TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

August 17, 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.

Staff Statements Appended to the Transcript

Mr. Holmes, Manager
Mr. Gramley, Economist
Mr. Axilrod, Economist

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8/17/76

Meeting of Federal Open Market Committee

August 17, 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, August 17, 1976, at 9:30 a.m.

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

Messrs. Baughman, 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, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist (Domestic Finance)
Mr. Gramley, Economist (Domestic Business)
Messrs. Brandt, Keran, Kichline, Parthemos, and Reynolds, Associate Economists

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

Mr. Coyne, Assistant to the Board of Governors
Mr. Keir, Assistant to the Board of Governors
Mr. Pizer, Adviser, Division of International Finance, Board of Governors
Mrs. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Mr. Williams, First Vice President, Federal Reserve Bank of San Francisco

Messrs. Balbach, Doll, and Eisenmenger, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Kansas City, and Boston respectively
Mr. Green and Kaminow, Vice Presidents, Federal Reserve Banks of Dallas and Philadelphia respectively
Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York
Messrs. Fousek, Kareken, and Mrs. Nichols, Economic Advisers, Federal Reserve Banks of New York, Minneapolis, and Chicago respectively
Mr. Hall, Economist and Director of Domestic Finance, Federal Reserve Bank of Cleveland
Mr. Ozog, Manager, Acceptances and Securities Departments, Federal Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting of
August 17, 1976

CHAIRMAN BURNS. We are ready to start our meeting this morning. The first item of business, as always, is to act on the minutes of the last meeting. Motion to approve. [Seconded.] The motion has been made and duly seconded. No objections heard.

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

MR. BLACK. Alan, do you think that, through realignment of currencies, [the European Community] will be able to preserve the [exchange rate] snake for any appreciable period of time?

MR. HOLMES. There are two alternatives. One, that everybody goes off and floats [separately]. Second, they do have a realignment in the snake, as they talked about last March, in which perhaps the dollar-mark relationship would not be much changed, but the other countries would depreciate in terms of the mark.

MR. BLACK. Which do you think would be more likely?

MR. HOLMES. I don't know. I think there will be a lot of sentiment in [favor of] trying to keep the snake together somehow, but there have been some real problems.

MR. PARDEE. The snake is essentially a political animal, and if the governments make a political commitment to continue it, then it will continue. It surprises a lot of people that it has lasted as long as it has. It's hard to make any projection simply on a market orientation or on an economic orientation.

MR. BLACK. I realize that. What would your assessment of it be, Scott?

MR. PARDEE. The small countries want to continue the snake. They feel very strongly [about it] and want to have a fixed relationship with the German mark. But the continued repetitive blowouts in the exchange market make it very difficult for them to continue it. It could break up.

MR. COLDWELL. Alan, are we making any move at all on Swiss franc repayment?

MR. HOLMES. We have not. That seems to be an insoluble problem at this time.

MR. COLDWELL. Or any Treasury bailout?

MR. HOLMES. From time to time we hear some noise from the Treasury that they would like to pay off and go out and buy Swiss francs in the market. It's not a very practical thing to be doing right now; it's also a little bit expensive.

MR. PARTEE. Did I understand you to say, Alan, that you think that the dollar will stick with the mark and therefore that the other currencies will depreciate against the dollar?

MR. HOLMES. I wouldn't say that the mark will not appreciate against the dollar to some extent. But not a great amount. I would think [there would be] a larger depreciation of the other EC currencies in terms of the mark and against the dollar.

MR. PARTEE. And against the dollar. So that our terms of trade will deteriorate to some extent against those countries.

MR. EASTBURN. Alan, what prospects do you see that we are going to be out of the Belgian franc situation?

MR. HOLMES. I think we are going to make it before year-end, certainly.

CHAIRMAN BURNS. What is the remaining debt in this, Alan?

MR. HOLMES. On the Belgian francs, about 62 million, Mr. Chairman. I think maybe we have accumulated 2 or 3 million in balances so it may be around 60, I would say.

MR. BLACK. You plan to notify Governor Holland immediately when we release the information?

MR. HOLMES. I think maybe we should.

MR. BLACK. It's his problem now.

CHAIRMAN BURNS. Are we carrying on conversations with the Treasury with regard to the Swiss franc?

MR. HOLMES. I know of no new conversation.

MR. WALLICH. We have one other difficult conversation with Treasury, Mr. Chairman, and 'til that's concluded, I think we'd weaken our position by also asking to be taken out of the Swiss swap.

CHAIRMAN BURNS. I'm not sure that is the case. I'd like to talk to you and Mr. Holmes, possibly this afternoon, about that problem.

MR. JACKSON. It might be more appropriate to talk now than at some other time.

CHAIRMAN BURNS. Any other question about that? Very well, Mr. Holmes, we thank you for your report, and now is there a motion to approve the transactions at the Foreign Desk? The motion has been made. Hopefully seconded. Inaudibly seconded. The Desk operations are approved. Do you have any recommendation, Mr. Holmes?

MR. HOLMES. Well, Mr. Chairman, there are no swaps maturing in the period before the next Committee meeting, so I have no recommendation at this time.

CHAIRMAN BURNS. Can you tell us anything about our arrangements with the Mexicans?

MR. HOLMES. I think Governor Wallich has had more conversations on that than I have.

CHAIRMAN BURNS. Do you think [you have] anything that the Committee ought to know about our conversation with the Mexicans?

MR. WALLICH. Well, we haven't had any direct conversation with the Mexicans so far. They're coming into town this afternoon--contrary to what we have heard before, that they were coming yesterday--and what seems likely to happen is that the Treasury will make a more modest offer than they had contemplated--on the order of activating the 300 million swap, plus maybe 100 million additional. In that case they would want us to roll over the swap that matures on October 9, unless by that time rate changes have taken place in Mexico--which is not at all impossible--that would make that unnecessary.

CHAIRMAN BURNS. Would there be any serious concern on the part of the Committee about the rollover of the Mexican indebtedness?

MR. COLDWELL. First or second rollover?

MR. PARDEE. It would be the second time, coming early October.

MR. COLDWELL. Second rollover?

MR. PARDEE. Yes, that would be the end of six months.

MR. COLDWELL. Well, I'm basically opposed to the idea, Mr. Chairman, but we could be in the same boat ourselves with Swiss francs. I know no other way but to speak out of both sides of my mouth.

CHAIRMAN BURNS. I think there may be some foreign policy considerations involved that I think we should respect. No one is enthusiastic about a rollover--I take that for granted--but I hear no serious objection.

MR. GARDNER. I think it's important, Mr. Chairman, that, as Governor Wallich has suggested, the Mexicans are attempting to do something with the Treasury position. Depending on their success there, we will be only one part of a two-part system in the rollover, if I'm not mistaken. It's a little different in my mind than our being approached directly with no other effort being made by the Mexicans.

MR. WALLICH. Right. I think that if the Treasury did not come into this operation, the situation would be quite different for us and we would not now agree to roll over.

MR. JACKSON. Do we have any current estimate yet as to the degree of U.S. private investment in Mexican CDs? I noticed that in a consumer-type advisory service in the Washington papers yesterday they were continuing to recommend to U.S. investors that they buy Mexican CDs at 12 percent. But do you have any idea of the nature of it and, if the devaluation occurred, the potential ratifications?

MR. HOLMES. I think it would pay for us to look into that very closely.

CHAIRMAN BURNS. These are CDs repayable and in what currency now?

MR. HOLMES. Mexican pesos.

MR. JACKSON. My understanding was all pesos.

MR. PARDEE. There are some in dollars as well.

CHAIRMAN BURNS. That may be more of a problem for the SEC than for us.

MR. JACKSON. I don't know whether it would have domestic implications or not for our relationship with Mexico. I don't have any idea what size it is.

MR. COLDWELL. Are we still supplying currency?

