we are ready to turn to our discussion of monetary policy and the kind of directive we want to issue to the New York Bank.

I think we have a relatively easy job to do this morning. As far as I can see, the economy is expanding quite satisfactorily. The decline in the rate of growth of real GNP during the second quarter is, by and large, I think a very healthy development--the continuation of the rate of growth of 8-3/4 percent would generate boom conditions very quickly.

Now, a good deal has been said this morning about the lull in consumer buying. As all of us know, during the course of business cycle expansions, lulls of this type are a very frequent occurrence, and our more recent weekly data on retail sales and on automobile sales suggest that the lull is just about over. And in any event, there is a significant pickup in activity in the durable goods sector, and I find the new orders figures very telling, particularly new orders for business capital goods.

The stock market certainly is reflecting a great deal of continuing and probably expanding optimism. As for money and interest rates, since mid-April, we've had a considerable run-up in short-term interest rates and a modest run-up in long-term rates. More recently, interest rates in the short-term markets have stabilized. The move that we've taken, I think, has been a prudent one, though we have received some criticism; by and large, it has been well absorbed by the markets, and it has been well received, by and large, as well, by the business and financial community.

My own feeling is that specifications under alternative B as indicated on page 6 in the Bluebook are close to the mark. Some stability in money markets is indicated at the present time. And actually, I would like the fed funds rate specification a little better if it were 5-1/4 to 5-3/4 rather than 5 to 6, but I could go either way.

So as I see it, we are in a period where we ought to mark time, and I don't think that we have a very difficult problem to deal with at this meeting. But these are my simple thoughts, so let's hear from members of the Committee. Who would like to speak? Yes, Mr. Jackson.

MR. JACKSON. I would generally concur with your comments, even to the [point] that I wouldn't object to a money market directive rather than the aggregates directive.

CHAIRMAN BURNS. Mr. Partee.

MR. PARTEE. I would agree with your thrust, too, and I would prefer the 5-1/4 to 5-3/4 funds rate range because it seems to me that, within the range of monetary aggregates that we have, we shouldn't be terribly upset by something that leans toward the high end or the low end. I think I would stay with the monetary aggregate directive but look for greater stability.

The only point that I might just have a little bit of disagreement about is, I would like to be a little more provisional about the economic outlook. I think it is good. I think that we will move ahead all right as we go into the summer and early fall. But at the moment, I am a little troubled about housing and consumer spending. And I think that is a good reason for pausing a bit in what may very well turn out to be a longer-term record of somewhat firmer rates and somewhat firmer money market conditions.

MR. JACKSON. I think the money market directive versus a half [percentage point] and a quarter [percentage point] on either side of the midpoint is in [unintelligible].

MR. PARTEE. Yes.

MR. JACKSON. So I don't think it's worth discussing.

MR. PARTEE. Yes.

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

MR. MAYO. Mr. Chairman, I subscribe to your comments. I think I do prefer the full 5 to 6 range for fed funds with our usual tendency, which would be the same, I suppose, under both of our prescriptions of leaving it pretty much where it is. But it gives a little more leeway to the Desk.

I think I'd like the idea of maybe 3-1/2 to 7-1/2 for M1 as against 4 to 8. I find it a little more in tune with our longer-term objectives, keeping those in a general subtle tendency perhaps of a bit lower. I'm thinking also that the results of this meeting will be published very close to the time you go up to testify before the Banking Committee at the end of July. And not prejudging where we are going to come out a month from now, I would make a guess that we probably would not be raising those ranges. Indeed this might be in the right general area, and although it doesn't make much substantive difference, it probably would look a little better than the 4 to 8. M2, I would take 6 to 10.

CHAIRMAN BURNS. One factual point. I have just checked with Mr. Broida, we would be releasing our policy--what do we call the policy actions?

MR. BROIDA. Policy record.

CHAIRMAN BURNS. --the policy record--on July 23, and the testifying would take place on July 22.

