TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

November 16, 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. Sternlight, Deputy Manager for Domestic Operations

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Meeting of Federal Open Market Committee

November 16, 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, November 16, 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, Davis, Kichline, Reynolds, and Zeisel, Associate Economists

Mr. Pardee, Deputy Manager for Foreign Operations
Mr. Sternlight, Deputy Manager for Domestic Operations

Messrs. Coyne and Keir, Assistants to the Board of Governors
Mr. Gemmill, 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, Boehne, Scheld, and Sims, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Philadelphia, Chicago, and San Francisco, respectively
Messrs. Burns, Davis, and Snellings, Vice Presidents, Federal Reserve Banks of Dallas, Kansas City, and Richmond, respectively
Mr. McNees, Assistant Vice President, Federal Reserve Bank of Boston
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis
Mr. Hall, Economist, Federal Reserve Bank of Cleveland
Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting of
November 16, 1976

[Executive session]

CHAIRMAN BURNS. [Two items] I thought it best to take up in executive session. One is to discuss a little [unintelligible] the Mexican situation and what [unintelligible] the subcommittee of this Committee has been up to. And the second item that I wish to discuss with the [Committee] is Mr. Reuss's request for the minutes of Reserve Bank board meetings.

Now let me say a little about the Mexican situation and then call on Mr. Wallich to talk to you about developments there and our own relation to those developments, and perhaps in detail. As you may recall, we have a swap facility for Mexico. Mexico can draw on us for up to $360 million; such a drawing was made earlier this year, and that amount was later repaid, or repaid recently. The original loan to Mexico of $360 million was not made by us with due deliberation, with due care. We acted, I think, a little mechanically. There was this arrangement, they asked for the money, and we asked a few questions, grumbled a little, and just went along. The fact of the matter is that we are very poorly informed about Mexico's financial condition, and I'm not proud of the way in which we have conducted ourselves. I'm not talking about the decisions. I'm talking about the degree of knowledge, the amount of information we had at the time we made the decision.

Since then, we have taken strong steps to familiarize ourselves not only with the situation in Mexico on a current basis but to keep up-to-date records, as thorough as we can make them, for each of the countries with which we have a swap arrangement. And we are far better organized today to deal with a request for a loan or a swap drawing than we were previously.

There was a time when swap drawings were virtually automatic. Our attitude has changed; mine certainly has. When Britain came in earlier this year, the initial request was for $3 billion. Without going through the details, I agreed with the British on the sum of $2 billion and indicated we would not go above that. And then I went to the Treasury and asked the Treasury to become our partner, the reason being that Britain is no longer as creditworthy as it once was. And I'm afraid that is the kind of world we live in as far as foreign borrowing from us--much of it--is concerned. We have not said anything about that publicly, and I don't think we should. We would only add to anxiety and uncertainty. But I no longer regard the swap facility as being quasi-automatic. I don't think it should be.

Now, I haven't found anyone who anticipated a depreciation of the Mexican peso of 50 percent or more. The financial policies conducted by that country have been scandalous--we were inadequately informed. Well, we now understand, I think, the situation in Mexico with reasonable thoroughness. The Mexicans have now come in for a request for a new borrowing. That request was studied with the utmost care by your subcommittee. We had one meeting after another on the issue, raised one question after another, one kind of conversation after another with the Mexicans, one conversation after another with the Treasury. The long and short of it is that Mexico may be very close to bankruptcy. I mean by that the enormous foreign debts Mexico has contracted--it is by no means clear that Mexico will be able to service these debts, and a moratorium may need to be declared, [with] the debts being rescheduled. Now that would be a most unfortunate development because our banks are heavily involved in lending to Mexico. And of course it could set off moratoria elsewhere around the world.

Taking things all and all, recognizing that Mexico is not a good borrower, recognizing that any amount that we might loan to Mexico may not be repaid for some time, the subcommittee still decided unanimously to make a loan of $150 million and not go above that. That is exactly what the Treasury has made available to the Mexicans, so we're being partners in that deal just as we were on the British case. Now, you might wonder why would we make a loan in the case of a country the prospects of which are so gloomy and the prospects of which in any event are so highly uncertain? The factor that led me finally to conclude that it was desirable, I believe--and other members of the subcommittee were governed by similar thoughts--was that if Mexico were to declare a moratorium in the near future, having received no help at all from this central bank, then we would inevitably share a certain responsibility for the collapse and for the difficulties that would be caused to our commercial banks.

Now, if you ask me, am I at all sure that a loan of a $150 million by us would prevent such a default, the answer is, oh, no, by no means. It's really a drop in the bucket, considering Mexico's enormous need to borrow. But a new government will come into power, and that, of course, influenced our thinking to a degree. And if a reflow of capital took place, Mexico could straighten out its affairs; if a reflow doesn't take place, then I am afraid Mexico will go down the drain. Now I am going to call on Mr. Wallich to add to my comments in any way he sees fit.

MR. WALLICH. Mr. Chairman, I don't think there's a great deal I can add to what you say. You've adequately, accurately described the situation of Mexico. Going into a little more detail, they have moved into a period of uncertainty about the exchange rate after many years in which it was taken for granted that the exchange rate was stable. As a result, there developed in Mexico a great degree of ease of moving between dollars and pesos; there is no exchange control, people can maintain dollar deposits in Mexican banks, they can take their dollars out of the country, of course.

This system, once stability has been abandoned, becomes very troublesome. The dollars deposited in Mexican banks can be sent abroad very easily, or they can be withdrawn in currency. That's the reason why we have these heavy currency shipments to Mexico. It's a form of capital flight that is difficult to manage by means of interest rate policy. Interest rate policy affects the corporate borrower, but it is not, on the whole, the corporate borrower who is taking his money out of Mexico; it's the individual who has dollar deposits, or even has peso savings, and cashes those in and buys dollars.

Now, in the face of that, the Bank of Mexico, in my opinion, has tried far too long and far too hard to hold up the rate. The Fund [IMF] told them at the beginning of the negotiations that led to the last agreement--the Fund has had three missions there this year--the Fund told them that they had concluded that a 50 percent depreciation would be needed. The initial depreciation was much less than that. They held the rate at this level, which cost about $1 billion of reserves. Finally, they had to let go and went to what is, in effect, close to 50 percent depreciation. The peso used to be 8 cents, and now it is around 4. Even then, the Mexican central bank has tried to manage the rate and convey a sensation of upward trend in order to reduce the capital flight.

They have invested less money in this effort than before, but they needed additional reserves, and that is one reason for the drawing.

The other reason for the drawing on Treasury and the Federal Reserve is that they need compensating balances. They typically keep 1.2 billion to 1.6 billion of compensating balances with their various banks--these are their exchange reserves. Now these are down into the low hundreds [of millions]. The Treasury examined the possibility of a swap that would give the Mexicans only compensating balances that they couldn't in effect draw out, but it was abandoned because it would create legal problems, and there are no particular strings attached to either the Treasury's or our drawing.

We had, in the new drawing that was agreed, a sharp cutback from the original level of the swap. That level remains as being a general authorization, but then in this particular case, instead of 360, we said a limit of 150. This they were to take down in two tranches of 75 each, the second one to occur after they had secured a loan from Bank of America, which is being negotiated--800 million--and which, according to reports from the Mexicans, is being signed today. So that would create the conditions in which the second drawing could be made. The first drawing was made right after the agreement.

We had a new wrinkle in this swap, which gives us a little added protection, although I would caution not to overrate it. They had to agree to a maintenance-of-value clause. If the peso, which fluctuates in the market, should go down during the period of the 90-day drawing, then, in the first place, they're expected to repay; but second, if it is [mutually] agreed not to repay, to extend the swap.

CHAIRMAN BURNS. You mean repay at the end of three months.

MR. WALLICH. Three months. But if we agree that it is to be rolled over, and if the peso has depreciated at that time, they have to put in additional pesos so that the dollar value of collateral is maintained. In the back of this there is the thought--which I am sure is obvious to them, although we have not made it overt--that we could go into their market and sell these pesos for what they would bring. Now this, of course, could [unintelligible] by blocking this account, and it is a thing that we would hardly do except in extremes, but the fact that they would have to take further action to keep us from doing so, I think, will slightly weight the scales in their mind in favor of doing what they can to meet their obligation. The Treasury tried to get a similar arrangement into their swap, but they found again the legal problems defeated them, so they are going without this little added protection.

Now as to the future, the Chairman has described the situation. A new government is coming in, and the President is a former finance minister. It is hoped that he will inspire confidence. His views are not 100 percent known, and there is some apprehension even that they might lean in the direction of the agricultural reform, and other things, that would certainly not add to confidence. The Fund thinks that the situation is manageable if they decide to do the right things, that is, cut down government expenditures and keep wages from rising unreasonably. On both fronts, so far, they have not performed very well. The government deficit looks as if it might be larger than expected and will have to be renegotiated with the Fund to preserve the standby. On wages, the increases were larger than were seemingly agreed with the IMF.

Other than that, there is as yet no obvious impediment to the continued viability of Mexico. They claim that this $800 million loan, negotiated after the devaluation, was oversubscribed. It's being signed apparently on schedule, to the date that they have said, although they're getting the money a little later than they had led us to believe. They have not yet negotiated for next year, on the ground that when one is negotiating one big loan, one must not be negotiating something else. They do have to borrow something on the order of $250 million a month, given that they will have something like, at best, a $2 billion current account deficit, and ought to restore their reserves by about a billion. That does not yet allow for any reflows. If they get reflows, their situation will be very materially improved. Total outflows just during this year were roughly guessed to have been at $2-1/2 billion. So very large Mexican amounts abroad could come back if there's confidence of great profit in pesos to the owners, and it depends entirely on the attitude of the new government.

CHAIRMAN BURNS. Thank you very much. There is one additional word that I'd like to say before exposing myself and Mr. Wallich and other members of the subcommittee to questioning. These conversations with Mexico were practically concluded by Sunday evening, November 7. On the morning of November 8, we [the FOMC] had a telephone conference, at which time we took up our longer-range monetary targets--the subject on which I had to testify on the 11th. Therefore it would have been possible for me to take up this subject of the Mexican loan on the morning of November 8 with members of the Committee.

Now, I thought long and hard about that. It certainly would have been my intention, my strong preference. But this is such a highly sensitive subject, and I'm told that our telephone hookup is not absolutely secure. Therefore, I decided that if any leak occurred, it could cause great convulsions that would cause waves all around the world, and I decided therefore not to do it. Now your subcommittee met continuously, with the exception of Mr. Volcker, who was out of the country part of the time. Mr. Volcker was fully informed, and the subcommittee was entirely unanimous, but I did want you to know that this technically could have come before the Committee at the meeting on the 8th and my reason for not bringing it up [then].

MR. BAUGHMAN. A clarification: $150 million [from the] Federal Reserve and $150 [from the] the Treasury?

CHAIRMAN BURNS. That's right.

MR. KIMBREL. Any magic in those numbers that they arrived at?

CHAIRMAN BURNS. No, no magic--hard bargaining. We started out being reluctant to do anything, but afterward, you know, [in] our own discussions [with the Treasury]--the attitude of the Treasury, taking into account repercussions on the world at large, on our own banks, the position that we would be in if we ignored entirely the difficulty of another central bank--the Treasury previously reached this agreement of 150 and indicated [to us] that they would be receptive to--in view of the possible consequences--increasing their loan. We went along with a 150 and indicated to the Mexicans that we don't have any intention of going beyond that. Mr. MacLaury.

MR. MACLAURY. As I remember our last spot takeout--in fact, for a short time, at least, it was the ESF--the Exchange Stabilization Fund--that took us out. Were they then funded by a drawing on the IMF? Is that the sequence of events, that's, in other words--

MR. WALLICH. The Mexicans paid us; it might have gone the other way.

MR. MACLAURY. But it didn't go that way, and at the moment, what is the status of the Mexican ability to draw on the IMF? Can we look to that as a takeout this time around, or are we on a limb?

CHAIRMAN BURNS. We have made no such condition this time.

MR. WALLICH. The effect of doing that is the Mexicans are going to get $235 [million] a year for three years from the Fund. The first year, 1977, the Treasury is going to prefinance in tranches of three pieces again, not the next two years, so there is nothing for us to get our teeth into.

SPEAKER(?). Mr. Chairman, what is the extent of the exposure of the commercial banking industry in this country? That's something you mentioned.

CHAIRMAN BURNS. Well, I don't have the figure in mind--$8 billion, I think.

MR. WALLICH. I think it's a little over, I think it's 9, close to 9.

SPEAKER (?). So this is merely a drop in the bucket?

CHAIRMAN BURNS. Well, you see, their borrowing needs as best we can judge are about $250 [million] per month.

MR. PARTEE. Do they remain in debt to the Treasury for that earlier, what was it, $300 [million]?

MR. WALLICH. That was repaid out of the IMF.

MR. PARTEE. So that all the debt to the United States officially [will be] this 300, and we have indicated to them that they can't use any of the remaining part of the swap. Is that right?