MR. BAUGHMAN. Yes, it's still going out at about 10 million a week.

MR. PARTEE. It's about the same rate as before, Ernie?

MR. BAUGHMAN. Yes. They refuse to take anything smaller than 50s. We have tried to pawn off 20s on them but . . . We did undertake to get people of our Branch to get a little indication of what their future expectations were as to need, and they said they could not project their needs. They also volunteered that most of this currency is paid out at the airport branch of their bank, and [they] suggested that from there it may go to many places in addition to Mexico.

CHAIRMAN BURNS. I take it we are ready to change the subject and move on to the economic outlook for the whole country. Mr. Gramley, please.

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

CHAIRMAN BURNS. Mr. Winn, please.

MR. WINN. Mr. Chairman, the thing that bothers me is when you look at all of the projections in economic activity, you come out with about the same picture [from each one], and the unanimity of opinion frightens me. And I can't say that I disagree with what's said. But just as a sort of probing effort, take some of the factors that we're looking to for support [of economic activity]. Take consumer demand and you're struck by the average weekly earnings flattening out, and you don't see much kick-out of [unintelligible] settlements in areas of that type.

Take automobile out of retail sales and you get [what is] not the most exciting kind of a picture. Automobile sales are stimulated by this extension of maturities of consumer credit, and I don't see how you can really project that continuing or expanding. When you look at the prices of services, utilities, taxes, insurance, that area, you really don't see much opportunity for the commodity side, the goods side, to come back because it is really a quite sharp increase that has taken place there.

When you look at what the decline in the oil tariff did and the dependence we have on the one supplier for oil, you get frightened as to what this means in terms of consumption over a period of time. And you can't really see too much stimulus coming in from deficits or other items, and so are we really going to get this upswing in consumer demand that we're sort of looking for?

State and local purchases of goods and services have gone up from 7 percent to 14 percent of GNP over the last year, roughly. And I can't see much stimulus coming in this area, with the New York City situation sort of typifying problems in that area. The solution of their medical problem struck me as being a Band-Aid because [the hospital workers] gave up their cost of living increase in exchange for what they think is not going [to be] any more layoffs. And I don't see how they can have layoffs that can come within that scope. You've got the New York state court decision in October possibly affecting them. It looks like they are playing for time, for the election, to get another solution for their problem, and so I can't really see any big increase in expenditures in the state and local area.

In investment demand, you're struck by the tremendous increase in construction costs. And I don't know whether we have elasticity of demand in this area or not. But look what happened in the postal service; they increased prices, but revenue hasn't really gone up as they projected.

And I wonder if more and more companies aren't looking at this in a more critical sense. On the capacity side, the steel companies are not really having a boom period, except for automobile steel, and more and more of them are talking about pushing back their expansion program. The utility companies had a cool summer, and so they've more than handled any demand coming out of the industrial sector, and their projections now look like they are being pushed back. Raw materials costs are going up, with some squeeze on working capital in spite of the huge [amount of] liquidity that corporations have acquired. And with the shift in the composition of output, with steel going down next year--[even though] the automobile industry booms--you surely don't have as much need for steel.

And so I'm really wondering if we can expect the support from the investment side that we've factored in. I'm really searching for what's going to be the push here for carrying us on, even though I agree with [the assessment that] I'm questioning.

MR. PARTEE. Joke.

MR. WINN. No, I'm trying to go to the extreme, Chuck, probing at the forecast.

CHAIRMAN BURNS. Well, I think that was a moderately comprehensive recital of doubts and uncertainties, and now would you want someone to comment on that? Mr. Gramley.

MR. GRAMLEY. Well, I was going to say, President Winn, you got up on an awfully bearish side of the bed this morning. I think you have put your finger on a lot of different problems that affect the economy. I think these problems are more numerous now than they have been in many past periods of cyclical expansion. But I believe I could recite every bit as long a list of positive factors as you have a series of negative ones.

Take the profitability of business investment, which I think is critical in this outlook, and let me focus my comments there. We have had, over the past four quarters, a very substantial improvement in business profits. That's still going on, and that's what I think is involved in the price increases we're seeing in the metals area and elsewhere--efforts to make sure that rising costs do not prevent a further substantial increase in profits as the economy recovers.

These profit increases have been large enough now, I think, so that a lot of businesses are convinced that they can go ahead with their capital spending programs and finance them more heavily internally than they could for many years. This is beginning to show up, I think, in the indicators of business fixed investment. This string of six increases in new orders for nondefense capital goods is the longest string in the history of that series, which goes back to 1968 as presently defined. And it's solid. It's a 25 percent annual rate of increase in real terms. If you crank that into our economic model, that model shows a larger increase in real business fixed investment than what we are projecting judgmentally for the next several quarters.

We're also seeing now for the first time what I think is rather solid evidence of a pickup in construction contract awards for commercial and industrial buildings. They're up about 25 percent on average in the second quarter over the first quarter, albeit from a quite low level. So I think business fixed investment is going to move forward.

I don't think we're in for a big boom. What we're forecasting is not a big boom in overall economic activity. It's a moderate rate of economic expansion consistent with, I think, the sorts of uncertainties and problems that you enumerated as well as the underlying strength which we see there.

CHAIRMAN BURNS. All right, thank you Messrs. Winn and Gramley. Mr. Kimbrel.

MR. KIMBREL. Mr. Chairman, maybe mine is an extension of Mr. Winn's interest, but maybe a slightly different concern with compensation and with the pressures he outlines for price moves. I wonder, though, on the other side, if I read the Greenbook numbers correctly, they're projecting a rise in compensation of about 8 percent over the next half year and 7-1/2 percent by the end of 1977. Just wondering, with wage settlements and the experience in prices Mr. Winn relates to, whether these modest numbers may very well be a reflection or feeling that inflation is not going to be a tremendous factor through 1977. You can expect to see some reduction.

MR. GRAMLEY. Well, we perhaps are guilty of over-optimism on our projections of compensation per man-hour, but over the past year the record has been that we have been forecasting increases which generally speaking have been too high. The actual increases have come in less than what we have been forecasting since the recovery began.

There is, I acknowledge, an element of circularity in our projections, in the sense that past price increases tend to be very important in future wage bargains. If exogenous forces such as those affecting food and fuel were to come in much stronger than we have allowed for in our projections, then our wage forecast would probably also be wrong. We've projected an increase over the next six quarters roughly at about 4 percent for food prices. And I think that's a reasonable forecast given the supply outlook in the agricultural area. If something should happen to prove that wrong, then I think the wage forecast could turn out to be too low.

MR. BAUGHMAN. Mr. Chairman, may I be permitted to slip in one extra question for reassurance?

CHAIRMAN BURNS. Please.

MR. BAUGHMAN. [Unintelligible], interest rates are sure to remain low, and maybe drift even lower, through at least the first half of next year. The reasoning is that corporate earnings are much higher, and that corporations are not making their [unintelligible] payments until the first and second quarters of next year. At that time, this will increase the payments of [unintelligible] will not need [unintelligible] no reason to expect that interest rates will be pressing up. I need some reassurance.

MR. GRAMLEY. Reassurance that our projection of rising interest rates is correct? Well, I wouldn't want to try to offer you too much assurance on that. Perhaps Mr. Axilrod will want to amplify, but as you know, the pattern of interest rate movements in this recovery has not been at all typical. And one reason has been a very substantial improvement in corporate profits, which has held down the need for external financing. Now that external financing gap has begun to grow and is projected to increase further. We anticipate that normal cyclical patterns of interest rate movement are going to reemerge. And as much as we've been wrong for the past five quarters, it is not entirely inconceivable that we might be wrong again. Mr. Axilrod may wish to amplify.

MR. AXILROD. Well, I'm going to have some comments on that at the time of my talk.

CHAIRMAN BURNS. Well, the final answer then will come a little later. Meanwhile, let's turn to Mr. Black.