MR. MAYO. And I would use 6 to 10 for M2, not that that is critical, but I would still pay a little more attention to M2, as we have the last couple of times. I would lean toward a money market directive this time, since that is perhaps a better expression of the way [alternative] B is set up, but I don't feel strongly about it.

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

MR. EASTBURN. Mr. Chairman, I would go along with your prescription. I think alternative B as prescribed would be appropriate. I would like to take a second, however, to revert to the earlier discussion about where we find ourselves with respect to the pattern of money growth and so on and interest rates.

We have done some exploring with other forecasts, particularly work on DRI and a little bit with Michigan. And, comparing them with the Greenbook and as far as the real economy is concerned, the results are pretty much the same for all of those. The interesting thing, however, is that these private forecasts come to this conclusion with the expectation that M1 will grow considerably more rapidly in the next three quarters than the Greenbook has projected. It's something like 3 to 4 percentage points.

Similarly, these outside forecasters are more optimistic on interest rates. They see a Treasury bill rate about 1-1/2 to 2 percentage points lower at the year-end than does the Greenbook. They see interest rates more along the line of what Steve was coming to, interest rates rising less than the Greenbook would have it.

In other words, what this suggests is that the Greenbook forecast, given those assumptions with respect to money supply and interest rates, is optimistic. And what this also suggests is that we may see some long-run implications--particularly next month, when we come to look at the long-run target--for whether we should reexamine those targets in the light of this, or at least to forgive the overshoot that we have had in the second quarter.

This is, I think, a problem in the making which we are going to have to consider. For the moment, however, I think that things are uncertain, but I would be content to hold where we are with alternative B.

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

MR. COLDWELL. Mr. Chairman, I'm delighted to join you in your prescription. I would also prefer a narrower fed funds rate, mainly because, with those wide margins [unintelligible]. I'd prefer that the money market conditions stay stable and that we take time to pause while we decide whether this economic lull is going to continue. I don't see any real evidence yet of a business loan expansion. I value Steve's judgment when he tells me that he's at least partially convinced that it will occur sometime, and I would agree with that judgment. Someday I think we will see it, but I don't see it yet, and I don't really think it's necessary that the policy must take an advance look at it that far down the line.

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

VICE CHAIRMAN VOLCKER. I don't have any disagreement with the general pattern of the remarks that have been made, and, too, I'm not terribly concerned over this hesitancy in the economy, although in our own projections I guess we have it a little greater than the Board's staff does.

I do remain concerned over the sluggishness of business investment. As we look ahead, I'm a little less optimistic than the staff projections there. And I'm also disturbed over the Gramley view of inflation, which is widely shared I'm sure, but I do think there is some possibility of making some further progress on inflation as expansion proceeds, and we ought to do what we can to facilitate it. And that leaves me with somewhat opposite prescriptions of wanting to boost business investment but at the same time wanting to be very cautious on the inflationary side, which leaves me right in the middle where the rest of you have been [unintelligible].

I would be very reluctant, however to see the actual fed funds rate go above 5-3/4 or below 5-1/4, so I'd be perfectly happy with that specification. I do share Mr. Mayo's feeling that we would be better off with a 3-1/2 to 7-1/2 percent M1 figure. In addition to the reasons that he presented, which I think are valid, I would note that in New York, we have a lower projection of the M1 figure that would be right at the lower end of the 4 to 8 percent range. So I would rather pick up the [alternative] C specification there of 3-1/2 to 7-1/2 and leave the [alternative] B specification for the M2 number. But that's a very small modification of the proposal you made and is directly in line with Mr. Mayo's proposal.

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

MR. MACLAURY. Thank you, Mr. Chairman. I likewise share what seems to be the consensus view of the economic outlook. This is just a pause. On the funds rate range, I think we should be consistent. If we are going to narrow the range to as small as 5-1/4 to 5-3/4, which I think is reasonable under current conditions, then we ought to use a money market directive rather than an aggregates directive. I think that's simply more consistent with the facts. I think we are going to end up as Chuck indicated, forgiving or forgetting April's bulge and not trying to retrace our steps as we go down the pike, and that would give us some leeway later on.