CHAIRMAN BURNS. Well, Henry and I had the initial conversations, and Henry carried on a conversation later on. My understanding is that that's what you communicated to the Mexicans. Would you answer that question precisely?

MR. WALLICH. They were told that we wouldn't go over 150 even though the swap remained at its original level of 360, and it's geared to be the same as to the Treasury; that's because the Treasury went to 150.

MR. COLDWELL. Henry, who are the banks besides Bank of America, Citicorp--I don't mean by name, not many, not at all.

MR. WALLICH. All I can tell you is that the bank that usually heads syndicates with them did not do it, and that's how Bank of America got into it.

MR. COLDWELL. You don't know how many other banks are involved?

MR. WALLICH. No, I don't. I was told by them that it was oversubscribed, which suggests that it was more than a very small number, but I can't tell you.

MR. PARDEE. It's a goodly number, I think 10 or a dozen.

MR. COLDWELL. I understood there's a number of regional banks waiting in the wings to participate.

CHAIRMAN BURNS. There are plenty of sheep in this country.

SPEAKER(?). Is this $9 billion all government debt, I mean to the Mexican government?

CHAIRMAN BURNS. Oh, no, their total debt, total known indebtedness is well over 20 billion. That is known indebtedness abroad.

SPEAKER (?). I'm thinking of the American banks.

MR. WALLICH. To American banks [unintelligible,] in part government, part nationalized enterprises, and part private enterprises. In Mexico, the proportion of private borrowers out of total Mexican foreign indebtedness is particularly high because it's that kind of a country.

CHAIRMAN BURNS. Let me call on Mr. Gardner, Mr. Gardner may want to comment, and then, I know, [Mr.] Volcker.

MR. GARDNER. Well, my only comments, gentlemen--you have heard a complete review of the conditions surrounding the request. I'll only attempt to again put it in a time and schedule structure. It's early November. We know there is a negotiation going on for $800 million credit. We know also that Mexico must begin rolling over and arranging for rollovers for this enormous amount of credit they already have outstanding in our country and internationally. The Echeverría government goes out of office on December 1. The IMF conditions which were so carefully drawn do not go into effect until January 1. The tourist season in Mexico begins on November 15. The U.S. foreign policy position as expressed by the Treasury is one in which they very clearly indicated they would like us to consider whether or not we could do something with them, move [unintelligible] the Administration for foreign policy consideration. So we end up with a small, carefully constructed interim bit of aid.

MR. PARTEE. Interim?

CHAIRMAN BURNS. Well, that's uncertain.

MR. GARDNER. Well, 90 days.

MR. PARTEE. That's awfully important, I think, because of the comparison with the U.S. situation.

CHAIRMAN BURNS. I must say I hope it's interim, but if this turned out to be one of these loans that stretches out uncomfortably, I would not to be too surprised, unfortunately, under the circumstances.

MR. GARDNER. I agree, I understand Governor Partee's comment. My point was probably poorly expressed. This amount of swap under our regular and some special conditions is a very small part--as has already been expressed here--of the external indebtedness of Mexico. It seemed to me, as a member of the subcommittee, quite wise to proceed in this small, cautious way with the schedule that I have outlined for you. And the earnest hope [is] that a new government headed by a former finance minister, the IMF conditions and their further drawings as Henry has described, and--as we all know now--a further depreciation in the peso, give Mexico a fighting chance to manage this situation without an official moratorium. I think that persuaded me that it was important for us to be a part, or a small part, of this picture.

MR. COLDWELL. Was there a consideration that our participation as an official body might have encouraged other people to lend?

CHAIRMAN BURNS. No, no; oh no. But, well, we thought long and hard about that, and the last thing that we would have wanted to do or did do was to give Mexico a loan and have Mexico use that as a basis for borrowing from the commercial banks and therefore be indirectly responsible for drawing in the commercial banks. We did not fall into any such trap.

Now, we could have gotten, for example, also an agreement out of the Mexicans--I think this would have been easy--under which, getting 800 million or 800 million plus from the commercial banks now, they would use some of that money to repay us. We talked about that, but we didn't have to spend much time debating that. That would have put us in an impossible position, you see. Here the other banks come in and we get our money back out of funds that they supplied. I don't think a central bank can ever put itself in that position. So we could have secured our loan, but we decided not to.

One other point--possibly you covered that, Henry, I know I didn't--we have reemphasized repeatedly to the Mexicans that they must use the funds supplied very sparingly and in the process of foreign exchange transactions, and they must not try to peg the peso, that they must husband their resources. We have all kinds of assurances from the Mexicans that they will do just that. These assurances were made initially voluntarily. They have repeated those assurances as we raised the question, but having said that, I must go on to say that my confidence in these assurances being respected is very limited. And my confidence in their central bank operations is very limited.

MR. MAYO. Mr. Chairman.

CHAIRMAN BURNS. Yes.

MR. MAYO. Where does this, what is our position in relationship to the supervision of our domestic commercial banks if we have a feeling such as you just expressed? Do we, policywise--is this related in any way to our member banks in order to avoid a possible problem that they might have if there were a debt moratorium on the credit extended?

CHAIRMAN BURNS. Now let me talk about that just a little in a more comprehensive or rather a more general way. We could advise the banks strongly to cut back on their foreign lending. If we did that, we run the risk [of] the very crisis in international finance that we are seeking to prevent. I'm not talking about Mexico, I'm talking about all around, because our banks have, in my judgment, been rather imprudent once again in lending abroad. That is my judgment; I may be wrong about that, but that's the way I feel. If we gave them strong advice to that effect, we could bring on an international financial crisis. On the other hand, if they continue lending on the scale that [they] have been doing, then I think it's only a matter of time before such a crisis will occur.

Now, what I have done, really, well, let me go back. [IMF Managing Director] Mr. Witteveen issued a word of warning, and that was done after consultation with us. He issued his word of warning in Manila, which you may have seen. [Treasury Secretary] Mr. Simon did the same, and that was done after careful consultation with us. In some meetings with private bankers, I tried to deal with the question lightly and indicated this is an area that bankers must consider carefully.

I thought about taking stronger measures, but here is the difficulty. There are two difficulties. The one that I just mentioned, namely that they might take that advice too strictly and then bring on a crisis. But there is a second difficulty: If we start telling banks publicly just to whom to lend, for what purpose to lend, we would be getting into the business of credit allocation. And you may recall the difficulties we had with the Congress in connection with the REITs. We did a little of that and all hell broke loose on Capitol Hill, the point being, well, now you are in the credit allocation business now, and what's wrong with the credit allocation bill that has been submitted.

So we have been quite cautious. I don't know if that is--it's as good a reply as I can make to the question. I would not want to say, and I have never said to anyone, to answer your question specifically, that banks should not lend to Mexico. I haven't singled out Mexico. I have talked generally about the LDCs, and honestly, in the world that we live in, the category of LDCs badly needs redefinition, in my judgment. Great Britain and Italy in today's world belong in a category of LDCs for every practical financial purpose. Yes, Mr. Eastburn.

MR. EASTBURN. I have heard some talk that the peso may now be undervalued. Is this optimistic?

CHAIRMAN BURNS. No, I rather think it is [undervalued]. But the way in which they have been handling their wage problems also makes me wonder how long that condition will continue.

MR. WALLICH. I think that is an accurate assessment. The Fund, surprisingly to me, concluded [that, in seeking a] 50 percent depreciation, at least 40 was what they needed. They didn't believe it. They finally got it. The price impulses are somewhat stronger than was anticipated, so the undervaluation is probably temporary.

CHAIRMAN BURNS. Any other questions?

MR. BAUGHMAN. Do we have an impression as to what the policy of the government or the central bank will be with respect to shoring up private business firms that find the devaluation places them in an untenable debt situation?

CHAIRMAN BURNS. I, I don't know the general--

MR. WALLICH. Yeah, this was one of the 12 or 13 points in the original program to take care of firms that were in that condition. If they're doing this, they are not doing it on a very generous scale, because one of the strong objections that are raised to further depreciation--for instance, one [wants to say] why don't you let the rate go, let it find its own level--is the threat of bankruptcy to firms that owe dollars but have been invested in pesos. How they got themselves into that position is the history of the last 12 years of stability, in which it was cheap to borrow in dollars and dear to borrow in pesos, and they did not properly as individual firms manage their exchange rate exposure.

CHAIRMAN BURNS. Mr. Volcker, would you like to comment?

VICE CHAIRMAN VOLCKER. I don't think I have anything to add specific to the Mexican situation other than reiterate a comment that has already been made, that Mexico is basically a country that could manage the situation if they are able to economically. It should be a manageable situation. I do think what we're seeing here is the symptom of general strains and tensions around the world that are going to be difficult to manage. They will be difficult in this case, they may be difficult in other cases, and I feel very strongly there is nothing we can walk away from.

And we will be called upon from time to time for this kind of difficult operation in Mexico--maybe there won't be any others, but I suspect there could be. It seems to me to be a very modest kind of effort on our part. It's got some risks, but the risks are limited in view of the risks from the situation not being managed correctly. I think we need to exert a little leverage here. A little help from us from time to time, and this is a manifestation of it.

CHAIRMAN BURNS. I would second that comment, that it's a situation we can't walk away from. Now, I think you all know that the British have applied to the IMF, but the British are putting on a very powerful political campaign to accomplish two things. First, no conditions by the IMF--in effect, have the IMF bless British financial policy. Second, to work out some arrangement whereby the sterling balances--which, in the aggregate, amount to about $10 billion, but of which the sensitive part is held by central banks, and that part amounts to $4 billion--would [be] somehow taken care of by other countries.

Now, this is a problem that has concerned me very deeply for some time. In response to a direct question from the Bank of England, and in response to an emissary sent by other central banks and to Mr. Leaver, who is an emissary of the British government--Mr. Galagan and Mr. Leaver are seeing the President today--I have taken a very hard position, saying that I, for one, will not even talk about the sterling balances until the IMF arrangement has been concluded. But while I have taken this very tough position in talking to the British--and a similar position, fortunately, I think, is being taken by the Treasury, and I've talked to the President about this, both before the election and since then, and to others, Mr. Kissinger, etc.--while I've taken as tough a position as one could, internally some work is being done by our staff, and some of us are considering various possibilities, but we've not indicated even one word that this is happening.

In a very uncertain world, it is difficult--well, worse than difficult, I think it's unwise to take a hard position and stick to it no matter what the probable or likely consequences may be. I think that the New York City problem was in the end handled quite appropriately. The position taken was, not one cent for New York. And that position was repeated so often that New York City finally came to believe it. New York City, New York State started doing something by themselves to solve their problem. In the end, some help was extended by the government, and I played a certain part in making that possible. But there was no hint ever given that help was going to be forthcoming, because we wanted New York to help itself as far as possible.

And that, I think, is our problem with the British today. And there will be other problems around the world, as Mr. Volcker has indicated. It's in the nature of planning really. You don't plan for success. Well, if success comes along you enjoy it. It's in the nature of good planning to try to think through how to prevent disaster; in other words, to make unfavorable assumptions and try to think through at as early a stage as possible how to prevent disaster, how to prevent the unfavorable event from occurring. And I want this Committee to know that very careful thought is being given to the entire world scene.

Let me say one final word. This meeting is an executive session. I wanted to share my concerns with my colleagues, not only about the Mexican situation: We've been actively at work and have been energizing this government to do something to prevent an increase in the price of oil. What will come of it, I don't know, but at last this government is awake. Now, my advice to all of you, and I can't put that too strongly, is to say as little as possible about any of these problems because they are so extremely sensitive.

MR. WALLICH. Could I make one comment going back to Mexico? The word "moratorium" has been used, and that is one way of describing something that might happen. The arrangements, however, that the Mexicans have in place in case one of their major units should be unable to roll over--and they're all actively engaged in rolling over, during the last two months of the year, some $600 million or $800 million of indebtedness--are that there would be a degree of central control so that one would not suddenly be confronted with sporadic nonpayment, but rather that it would be possible to enter into negotiations so that what otherwise might be a moratorium would look more like a rescheduling, and I guess would be a rescheduling. This is something, of course, that has happened to other countries--Argentina has been rescheduled more than once; Brazil has been rescheduled repeatedly, and today these countries enjoy a great amount of credit. So the world has not come to an end, because countries don't come to an end when that happens. There is a new situation with respect to what the accountants might do to reschedule loans today. In that regard, we're in a different ball game.

MR. JACKSON. Let's don't say "enjoy" that much credit; they just have that much credit. It's an important difference.

MR. WALLICH. You get $25 billion credit.

MR. PARTEE. The way you put it Henry, it makes me sympathetic with the position of the accountants.

CHAIRMAN BURNS. Any other question or comment on--

MR. JACKSON. Just how long do you think this will hold the Mexicans, if I could use that expression?

CHAIRMAN BURNS. My judgment is very simple. If you have reflows of capital, this will all turn out very happily. If you don't, I don't see how a moratorium or rescheduling can be prevented very long.