MR. BLACK. Mr. Chairman, I don't know whether I've got a quarrel or not. I think what I'm really seeking is some elucidation of this large growth in the labor force last month. Does this look like a one-shot fluke, or are there fundamental forces at work there that are encouraging greater labor force participation?

CHAIRMAN BURNS. Before you get a scientific reply, let me say to you that I just don't trust that figure. And all the statisticians I've had, you know, that's something I've lived with. I can tell you a lot about that--what I've learned from statisticians. How they've assured me about the sanctity of their small sample and what has happened over the years, but I just don't believe that figure. But now, put that to one side. You're going to get it.

MR. GRAMLEY. May I pass?

MR. BLACK. I'm inclined to agree with you, Mr. Chairman. I guess the reason that I raised the question is the unemployment rate looks kind of high for me for the projection period, and I am just wondering what they assume in the way of discouraged or encouraged worker effects or the rates of participation in the labor force for the balance of the year.

MR. GRAMLEY. This is a one-month increase. I wouldn't assign any significance to a one-month increase, particularly when you can't associate it with something like improving job opportunity, which might encourage more people to go into the labor force. What we're assuming is a return to a more normal rate of increase in the civilian labor force.

What we have over the latter half of the year as a whole--well, let me project the third quarter to the first quarter of next year, which will be the next half year. We [have] just a half million increase from the high third-quarter average level. But if you take a longer-range period, so that you can see what the trend rate of projection is, we're projecting an increase at roughly a 1-3/4 million annual rate. Have I answered your question?.

MR. BLACK. Well, not in exactly the terms I was hoping, really. I can think of a couple of reasons why you might have a high participation rate. One would be that inflation has made the earnings of one breadwinner inadequate in many families, and two people have been driven into the labor force.

CHAIRMAN BURNS. Yes, well, that would be a trend or longer-term phenomenon.

MR. GRAMLEY. That has been a definite factor. We have reported on that repeatedly as a factor influencing labor force growth over the period since the recession began. The labor force developments during the recession and recovery have been quite abnormal. We've had much larger increases in the labor force than we would have anticipated. And this inflation factor is clearly one of them. But that certainly does not explain what happened in July.

MR. BLACK. No. I didn't--I'm sorry if I misled you on that--I was trying to get at your projections for the balance of the year. Another thing that I can think of is the changing attitude of women toward permanent work. I think that is considerable.

MR. GRAMLEY. That has been an even longer-range trend, and it continues, and the recent increases in the labor force over the past several months have been heavily in the adult female component.

MR. BLACK. Do you assume a continuation of this for the balance of the year?

MR. GRAMLEY. Yeah, well, not over the balance of the year. The fact that we have had this big jump means that the average from the third quarter to the fourth probably will be small. But what we project for the projection period as a whole is a continuation of fairly high rates of growth of the labor force relative to long-term trends. A long-term trend would be something like a million and a half at an annual rate. We are projecting a million and three quarters. So the participation rate continues to rise.

MR. BLACK. The participation rate continues to rise, right? Well, this is the kind of thing I was trying to get at in trying to come to grips with those projections.

CHAIRMAN BURNS. All right, thank you, Mr. Black. Mr. Eastburn now, please.

MR. EASTBURN. Lyle, you touched on the elusive question of confidence, and as I heard you, I get the impression that you think confidence will continue and perhaps build. We do a survey of business opinion and so on in the area once a month. And one of the questions we ask is the outlook for the next two quarters ahead. The latest month shows that only two out of three executives see better business conditions over the next two quarters. Previously, that was about four out of five. So there has been by this qualitative measure some deterioration in confidence about the outlook. Of course, nobody knows what's going to happen to that, but I think that this does suggest some question as to whether confidence is going to hold and what this might mean for capital expenditures.

MR. GRAMLEY. We noted that in your District's response in the Redbook this time. I think the other responses in the Redbook are not closely correlated with that. That is, generally speaking, I think the tone [in the Redbook] is that the degree of confidence in the future is about the same as it was a month or two ago. Although there are some more question marks. Now if in fact the slowdown in consumer spending were to continue through August and on into September, then I think there would be some serious question as to whether confidence would not deteriorate. But my feeling is that we are going to see an improvement in consumer spending, so these concerns which are building, which are obvious factors in businessmen's thinking, are going to be allayed.

CHAIRMAN BURNS. All right, thank you, Mr. Eastburn. Mr. Partee now please.

MR. PARTEE. Mr. Chairman, I think that Willis Winn has done us a great service today by pointing out the pessimistic views. And I think I agree with him that that's not the most probable course, though I think that the odds of a disappointment have increased in the last couple of months' figures. There is no question in my mind that a pause of some considerable dimension has occurred recently, largely in the retail area, although I've been bothered for some months by the lack of more strength in housing.

But it's largely retail, and I note from the Greenbook--it's only one month--but we have a substantial decline in the rate of increase of personal income in June. That may be reversed in July or August but, of course, the whole danger in a pause of any size is that you will retard income streams. And thus what looked like the prospect for a rebound in retail sales and consumer spending is impaired because the income won't be there to support it.

And it's true that the labor force figures and the unemployment figures are highly volatile month by month--and we're having particular difficulty with them this year, I think, because of the seasonal adjustment problem--but from May to July there's been a considerable increase in the unemployment rate for the adult man, household heads, married men--that is, for the stable components of the employment force. And we also see a considerable increase in insured unemployment over the last three months or so.

So something is a little bit amiss in the way things have been going in the last two or three months. I agree with Lyle that we should have an increase in capital spending, and the new order figures do look better. The Redbook doesn't seem to pick that up very well. It hasn't for a long time. The big Districts where machine tools are important, like Cleveland and Boston and Chicago, haven't mentioned real strength in that--

MR. WINN. If you take autos out of that, what does it look like?

MR. GRAMLEY. The autos are not in the new orders for nondefense capital spending.

MR. PARTEE. You mean new orders--

MR. WINN. Related to the automobile industry.

MR. PARTEE. I don't think we know what that would be.

MR. MAYO. You mean the tool purchases?

MR. WINN. That's right.

MR. PARTEE. Well, I think the order figures do look pretty good, and furthermore, I've always felt that if the profits were there, capital spending would follow. And the profits do seem to have come back quite a way. One could say on Willis's point that businessmen are much more conservative than they were during the previous cyclical recovery. Their attitude both toward inventory accumulation and toward extending themselves in any way on capital spending is going to be conservative, particularly in an election year and all that that brings up. And therefore it could be that we won't see returns to normal rates of inventory accumulation of the desired strength. It could be that we see continued slowness in the recovery in capital goods.

And if that did occur, along with a less rapid increase in personal income and a sluggishness in retail sales, why, we could have a pause that will even turn into a small decline. Probably not a decline of cyclical portions, but one more like, say, in the spring and summer of 1962, a year or so after the beginning of the recovery. [Or] one that started perhaps to show itself in mid-1959, although the steel strike complicates that comparison. There have been times during the course of a recovery when there was a pause that became rather elongated, rather extended. We could be seeing the start of that now.

I guess what it comes down to as far as I'm concerned is that I would still have to put my bets about with the kind of patterns that the staff projection shows. But that is a rather significant [change for] me because, all year, I've expected the recovery to be stronger than the staff projections. And now I would have to say that my own expectations have deteriorated to the point where I would say that maybe that's about the most probable number, and there is a significant minority possibility of a softness that Willis has described. I think there has been a change in the character of the situation that we ought to recognize.

CHAIRMAN BURNS. Well, I'd like to comment on this issue. I think it is wise for us to keep in mind, in our search for objectivity, the negative elements as well as the positive elements. I fundamentally agree with the staff, and if I interpret Mr. Winn and Mr. Partee correctly, they agree with the staff as well, although they are more concerned now about negative possibilities than they were a month or two ago. That is also my own feeling.