I think likewise if we are going to use this narrowed range for the funds rate, perhaps there's something to be said for what I think was a pattern we set at our last meeting of keeping our two-month targets consistent with our long-run targets. I like that idea and I would like to reiterate it at this time, particularly if we are going to use, as I say, the narrower funds range. It seems to me we can then stick with a narrower and lower money supply target, and I would simply buy the 4-1/2 to 7 percent range, rather than the 3-1/2 to 7-1/2 percent.

CHAIRMAN BURNS. All right. Thank you, Mr. MacLaury. Who would like to speak next? Mr. Guffey, then Mr. Morris.

MR. GUFFEY. Well, Mr. Chairman, I agree with the narrowing of the fed funds range. I guess my principal concern is that we don't get a turnaround in the aggregates in July, and as a result I'd like to propose that we drop the top [end] of the 4 to 8 and the 6-1/2 to 10-1/2 a whole [percentage point] rather than a half . If we are going to go with the money market conditions directive, if I understand it--and I'm not sure I totally do--but we would basically stay at 5-1/2 even if the aggregates begin coming in, under alternative B, up to 8 percent, and I think that would be a mistake.

CHAIRMAN BURNS. No, no. Mr. Sternlight, would you explain how you operate at the Desk in view of our recent practices?

MR. STERNLIGHT. Well, I think we would observe a zone of indifference within which we would make no reaction but just continue to hold to the middle of a funds range. If it were, say, 5-1/4, 3/4--

CHAIRMAN BURNS. That zone of indifference would not be equal to the full M1 range.

MR. STERNLIGHT. But it would be something within the range [even] if we haven't always agreed on just precisely what--how wide that zone is. We tend to think of it [in terms of,] if the M1 range, say, was 4 percentage points, then perhaps 2 percentage points would be a zone of indifference. But as we move beyond that then we would move to the higher or lower side of the funds range.

MR. GUFFEY. If I understand then, at the time you might get around 7 percent under money market conditions, then you might be moving that fed funds rate up to the 5-3/4--

CHAIRMAN BURNS. If it were 4 to 8?

MR. GUFFEY. If we stick with 4 to 8.

CHAIRMAN BURNS. No, I don't think so.

MR. STERNLIGHT. I don't think we would go all the way to 5-3/4. We wouldn't go all the way to the top of the funds range unless the aggregates were slightly over the top.

CHAIRMAN BURNS. Or at the top.

MR. STERNLIGHT. Well, all right, at the top.

MR. GUFFEY. Well, I guess you bolster my thought, and I'd like to see the range narrowed a little, and on the top side principally, a full percentage point under alternative B, which would bring it to 4 to 7 and 6-1/2 to 9-1/2. Because I'd hate to see us sit at the 5-1/2 level if we see those aggregates coming in fairly strong. I'd like to see us move on to the 5-3/4.

CHAIRMAN BURNS. Thank you, Mr. Guffey. Mr. Morris?

MR. ROOS. Mr. Chairman, may I just ask a question? Is the significance of the lowering of the upper end of the fed funds rate from 6 to 5-3/4 the psychological effect that the publication of 6 versus 5-3/4 would have? In other words, why do we tend to artificially restrict ourselves from moving 1/4 of a point higher if circumstances in the aggregates dictated our doing that. Does that have a detrimental or a depressing psychological effect when it's published? Is that it?

CHAIRMAN BURNS. Well, I think that question is better addressed not to Mr. Sternlight but to members of the Committee. Let me attempt an answer, and members of the Committee may wish to comment. As of today, I would like some stability for a little while. The money markets have stabilized, the monetary growth rates have moderated. I see no clear reason for moving in one direction or the other.

To move down to as low as 5, well, if the general expectation--and this extends far beyond our own staff--for some rise in short-term interest is valid--it's certainly widely held--then to move down to 5 and then move up again very shortly I think would create unnecessary flurries. And likewise, to move up to 6, well, there is an element of uncertainty. Mr. Partee underlined it, Mr. Coldwell did. I did not, but I don't differ, really, from their views. I doubt whether that is a wise decision today. Two weeks later, one month later, it may well be.