MR. BAUGHMAN. Mr. Chairman, I just might report that the qualitative types of thing that one picks up indicate that the uncertainty--and I guess I could even use the word "tension" now--is still building up rather than leveling off with respect to the people who move across and do business across the border on a rather personal sort of basis. There is coming into these conversations now hints of concern about personal security as well as financial security. This comes to my mind in connection with the reference to the possibilities of some agricultural reforms or something like that coming into the picture. I heard reports, after the initial devaluation, of a number of people approaching border banks and inquiring as to whether they could borrow funds to take a speculative position in the peso. I've not heard such reports following the further devaluation, notwithstanding the fact that the value's a good deal lower now. It may be that there's less confidence in the current value than there was in the earlier one.

CHAIRMAN BURNS. There is one item that will come up at our regular meeting that I think I should mention, and you correct if I'm wrong, Mr. Pardee. I believe you will be recommending to the [FOMC] that the present swap schedule be reaffirmed.

MR. PARDEE. Right.

CHAIRMAN BURNS. I think we ought to reach that decision here, rather than in open, that is, at our formal meeting. My own view is that we certainly ought to do that, but we ought to do that with the understanding that the swap facility no longer has the automatic meaning that it had previously. For us not to reaffirm the present swap schedule would cast doubt and uncertainty and it could have very serious repercussions. I think we definitely ought to reaffirm, but we ought to understand among ourselves that the swap facility no longer has quite the meaning that it did. Now, actually, historically, it never was completely automatic, but it is definitely less so now than before.

MR. WALLICH. Mr. Chairman, I think it's getting increasingly understood in the world that the swap facilities are a framework within which one negotiates, rather than an automatic drawing right, and to that extent I think your wishes are being met. We have to bear in mind that we, too, draw on swaps, although on a very small scale, when we engage in open market operations, so that we wouldn't want to build up the resistance, for instance, of the Germans, who usually ask questions or may put limits on what we can draw. We wouldn't want to build that resistance up any more than we have to.

MR. EASTBURN. Mr. Chairman, my comments are similar to this type. The question is, what does this mean in operational terms--to make less automatic?

CHAIRMAN BURNS. Well, in operational terms, what it means is that when a request comes along and we have doubts about the creditworthiness of the borrower, or we have doubts about the purpose of the borrowing, as in the Austrian case recently--you know, what the Austrians were doing, essentially, was really arbitraging on interest rates, and I don't see why we should lend money for that purpose. What it means operationally is that we're far more cautious, far more deliberate, as to country and as to purpose, than we used to be.

MR. COLDWELL. Are there elements in our present swap network which you believe are either unnecessary or undesirable?

MR. PARDEE. No, I think the swap arrangements, as they are set forth now, cover the ground well. I think in the context of the recent experience we've had with Italy, Britain, and the Mexicans, we can, on a case-by-case basis, make the adjustments we need in swap arrangements to appropriate provisions at the time. We have thought very carefully in New York that there might be some suggestion of changes in the swap arrangement itself, but at this stage I see no reason to do so. Rather, I would prefer to continue it as now, on a case-by-case basis, to make determinations of conditions to fit the situation.

MR. PARTEE. Mexico is the only LDC member.

MR. PARDEE. And Britain and Italy.

CHAIRMAN BURNS. Well, only--

MR. PARTEE. Well, they're not exactly overdeveloped countries.

SPEAKER(?). They're not basket cases.

SPEAKER(?). Overdeveloped.

CHAIRMAN BURNS. That's a nice term.

MR. COLDWELL. We have no further requests for drawings of swap arrangements?

MR. PARDEE. No, nothing formal at this stage. Feelers from time-to-time.

CHAIRMAN BURNS. Well, I think we will be more circumspect about any such requests than we have been. I was not enthusiastic at all, in fact resisted for some time, the request of the Mexicans to double the amount of the swap facility going up from $180 to $360. Well, we did it, and that kind of resistance or that kind of question would be greater in the future, I assure you. This isn't a happy picture, gentlemen, not the best way to start our deliberations, but I felt that it's only proper to advise the members of the Committee on what your subcommittee, and in certain areas, I myself, have been doing.

Any further questions? If not let me turn to the second item for this executive session, and that is the request that Mr. Reuss made some time ago that we deliver to him by 5 p.m., October 15, the minutes of all our Reserve Bank meetings for the past five years. Now just before I went off on my foreign trip, I advised Mr. Reuss that I was going abroad, that it would be impossible to comply with the request by October 15, and that the matter is being explored with our Reserve Banks, and that I would be in touch with him soon after my return. I had a meeting with Mr. Reuss and subsequently received a letter from him indicating his understanding of our conversation. I would prefer not to go into detail on that and merely say that my understanding is not the same as Mr. Reuss's understanding of that conversation. Now, I have before me a letter that I haven't yet sent, which I do intend to send today. I'll read this letter to you and then we can discuss that on whatever scale you wish.

Dear Henry:

In accordance with our conversation last Friday, I shall advise the Reserve Bank boards to send you the minutes of their meetings.

As you and I agreed at our meeting, the following highly sensitive items will be omitted: those pertaining to borrowing or prospective borrowing by individually named banks at the discount window; those pertaining to transactions with foreign central banks; and those pertaining to real estate plans or negotiations in process. Also, items pertaining to individual personnel matters or to safety measures at the banks will be put in a separate file, and you and I alone will sit down and go over them. Let me say once again that I am pleased that this matter has been resolved and that I shall do what I can to expedite the delivery of the minutes for 1972, 1974, and 1975.

Now I hope that this will end the matter, but I cannot be entirely sure.

MR. BLACK. You omitted 1973, Mr. Chairman.

CHAIRMAN BURNS. Well I omitted--I have three years here instead of five, you see. I tried to persuade Mr. Reuss--really, since his purpose is apparently to see what the Reserve Banks do; it's some kind of fishing expedition--that a one-year sample would probably serve his purpose. If he finds that it doesn't, well, he could come back and ask for another year. We reached this compromise on three years instead of five, which will cut down the labor, since this editing process will be not a small burden for the Reserve Banks.

Now, I tried to persuade Mr. Reuss to follow another course, namely that since his interest originally was on the question of how much control do the Reserve Banks and the directors of those Banks have over the Federal Reserve's monetary policy--I thought that was his interest, and earlier correspondence did indicate that that was his interest--I tried to persuade him that that interest could be met quite adequately without turning to the Reserve Banks at all, and I indicated to him that I would be pleased to make available to him every communication from each of the Reserve Banks with respect to the discount rate; second, that I would make available to him all petitions that we receive from time to time from the boards of directors of individual Banks; and that I would be willing, further, to make available to him all letters that I had received from individual members of our Bank boards. Mr. Reuss indicated that would not meet his need because his need was to determine what the Reserve Banks really do, and that he or his committee was entitled to that information.

And then we turned to the expurgated minutes--that was the next point that I took up, the sensitive areas and how they're to be dealt with. Now, if all of this is acceptable to Mr.

Reuss--which I devoutly hope will be the case--then at the time when these minutes are transmitted, I will express the hope that they will be treated confidentially by his committee. I don't want to do that in this letter. I don't think this is the time to take up that question.

I'd be glad to answer any questions about this at whatever length members of the Committee may wish. I assure you that a great deal of thought and trouble has gone into this at the [Federal Reserve] Board's end and my personal end, as well as at the individual Banks. And if this agreement stands, I do think that it is a very reasonable and a very good resolution of a very difficult problem that unfortunately has arisen, which need not have arisen.

Now, at some stage, I'm going to call on Mr. O'Connell to talk about technical arrangements with the Banks with regard to the understanding as described in the letter that I've just read to you. But are there any questions first? Yes, Mr. Winn.

MR. WINN. Obviously, this does not include Branch board minutes?

CHAIRMAN BURNS. I think the answer to that question is yes. That question was not asked, and we're not going to volunteer.

MR. GUFFEY. Are these being submitted to Mr. Reuss as chairman of the committee or as an individual congressman?

CHAIRMAN BURNS. These will be submitted, the letter will be addressed to "The Honorable Henry S. Reuss, Chairman."

SPEAKER(?). Does he have the backing of his committee? Do we know that, or is it an individual request?

CHAIRMAN BURNS. That has not been tested, and I thought that it would be far better to work something out with Mr. Reuss rather than subject this question to methodical testing, which would have created the spectacle, at least, of a confrontation, which would have seriously exacerbated feelings. Whether he would have the backing of his committee or not on this question, I simply do not know. What I can be sure of is that, if we refuse and ask for an expression by the entire committee, this would certainly be hotly debated, fought over, and no matter how the matter was resolved by the committee, scars would be left.

MR. COLDWELL. I don't think this is a matter which I'd want to go into that kind of fight on, Mr. Chairman, but there may be some down the road which I hope we would not accede to his request just as a chairman or a congressman.

CHAIRMAN BURNS. Well, I can assure [you], first, that your judgment about the future is something I share--and your word of caution, I also share that feeling completely. Yes, Mr. Morris.

MR. MORRIS. Mr. Chairman, do we [unintelligible] just the bare minutes or [also the] supporting documentation and reports that would be referred to in the minutes?

CHAIRMAN BURNS. Well, I think this is one of the technical matters that Mr. O'Connell will take up with the officers of your Banks, and Mr. O'Connell will comment on that presently. My own feeling is that the attachments should not be, or need not be, submitted. But I would not be surprised if that question were asked. This question I deliberately omitted from our discussion, and Mr. Reuss did not raise the question. But as your question recognizes by its very nature, this is a gray area. However, certainly in the case of certain attachments pertaining to individual banks or their names, you see, well, that's covered by the agreement. Any attachment pertaining to relations with foreign central banks--now this may apply solely to the New York Bank--any such attachment would be omitted.

MR. O'CONNELL. Mr. Chairman, I think perhaps the reference is to such as executive committee minutes, audit committee minutes, established committees of the Reserve Bank board, as to which each keeps separate minutes.

CHAIRMAN BURNS. Well, there again, my own feeling is--I may be mistaken--that these need not be submitted.

MR. O'CONNELL. That would be my recommendation.

CHAIRMAN BURNS. But I would not be too surprised if that question were raised by Mr. Reuss in due course.

MR. ROOS. Mr. Chairman, is there a vulnerability to us if there's great variance [across Reserve Banks], which I would assume there will be, in the style and depth in which minutes [are written]--we're stars, at present, in having taken minutes over the years that are absolutely meaningless. Now, would he ridicule this and say that Presidents of the Reserve Banks do nothing?

CHAIRMAN BURNS. Probably. Certainly possibly--I even think probably. I would hope that, in due course, Mr. Reuss will become interested in other questions of [unintelligible]. He'll not pursue this [unintelligible].

MR. MACLAURY. The treatment of the separate file on personnel matters and protection at the Banks--are those minutes to be held here at the Board of Governors?

CHAIRMAN BURNS. Mr. O'Connell will talk about the technical aspect. Well, let me say a word about that as I visualize the matter at this stage. You have your minutes. Now there are at least five categories, and you have technical procedures under which certain lines or paragraphs can be omitted. That is, you have a Xerox, but certain parts are covered up. Now just how that's done, I don't know, but we are engaged in this kind of business, unfortunately, too often. Now then, the parts relating to these two categories, personnel items and [Bank safety] items--those parts will be omitted in the first instance, you see, wiped out, but then included in a separate folder. And that separate folder--the arrangement is that Mr. Reuss and I--this will not go to his staff--but Mr. Reuss and I will go over that; what will happen at such a meeting or will result from such a meeting, I'm not able to predict. My guess is that, after looking it over, Mr. Reuss will show no further interest.

SPEAKER(?). Do the boards of directors [know of] this?

CHAIRMAN BURNS. The Reserve Bank directors have been informed about this correspondence, and to what degree the Reserve Bank boards have considered it is something that our colleagues can advise us. I don't know, but let me indicate that my letter's worded carefully. It says: "In accordance with our conversation last Friday, I shall advise the Reserve Bank boards to send you the minutes of their meetings," and this is what I'm doing. I very much hope, in view of this, that the advice will be taken by the Bank boards, but this is something that the Bank boards will have to take up themselves, and I personally feel that this is as good a resolution as we could have gotten. I only hope that it stands.

MR. KIMBREL. Won't you be having the chairmen and the deputy chairmen [of the Reserve Bank boards] here in a couple of weeks? Would you feel at liberty to discuss this with them at that time?

CHAIRMAN BURNS. Oh yes. But I do think, having said what I'm saying in this letter, I shall do what I can to expedite the delivery. I do think that if the Bank boards are going to do this, as I now hope they will, that this will get under way and that we'll not delay unduly.

MR. EASTBURN. I'd like to mention, Mr. Chairman, some of us have board meetings this coming Thursday. Did you say you intended to send this today?

CHAIRMAN BURNS. I intend to send this today, and copies will be made available to all of you, that is, the Bank Presidents, today, before you leave.

MR. WALLICH. I wonder if I could get the view of the Reserve Bank Presidents on this? Is this likely to lead to a change in the way the minutes are going to be written hereafter?