But I would like to make two supplementary comments. In addition to the lift that is occurring in orders for capital goods, we've seen for the first time, really, in this recovery some life during the past three months in the physical volume of construction contracts for industrial and commercial building. And there has been a significant lift all along in the volume of nonbuilding construction--as represented by pipelines and power plants and refineries. So the picture on the capital side is one of recovery, although a slower recovery than many of us, including myself, had anticipated.

As to the cause of this, Mr. Partee commented correctly on the element of caution in business thinking. That should not surprise us. You now have among the men who control our business enterprises today very few who have lived through an honest-to-goodness depression or recession. Here we have the severest recession in the postwar period, by far. It was unexpected by the business community. The business community had come to think of the business cycle as being either dead or a very minor fluctuation, and here we have a very old-fashioned decline. They were caught by surprise. Such a thing couldn't happen in our economy. After all, we had learned how to control the business cycle. That was the popular thinking. Once confidence is badly shaken, as it was, the self-assurance of the new business leaders was shaken. Confidence revives gradually, I think that is human nature, and that is the history of mankind.

Now one more observation. Mr. Partee has warned us against this, and I simply want to elaborate on the comment that he made. There is a tendency on the part of perhaps many business observers to think of a business cycle expansion as a continuous upward movement at more or less the same rate, or at a rate that gradually diminishes as the peak of capacity utilization is reached. This is a picture that many of us carry in our minds, but it is not a picture that fits reality.

At the National Bureau [of Economic Research], as I think you know, we made extensive detailed studies of business cycle developments in industrial countries. We found a phenomenon that we described with the awkward phrase "mid-expansion retardation," which meant that after a year or two of a business cycle expansion, there is stagnation for awhile, a lower rate of growth, or even an actual dip. And then a reacceleration follows. That's not the picture of the business cycle that we have in our minds. But that is what we found some years ago.

One of our investigators at the National Bureau wrote a sizable volume dealing with a phenomenon described as subcycles, and these subcycles were subdivisions of business cycles as historically identified by the National Bureau. These subcycles were in large part minor inventory adjustments occurring in contrast to the larger inventory adjustments that have come to be known as part of business cycle history. Mr. Partee mentioned some historical instances. The most dramatic one that I recall at the moment was in 1951, when many business commentators spoke of a recession, and as we all know, this was a lull in activity.

Now of course when you have a lull, it could be the beginning of an economic decline. That's always true. But if the kind of sequence that occurs in business cycle phenomena has any repetitive value, and I believe it has very considerable repetitive value, I don't see how, on the basis of sequences in leading economic phenomena, one can argue persuasively that a recession is imminent. There isn't any evidence to support that. One can argue, as Mr. Partee and Mr. Gramley did, that if this lull in economic activity continues for a few months, then the sequences in economic process that we associate with the early stage of recession could well come into being. We are not at that stage now. But I think it's healthy to bear in mind the possibility.

My own judgment is exactly the same as Mr. Gramley's, that we're experiencing a lull and that the underlying trend is still clearly upward. That business confidence is not waning. That it's gradually reviving and that business capital investment is gradually reasserting itself as the driving force of the economy. Well, I've talked too long, I think. Let's listen to Mr. Mayo now.

MR. MAYO. Well, Mr. Chairman, you have articulated a couple of my points better than I could have, but I was about to say something along the same line. I put a little different interpretation on Mr. Winn's list, which is impressive, than I think either Mr. Partee or you do. I think that it contains some of the elements, actually, of strength rather than weakness in terms of perpetuating the recovery. I acknowledge here your point of the midrecovery pause, or whatever we call it. But it seems to me that many of these factors are "normal" factors--that analysis would bring forward if we were to do it in depth--that characterized almost all of our recovery periods over the last generation. It seems to me, therefore, that, while I recognize the somber nature of President Winn's list, I find in that list a number of factors that, instead of giving me increased concern, give me a little more confidence in the lasting nature of the recovery and expansion that we are in.

Having said that, I again will revert to the type that seems to characterize all of us. I find the staff projections already encompass what I have just said. It is a recognition of factors that keep this from being a worrisome, if you please, type of expansion that would lead to ultra-high interest rates, super inflation again, and a bust that would follow. So I would like to put a positive tone on Willis' list.

I would also remind the Committee that this happens to be an odd coincidence of the August doldrums--not always statistically measurable--with perhaps a mid-expansion phase in our economy. And I think that, psychologically, this has considerable importance. My friends in New York as well as in Chicago find that there is less activity going on in August than is usual. And again, this is a year divisible by four, which has something to do with it, too. People are sitting on their hands a little more. I think the confluence of all three of those factors makes me feel even more that I'm not ready to make a judgment yet as to whether the economy is sputtering.

One other facet of this. No one has mentioned the interpretation of some of our leading indicators as optimistic. I noted with some interest the article in, I think, the *Wall Street Journal* the other day--and I'd like to have Lyle comment on it, if he cares to--that [characterized] the ratio of the coincident to the lagging indicators as being a very bullish factor. Again, I don't want to get into gimmicks, and [in this case] maybe the ratio of one gimmick to another.

CHAIRMAN BURNS. You're close to it.

MR. MAYO. The ratio of one gimmick to another may be double gimmicking, but in a political year I think we can engage in some discussion of gimmicks that's not on the record, especially when it becomes newsworthy enough for the *Wall Street Journal* to run a front page article on it. Do you have any confidence in this particular ratio, Lyle? Have you studied it all?

MR. GRAMLEY. I have never been a fan of leading indicators generally. I think one does much better to look over all the leading indicators individually to try to assess their meaning for what's going on in the various sectors of the economy. And if the leading indicators give confirming evidence of what you come up with, well, fine. If they don't, I would be more inclined to toss out the leading indicators than analysis in depth. I do think the leading indicators are all still pointing upward, and that gives me reasonable confidence that the judgments we've arrived at with a more thorough study of the economy are right.

I would like to add one point, if I might, Mr. Chairman, in regard to Mr. Partee's comment. And that is that though personal income growth did slow in June, it slowed because we had both a decline in employment and a slow rate of increase in average hourly earnings. The average hourly earnings index went up quite slowly that month. In July we've had both a large increase in employment and a larger rise in average hourly earnings. In addition, we're looking at a quarter in which we're getting Social Security disbursements increased. And those factors should act to increase spendable income in the third quarter and help to sustain consumer purchases in the short run.

MR. PARTEE. Social Security is an important point that I entirely forgot. The other, I don't know, it's variable from month to month. The increase in industrial production has continued to moderate; that is, July was less than June. And you mentioned the August doldrums, Bob. We don't have any August measures yet. Maybe we're really going to have August doldrums. But with Social Security we should get a big kick to this July. That's a cost of living increase?

MR. GRAMLEY. Right.

CHAIRMAN BURNS. I'd like to comment on Mr. Mayo's question about the gimmicks. Now, unlike Mr. Gramley, I have very considerable confidence in leading indicators, if only because I made the original [National] Bureau [of Economic Research] study back in 1937. But I've always viewed economic indicators in a rational context, never in isolation of other evidence, and certainly not in isolation of economic interpretation. That specific ratio belongs to the category of latter-day gimmickry that I want to have nothing to do with. And you have to strain to rationalize that ratio. But for heaven's sake, you can rationalize it in terms of arithmetical patterns--ratio of the coincident indicator to the lagging indicator. And that ratio will have, so it is claimed, a consistent long lead, you see. And you can rationalize that in terms of rates of change of these two series, but you cannot give it, or at least I've been unable to give it--well, I must say that when I see a gimmick like that, which is pure arithmetic, I don't even look for economic interpretations.