MR. MACLAURY**.** Mr. Chairman, isn't also another point on this, that if we got as high as 6 with the funds rate, it calls into question the discount rate, which is 5-1/2. I think that becomes a potentially more pressing issue, and you may or may not want to contemplate a discrete overt move that would be interpreted as tightening.

CHAIRMAN BURNS. That's well worth keeping in mind.

MR. PARTEE. We know the [unintelligible] is 5-3/4 as the top in this past intermeeting period. Is that the point you were making, Larry, that if you put in a higher figure than the 5-3/4, it would look as if there was some movement that we could make?

MR. ROOS. Yes, that was my question.

CHAIRMAN BURNS. It would be interpreted to indicate some movement toward a tightening today.

SPEAKER(?). [Unintelligible.]

CHAIRMAN BURNS. Yes, I do. I think that is a valid observation.

MR. WALLICH. In a general direction, I think we have little choice but to accept the rise in short-term rates. This lull is perhaps not the best moment to start it, and as a compromise of these two things, I would go with the 5 to 6 fed funds rate.

I would also like to get back to a narrower aggregates target. We have had this time of great uncertainty about M1, and it may not be over. But eventually, I think 4 percentage points will be too wide, and I think this time we could afford to go to 4-1/2 to 7 and thereby match our long-term target. I have no quarrel with the existing specifications of M2, and I would prefer an aggregates directive.

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

MR. FOSSUM. Mr. Chairman, we group ourselves with those that appraise the national recovery as still pretty solid and the economic outlook as quite favorable. As evidence of this, looking at the Sixth District, Florida is the state that had the deepest economic dips during the recent recession, not only in this--

CHAIRMAN BURNS. It's an interesting comment. Is that the deepest in the country or [just] in your District?

MR. FOSSUM. Well, [Florida's recession is the] deepest in our District, and there are those who would point to it as, if not the deepest in the country, among those. Its recovery is ahead of what was predicted just a month or two ago. Single-family housing starts and general employment figures are up in Florida.

We had the responsibility this past month to put together the Redbook, which gave us a ringside opportunity to watch the response which came in from around the country on the question of capacity. And while there was considerable variation from area to area, the general [impression we got] from that is that there is less excess capacity in the economy today than we would have thought with the--

CHAIRMAN BURNS. That's the way I read the Redbook.

MR. FOSSUM. And while there doesn't seem to be any great bottleneck in the economy at the moment, looking on down the pike it would appear that we likely are going to have some supply problems by, say, mid-1977. And so the way we read it, the issue for monetary policy seems to be whether we should in fact, as people are saying, get a head start on facing up to the price pressures that usually accompany those shortages, or growing shortages, or whether to pause.

And [our conclusion], all things considered, is that the balance of argument favors a pause at this moment, since the growth in monetary aggregates seems to be moderate. So we would certainly support your prescription. As far as the ranges are concerned, I would like to see the fed funds range narrowed to 5-1/4 to 5-3/4 if, in fact, the Desk feels that they can operate within that range.

CHAIRMAN BURNS. Thank you, Mr. Fossum. Mr. Baughman now, please.

MR. BAUGHMAN. Mr. Chairman, I think I substantially agree with the thread of discussion here, but there are a couple of aspects of it that bother me somewhat. I fail to grasp the reason for the desire that has been expressed to go to the money market condition directive this time. I just don't quite grasp the reason why that should prevail.

I generally like the alternative B in terms of quantities, but I would share the view that the top on a couple of those measures could well come down a bit. And I would be inclined to bring them down in line, I guess, with the longer-term objective, or target. In particular, looking back over the past year's experience, I become pretty well persuaded that an M2 growth rate in excess of 10 percent is probably not consistent with the move toward economic stability.