MR. ROOS. Mr. Chairman, I would respond in this way, that I don't think that this should be interpreted to our boards in any way other than a ridiculous request coming--I refer not to our Chairman--in other words, I think that the reaction of our directors will be one of great indignation and that I would do little to disabuse them of that feeling. I would also think that if this involves a lot of work, which it will, needless work, that someone on Mr. Reuss's committee, a friendly individual, should know what we're being called upon to do. Because I think this can be used against Mr. Reuss if we react intelligently. And, as I see it in the St. Louis case, it's appalling how skimpy or meaningless our minutes are. I'm sure we did this with great wisdom knowing that a man named Reuss would ask for them. The minutes are really terribly shallow. Tell nothing.

CHAIRMAN BURNS. Mr. Mayo, please.

MR. MAYO. To what extent do you visualize coordination to be sure that we all read the agreement in the same way? I can see a possibility of one Bank including something, then Reuss coming back and saying, "Well, where's this from the other 11?" And this sort of thing. Should the Conference of Presidents [of the Reserve Banks] be involved directly in terms of, shall we say, monitoring this, or should O'Connell--

CHAIRMAN BURNS. Well, I was thinking of having Tom O'Connell do the monitoring, in the process achieving a substantial uniformity among the Banks.

MR. MAYO. We think it is very important that it be done.

CHAIRMAN BURNS. Yes. You see, these five categories that I mentioned are the five categories that turned up in the course of conversations of Mr. O'Connell with officers of the individual Banks. Now, I'm not at all sure that these five categories are comprehensive enough. But if they're not, or if it appears that they're not, that will turn up in the course of Mr. O'Connell's work with the officers of the Banks, and then, with your consent, I will try to resolve the matter. And the way in which I think I would resolve the matter would be that if, let us say, there's a sense that a sixth category [is needed]--you might handle that in the same way that the personnel items and the security items are being handled. However, that, of course, would become another subject for possible negotiation and possible confusion. I'm very hopeful that Mr. Reuss will become very busy as the weeks and months roll on. I certainly will be, but that will not stop Mr. Reuss. He must be busy. If he can discover ways of keeping busy on other items--but I think he's good over [unintelligible]. He has a staff that he--

MR. COLDWELL. His staff--

MR. JACKSON. Are references to actions [unintelligible] personnel issues of matters of substance?

CHAIRMAN BURNS. Well, I'm going to leave that for Tom O'Connell to work out, you see, and that may become a sixth category put into a special file. I would not want to treat any sixth category that may arise the same way that the first three categories are being treated. It's because the last thing that I can ever do or will ever do is to go back on an explicit understanding. But this is a possible gray area, and I think that my concept of a third file is perhaps as good a way as any of handling that if that problem arises. Mr. O'Connell, would you like to comment now on technical issues.

MR. O'CONNELL. Yes, Mr. Chairman, with the permission of you, Mr. Chairman, and the Presidents, who are so closely involved in this. Subject to the action of your Banks [in accordance with] the Chairman's advice that would be contained in the letter that would be transmitted, I would like, even as you're returning to the Banks today, to be on the telephone in the conference call with the secretariats of your respective boards and the first vice presidents of your Banks, exclusive of John [Williams]--if it's appropriate, I'll get from you a designation, John, of an individual to whom I might speak at your Bank in this conference call. The purpose of [my call]--after the Chairman's letter is mailed to Mr. Reuss--[will be to read aloud] the letter and to give an outline indication of what I perceive to be the intention of the phraseology contained in the Chairman's letter.

And I intend, with your foreknowledge, to make a request to the people to whom I'll be speaking that the minutes for the periods designated be transmitted in their whole form to me here at the Board [and that they be marked] using a method that will capture the categories the Chairman will reference in his letter. Namely that we bracket--and I'll describe methods to the people to whom I'm talking--the categories one, two, and three that we are going to remove as sensitive. That a different designation be placed on those items in each of your minutes that don't meet this first general removal category but [that] in your judgment [meet] the second category [of] individual personnel matters and matters relating to security measures of the Banks, [which] will receive a separate designation. And then thirdly, the group that the Chairman last addressed--namely, highly sensitive matters that don't appear, in the judgment of your Banks, to fall in either of the two categories mentioned in the letter [but] which you feel, for stated reasons, should be kept out of the transmittal.

By a separate marking of each [of these categories], I'll be able to see and coordinate the precise identical measurement of those withdrawals and deletions. Then I'll return to your Banks a simulated copy that will be identical--hopefully, we've coordinated it, then, throughout the System. And a separate method of placing in a separate file this third category [not yet covered in the agreement with Mr. Reuss].

In total, what I intend to achieve, Mr. Chairman, is a uniform method of removal and deletion--a uniform method of closeting that which we will not disclose to Mr. Reuss pursuant to the Chairman's letter and hopefully to do it as quickly and in a short a period of time as possible. Initially it will require, as has now been done in my conversation with respect to Reserve Banks--I'm of the impression that most of the minutes had been combed for all five years, through 1975. I'm grateful that we can remove two of these years from consideration and that our efforts then will bend toward the three years mentioned in the letter. I'll undertake this effort of coordination by telephone conference today and then I'll be in contact with your Banks as this process goes on.

CHAIRMAN BURNS. I should add one detail, that is, in getting Mr. Reuss to cut back his request from five years to these three selected years, I do have an understanding with him, that I don't refer to in this letter, but he does refer to in his letter, and that part of his letter is accurate. Namely, that if he should find that these three years do not satisfy his needs, he can come back and ask for those two additional years. For that matter, he can come back if he wants to and ask for, well--when was the Federal Reserve established?--1913, '14; who knows.

This is really an outrage, I think. You know, it's a fishing expedition pure and simple. Because if he really were interested simply in assessing the influence that the Reserve Banks have on policy--monetary policy--then my offer to him was, I think, very generous. Every communication with regard to the discount rate--not just, you know, the actual communication as it came and the telegram that you sent us or the letter--plus any petitions by individual Bank boards, plus any correspondence from individual directors. I thought I was very generous. But as I say, that did not satisfy his need as he expressed it, and the closest that [he] came to expressing his need was to say, well, he'd like to know what the Reserve Banks do, and he feels he's entitled to it.

MR. MAYO. If he were to have any of his staff people contact any of us directly to get further information, what would our posture be, Tom?

MR. O'CONNELL. It would be my recommendation, once we've coordinated the undertaking, that, unless it was a question of information that you could readily give, namely, did you mail, what was included, and so forth, that you refer the question back to me here at the Board. I'm saying that only as a matter of coordinated policy because as it's now proposed, subject to the affirmation of your Banks, we would use this office and certainly the Chairman's signature in transmitting this material to Mr. Reuss. Then I think it would be appropriate that any inquiry be directed to us. I would say, Mr. Chairman, that, responding to a question earlier raised, I would intend to recommend exclusion from the transmittal of separately incorporated minutes, even though referred to at the initial transmission, that they're not subject--

CHAIRMAN BURNS. You mean separate various attachments, appendices, and the like?

MR. O'CONNELL. Correct, sir. Yes.

MR. COLDWELL. What about audit committee minutes?

MR. O'CONNELL. I would intend, Governor--my recommendation [would be] negative.

CHAIRMAN BURNS. I would say at this stage that only full board meeting minutes be covered by this request. At this stage, I think that's a fair interpretation, but I would not be surprised if further requests were made, unless Mr. Reuss becomes busy with other problems.

MR. MAYO. In other words, you would eliminate all executive committee meetings that act on the discount rate?

MR. O'CONNELL. That would be my--at this point, President Mayo, I would recommend that we exclude from transmittals anything but the main minutes of your board of directors, even though reference may be made to executive committee minutes, audit committee minutes.

CHAIRMAN BURNS. Let me just pause for a minute. Each Bank has a range of committees--as I think about the matter now, I am not sure that omission of executive committee minutes is really wise because, so often, discount rate questions, you know, will be taken up. You see, there's Mr. Roos's problem that he mentioned, these minutes being so slender in his Bank. And the chances are that that is true of a number of our Banks, possibly all of them. And since discount rate applications are, or discount rate decisions by a Bank board will, frequently be taken up at executive committee meetings, and other vital business handled by executive committee--as I'm thinking out loud with you, in going back on earlier statements and in questioning Mr. O'Connell's advice of this point--on second thought, I believe that probably executive committee minutes should be included.

VICE CHAIRMAN VOLCKER. My reaction is the same yours, Mr. Chairman. There's no distinction basically between the executive committee meeting and our regular board meeting in the Bank. If there are not enough directors there, we have an executive committee meeting, and I think we would leave irregular gaps that would just raise questions.

CHAIRMAN BURNS. That would [not apply] to special other committees. They are in a very different category.

MR. O'CONNELL. Mr. Chairman, may I urge then, that to the extent executive committee minutes would be included, that the same right and function of withdrawal and exclusion from those be followed?

CHAIRMAN BURNS. Oh yes, absolutely.

MR. ROOS. How do we protect ourselves from the reverse of giving meaningful information to him? If he has too little information, he comes back and says one of two things, either we're highly [unintelligible] in the case we do nothing, or we are so secretive in our activities that we don't dare put down our nefarious activities. I mean, it seems to me he's got us either way if he wants to play that game, and I don't know--

CHAIRMAN BURNS. Well, I don't know if there is any protection, and I would not be at all surprised if a by-product of this fishing expedition turned out to be a strong recommendation by Mr. Reuss, possibly by his entire committee, possibly of a piece of legislation that he would introduce as to the character of minutes. I would not be surprised in the future--first, a condemnation, laying the basis, you see, for this request as to the future. Well, gentlemen, that's the kind of world we live in, and I don't think that this environment in which we function, that it's going to change very quickly, nor am I ready to predict that it's going to improve this year. Any question, comment, criticism of this procedure? I haven't sent this letter yet.

MR. PARTEE. I would consider it very fortunate if we can, get it off, and get it accepted--

VICE CHAIRMAN VOLCKER. Well, the important thing to protect here is the attachments to the minutes--in our case, they're very long minutes and they include a great many sensitive, as well as a great many dull, things.

CHAIRMAN BURNS. Well, you see if a question were raised about attachments, later on, then these understandings, if they hold--and I assure you that I'll do everything in my power to achieve that objective that would apply to the attachments. In other words, if, let's say, Reuss asks later on for the attachments, [then] these categories of exclusion and separate filings--these attachments would be handled in exactly the same way as the body of the minutes. But let's not anticipate too much. There is still, I've said this three, four, five, times already, there's still a possibility Mr. Reuss will acquire other interests in the course of the year. One of the difficulties here, of course, is--you know, that's part of the world we live in. Mr. Reuss may well acquire other interests. He has a very large staff. I think they've put in long hours thinking up ways, you see, of harassing, etc.

VICE CHAIRMAN VOLCKER. The trouble is, he's got a big enough staff so one of them could make this his personal interest.

CHAIRMAN BURNS. Oh yes.

MR. O'CONNELL. Before closing, may I touch on a matter that Mr. Volcker has remarked, about the attachments again? It's quite possible that board of directors minutes will contain a reference to that board's recent action in recommending a discount rate for the Board and the Board's response thereto, attached as Exhibit A. Mr. Chairman, it's quite possible that's the very type of attachment you would want to exhibit to Mr. Reuss, consistent with the position you've taken all along with respect to the role that the Bank directors play in this action of monetary policy. So that at the very outset, we may be including specific attachments as we review these minutes. I didn't want--

CHAIRMAN BURNS. Well, let's think very carefully about that. If you start including some attachments, but not others, then, to the extent that Mr. Reuss's staff is less imaginative than I hope they will be, you will ignite the imagination of one or another of his numerous troublemakers.

MR. O'CONNELL. In a way, you've done that when you've included the executive committee minutes, Mr. Chairman.

CHAIRMAN BURNS. Well executive committee meetings are different, as I think that Mr. Volcker explained that better than I did, that the [unintelligible] are an executive committee function for the board and at times, meetings of the executive committee are virtually indistinguishable from full board meetings.

MR. O'CONNELL. All right, sir.

CHAIRMAN BURNS. Anything else, gentlemen? On this we've had two unsavory subjects for discussion, and if there is no further question or comment, let's drink coffee and that would fortify us perhaps for--

[Coffee break]

[End of executive session]

[GAP IN TRANSCRIPT AT OPENING OF REGULAR MEETING]

MR. MAYO. [Unintelligible] is an even bigger question mark. They have no familiarity with, nor have they paid as much attention, as usual, to the statements that have been made in the campaign or to the extent that they have, they write some of it off as campaign rhetoric. They're waiting for a philosophy to be expressed. It doesn't mean that they expect that to be against their interest, it's just another element of uncertainty, and I think that's [unintelligible] the stock market which again [unintelligible] has heightened the uncertainties.

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

MR. BAUGHMAN. Mr. Chairman, I simply reiterate the references that have been made to the conservative outlook or feeling of caution that businessmen seem to be expressing at the present time, and this notwithstanding the fact that those that I have come in contact with are for the most part sitting in a rather vigorous economic setting. I find a rather widespread expectation that there will be a move to more stimulation of the economy, and along with that, or shortly thereafter, a need for bringing into the picture some form of price-wage restraint or control.