MR. MAYO. Well, one of the troubles with it, as we all know, is that it equates one stock market [index] with one labor index with one of all sorts of things, and--granted they're trying to equate the trends in each one--the weighting is an impossibility. I think that the only support I would give to such an indicator is as Lyle suggests. If that indicator upon analysis--not just arithmetic but upon analysis--seems to give a little more cohesive support to conclusions already formed on the basis of substantive analysis, maybe this gives me a little more comfort. We have a discomfiture index in the weather, and we can have one in economic projections as well. And maybe that is false analysis.

CHAIRMAN BURNS. Well, I will never argue against anything that gives any man an added measure of comfort.

MR. MAYO. We just hope it isn't false comfort.

CHAIRMAN BURNS. Well, that specific thing, if it serves that purpose, it serves a useful purpose. But I don't think it goes beyond that.

MR. MAYO. One other observation, Mr. Chairman. You, with all of your background, found it somewhat discomforting that 4 equals 8 when we were working with the seasonal adjustment problem on money supply. Knowing how sensitive those seasonals are, some of us may tend to forget that they are equally poor, if I may use the term, on unemployment and more particularly on some of the price indexes.

It was called to my attention yesterday morning that some of our people have a real suspicion, for example, of the agricultural price decline in the wholesale price index. In July the change in the unadjusted figures was zero; this was publicized, though, as a decline of 1.7 percent, or something like that, in food prices. Some of my people who are very cognizant of the construction of these seasonals say, in effect, let's not play games. That's the reason the wholesale index looks so good in this last month. But 'taint really so; the seasonal isn't that good. So I think, again, we can draw from our own experience with our seasonal problems on money supply and recognize that [the data on] much of our economic world is suspect in one degree or another.

CHAIRMAN BURNS. Well, I don't know about vacation habits, but they may well be changing. A good portion of mankind remembers that there is a month of August, and an increasing number of people I believe are taking advantage of it. And whether seasonal factors catch that phenomenon is not a subject that I've studied. I think it deserves study. Mr. Baughman, please.

MR. BAUGHMAN. Mr. Chairman, just a question. Possibly an outlandish one. That is, whether the rather slow growth in money stock through the last quarter of last year and first quarter of this year and the current slowing in some of the economic measures are considered to be rather completely unrelated developments, or whether there may be some relationship between them.

CHAIRMAN BURNS. Good question. We'll hear first from Mr. Gramley and then from Mr. Axilrod.

MR. GRAMLEY. Well, I would say they're entirely unrelated and coincidental and I would base that judgment on two sorts of evidence. One is that, if you expect a slower rate of growth of M1 to feed through to the nonfinancial economy, you would anticipate that it would take place through such signs as rising interest rates. That's the way increasing tightness in financial markets initially evidences itself. That has not happened. Secondly, I would have a hard time understanding how slow growth of the money supply could have the sorts of distributional effects we see in the data. The slowdown has been almost entirely in nondurable goods production. The rate of durable goods production increased from last fall to this spring. That's not the sort of thing you connect with an increase in monetary tightness.

CHAIRMAN BURNS. Mr. Axilrod.

MR. AXILROD. Well, Mr. Chairman, I guess I've never been a believer that you can go from money supply growth to growth in GNP that mechanically. I would tend to analyze things in terms of real effects that affect GNP, such as interest rates, markets, overall liquidity. And I wouldn't see anything in those developments that would be, per se, factors that would slow down real GNP, and I don't think we're projecting this significant slowing. If it does occur, I think that President Baughman is quite right. Monetarists will indicate that the cause was the slower growth in money, that the lags have shortened considerably from the usual lags, and that this further proves that the Federal Reserve is wrong in the way it runs policy. But I would not make that connection at this point.

CHAIRMAN BURNS. But there is some question about the fact [of slowing growth in the aggregates] itself. I would not interpret the figures on page 4 of the Bluebook as indicating a slowing in the rate of growth in the money supply.

MR. AXILROD. Mr. Chairman, if I may, in point of fact there was a very slow rate of growth in the money supply from midyear-- from June as a base through the first month of 1976. That rate of growth was on the order of 2-1/2 percent at an annual rate, and since then we've been growing at around a 6-1/2 percent annual rate. So if you pick these particular months as kind of inflection points, you will notice a very definite change in trend.

CHAIRMAN BURNS. You're looking at M1.

MR. AXILROD. Yes, M1.

MR. BAUGHMAN. Appendix table 1-A in the Bluebook, Mr. Chairman, shows the numbers fairly--

CHAIRMAN BURNS. Tables which?

MR. BAUGHMAN. Appendix table 1-A in the Bluebook. I believe the page is not numbered.

CHAIRMAN BURNS. Is that the one with the quarterly figures?

MR. BAUGHMAN. Yes, the M1 column in the center of the page.

CHAIRMAN BURNS. Oh. Well, I think you have a useful summary, the past three months, past six months, past twelve months, and on page 4. Well, one can read these figures very differently. I appreciate that. Well, thank you Mr. Baughman. Would anyone else like to speak on the economic outlook? Yes, Mr. Wallich.

MR. WALLICH. I think one of the important determinants of investment is capacity utilization. I wonder if we could hear a little about the various seemingly conflicting data on this. The Federal Reserve capacity index for manufacturing is quite low but is generally regarded as being statistically too low. The Commerce Department has a series, which I'm not well informed about, which seems to have reached 4 to 5 points below its previous peak. The Wharton index is always high by nature of its construction. There seems to be an index by [unintelligible] which shows capacity utilization well above our data. So we're left with our index low, and the materials index somewhat higher, but still not showing any pressure on capacity, and then these other indexes possibly pointing in another direction. Any useful conclusion that can be drawn from all this?

MR. GRAMLEY. The conclusion I would draw, Governor Wallich, is, first, our measures of capacity utilization are poor and need improvement, and we are working on that. We hope to have some revised indexes out this fall on the capacity in all of manufacturing.

More generally, I would say my conclusion would be that except for isolated cases, we're not now in a situation in which bottlenecks or shortages are likely to impede the rate of expansion, nor are we likely to find ourselves in that situation over the next six months to a year, assuming the rate of economic expansion follows the path we're projecting. But it is, I think, evident that in a number of industries, particularly in the materials area, the rate of capacity utilization has increased sufficiently to make businesses think about their expansion plans.

For example, in the nondurable goods materials industry, where we've been at an 86 percent rate of capacity utilization throughout 1976, compared with a peak of 94--admittedly considerably higher, but that was a period of extreme shortages--and a trough of 70. Now that's a very significant increase in the rate of capacity utilization in those industries. The bounceback in the durable goods industries has been smaller and slower, in line with the fact that durable goods production has not gone up as much. But in the first six months of this year in the steel industry, to cite one example, we have had a very slow, significant rise in production and in the rate of capacity utilization. And in that instance, I would think that the industry would be thinking about expansion of capacity as time goes on. The utilization index for raw steel is now at 91-1/2 percent, compared with a cyclical trough of about 73. So that's a very substantial bounceback.

CHAIRMAN BURNS. Lyle, what do you know about the Commerce Department measure of capacity utilization?

MR. GRAMLEY. Well, we have a memo under way to evaluate that. It's a new index that's been out for several years.

CHAIRMAN BURNS. Really. I just learned about it recently, and it shows a startling--well, Mr. Wallich described it, you know--[only a] 4 point difference, I think--an index of 86 at the peak of the latest boom and 82 now, not very far away, and it's a startling measure. Whether there's any degree of validity at all I don't know. It would be very useful to learn about.

MR. GRAMLEY. We do have a study of that under way, and we'll report to the Committee.

CHAIRMAN BURNS. It'd be useful to send out a memo to all members of the Committee.

MR. GRAMLEY. Be happy to.

CHAIRMAN BURNS. Thank you. Anyone else like to speak on the economic outlook?

MR. WILLIAMS. Yes. Is there any steam left in the consumer? The inflation rate's gone down the last three quarters, particularly the unanticipated or surprise inflation rate, which should contribute to a decline in the personal saving rate. And also we know that consumer sentiment seems to be up. Do you see further steam left in the consumer part of the recovery?