As to the range on the fed funds rate, there again, it seems to me that, in the current circumstances, 5-1/4 to 5-3/4 would certainly take care of the needs that might develop over the next month. But I don't really see that we accomplish anything positive by knocking a quarter off of [the top and adding a quarter to] the bottom a 5 to 6 range. But I could go 5-1/4, 5-3/4, and in fact, could go with the whole alternative B listing. On M1, I prefer the top to drop to about 7 and on M2 the top to drop to 10.

CHAIRMAN BURNS. Very good. Thank you, Mr. Baughman. Mr. Balles, next please.

MR. BALLES. Mr. Chairman, as far as the economy is concerned, I share the thought that's been expressed by several others around the table that most likely we are just seeing a pause now and that we will experience, as the year goes on, pretty broadly based, solid, further growth.

And in that context I share what I think Governor Wallich was saying. Take the Bluebook forecast of where we might be from an interest rate standpoint under the three alternatives, and I would prefer to see a little rise in interest rates now rather than a big one later on. And therefore it would not disturb me to see the fed funds rate climb up to 5-3/4 percent during this intermeeting period. And given that conclusion, I would lean toward the full 5 to 6 percent range on the fed funds rate.

With respect to ranges for M1 and M2, I share the view that's already been expressed by three to four members that the top end of the short-term range should not exceed the top end of our longer-term range. We're already, from the standpoint of the level of the aggregates, over the rates that we have set out for ourselves in terms of the 12-month target.

In that respect, I would just like to refer briefly to an experimental set of charts that I distributed last month and again this month to the members of this group, which is an effort to try to relate our short-term actions to our 12-month target. We set these 12-month targets, as we all know, to give ourselves a considerable degree of latitude in M1, M2, and M3. They are fairly wide ranges that allow a good deal of flexibility, as I think is perfectly appropriate. And yet at the same time, some of us have been making an effort to get a better tracking mechanism on where we stand on the level of the Ms--through the use of moving averages as, in my view, a best indicator--in order to get away from a problem you pose, which is 4 equals 8, that is, the unreliability of any given month's seasonally adjusted data.

I think that we have a method for getting around that through the use of this filtering device of smoothing the data through moving averages. [We use] the Board of Governors' own staff forecast of five weeks ahead as to where the Ms are likely to be. And the net of all of that is charts that I have been using that show that we are above our own range for both M1 and M2. And I find it difficult, therefore, to support any short-term range which would bring us further above the upper limit of a longer-term range that we ourselves set.

So that's my rationale for supporting an upper limit for M1 of 7 percent for the next two months and an upper limit for M2 of 10 percent. And in fact, if we were to take the next step that would bring our short-term targets within at least the upper bound of our longer-term targets, we would have to have a lower limit for M1 of 2 percent for the next two months and a lower limit for M2 of 5 percent. And if we were to follow those lower limits, that would bring us barely down to the top end of our longer-term ranges by the end of July.

I think that this Committee is still faced with an unresolved problem of how to limit its short-term targets for this longer-term range. These charts that I've been playing around with are an effort to do that. I'm not sure we'll get there right away, but I see an unresolved problem in [that] we are able to [unintelligible] month by month with what we set out for ourselves as a [unintelligible] wide range of growth in the aggregates for a 12-month period ahead. And doing a little forecasting, I suspect that what we'll end up with next month is to forget the overshoot in the second quarter. And if we do that without the second quarter as a base for the next 12 months ahead, and even if we were to make no change in the growth rate ranges of both M1 and M2, we end up with something like $3 billion more of M1 by the first quarter of '77.

Or, to put it another way, by the time we get to the fourth quarter of this year, if we forget the second-quarter overshoot, which I'm not opposed to, we would end up with year-to-year growth of M1 of something like 5.8 percent from the fourth quarter of '75 [to the] fourth [quarter of] '76. Due to your last testimony on our longer-term goals, it seems to me that 5.8 percent in the calendar year of '76 is a very generous, maybe overly generous, rate of monetary growth in view of the fact that we have not gotten inflation down as much as I would like to see it, and [also] in view of my personal hunch that, if anything, the rate of inflation is going to get somewhat worse rather than better in the months ahead.