And there is amongst the groups that I have contact with a widespread feeling that it is important that the anti-inflation posture be maintained. And I think flowing from that is this concern that this may not be maintained and is the reinforcement for this feeling of conservatism with respect to commitment on future economic activity. And, of course, in the petroleum industry, there is so much concern as to what the government policy is going to be. And so much of business there is related to the developments in petroleum. So just more of a feeling of sitting and waiting than I have observed, I think, [than at] most any time that I can recall in any particular setting.

With respect to our economic forecast, it seems to me that there is reason for doubting the relationship between interest rate developments and the projected general economic developments. And [that is] particularly [so] if we should not see the indications of some strengthening of inflationary forces. With the amount of slack that there would still appear to be in the economy, [then] quite a few months in the future, if our projection of economic activity is realized, it seems a bit odd that there should be associated with that higher levels of interest rates than prevail at the present time.

So I would raise the question whether there is not a distinct possibility that, for some period of time yet, we may not see a continuation of what we've seen in the past month. Some gradual rise in economic activity associated with some gradual decline in interest rates--it seems to me that that would be a fortunate situation if it were to develop. It seems to me, further, that it might be appropriate for us, as far as we can, to encourage this development.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Who would like to speak next? Yes, Mr. Williams.

MR. WILLIAMS. As we see the same softness in retail sales, we have one unique feature in California; we have experienced a drought, at least until the last weekend or so. We have [had] summer continuously through November, and this is resulting in [unsold] goods that would normally be sold as weather changes in the fall.

CHAIRMAN BURNS. Would you just pull up the microphone please.

MR. WILLIAMS. We see the same softness that the others see in retail sales. One unique feature in California has been the weather--we have been experiencing a drought. We've had summer weather practically through the present time except until the last weekend. Several of the retail stores have mentioned [that] they have stocked goods for fall and winter that are not moving at all. One other feature that one of our directors mentioned, which is a very good short-term indicator--corrugated containers and envelope stocks have dropped rather precipitously in the last 35 days, and this is usually a good indicator of business conditions. This has really changed in the last month.

CHAIRMAN BURNS. Now what about, are you referring to production or sales of corrugated paper?

MR. WILLIAMS. This would be the orders that they are receiving from buyers.

CHAIRMAN BURNS. Orders they are receiving? I see. That's a very good point there. Well--yes, Mr. Volcker.

VICE CHAIRMAN VOLCKER. One short preliminary question with respect to the wholesale price index in particular. My impression is that that has been decidedly affected by some fuel prices, including gas prices, in the last couple of months, where there have been some administrative decisions. Is that correct or incorrect?

MR. GRAMLEY. That's correct. There were two things that were big elements in the wholesale price index in October. One was the rise of natural gas prices and other was the inclusion in the index of the increased prices of new cars. I have a figure, if I can find it quickly. The increase in wholesale prices of industrial commodities, take out the energy items, in October was 7/10. Whereas the total was 1.0. A fairly large part of that increase was for energy items, and in particular, natural gas.

VICE CHAIRMAN VOLCKER. That was my impression, and that explains some of the seeming puzzle, I think. But in general, my comments are very much parallel to those of Mr. Baughman, I think. What I find in all the areas that he has mentioned, Mr. Chairman, is substantial uncertainty. It’s not so much that people are outright gloomy as that they feel substantially more uncertain about things than they did earlier, whether you are talking about retail sales or investment--where they were never very optimistic, particularly on our board of directors, anyway--and the price thing seems a little inexplicable to some of them under the circumstances.

In terms of the outlook, I just want to emphasize the point that he really concluded on. Some of this uncertainty--to some degree, I suppose, a more restrained outlook--is related to concern about inflation itself. And the uncertainty is particularly emphasized by the coming to office of the new Administration that we don’t feel so sure about, and some concern that an increase in inflationary pressures will eventually [emerge] that will not be healthy for our own investment plans or for the economy in general. So while the uncertainty is there, the policy implications of the uncertainty are not all that clear in terms of that concern about relaxing on the inflation front.

CHAIRMAN BURNS. Thank you, Mr. Volcker. Anyone else like to speak now? Mr. MacLaury and then Mr. Roos.

MR. MACLAURY. I wish I had a better reason to feel that we may be overly pessimistic in our comments. The one thing that John Williams mentioned was the drought in his areas--[our drought] has colored the sentiment in the upper Midwest particularly. It has persisted and it is now really very severe. It affects a couple of our states in particular, two or three. Certainly retail sales, agricultural implement sales--I think I said this last month--have been very seriously affected by the drought per se, which is not a national phenomenon. That was coupled, of course, [with] the large harvests [which] have generally put their considerable squeeze on agriculture in our District.

Retail sales--I think you mentioned, Mr. Chairman, [unintelligible] and his figures, perhaps in the last two or three weeks, I guess three or four weeks, those have softened a little bit. In other words, that steady uptick from two years ago that had impressed him has now faltered slightly. I think that’s the only way to put it, faltered slightly. It’s not a downturn by any means, but it’s not the persistent uptrend that he had mentioned to us a month ago.

I say all of that, and that’s sort of on the downside, and yet I say my feeling is that, [although] this uncertainty is pervasive, it seems to me that it could go either way, and I guess I would disagree with Lyle’s feeling. I would have a different feeling. With the markdowns that have now taken place in the Board’s staff estimates of the outlook over the last two months--those markdowns are really quite substantial, $16 billion or so, I think, in final product at the end of ’77--I think it could as likely turn out that that now is on the too-bearish side; and the foundation in terms of income, liquidity in the economy, is there. And if we can get some confidence started one way or another, it seems to me that it's very uncertain which way we go. I would not consider it more likely to be bearish than to be bullish.

CHAIRMAN BURNS. Thank you, Mr. MacLaury. Mr. Roos.

MR. ROOS. I would very briefly like to report, Mr. Chairman, that the head of one of the largest retail food market chains in our part of the country reported that, for the first time in several years, their industry is seeing a reemergence in artificial increases in prices, which he attributed totally to an anticipation of the possible reimposition of price controls, with all types of discount deals being offered as a means of keeping prices at their proper level but hedging against the possibility of controls. And this was echoed in one or two of the other industrial reports at our recent board meeting. I think it's just interesting to put on the record.

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

MR. PARTEE. Mr. Chairman, I don't have any first-hand information, but just observing the data and reading the Redbook and looking at the staff projection and that kind of thing, I conclude that the economic setting [has been] weakening progressively over the last several months. And it's circular. The difficulty is that the sales haven't come in in a strong way. In real terms over the last six months, retail sales are not up at all. And as that has occurred, inventories, which should have seemed moderate, have looked rather heavy, and output has been cut. And as output has been cut, income has been lost. The increase in nonfarm personal income from April to September in real terms has been at only a 2 percent annual rate. So the income stream in fact does seem to be getting narrower, weaker, and that troubles me very much.

And I can't help but wonder, when you have sales, production, and income all working in tandem to restrain the expansion in the economy and where that makes inventories look rather heavy rather than light, whether the next development won't be a general backing away from capital spending plans. We often around here said that, well, in an up year, what you generally find is that the surveys underestimate the increase in capital spending. We, I think, intended [unintelligible] to look that way, even if the risk is assuming that it was going to be an up year. It's also true that in a down year the spending surveys can overestimate capital spending.

I sense the possibility that we're shifting in that direction, and in fact our next major disappointment may very well be what has been in the figures--some increase in capital spending is going to lose momentum. I think that would be the next development that would convince me that in fact we may well have a smaller rate of real growth than the staff is projecting now. I still can't see the basis for an absolute decline. I can't see it in inventories, although I'm disturbed about--they raised the level of retail stocks by 3 percent?

MR. GRAMLEY. Right. This is an annual revision of the retail inventory numbers that takes into account principally the annual census survey of retailers, and the revisions went all the way back to '74. But the '74 numbers were not materially different. They were affected mainly by some changes in seasonal adjustments, which they do at the same time. But beginning in '75, the new estimates indicate the progressively larger level of inventories than earlier had been indicated in the data, such that by March, and still today, the level of inventories is about 3 percent higher than indicated in the earlier statistics.

CHAIRMAN BURNS. An interesting question. You say progressively larger. I don't quite understand. I understand that as an arithmetic thing, but what I want to get at is whether this is mathematics, or data, or experience. I assume that this revision is based on one or two new benchmark figures and that what happens in between is pure arithmetic.

MR. PARTEE. I think we need to reveal the stock-sales ratios.

MR. GRAMLEY. The stock-sales ratios have all been increased by that.

MR. PARTEE. Up to that point, I had not really thought there was really any chance of inventory shake-out. And for that matter, I thought capital spending couldn't go down very much--it hadn't gone up very much. It didn't seem likely that it could go down very much. And I would expect that there could very well be a stronger fiscal policy than we have assumed in the staff projection, though I would note that that probably wouldn't occur before early next year--maybe March or April or the first of May, but it is very distant--

CHAIRMAN BURNS. Unless there is--

MR. PARTEE. This catch up for--

CHAIRMAN BURNS. This is still a cloudy--

MR. PARTEE. Just to conclude, Mr. Chairman, I have to say that the figures to me have been very disappointing, almost unbelievable in terms of my prior perception of what would probably occur as we went through the fall. And so I find myself quite concerned.

CHAIRMAN BURNS. Thank you, Mr. Partee. Yes, Mr. Wallich.

MR. WALLICH. Well it's most natural that one should search for signs of weakness at a time like this. I note one that I think has not been commented on much. Projections involved a slight reduction in the saving rate from the second to third quarter and then it stays [put] on out. It goes from about 7 to 6-1/2 [percent] and stays there. But as I look at the data, the main reason why this seems to happen is that, in the third quarter, personal income indeed did not rise very much, an assumption more or less carried on, and so that automatically cut the saving rate. But now I ask myself, is there any good reason not to up it again after this quarter? Was there any reason why it should have come down in the third quarter, however slightly, and stayed down thereafter? It's about 1/2 percentage point--that's more than $6 billion--I think that's not altogether small.

The second point ties in with the discussion of the shortfall. We have now more or less inadvertently slipped into a continuous full-employment surplus, with the exception of next quarter, where there is a minute deficit, but in general there is a small but not rising surplus. I would have thought that this is rather early, for this stage of the cycle, to reach that condition, although I realize that at some point we ought to get there. But given that we don't have a very strong recovery, it makes me think a little about 1958-59, when the budget also turned out to be stronger, in the sense of less of a deficit than one anticipated, and I realized that we may be doing something similar again here. I realize, of course, it's a hypothetical computation on the benchmark full employment, something other than 4 percent, and you get a deficit. Nevertheless, compared with what we thought earlier, the same benchmark, this is, I think, a significant change, unless it's made up by a catch-up in the shortfall.

CHAIRMAN BURNS. May I ask you a question? Has the staff explored with the Budget Bureau people what they see in the figures they're now compiling--what the level of federal expenditures for fiscal 1978 might be?

MR. GRAMLEY. Not to my knowledge, Mr. Chairman, no. We have certainly looked at the recent release of the current services budget figures, but I don't think we have talked explicitly with them about probabilities for fiscal 1978.

CHAIRMAN BURNS. Well, our current services budget, I have not really looked into this myself, but I have the impression that shows an increase of some 8 percent. Is that correct?

MR. GRAMLEY. That's correct.

CHAIRMAN BURNS. And as of today it seems unlikely that the new budget that will be presented by the incoming Administration will be lower than that. A reasonable guess as of today will be that it would be higher, isn't that true?

MR. GRAMLEY. I think that's a real possibility, yes, that the new Administration will be moving toward higher budget expenditures.

CHAIRMAN BURNS. It may or may not, but that is certainly a real possibility. Who'd like to speak now? Yes, Mr. Gardner.

MR. GARDNER. I think it's been well stated around this table that there's a natural caution at the time of significant change in Administration. Sitting and waiting is a kind of exercise that brings on worry; it hardly ever brings on optimism. I am very interested in some of the comments that have been made. Clearly our concerns as to whether or not we have a pause have been answered. We do indeed have a pause, and we have considerable doubts in the minds of our Committee members. It is entirely justified by events.

But I also have to take some of the messages that I've heard appraise it. Bruce says things could go either way, and, Bruce, I absolutely agree with that. Chuck has described some of the underlying economic basis that has led me for a month or so to conclude that it's rather difficult to perceive higher unemployment, basically lower production, basically a sharp or even a significant drop. We have ample liquidity in the economy, as you all know; we seem to have avoided, at least for the time being, mass hysteria about the return of inflation. Indeed, there are concerns, but basically the country is not convinced that they are going inevitably into inflation. Capital investment which has been very modest to date in this recovery, understandably so, has an added value and the added value is the backlogging, or postponement, of things that business firms know they need to do, to a period where their vision is a little clearer.

Foreign investment is rising in this country. I think this country is going to experience significant foreign investment considering the size of our economy. The importance of our currency as the world's trading currency and the figures occasionally encourage me it's coming up quite significantly.