MR. GRAMLEY. Well, my feeling is that the evidence we have on consumer confidence is a little bit out of date. The latest statistics we have are based on surveys taken in May and June, and things may have happened since then. They don't show an appreciable change from early in the year. One of the indexes shows a slight improvement in confidence; the other shows a slight deterioration but, at the same time, an improvement in buying intentions.

As far as the rate of inflation is concerned, my feeling is that consumers are not likely to react to one or two months' change in the CPI or to what they see in the grocery store but rather to longer-term trends. And I think that what they have been seeing in terms of longer-term trends is a general improvement in the performance of consumer prices during most of '75 and relative stability since then. So I see nothing--

CHAIRMAN BURNS. I wonder if consumers really feel that way. I think consumers think of the level and not rates of change. If consumer prices are going up at an annual rate of 6 percent, by Job they're going up period. It's economists who talk about stability of rates of change. Consumers know nothing about that. They know the grocery prices and other prices are going up.

MR. GRAMLEY. Well, I think our consumers have gotten sophisticated enough now so that, though they don't sit down and make calculations on a calculator and compute annual rates of change compounded monthly, they are reacting at this point to rates of change rather than levels. They expect general increases in prices to take place. They see it all the time. And I think that view is consistent with the way the consumer surveys have behaved. As the rate of inflation slows, consumer surveys begin to report an increase in consumer confidence. They began to report that consumers think it is a better time to buy, they are less worried about inflationary pressures.

CHAIRMAN BURNS. Any other question of comment? Well, if not…

[Coffee break]

CHAIRMAN BURNS. We'll resume our deliberations, and if we do so promptly, there is a chance that we will not go hungry today. An opportunity that we ought not overlook. We will hear now from Mr. Axilrod, who as usual, will be very brief.

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

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

MR. WINN. I just hate to speak again, but this is a technical question, Mr. Chairman. To what extent are our M measures affected by the balances in branches of U.S. banks abroad? When we measure income velocity in other [unintelligible], we're not measuring it only against domestic?

MR. AXILROD. We don't have deposits in U.S. branches abroad in our money supply numbers, and I do not believe that transaction balances are to any significant extent kept there. Corporations may have some CDs in such branches, but then we don't have CDs kept here in our money supply numbers.

MR. WINN. Thank you.

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

MR. GUFFEY. You spoke of the payment of the Treasury financing and how it fits into--is that affected only for August? And then you would see growth again in September in M2?

MR. AXILROD. It affects the time deposits from going into M2, we believe only in August, and there will be something like a one-time diversion of funds. Maybe funds would otherwise go into the [unintelligible] and maybe some little shifting out of actual deposits. And then you'd expect to go back to a more normal rate of growth in other time deposits for September, and that's in effect what was done.

MR. GUFFEY. The thing is that Treasury balances run down where you have a bulge in September in M2 [unintelligible].

MR. AXILROD. We have a sharp rundown of about $3 billion projected in September. When a rundown of that magnitude last occurred, it was in April, and we had a very sharp bulge. We didn't project it, and we're not projecting such a sharp bulge this time. We're projecting growth only up to around 7 percent. So there is some risk involved, and maybe we're underestimating the impact. As I've said, we've run through various econometric models and tests, and we've never been able to find a consistent significant relationship between the Treasury balance and the money supply over a period of a month or two.

CHAIRMAN BURNS. All right, any other questions? Yes, Mr. Wallich.

MR. WALLICH. I saw some data indicating that the change in velocity in M1 during the second recovery year since the war has been remarkably constant, that is, within a lower limit of 3.7 percent and a higher limit of 5.2--average of 4.2. Does that sound still applicable to you in the light of the recent shifts in demand we've seen?

MR. AXILROD. In the first three recoveries of the postwar period--in the second [year], [the] velocity increase for M1 was 4.1, 4.3, and 5.2 percent respectively. It was lower in subsequent periods, and that's roughly in line with what we're expecting now. In the first two of the postwar periods, rates rose, and in the third one they rose also, but by the eighth quarter we were out of the recovery. The rises were modest, but the levels were much lower, so it gets into the question of percentage versus absolute change.

MR. WALLICH. Yes.

MR. JACKSON. Did you have similar changes as a non-M1 transactional concept of money that we've had like in our [unintelligible] occurred in [unintelligible] those periods of--

MR. AXILROD. No, I think [unintelligible] so. But what was occurring in the early periods, I believe, was an economization of surplus cash balances as you came out of the war. There was this trend economization of cash, raising the rates of growth of velocity in somewhat the same sense that movements to other types of instruments for holding money-type balances are affecting it now.

CHAIRMAN BURNS. A certain quiescence has descended on this assembly, and therefore I think we're ready to move to a discussion of monetary policy and the domestic policy directive. I'm not adequately informed about the vacation plans or doings of members of this Committee. But I do know that one of our distinguished members has recently been away and become reacquainted with the blue sky and calm waters and so therefore must have gained perspective on the world we are living in and maybe moving into. So I'm going to call on Mr. Gardner to open this discussion.

MR. GARDNER. The Chairman is right. I relaxed thoroughly for two weeks, and I have heard nothing this morning that disturbs my relaxation. I think Willis performed a fine service with his point-counterpoint. That sparked a very useful discussion. Lyle, with his usual clarity, has persuaded me that we still do have a recovery, although it's certainly not an economy plunging out of control in any sense--certainly not for the last month or so. I agree with the Chairman's comment that it is no surprise that businessmen are more cautious today, considering what they've been through. I realize that the expert professional economists among you know a great deal more than I do about the history of business cycles and the relative activities that have occurred. But I also give a good deal of weight to change in our economy, in our society, and in our environment. And I think that's why we're useful. If everything could be predicted entirely on the past, why it would be a rather mechanical function.

In any event, it seems to me that this is indeed a time when we are having a pause, or at least no outward reason to change the performance or our goals or our ranges, which have served us pretty well since the last meeting. Curiously, even the banking industry today is not expecting a revival of loan demand until early '77. I've never been through a fall when there wasn't an increase in loan demand, but the bankers don't seem to think they're going to have it until early '77. In any event, the Treasury has been successful, the situation is relatively stable, and it's my strong conviction that we should not make a change in our ranges at this time.

CHAIRMAN BURNS. Well, Mr. Gardner has brought a relaxed mind to our deliberations. I bring a very tired mind to our deliberations. And I have a little more confidence in my own judgment now, despite my tired mind, than I might have had were it not for the fact that Mr. Gardner brings a clear, relaxed mind to our problems.

As far as I can see there is no reason for changing our basic monetary stance at this time. Alternative B as specified on page 5 I think is reasonably satisfactory. I would like a somewhat lower federal funds rate. I would like a somewhat lower midpoint for M2, but these are subtle differences; I would not press them. I'm not a believer in fine tuning, and if alternative B is satisfactory to my colleagues, it certainly would be satisfactory to me. Who would like to speak next? Mr. Coldwell, please.

MR. COLDWELL. Mr. Chairman, I don't find great difficulty with what you or Governor Gardner has said. Perhaps a nuance. I'm not ready to write off this recovery. I think we are involved in the pause, at least with some dimension, probably for another month and perhaps longer. [If] we recognize this pause in the policy prescription, I would think it would be a matter of minimal response.

At least, however, [it] ought to call for some caution on our part. Perhaps a shading of our judgments in Desk operations might be sufficient. It doesn't mean an overt move, but I suspect not perfectly steady in the boat either. I'm a little bothered by the continued Desk mechanization with policy and response. I'd prefer to shade just a little bit as the Desk sees opportunities, capitalizing on those opportunities as the market believes it ought to move.