CHAIRMAN BURNS. Well, that's a very interesting comment. I only wish we could have the time to pursue it. The only comment that I would make is you have been entirely silent on the velocity factor. [There] has been a change, and the change seems to be the dramatic increase that we have had over three quarters that isn't being repeated in the present quarter and may not be in the succeeding quarters.

MR. BALLES. Well, I think we ought to ask you, as the most successful forecaster of velocity, Mr. Chairman, what you think is going to happen.

CHAIRMAN BURNS. I don't think that the level we had in the third and fourth quarters of last year and the first quarter of this year is going to be repeated. I think we will get a little lower level.

MR. MORRIS. Mr. Chairman, Murray Altmann complained to me at the coffee break that he's going to have a hard time writing an expanded policy record this time because [there] wasn't enough dissent.

CHAIRMAN BURNS. If that is Mr. Altmann's comment, I don't think you should take it too seriously.

MR. MORRIS. I can't help him this time, I promised in some future date to help him. But I think at this point I support your thesis that the appropriate policy is a pause, so I therefore support your narrow range of the funds rate. I would not be concerned to lower the upper ranges of the aggregates because, if the only long-term objective we're concerned about is the most recent one we made, it is true that we are running above that more recent objective, but it's also true that we are about in the middle of the objective through the fourth quarter, and we are a little on the low side of the objective [unintelligible] the third quarter.

Now, all of the discussion seems to be centered around the most recent path, and if this means that the earlier paths are to be ignored, then in effect we only have a three-month projection instead of a 12-month projection factor. Seems to me we have to give some concern to the other objectives and also to the fact that in establishing the most recent path and the preceding path, we established them in relatively low quarters. So it seems to me that I'm not concerned about what is called this second quarter bulge. And I'm a little happy, in fact, that we are going to continue our procedure, [although] I think, sooner or later, it's going to get us in trouble projecting 12 months ahead on the most recent quarter regardless of what random movements may have biased that recent quarter up or down.

CHAIRMAN BURNS. If we think a bias is misleading us, there is a very simple way of correcting for it and that is to have a lower rate of growth for the next 12 months.

MR. MORRIS. Well, I'm not so sure, Mr. Chairman, that it's simple from the public relations point of view. That is, I think it would take a lot of explaining, and a lot of getting the message across, if we were to come out with the substantially lower rates and adjust [unintelligible] if we had a higher base. So I'm concerned about the--

CHAIRMAN BURNS. We'll have difficulty either way, I think--

MR. MORRIS. --since maybe one of these days, one of these quarters, we are going to run into a situation where, in order to avoid an excessively rapid or an excessively slow growth in the money supply, we would have to come out with numbers for the next 12 months which the public and the press are likely to misinterpret as meaning a radical shifting in policy in one direction or another. I was talking [about it] to Mr. Partee this morning at breakfast as something that our Subcommittee on the Directive ought to examine, not in terms of the immediate problem but in terms of what sorts of situations this might lead us to. That's all I have to say.

MR. WINN. I have no quarrel with the sense of the discussion, Mr. Chairman, and if we are right, then the behavior is going to be pretty much on target anyway. But I think if we are wrong, we ought to consider whether we ought to go to a money market target at this stage because of the difficulty of extricating ourselves if we are wrong on either side. I would be a lot happier to stay with an aggregate target than I would a money market target, even though I have no desire to do anything but keep a low visibility and hope things will stay about the same.

MR. BLACK. Mr. Chairman, today seems to be a day where an unusually large number of hybrid policy prescriptions are emerging. I guess mine is of the same variety. I would go for a full 5 to 6 percent range on fed funds. I feel the economy is probably going to be somewhat stronger than the staff has projected. The international economy is heating up, and the Puerto Rico [G-7 summit] meeting may lead to some further tightening of foreign monetary and fiscal policy, and so I want that full maneuverability.