The point I guess I'm trying to make is that it's my view that we are in a period of maximum concern about the policies of the new Administration. And as the months ahead come by, I think we must remember that the Administration coming into power has announced that they will balance the budget in four years, that they will attack unemployment, and as these events unfold and a mindless trivia of interim press conferences gets put aside for real pronouncements, I think you are more likely to find some points of confidence in these announcements rather than further concerns. In substance, I'm willing to accept the clear fact that our signals are very unclear. We are in a period of, not only pause--I wish I could coin another phrase, but I don't read--

CHAIRMAN BURNS. Well, you know, I'll give you nice long phrase, which I hope you never use: a "mid-expansion retardation"--what we used to call it at the National Bureau [of Economic Research].

MR. GARDNER. The National Bureau calls it a mid-expansion retardation. My basic concern is of more [significance than] what the new President is going to say at tomorrow's press [conference], and that is what the OPEC countries are going to do in December. That is a condition of uncertainty, and that augments our fears and concerns. But, you know we are going to shortly find out, and most [of what] has been suggested is unacceptable to us, but at least it's finite, and therefore Americans will get about their business when they learn the outcome of those deliberations--perhaps in compact with the Administration policy--and try to do something about it.

So I'm not altogether pessimistic, gentlemen, and I would expect the position we're in today is very understandable. I do think it's a very understandable condition, but I do not take from it the inevitable conclusion that we are in a period of significant and important decline.

CHAIRMAN BURNS. Well I might add a word at this stage. Any talk about a recession, I think, is absolutely premature. With housing starts moving up rather sharply, with orders for nondefense capital goods in real terms rising at a moderately good clip, with the formation of new businesses moving steadily upward this year--I think talk about recession has very little foundation at the present time.

Of course, there's a very big pause in the expansion of the economy. The question we're discussing or that should concern us is where we're going, and in my judgment, unless some very serious mistakes [in economic policy] and in the rhetoric of economic policy are made in the near future--and I don't [think] they will be made, I think they'll go the other way--I think the expansion will continue. Now, a new report on housing will be released sometime today. That report will show that last month's spectacular increase in housing starts has been revised upward, and that there is some decline in the October figure--but that's a small decline, whereas a rather large decline has been largely anticipated.

MR. BLACK. Mr. Chairman, is that in single-family or multifamily?

CHAIRMAN BURNS. The multifamily figure has been revised down for September. I don't really remember what the October figure is; the strength appears in one [that is, single] family. Mr. Morris, please.

MR. MORRIS. Mr. Chairman, I share your feeling that it's premature, to say the least, to be talking about recession. I don't think the numbers suggest that. I think the issue is whether the rate of expansion of the economy is going to be anywhere near what we consider to be optimal. It seems to me that the projections the staff had given us are, I think, not unrealistic, and they are well below the rate any of us would describe as the optimum rate of expansion for the economy next year. It seems to me this is the issue we ought to be concerned about in formulating the policy for the next period.

CHAIRMAN BURNS. I think you are entirely right. It's so difficult for us. I don't attach very much importance ordinarily to rhetoric, but if there ever was a time when good rhetoric would have an effect on business and consumer psychology and propel the economy upward, I think this is the time. My own guess is that good rhetoric will be forthcoming. It is a guess, and the good rhetoric will be accompanied, I think, in due course by rather constructive action. That, too, is a guess.

So it's so difficult. You take our staff forecast--these poor fellows, they struggle to do what they can. They know nothing about the budget, they know nothing about other policies. They are very honest in keeping score on themselves, and on the basis of data now available, I think that our staff projection is a very respectable one. One that certainly deserves respect. I'm more optimistic than the staff, but the uncertainties are peculiarly great right now. And if the outlook were no better than in our staff projection, the future would look very, very grim to me. Mr. Coldwell.

MR. COLDWELL. Mr. Chairman, I'm not [unintelligible] pessimistic about our economy, and I agree with you that declaring a recession now is way too premature. I am very concerned, however, about the state of confidence, and I'm afraid we may get a couple of additional shocks. One which I keep saying--and I haven't found anybody that agrees with me yet, but I will continue to say--is that I am wandering around this country and believe that we are getting Christmas sales very early this year. We may get a severe shock in terms of the rate of sales when Christmas gets here.

CHAIRMAN BURNS. You're more pessimistic about sales than Mr. Lilly.

MR. COLDWELL. Perhaps so, but I keep wandering around, going into stores to see if I can buy Christmas presents for myself, and I find Christmas sales going on at a pretty good clip, and yet I don't see a major movement in the sales. And if we are really borrowing from the Christmas sales level, we may find ourselves greatly disappointed.

CHAIRMAN BURNS. But, you know, our statistics on retail sales are scandalously poor. Exaggeration, Lyle?

MR. GRAMLEY. No, not at all. The only thing [worse] that I know are the inventories.

CHAIRMAN BURNS. Look what you get. You get weekly figures, and then you get--what do you call it--the advance, and then you get something called preliminary, then something called, very much in quotation marks, final, and they keep on jumping around. You don't quite know where you are, and by this time our government ought to have vastly better statistics on retail sales. Would you agree with that, Chuck?

MR. PARTEE. Yes, and I would remind you that the program was beefed up a few years ago. Quite a lot of money was spent on it--four or five years [ago] or so, I don't remember quite when that occurred. It is a very hard thing to measure, with new stores opening--

MR. COLDWELL. Well, for whatever reason, I still think we have a problem with that. I think the uncertainty that I feel in talking to people around the country not only relates to this but also to no real incentive to expand purchasing. On the capital spending side, in talking to businessmen, I find they are still quite hesitant about it and [have] no real push behind it and they are still looking at an interest rate level which they consider to be quite high for commitments in the long run.

On the employment side of it, I also feel [that] is an area of potential shock. Just a very random piece of information--even some of the banking openings are not very plentiful right now. I'm talking about the lower level, not [about] the people sitting around this table. I find some people out in the streets, which surprises me a little bit in the banking field. And I wonder if, not only this, but the potential of our foreign banking problems, might constitute some difficulty for us in the next few months. All in all, this is a kind of psychological problem I think we face and one which needs some [unintelligible].

CHAIRMAN BURNS. I think the hour has come for somebody to speak of, not shocks, but of pleasant surprises. Can someone affect the gloom Mr. Coldwell has passed over us, over this meeting, at least over my own life in the past minute? Mr. Wallich, he has volunteered for the purpose; make it good, now.

MR. WALLICH. Mr. Chairman, this isn't going to relieve your gloom, I fear, but that of some people--which seems to be the increasing probability of a tax cut of some kind. More and more, the newspapers are full of not only political but economists' statements pointing in that direction, and I think one has to begin making one's forecast, to begin to think what kind of a tax cut this might be. I would very much hope that it would be something that is at least in part oriented toward investment, not all oriented toward consumption. I hope it would be something short-lived. I think it would have some negative confidence elements, but on balance I would think it would be expansionary if it isn't made permanent. If it's made permanent, I think the confidence element would become more serious. Well, this cannot be in our projections here, obviously, but I do suggest that it's not an unrealistic expectation.

CHAIRMAN BURNS. In that connection, have you ever given a lot of thought to that, and--well, maybe I live in a strange world, or my thoughts dwell in isolation, possibly--when I hear of proposals concerning a tax rebate, I just scratch my head. What does it mean? It means that our government, which is heavily in debt, will now go out and borrow more--$10 billion, $15 billion, figures like that are being thrown around--and then a check will be written to each one of a certain category we've talked about, poor, or poorer, people, and how do you build?

And if this is the best that we can think of as a way of building the strength of our economy, then I'm going to join the gloomy fellows, and I'll become gloomier than Phil Coldwell, really.

If you want to build the economic strength of our country, there are ways of doing it. Now one of the very best ways of doing it, one that I think recognizes the need to avoid social conflict, one that also recognizes the limitations of our economic knowledge, is the technique that was used by President Kennedy and by the Congress. Kennedy proposed in 1962 some refinements that became law in 1964, but what kind of tax reduction was it? It was a tax reduction that applied across the board for individuals and that applied to corporations as well as to individuals, and therefore a tax reduction that met two basic criteria--there are others, but it met two: minimization of social conflict and, second, recognition that, well, we don't quite know [what would be best]--we have [only] theories, we have ideas, [about what] is the most advantageous way of stimulating--and therefore, you see, the bets were being hedged with this across-the-board tax reduction, individuals and corporations. I thought that was a stroke of political genius at the time, and there was a tax cut that proved--I think "proved" may be too strong a word--in my judgment, it worked extremely well.

A rebate, it's like an aspirin pill to my mind [unintelligible], just a little bit, and what you want through a tax bill, if this is conceived of as a measure to stimulate the economy, you want to change peoples' minds about themselves and about the future. And how you can do that with a rebate, I don't know--even if the rebate applied to everyone, you see, rather than being concentrated at one end of the income scale. But maybe I have a 19th century mind and don't understand the world we live in. But I do think, really, that better counsel will prevail, and I'm quite optimistic about that. Mr. Winn.

MR. WINN. I'd just like to pick up Steve Gardner's point, which I certainly share. I think this uncertainty is going to disappear in a way that will be constructive before the trees come into blossom in Washington in the spring. And again, we have our old cliché, perhaps maybe we are worried too much about it at this point--we have nothing to fear but fear itself. And, indeed, when we discover a little more about the philosophy of a new government, we will find that business confidence will have a resurgence that will make our present projections look very conservative.

CHAIRMAN BURNS. Anyone else like to speak? Mr. Guffey, please.

MR. GUFFEY. You were looking for optimism, Mr. Chairman.

CHAIRMAN BURNS. No, no I wasn't. I was a moment ago; now perhaps it's time to become a little more pessimistic.

MR. GUFFEY. Well, I'd like to report that, in the Tenth District, retail sales are holding up quite well, and as a matter of fact, looking toward the Christmas season, retailers are anticipating a very good season. But to also, I guess, endorse what President Mayo and Governor Gardner just said, it seems to me--and you will excuse me for not relying upon figures, because I am not a trained economist--it shouldn't be surprising that businessmen and even consumers are in a period of uncertainty. And it seems to me fairly certain, also, that, without regard to what the final outcome when the new Administration [unintelligible], it may be that businessmen are going to accommodate those, and this inactivity is going to burst out. And whether the timing is by the blooming season in Washington, I don't know. But I think it's fairly quickly into the year 1977.

CHAIRMAN BURNS. You know, if I may join Mr. Coldwell in the interest of balance, I feel as he does about an increase in the price of oil at the present time. The world has not yet adjusted, not by a long shot, to the quadrupling in the price of oil that occurred toward the end of 1973 and the subsequent increase in 1975. I feel very strongly about that and had some quiet--I don't know how quiet--something to say about that in the recent testimony as one of the major uncertainties facing our country [and], for that matter, the world economy, at the present time. And if that can be prevented--I think it can be prevented--I think all of us will have very good cause to feel much more cheerful about the economy. And on the other hand, if it goes into effect, then I think that the words of gloom that have been heard around this table might well be intensified.

Anyone else like to speak before we break for luncheon? Very well, we'll do that now, and we'll be back, let's say--what is your preference, 2:15? It's 1:15 now, 2:15 or 2:30? Let's have a show of hands for 2:30. A show of hands for 2:15. 2:15 is agreeable.

[Lunch recess]

CHAIRMAN BURNS. Gentlemen, we should be resuming our deliberation, and let us give the floor now to Mr. Sternlight.

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

CHAIRMAN BURNS. Thank you, Mr. Sternlight, any new questions?

MR. EASTBURN. Peter, what would be the market reaction to a 1/4 percentage point cut in the discount rate?

MR. STERNLIGHT. I think it would be fairly moderate. There's been talk of a possibility of a discount rate cut. It was a little more active a few weeks ago. It is dampened down in the last couple of weeks as the market perceived stronger aggregates. But I think it would be a fairly moderate reaction at this point, even so.

MR. PARTEE. A 1/2 point would come as a great surprise.

MR. STERNLIGHT. I think a 1/2 point would be rather a surprise, and that would generate a sizable reaction, yes.

MR. BLACK. What would be the nature of the reaction?

MR. STERNLIGHT. Well, I think it depends on what accompaniment of open market operations there were at the same time. If we were still around the 5 percent funds rate, I think the 1/4 percentage point--unless the market perceived that we're going to be edging down from 5 percent funds--that would be a rather mild reaction, with bill rates not moving any more [than], perhaps not as much as, that 1/4 percentage point, and lesser rate moves in the longer end of the [curve]. If there were any accompanying lower federal funds rate atmosphere, depending on just how much lower and over and what time path, whether it could be a little more reaction on the discount rate--

MR. BLACK. Suppose you did lower the federal funds rate and simply announce the discount rate changes as a realignment of the discount rate to minimize the [unintelligible] effects.

MR. STERNLIGHT. Well I think it could be a fairly moderate reaction, and perhaps if the funds rate were down 1/8 to 1/4 below the 5 percent, and the discount rate came down 1/4 percentage point with accompanying announcements of technical realignment, then the market rate might be at the short end in the same order of 1/4 percentage point, perhaps.