I would like to raise, though, with the Committee the possibility of again taking the opportunity of the fall and the seasonal demand period to look at--what is essentially a [Federal Reserve] Board action, of course--a change in reserve requirements. I know that it is difficult to do this in a period of recovery, but we have a seasonal demand which, in the past, we have met with this device. I continue to believe that our reserve requirements are larger than necessary for policy action, and it would be helpful to our [Federal Reserve System] membership problem if we could get them further reduced.

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

MR. PARTEE. Mr. Chairman, a question I ask myself is whether we ought to do anything on our own initiative to help the trend in business activity, and if so what it ought to be. And I guess I conclude that I don't quite see what we could do that would be very helpful and would not seem a very activist policy from the standpoint of the market. The flows are good, the aggregates are growing well--not spectacularly, but well. If business truly does have a conservative attitude toward what it wishes to undertake, then the prescription I would say is just to lower interest rates in order to induce business to overcome this reluctance to invest.

But I'm not quite convinced that they're that conservative; I'm not quite at the point where I would be prepared to push actively toward lower interest rates. In another month or two, if the pause continues, I might have a different view. So I guess my leaning is toward ease in terms of money market conditions. But I don't feel strongly enough about it to want to vote for alternative A or to have a meaningfully lower funds rate, so I guess I would accept your specifications.

CHAIRMAN BURNS. Thank you, Mr. Partee. Mr. Eastburn, please.

MR. EASTBURN. Well, I would share the views expressed earlier that there is some concern about this so-called pause that we seem to be having, that it may well be that we'll come out of it satisfactorily. But it seems to me that the risks, as Chuck Partee has pointed out, have changed somewhat. So my feeling would be that we should be moving a little toward A from B. I could accept B, but I think, given these increased risks, that we could afford to move a little toward A. One way to do this would be to change the range under B to raise the lower end of that range somewhat, say, to 5 to 8, and perhaps drop the lower end of the range of the federal funds rate by a quarter of a percentage point. I would like to see the range on the aggregates narrower anyhow, and the range on the federal funds rate wider, so this would be a move in that direction. I wouldn't consider this a major move of any kind, but simply leaning, as Chuck has indicated, to a little bit more ease than we have under B.

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

MR. BLACK. Mr. Chairman, I think the recommendations emanating from the rested mind of Governor Gardner and from your allegedly tired mind are very good, and I come out exactly where you all do on that. I would just like to throw out one word of caution. I'm becoming increasingly concerned about this divergence in the rate of growth in M1 and M2. M2 is moving up pretty fast, and I think we ought to keep a close eye on that one because I think it's becoming increasingly important. We've said we would give equal weight to it [and to M1], but I think in practice that I, along with some of the rest of you, have weighed M1 more heavily than perhaps we should. But this is a caution for the future, and not applicable for the moment.

CHAIRMAN BURNS. Thank you, Mr. Black. Mr. Morris now.

MR. MORRIS. Mr. Chairman, I believe the staff's economic projection is correct, and I think alternative B is the proper course for us at the present time. Although, I would emphasize that, along the lines of Mr. Partee, I would expect the Manager to use the full range that is provided to him on the funds rate, particularly if the monetary aggregates come in on the low side, suggesting that the period of sluggishness is extending.

And I would also like to support the proposition that Governor Coldwell made. I think it is highly appropriate for the Board to be planning a fall reduction in reserve requirements, and I think such a change would be extremely helpful to us on the membership problem which is raising its head in New England very severely now. And I think it can be explained to the public and the press that this does not reflect an easier monetary policy but simply one of the options we have to meet the seasonal needs for credit. So I think that's a very good suggestion, Phil, and I hope we get some support around this table. Thank you, Mr. Chairman.

CHAIRMAN BURNS. Thank you, Mr. Morris. Mr. Kimbrel now, please.

MR. KIMBREL. Mr. Chairman, I'd like to pick up at the same spot and suggest that I very much hope that the seasonal opportunities will be utilized to accomplish some reduction of reserve requirements for the reasons that were already stated. I'm hopeful that this would be a good opportunity to capitalize on that.

For the other, [unintelligible] longer-run expectations remain good. We have not seen a lack of funds [that would] threaten the economic upswing. The liquidity positions of both the lenders and the borrowers remain [unintelligible], certainly at this moment--an easier monetary policy would change the attitudes that are prevailing. So we would certainly be inclined to associate ourselves with the suggestions of alternative B.

CHAIRMAN BURNS. Thank you, Mr. Kimbrel. Mr. Jackson now, please.

MR. JACKSON. I would agree with the fundamental approach being taken. However, I would not recommend any strong move that might be interpreted by the public as an overt action, primarily because I think the public would misinterpret it. One, there would be allegations that it was done for other than monetary reasons despite what the real reason may have been. Two, if overt action toward ease [through a] change in reserve requirements were made, I would suggest that, if you have a business community that's cautious, this might reinforce their caution because the monetary authority would be adding its doubts to those already in their own minds and so perhaps inject an additional element of caution. So I'm not sure that psychologically the [unintelligible] expression of a level of interest rates would necessarily overcome the attitude of the monetary authorities.

Getting back to the other issue, I'm not sure I'd agree with President Black about M2. We had this balancing point creating arbitrary rates of growth around Regulation Q, and therefore I would think that M2 rates of growth to a significant extent are still artificial as we go to one side or the other of a Q rate. And so while I'm not a worshiper of M1 for any reason, I wonder whether we really ought to be that persistent in our attention to M2 when we are at this peculiar balancing point where we can have all of the money flow in one direction due to just a slight change in the rate.

In short, I would stick to alternative B, and certainly--unless we're going to change the rules--I would say have the full range available based on the incoming evidence that is available to us.

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

MR. MAYO. I have no problem with your recommendation or your points, Mr. Chairman and Vice Chairman. I would buy alternative B. I don't want to suggest a change in the range for M1. But I think it might be appropriate to raise a caution that if M1, in the preliminary judgment of the Desk and the people here, seems to be expanding because of the decline in the Treasury balance, I wouldn't panic and go to the top of the federal funds range just because of that factor, because it itself is something of an aberration. It's not something to be ignored, but it's something to be given a little lesser weight than other short-term movements in M1.

CHAIRMAN BURNS. Thank you, Mr. Mayo. Mr. Williams, please.

MR. WILLIAMS. Yes, we would support alternative B. We'd like to see an expansion in the band of the federal funds rate, may be out to 1-1/2 percentage points. And I would certainly support Governor Coldwell's [recommendation of] taking a close look at the reduction in the reserve requirements with respect to the membership policy.

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

MR. WALLICH. I think there is a balance of considerations here, Mr. Chairman. The economic situation might induce one to want to give a little push, but this pause probably will be over long before the major part of that [push] would be felt. And as the [push might] indicate a high degree of concern, the announcement effect, as I would see it, would possibly be negative.

There's also the fact that we've had interest rates low [for] very long in this expansion, [so] a great deal of liquidity has accumulated in the economy, which at some future point might raise problems for us which we do not want to intensify. Also, if we stick to our one-year target, then anything we do now to ease means a faster rise in interest rates later. This is perhaps more a defect of the way we handle our projections and calculations now.

There's really no reason why one needs to gear the expected rise in interest rates to the midpoint of the long-term range. One could gear it to the edges and, say, associate a policy of money growth higher than in the long run, not with alternative B for the long-term of the midpoint, but with alternative A, and that would give one less of a rise in interest rates. But in any event, it seems to me that [counter]balancing the desire to give some push for the negatives that we have here, I come out, as do our colleagues, with the conclusion that B is the right thing to do.

CHAIRMAN BURNS. Thank you, Mr. Wallich. Who would like to speak next? Yes, Mr. Volcker.