At the same time, I really don't believe that the aggregates are going to show quite the growth that the staff thinks, and I would be a little happier with 3 to 7 percent on M1 and 5 to 9 on M2. And having said this, I would then do about what you recommended originally and keep the fed funds rate around 5-1/2, unless one or the other of the aggregates starts breaking out on the top side. This might suggest that I would favor a money market directive, but my prejudices lie in the other direction, and I would still stick with an aggregates directive.

MR. ROOS. Briefly, if we are going to agree with the wisdom of a policy of temporary pause, and if we do look ahead to the projections of rates in the 7-1/2 to 8 percent range, fourth quarter [of 1976], first quarter of '77, I think we should be alert to the possible need to gradually get toward those rate levels. If I had my druthers as a voting member, I would prefer to see us go to the 6 percent upper limit [on the federal funds rate] even though the Desk did not reach that level. But we would certainly accept the wisdom for thirty days of sticking to 5-1/4 to 5-3/4. We would prefer narrower M1 and M2 ranges, reducing the upper limits of each of those aggregates.

MR. GARDNER. At the start of this meeting I was persuaded that we didn't have sufficient cause to go [unintelligible] to alternatives A or C, so I obviously support the pause. I think the pause is appropriate. I want to comment that we do meet monthly on a regularly scheduled basis. If we met on a basis related to events in the marketplace, we might not have had a meeting today. I want to just say that I'm rather pleased that we are in a position where we can pause to some extent.

I think we started a process earlier to build a little bit of stiffening in the rates. At this point it seems to me that the evidence is unclear and that we don't have sufficient cause to make important changes. I'm impressed [by the proposal to pause] because of the propensity of human beings to act when they come together. So far we have a general consensus of not much action.

I would make one plea. I'm very sensitive to the fed funds rate because, in the banking world, these rates result from the interactions and expectations of many people in the money market, whereas your aggregates are published as statistical facts. I would therefore urge on the Committee that we do narrow the range. I think a 6 percent fed funds rate during a pause would be a mistake. I think we should perhaps consider this again as events move on in the economy. So I would vote strongly for 5-1/4 to 5-3/4, narrowing the fed funds range.

CHAIRMAN BURNS. I think we have had a useful discussion. There are differences among us that I think are at the margin. I think we could start, perhaps, with the fed funds range.

There is some margin within the Committee in favor of a 5-1/4 to 5-3/4 range, but let's test that with a show of hands from the members of the Committee [to see whether] that range will be generally acceptable [if] not necessarily preferred. And then we can test another range, a wider range, if that is the Committee's wish. All those who can be relatively comfortable with a range of 5-1/4 to 5-3/4 for the fed funds rate range will kindly indicate that by raising your hands.

MR. BROIDA. Eight, Mr. Chairman.

CHAIRMAN BURNS. Would you want that tested? No strong wish as to the range for M1. I think that, on the basis of the record before me, a range of 4 to 8 seems to be preferred by a thin majority of the Committee. I think there is a good case to be made for 3-1/2 to 7-1/2 and that might be a compromise for the views expressed all around the table. Let's choose between the two. Those who prefer 4 to 8 as over against 3-1/2 to 7-1/2, would you kindly raise your hands. Three.

Now let's see if our arithmetic is correct. Those who prefer 3-1/2 to 7-1/2 as over against 4 to 8, would you kindly raise your hands. Eight.

I think that implies that M2 would be 6 to 10 rather than 6-1/2 to 10-1/2.

Now there is a question about the directive. Now logic is something to be recognized but not always to be effected. Logically we have the money market directive if we go with a 5-1/4 to 5-3/4 percent range. But as I say, logic is not and should not always be respected in life. Let us have a show of hands. Those who prefer a money market directive and the language of the money market directive which reads, "The Committee seeks to maintain prevailing bank reserves and money market conditions over a period ahead, etc."

Now those who would prefer a money market directive as over against the monetary aggregates directive will kindly raise their hands. Three.