MR. BLACK. What I was really getting at, I guess, was Chairman Burns's remark earlier today about the good rhetoric.

CHAIRMAN BURNS. All right, any other questions for Mr. Sternlight? Well, thank you Mr. Sternlight. We will now hear from Mr. Axilrod, who also will be brief.

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

CHAIRMAN BURNS. Thank you, Mr. Axilrod, any questions? Well, you've been so lucid, Mr. Axilrod, there's no need for questioning. We're ready to turn now to our monetary policy discussions. We hope that, as we go around the table, members of the Committee would address themselves, among other things, to the question whether our economy is now short of liquidity and what economic gain, if any, members of the Committee would or might expect from some easing in credit conditions. I hope also that the Bank Presidents would express their view on the desirability of a reduction in the discount rate.

I would like to say just a few words, not about the discount rate but about what I think is the basic question: Is our economy short of liquidity? I don't see it really. The banks are hungry for customers, and savings banks, particularly savings and loan associations, have enormous inflows of funds. I doubt, really, if the easing of the monetary conditions would have any significant influence on the behavior of the economy at the present time. However, I do think that, in view of the economic information that has come our way and that we expressed at this table, some easing is presently indicated. But I also think that the easing should be slight. And I say that for several reasons.

First of all, the very high rate of growth of the monetary aggregates in October has been noticed, and while it appears that the November figures will show moderation, the exceptionally high numbers in October are still in the minds of many people who watch statistics on the money supply. [Also] I think that the easing, if any, should be slight in view of the very large increases in price indexes that have recently been published--though the interpretation of these indexes leaves something to be desired. [And] I think the easing should be slight in view of the possibility that the discount rate may be adjusted downward. Finally, I feel that the easing should be only slight because there is a widespread view around the country among businesspeople, financial people, that the Federal Reserve more than ever is the main bulwark against inflation and that the basic monetary policy received by the Federal Reserve has served our country well and should be continued.

Now as for specific numbers, to give you something to shoot at, I lean toward alternative B with some modifications--some slight modifications: M1 range as designated; M2 shaded down slightly to 9 to 13; and the federal funds rate at 4-1/2 to 5-1/4, the midpoint being 4-7/8--the intention being to move down to the midpoint this week unless the figures that appear on Thursday show extraordinary growth in monetary aggregates, which seems rather unlikely from the preliminary indications that we have.

Now as I say, these are suggestions for the Committee to shoot at, to oppose one way or another or possibly to endorse. Who might speak first? Mr. Kimbrel, Mr. Guffey, Mr. Morris, Mr. Black, Mr. Mayo, Mr. MacLaury, Mr. Wallich, Mr. Partee, Mr. Winn, Mr. Coldwell, Mr. Jackson, Mr. Williams, Mr. Baughman, Mr. Volcker, Mr. Gardner. [Mr.] Volcker will definitely be last. Mr. Gardner will speak whenever he wants to. Mr. Kimbrel please.

MR. KIMBREL. Mr. Chairman, I think [there is] not much more to be added because I'm prepared to accept almost literally just what you concluded. I think there is adequate liquidity, I see no indication of any lack of liquidity in the system, so I do not foresee the need for easing for that reason. I remain considerably concerned, as do our directors, about inflationary expectations. I would also hope that consideration of the discount rate could be favorable, maybe of 1/4 point, and I say that mainly because of the announcement effect that might have with the market. Obviously, it isn't being used a great deal, but I think it might have some favorable influence from the announcement.

As for the numbers you assigned to alternative B, I am prepared to accept all of them. I guess I feel very strongly, though, that if we could, I would hope we could operate almost [always] in the range of 4-3/4 to 5 percent. During this period, I would be reluctant to see the rate come below [4]-3/4 and I most assuredly would not like to see the rate going up. I am prepared to accept the numbers you assigned there. I would hope actually it would be somewhat more constrained.

CHAIRMAN BURNS. Thank you very much, Mr. Kimbrel. Mr. Guffey.

MR. GUFFEY. Well, I would share that feeling [about] moving to 4-7/8 and fairly quickly--what we tried to do a month ago and were not successful. It seems to me that the case is as good now as it was then. The only question about the numbers that you propose, Mr. Chairman, with respect to M2--if we're going to give equal weight to the two of them [M1 and M2] as we have in the past, I would just as soon adopt the numbers [for M2] in alternative B, which are 9-1/2 to 13-1/2, in view of the staff's projections.

With respect to liquidity, everything that we see would indicate that liquidity is very good and that most of the financing that's going on in the business community is out of cash flows, which indicates that liquidity is there. With respect to easing credit, I wouldn't think it would have a great deal of effect at the moment to go only to 4-7/8, and it seems to me that the public needs sort of a stroke or boost, which this might provide. And with respect to the discount rate, it would be that additional kick, coupling the two together. It seems it does very little damage in terms of the aggregate growth rates as projected by the Board's staff, and I think it may be vitally important.

CHAIRMAN BURNS. Thank you, Mr. Guffey. Mr. Morris, may we hear from you?

MR. MORRIS. Mr. Chairman, with respect to the three points you asked us to comment on--this issue of shortage of liquidity, I think you really have to say, "compared to what?" I think, certainly, the economy is more liquid than it was a year ago, but if you ask about the state of liquidity relative to where it has been in corresponding periods of the business cycle, earlier business expansions, I think you would find that the answer to the question is that the economy is less liquid than it has been in corresponding periods of expansion. Certainly this is true of the corporate sector, [which] is nowhere near as liquid as it was in the earlier economic expansions.

CHAIRMAN BURNS. Of course, you've had a secular trend there that complicates interpretations.

MR. MORRIS. Yes, I know that it has a secular trend, but I think, nonetheless, if you would ask the question, is the corporate sector more or less liquid than it was in corresponding states of business expansions, you would have to say--

CHAIRMAN BURNS. All that I mean to say is, that's a very fair question, but you have to interpret it, I think, in the light of the secular trend. Now, whether your statement will still be correct, I don't know. You're probably right; I'm just not sure.

MR. MORRIS. The other dimension of it is that if you think of liquidity in terms of the availability of money, I think quite clearly money is available, but here again, money is available at substantially higher interest rates than was the case in corresponding phases of business expansion. I think it's particularly important for the housing market. That is, mortgage money is available, but it's available at rates considerably higher than we have encountered in other periods when housing was expanding.

CHAIRMAN BURNS. You say that about the real rate of interest?

MR. MORRIS. Well, no but I don't think the real rate of interest is particularly important to the individual buying a home. I don't think he thinks in terms of real interest. I think he thinks in terms of the amount of the monthly payment relative to his salary. And I think that the increase in interest rates we have seen over the past five years has required, say, the young adult buying a home for the first time--

CHAIRMAN BURNS. I not only agree with that, but I'm making a speech on Thursday, and I'll make a great deal of this very point.

MR. MORRIS. He has to pay a higher percentage of his income than we did when we bought our homes. Would it make a difference if we moved to a different policy? I think yes. I think it would certainly be helpful to the securities markets; I think it would be moderately helpful to the stock market as well as the bond market. And to the extent that it would promote a trend toward lower mortgage rates, I think that would be helpful.

On the discount rate, I think we ought to move. I've been restraining my board from moving, but I think that the time has come. I think in moving, though, I would recommend that we move a 1/2 rather than a 1/4. That is, if we move a 1/2, that would only bring the discount rate down to where the federal funds rate is at present.

I am pleased that you propose that we do move to a somewhat more expansionary policy, but I think I would move a little further than you suggest, Mr. Chairman. I would propose a 4-1/2 to 5 range on the funds rate, instructing the Manager to move to 4-3/4. This is a marginal difference, but I think the evidence is persuasive enough to me that we need to move more than 1/8. And therefore I'd like the specifications of alternative A better. It seems to me, for us to be publishing specifications showing a range [with a lower bound] as little as 2-1/2 percent on M1 in this context bothers me a bit. I'd rather see the range on M1 be 4 to 8.

And it seems to me in this context that we ought to give more weight, at least temporarily, to M1. Because I think it's pretty clear to me that if you have to ask yourself which series, M1 or M2, is more descriptive of what appears to be going on in the real economy, I think that you'd have to argue that M1 should be given, in this context, more weight than we normally would give it. That's all I have to say.

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

MR. BLACK. Mr. Chairman, when the aggregates spurted in October, I think it was quite wise to resist overreacting by pushing up the federal funds rate. Now that we see the aggregates are likely to come in less rapidly than they have been, I was hoping that you would show similar precaution, not overreacting to the downdrift in M1. Regardless of what happened to M1, I think your time and savings deposits are going to continue to grow pretty fast. Thrift institution deposits are going to grow, with the interest rate relationship [being] what it is, and I think this means that there's going to be a continuous amount of liquidity added to the economy, and I believe that the liquidity level is very adequate [unintelligible].

I feel that the economy is a little stronger than the staff thinks, but I must confess that I have growing doubts about my position on that, whereas I think that liquidity is adequate. I think Governor Coldwell made a very important point: Most businessmen think interest rates are too high in order to commit on plant and equipment [unintelligible]. So I'd like to see us move gradually downward a little bit. I emphasize that word "gradual." I ordinarily favor an aggregate directive; at this time, I am leaning toward a money market directive. And I would set a ceiling of 5 percent on that. I just don't think we should dare move above 5 percent; the risk's on the other side. I would put 4-3/4 on that and go down to 4-7/8, like you suggested.

Having done that, I think the stage would then be set for perhaps a 1/4 percentage point decrease in the discount rate. I think this is a good chance for some of us to use some of that rhetoric you talked about. If the [Federal Reserve] Board thinks it wise, I'd hope you would consider what you might do on reserve requirements, expressing that this is not really a change in policy but a structural change, the same way we would change the discount rate to bring it in line. Because I think part of the lack of confidence we must not [forget] stems from fears of inflation. If they think we've thrown in the towel [with] this little easing now, actually it could be counterproductive.

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

MR. MAYO. Mr. Chairman, I'm prepared to accept a repetition of our range at this time on federal funds for a 4-1/2 to 5-1/4. I feel strongly about the 5-1/4. I do not want to see a 5-1/2; I think it gives the wrong impression all the way along. I could be talked into a 4-1/4 on the low range as against a 4-1/2, but I think my preference is the 4-1/2. It gives a feeling of stability, and yet, the midpoint being 4-7/8, I think this is something that we can gradually work toward. It would give a little feeling of ease to go along with what I agree, too, should be perhaps a 1/4 point change in the discount rate. I wouldn't go as far as Frank. I, too, have resisted movement within my board to lower the discount rate. It's been quite a vocal and articulate response, interestingly enough, by the bank members [of my board], not by the nonbank members. I don't know how you would explain that to the chairman of the House Banking Committee. But I find that this is the way the sentiment runs.

CHAIRMAN BURNS. That's the nice thing about our country. We don't all think alike. Everyone does his own thinking in his own way.

MR. MAYO. I have already indicated to our board of directors that my recommendation is still firmly in favor of keeping the discount rate where it is, but I'm not guaranteeing that there would be no change in that recommendation as we look to the next full board meeting, which would be a week from tomorrow.

On the M1 and M2, however, I guess I split a little here. I think I prefer the 3 to 7 [for M1] and the 10 to 14 [for M2] as the points to watch on our ranges for November-December. I share some of Frank's problem with the 2-1/2 [lower bound for M1growth] looking awful [skimpy], and I haven't that much confidence in the figures. I'd rather just round them, and I'd round up rather than down in both cases.

CHAIRMAN BURNS. Thank you, Mr. Mayo. Mr. MacLaury now.

MR. MACLAURY. Thank you, Mr. Chairman. I find myself in virtually total agreement with the specifications you gave and the reasoning for those specifications. On the discount rate, I would certainly favor, at this point, a 1/4 point reduction. I realize that there are a number of interpretations that one could give to a discount rate reduction. But I would see it as a modest stimulus to confidence, and it seems to me that's [what] we are talking about at the moment, trying to find ways in which we can bolster confidence [so] that the future will be less bleak than the staff projections or others are predicting.

And in that context, I guess, given Mr. Gardner's comment about my wishy-washiness on my earlier intervention, I ought to say that I share Bob Black's feeling, and yours, I guess, Mr. Chairman, that the staff projections are too low. That doesn't mean that I'm far above them, but it indeed says that if I were at a 5-1/2 percent kind of real GNP rate for '77, then you'd still argue that that's too low given the circumstances. So it does not trouble me at all to see us indulge in a mild easing at the moment, and that's I guess how I'd interpret your specifications.

CHAIRMAN BURNS. Thank you, Mr. MacLaury. Mr. Wallich now.

MR. WALLICH. As I look at the liquidity, Mr. Chairman, first, I share Frank Morris's feelings that, in technical terms, using the usual measurements of liquidity applying to the working capital, liquid assets, debt/equity and so forth, we are not in a very liquid condition. We've made some improvement, but it's small improvement compared to long-term deterioration. Liquidity at the present time exists in the sense of plenty of funds around--could very well be the result of slack business rather than a cause of better business. That is always a possibility. So the fact that there are seemingly idle funds around does not suggest to me necessarily that these funds are going to go to work.