VICE CHAIRMAN VOLCKER. I don't take all of the discussion of the so-called pause in business as indicative of an emerging long pause or recession along the lines that everybody seems to agree upon this morning. But I do take it as resolving some doubts in my mind [about] a real booming picture in the economy in the next year, either in actuality or in psychology. I am less concerned than I was a few months ago about shortages and bottlenecks arising in the next 12 months. I'm less worried about it for various reasons, first in the general price level. I can't believe the unemployment figures month to month, but we know that after a year of recovery they're pretty darn high. And I'm still not entirely convinced by the investment outlook. So I put this all together, and it's clear you can make a case for a little bit of easing. I don't feel strongly about that case.

My concern is that, when I look at alternative B, it still leaves me with the possibility that in the face of this situation, we could have a substantial rise in the federal funds rate in the next month. I feel a bit at the mercy of what happens to the aggregates in that respect, and I don't like it. In fact, I think that would be a signal in the wrong direction. I'm not bothered by the ranges in the aggregates in alternative B. In fact the New York projections for this particular period are a bit below the Board's projection, which gives maybe some feeling of comfort that the rise in the aggregates will not be so high as to trigger a sizable increase in the federal funds rate. But still, taken literally, it leaves me quite uncomfortable to be at the whim of how these statistics come in and to [possibly] find myself with a 5-3/4 percent federal funds rate two or three weeks from now.

To sum up my feelings, in the old days I would say we ought to conduct ourselves so that, if we err, it's a bit on the side of ease. I feel that way in spirit, but how you put [that spirit] in [terms of] these kinds of constraints, I'm not quite sure. But I guess I'd rather see that federal funds rate at something like 4-3/4 percent to 5-1/2 percent without any implication that it be changed now. We [admittedly] skew the thing a bit, but I don't like the possibility that, in the face of all that is going on in the real economy, we end up with a 5-3/4 percent federal funds rate.

CHAIRMAN BURNS. Thank you, Mr. Volcker. Yes, Mr. Guffey.

MR. GUFFEY. Just to kind of catch on to what Paul has just said, I think I'd like to do it another way. I wouldn't want to see the federal funds rate go down nor go up to 5-3/4, as you suggest, Paul. But isn't there another way to do it, and that is to go with a money market condition directive, as opposed to an aggregate directive, with the anticipation that we'll sit right where we are for the next 30 days. And it's what I would opt for.

CHAIRMAN BURNS. All right, thank you, Mr. Guffey. Mr. MacLaury, I'm looking at you.

MR. MACLAURY. I wish you could have given us your suggestion at 9:30, Mr. Chairman, because I really feel that today was a day when I didn't have anything to add to the discussion. I'm perfectly content with B. I would like to ask, if I may, when we as a Committee are going to have that discussion of our operating methods.

CHAIRMAN BURNS. Well, I have that very much on my mind, and I've had several discussions with our staff about this, and staff work is going forward. I hope we can have such a discussion at the next meeting. But I see no point in putting that on the agenda until I see where the staff is in its preparation.

As for your suggestions about 9:30, I must say to you in all honesty, that thought occurred to me, and I thought it would be poorly received by this Committee, and that's why I didn't make it. Also, a more rebellious thought actually occurred to me, namely, to suggest to the members of the Committee that we not even hold a meeting, but then I thought it would be so rash, so outrageous, that the Chairman would be accused of approaching senility. And I've reached an age where that is the last kind of interpretation that I could take. We still haven't heard from several members of our family. Who would like to speak now.

MR. BAUGHMAN. Mr. Chairman, I haven't spoken, but I really have nothing worthwhile to say. I've concluded that alternative B is an appropriate posture [in which] to continue in the present circumstance.

I would register support as strongly as I could for Coldwell's suggestion that we reduce reserve requirements at every opportunity.

But the only other thing I would comment on is that I think we probably don't qualify as psychologists. I'm not sure that anyone really does, and in terms of [determining] our actions, we should go pretty much by the numbers in our judgments of the economic situation and not be influenced very much by our guesses as to how others will interpret our actions. Because I'm not sure that we can make very useful guesses in that respect.

With respect to giving signals, there's at least one place in the country where the board of directors of a [Reserve] Bank would not be averse to considering a signal on the discount rate. But I think that would be a bit premature at the present time.

SPEAKER(?). You mean an increase?

MR. BAUGHMAN. Pardon?

SPEAKER(?). You mean an increase or a decrease?

MR. BAUGHMAN. Decrease.

SPEAKER(?). Decrease.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Would anyone else like to speak? Well, if not, I think we're ready for a decision. I would like to test the sentiment of the Committee on a money market directive. In my judgment, that is an appropriate directive, in view of the [opinions] that have been expressed around this table at this meeting. Now, with a show of hands, how many would find the money market directive acceptable at this time?

MR. BROIDA. Do you want members?

CHAIRMAN BURNS. Oh yes, members.

MR. BROIDA. Eight, Mr. Chairman.

CHAIRMAN BURNS. On M2, let me have a show of hands on a very subtle item, really, a preference of 7 to 11 as against 7-1/2 to 11-1/2. Members of the Committee who prefer 7 to 11 and who are against 7-1/2 to 11-1/2 would kindly raise your hands.

MR. BROIDA. Three.

CHAIRMAN BURNS. Now, as to the federal funds rate, I'd be inclined to leave it as is, recollecting our discussion at the last meeting, but I can assure Mr. Volcker that this is a matter that not only the Desk but that I personally would watch very carefully. And I think they ought to have a pretty convincing reason for going to 5-3/4, and I might want to communicate with the Committee on that if a purely mechanical interpretation of our rules would lead the Desk to that conclusion.

In view of what may be happening at that time in the economy and the markets, I might want to communicate with the Committee, and all that I can promise is that I'm going to remain very alert to that because I'm sensitive to such a possible increase for what might be a purely mechanical reason, just as Mr. Volcker and, I believe, others around this table are. Mr. Partee?

MR. PARTEE. Well, I was just going to say that with eight indicated in favor of the money market directive, it would be quite appropriate, I think, to cut the range in the funds rate. And then if you're outside the range on the aggregates, you have a wire communication, but I would myself give them a money market directive [unintelligible]. I'd prefer 5 to 5-1/2 as the funds rate range.

CHAIRMAN BURNS. This is my preference. I hesitated a little to indicate it in view of the somewhat painful discussion we had--

MR. PARTEE. Because of the money market directive, you see.

CHAIRMAN BURNS. --at the last meeting, when one or another of us sounded as if he might have a direct line to the Almighty himself, and the difference I thought was rather subtle. And we're not asleep here, so I would go along entirely with Mr. Partee. This is my own definite preference, but it's not anything that I would want to--in fact I'm not a belligerent on any subject today. Well, let's have a show of hands of those of us who would prefer the narrower range of 5 to 5-1/2 with adequate alertness on the part of the staff and the Chairman. Those who would prefer that would kindly raise their hands.

SPEAKER(?). That's on the assumption you have a money market directive.

CHAIRMAN BURNS. That's right.

MR. BROIDA. Eight.

CHAIRMAN BURNS. Well, I think I'm breaking all records today. Is there any other question or comment to take up before we have a formal vote? If not, would you be good enough to let me specify what we'll be voting on? We'll be voting on a money market directive; the range for M1, 4 to 8; the range for M2, 7-1/2 to 11-1/2; the range for the federal funds rate, 5 to 5-1/2. And I take it, although this has not been discussed with any thoroughness, that [the Desk will give] approximately equal weighting to M1 and M2--a procedure we have followed in recent meetings. I hear no objection to my statement of what we'll be voting on. Therefore would you be good enough to call the role.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Mr. Black	Yes
Mr. Coldwell	Yes
Mr. Gardner	Yes
Mr. Guffey as alternate for President Balles	Yes
Mr. Jackson	Yes
Mr. Kimbrel	Yes
Mr. Lilly	Yes
Mr. Partee	Yes
Mr. Wallich	Yes
Mr. Winn	Yes

Unanimous.

END OF MEETING