It's reasonably clear that the monetary aggregate directive will express the sentiment of the majority somewhat better, and I prefer it myself, even though logic is thrown to the wind.

MR. JACKSON. Chairman, nobody discussed relative weights of the [M1 and M2] aggregates and--

CHAIRMAN BURNS. We were proceeding in this meeting on the principle of assigning approximately equal weights for the two.

MR. JACKSON. It appears from staff projections that the behavior in the savings deposit market would be different from expectations, that it may be more different to date, and I would personally be inclined to shade emphasis on M2 somewhat compared to 50-50.

CHAIRMAN BURNS. Any view on that?

MR. AXILROD. Mr. Chairman, the savings deposits, the other time deposits, did behave in a sense a little differently than we had for these particular M1s--they remained relatively stronger. But the savings deposit actually behaved about as we had thought, and there was an outflow, and what didn't behave as we had thought was the other time deposits that we're offsetting. And I would tend to agree that when you are in a period here of interest rates having moved above Regulation Q ceilings, you get uncertainties on deposit flows, and that puts a little more uncertainty on M2 and M1, but it's a marginal matter.

SPEAKER(?). I think we may have accomplished my result whether we changed the directive or not.

CHAIRMAN BURNS. I have not observed any degree of uncertainty with regard to projections of M1.

MR. PARTEE. I just wanted to point out a small arithmetic fact, and that is that saying equal emphasis on M1 and M2 approximately means that in fact you place about 3/4 emphasis on M1 because M1 is contained in M2, which is plenty for me.

CHAIRMAN BURNS. Any sentiment to move away from the approximate equality? Apparently there is no such sentiment.

I think we are ready for a vote, and we'll be voting on the following: a monetary aggregates directive; a range for M1 at 3-1/2 to 7-1/2; a range for M2 of 6 to 10; a range for the federal funds rate at 5-1/4 to 5-3/4; and understanding that M1 and M2 will receive approximately equal weight at the Desk. Any questions? We are ready for the vote.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
President Balles	Yes
President Baughman	Yes
President Black	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
Governor Jackson	Yes
Governor Lilly	Yes
Governor Partee	Yes
Governor Wallich	Yes
Governor Winn	Yes

Unanimous.

MR. BAUGHMAN. Mr. Chairman, can I raise a very small point?

CHAIRMAN BURNS. Small or large.

MR. BAUGHMAN. For some period of time it has bothered me that we have described the rate of change in wage rates as moderate or something that is sort of vague. And it appears again in the general paragraph of line 16.

CHAIRMAN BURNS. Well, I think that, I must confess I've gotten into the habit of having so much to do that I have paid very little attention to the general paragraphs--I think you are right. It can be interpreted as a blessing by us. I would just omit the word and have it read, "the advance in the index of average wage rates was larger in May than the gains in other recent months," and so on. I don't think we ought to bless it by characterizing it one way or the other.

MR. BAUGHMAN. It's quite inconsistent with the achievement of economic stability.

CHAIRMAN BURNS. Well, I think that point is very well taken. Any objection to deleting the word moderate on 16?

MR. VOLCKER. I think it is a good idea.

MR. PARTEE. I do also think, Mr. Chairman, that we ought to ask the staff to insert a reference to the CPI.

CHAIRMAN BURNS. Well, I think that's a very good observation. All right, our staff will do that.

Let's turn to item 6, and this arises because of Mr. Holland's resignation. If it's satisfactory to the Committee, I would suggest that the responsibility previously borne by Mr. Holland now be assumed by Governor Gardner and in his absence by Governor Coldwell. Any objections to that? All right.

Now, item 7 may or may not evoke a debate. There is one reason--quite apart from the factor of time--for delaying it, and that is that Mr. Holmes is absent. All right, we simply have to confirm the date for the next meeting, and I take it there is no question involving that, and therefore we conclude our meeting at a very early hour.

SPEAKER(?). Could we note for the record that we started at 9:30 this morning and had an executive session, and nevertheless we ended at 1 p.m.

END OF MEETING