As for the gains from easing, I think that they're probably not likely to be that great. There's even a danger at this time. To start easing late in an expansion--after all, it's a year and a half, now, into this--could get us to the point where, if this took and really were effective, it could cause us to hit the capacity ceiling a year or two from now with too much speed. We made that mistake before.

Well, saying all this, I come out for a slight easing. I'm not too much concerned by the longer-term interest consequences of something like alternative A--that we would have to raise rates substantially later on. Aside from the fact that we can change the one-year target, I think base drift alone, if it occurs, would take care of this and not necessarily drive us into higher interest rates. So I would recommend a 3 to 7 on M1; 9-1/2 to 13-1/2 on M2; and 4-1/4 to 5-1/4 on the funds rate, bearing in mind that I think we are slipping into a dangerous habit if we narrow the funds rate. We've put ourselves into a box, and I'd like to keep us at least at a 1 percentage point [range for the funds rate]

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

MR. PARTEE. Well, Mr. Chairman, I agree to a very considerable extent with Governor Wallich. I don't know whether there's enough liquidity or not, and the statistics seem to show considerable improvement, but the economy is not performing well. And so, in terms of defining what we want in the economy, why, I think we could use some more liquidity. The idea used to be expressed as "you can't push on a string," but I don't think we are in that soggy a situation. And I think that liquidity would improve borrowing and lending attitudes. One positive effect of some increase in liquidity would be the downward pressure on short-term interest rates. Lower short-term interest rates, it seems to me, would present institutional managers, particularly the banks and thrifts, with the portfolio problem of deciding whether to continue to put their funds disproportionately into very liquid assets at a possibly negative carry or whether to push more aggressively to make longer-term loans and investments.

CHAIRMAN BURNS. This is where they have been now for a while, but you mean it would intensify them?

MR. PARTEE. This would intensify them. Their third alternative is to reduce the inflows of funds by cutting rates off on savings. Some, I think, would go in every direction. But at least some institutions would move more aggressively and try to make long-term loans and investments and thereby communicate some easing in the long-term markets, some downward pressure in the long-term rates.

Now, as far as the aggregates are concerned, I'm not terribly concerned about that October number on M1 because I do think now that we have to look at September and October combined. And if we look at that combined, if we look at the year to date, the expansion rates don't seem excessive to me. But in any event, if we choose an aggregates directive, which I think we definitely want to do, we protect ourselves against the possibility that the aggregates will go up quite strongly in November and December. Because if they do, we'll move the funds rate, we'll be up at the top end of the range--and maybe above the top end of the range, and perhaps it will be a reason for an additional instruction to the Manager if the aggregates do grow strongly.

Now, I'm more inclined to think that the aggregates are going to grow quite weakly in November and December because of the state of the economy. But then, that could be wrong too. If they do, however, grow weakly, then having the aggregates target would mean that we would be moving down in the funds rate and perhaps again have a special meeting. So I think it's an important time to have the directive stated in terms of the aggregates simply because of our total state of ignorance of what is going to be shown in the aggregates performance in this and the next couple of months.

Well, I would support alternative A, but I would support it with the variations that Governor Wallich suggested. That is, I think we could cut the M2 growth rate a little bit, and then--I think you said we'd cut it a 1/2 percentage point on each end, didn't you, Henry?

MR. WALLICH. That's right, up to 3 to 7 percent.

MR. PARTEE. I'm speaking of M2.

MR. WALLICH. Oh, M2, 9-1/2 to 13-1/2.

MR. PARTEE. I think I would buy that, and I think I would also buy the 4-1/4 to 5-1/4 funds rate range, which means that the midpoint is 4-3/4, and it would presume a move to 4-3/4 unless the aggregates were performing quite unusually, quite abnormally high or low. We would move, say within a week or so, to 4-3/4, so that would be my view. And I won't say anything about the discount rate.

CHAIRMAN BURNS. Thank you, Mr. Partee. Mr. Gardner now.

MR. GARDNER. Well, in hopes that I can conform to what I said earlier, I would support some easing, as you've suggested, Mr. Chairman--modest, responsible easing--because I'm convinced that developments will unfold in this period and give us further indications of what the real underlying situation is. I feel a little like somebody with a surgeon's scalpel attempting to treat a patient with hives--mysteries of the formulae compounded by the staff are still new to me. Nevertheless, I don't want to overlook the fact that, while November aggregates may indeed bring the October burst into better perspective, we did, in fact, have a very substantial growth in October--very substantial, much more than I've seen since I've been on this [Committee].

Well, the aggregates, even with a modest November, appear to be growing satisfactorily for this stage of the economic cycle that we find ourselves in. And in short, I would support a modest easing. Governor Partee picked alternative A and modified it, when I thought, really, Governor Wallich modified B. I therefore end up a little more comfortable with 3 to 7, 9-1/2 to

13-1/2, and I don't want to go down to 4 percent on the funds rate. I think that's prejudging far too early. [Unintelligible] so I would stay with the 4-1/2 to 5-1/4.

[GAP IN TRANSCRIPT]

MR. WINN. I found the Greenbook this time terribly depressing reading. It seems to me that we have to show some concern in that area, whether you accept it or not. I would be interested to know whether we have run the projections on the basis of the high end and the low end of the aggregates to see what difference it made in the outcome, in contrast with the median figure we used for our monetary estimate, because I feel flying blind is [not] knowing what the implications would be.

CHAIRMAN BURNS. Well, I found out, but the question as to blindness or good vision still remain open. Mr. Gramley, since--

MR. GRAMLEY. We make our estimates taking the aggregate growth of the midpoint at the longer-term range. I have presented, on various occasions, estimates of the impact of moving from one end of the range to the other. We did not do that at the time of the last long-term projection meeting because my feeling is that, given the uncertainties about what's happening to velocity and what's likely to happen to it in the future, and given the effects that traditionally are associated with 1 percentage point more or less money growth, that we're not giving the Committee information that's particularly valuable. That is, the uncertainties are sufficiently large that these tiny differences in GNP growth that we get adding 1 percentage point more money growth, 1 percentage point less, are insignificant.

MR. WINN. Mr. Chairman, [unintelligible] I think my feeling would be to associate myself with alternative A modified to the funds rate of 4-1/4 to 5-1/4 as an indication of concern over the current outlook. The second is, by changing the rate, hopefully we'll change some of what I consider some of the sticky market rates and get the effect both in the short-term area and in the long-term area, which I think would be conducive at this time.

I think my preference would be to take advantage of an easing situation to move the reserve requirements because I think we're going to be faced more and more with [Federal Reserve System] membership problems as [banks] look at their earnings. On the other hand, a change in the discount rate would have a psychological [unintelligible]. Rather than complicating the Desk management problems in a series of changes, I would be in favor of the 4-1/4 to 5-1/4 [for the federal funds rate] and a move down [in] the discount rate.

CHAIRMAN BURNS. Thank you, Mr. Winn. Mr. Coldwell please.

MR. COLDWELL. Mr. Chairman, I've been accused of being a harbinger of gloom today already, a couple of times, but I really think that our economic prospects have dimmed over the last couple of months. And whether we accept the staff projection or not, the unemployment levels predicted in those projections are unacceptable, gentlemen. I think the only question that I face here is a question of stimulus. Do we stimulate this economy in fiscal or monetary [ways] or both? I have a great reservation about leaving all stimulus to the fiscal side of life. If we're going to hold monetary policy and leave it to Congress to stimulate this economy, I think we'll come out much worse than if we attempt to do some ourselves. I think the policy can provide a little bit of help in easing rates.

As a consequence, that's where I come out. I would prefer to see the federal funds rate of 4-1/4 to 5, and I would stop at 5, because I think we are at 5, and I would prefer that we not go down to the midpoint of that range--that it be asymmetrical, as we've done before--go down to 4-3/4 and then look and see. But I would not prefer to have an upper [limit] over the 5 unless we reconsidered the matter. On the monetary growth rates, there's been a suggestion of 3 to 7 [for M1]; I would hope that we would not go down as low as 3. I would prefer to put a bottom of 4 on it, but I suspect I'm going to be in the minority here. But nevertheless, I would prefer a 4 to 8 range. As far as the other matters of policy on discount and reserve requirements, I will not comment at the moment.

CHAIRMAN BURNS. Thank you, Mr. Coldwell. Mr. Jackson please.

MR. JACKSON. I share Governor Coldwell's feeling about the economy and particularly the unemployment rate. At the same time, while [the unemployment rate] may be unacceptable, I think the real question is, what are you going to do about it, if [there is] anything you can do about it? To that extent, it's my conclusion that there's a relatively limited amount that monetary policy can do about it. There may be only slightly different action that fiscal policy can take, and I'm inclined to believe that there are limits as to what fiscal policy can do about it. To that extent, I think that our action in this country in that particular area lies in fields as yet untried, in the area of structural changes to which we've been addressing ourselves in various speeches and so forth. And until the country does address itself to some of these structural changes, we will continue to be frustrated in our conclusions. And the consequences may be counterproductive rather than effective.

Nonetheless, having said that, I do feel that in the general environment in which our country is operating today, that some ease in nominal rates of interest are appropriate. I really wonder whether lower interest rates necessarily will produce the more expansive growth in monetary aggregates, particularly over the short run, that we're discussing today. At the same time, I'm inclined to think that if we only ease 1/8, it will not be sufficiently [evident] to the general public to accomplish the goals that we're really trying to [accomplish]. It's my judgment that, to a significant degree, these are cosmetic rather than substantial, and properly so--only cosmetic.

To that extent, I would be more inclined to have a federal funds rate of 4-1/4 to 5, or 4-1/2 to 5-1/4. I'd be inclined toward 4-1/2 to 5-1/4 with an asymmetrical 4-3/4 [midpoint] rate, but I think these are mechanics. The main thing is, I'd like to see us go to 4-3/4. [For M1 and M2], I would be inclined to use [alternative A]--3 to 7 for M1 and 10 to 14 for M2. It appears that the staff's projections--and we're a quarter of the way into the two-month projections--lead us to believe that we'll have about a 12 percent rate of growth in M2, anyway, and it strikes me that the portion of the market where M2 rates of growth are so sensitive are the places where we do continue to need an assurance of liquidity, if I can put it that way--the housing market being one of them.

I share Governor Partee's feeling that we may be getting close to the place where managers, particularly in the thrift institutions and savings departments of commercial banks, may be having a reassessment of what they can continue to pay and at what rates they may reinvest their funds in order to stay in business. It strikes me that if we view the housing market as being one of the basic strengths, a significant reduction in interest rates on long-term home mortgages, and by that I mean 1/4 or a 1/2 point, as a result of continued liquidity that thrift industries [unintelligible], would be a method of sustaining that demand. I don't think it would help the multifamily side of that market at all. I think it takes something substantially more than that, and, in fact, the inflationary trend in construction probably will outrun even any change in interest rates that are likely to take place, so I don't see much change in that.

But it strikes me that, if we're hanging onto two things right now as being signs of strength, namely housing and hopefully final consumer demand, these two areas strike me as being a good place where we might have some genuine impact from a monetary policy point of view. And to that extent I would be inclined to [put] M2 [at] the 10 to 14 range.

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

MR. WILLIAMS. We would favor a 1/2 percentage point reduction in the discount rate. This could probably be done in two steps of 1/4 each. We think this would give a better alignment with the federal funds rate, and it would also give a lift to business expectations. We would also support a slight easing of policy. We think that this can be done under the established or the existing ranges rather than changing the ranges. We would favor alternative B, although we could support alternative B as modified by Chairman Burns.

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

MR. BAUGHMAN. Mr. Chairman, I can find quite acceptable your suggestions on modified alternative B. I'm a little uncomfortable with a 2-1/2 on the bottom side of M1. And so far as the fed funds rate is concerned, I guess I'd be a little more inclined toward 4-1/4 to 5-1/4 than the 4-1/2 to 5-1/4. With respect to the directive, I would endorse Governor Partee's very appropriate arguments in favor of an aggregates directive. It seems to me that that applies to most circumstances, but I'd agree that it applies particularly well at the present time.

I would agree also with those who indicated that they would welcome seeing some change in reserve requirements. With respect to the discount rate, I would argue as strongly as I can that we make a change of 1/2 [point] at the present time. I think 1/2 is justified for a number of reasons. I think it's superior to 1/4 on the grounds that a change of 1/4 now probably would need to be followed by another change of 1/4 before very long, and I think two such changes coming in sequence would tend to carry more of a suggestion to the public that the economy was continuing to weaken. For five weeks now, the average of the three-month bill, the three-month CD, and the three- to six-month finance paper rates have been more than 50 points above the discount rate.

MR. PARTEE. Below.

MR. BAUGHMAN. Below the discount rate. And it seems to me that the rationale for changing the discount rate should be aligning it with the market. And it seems to me that that rationale cannot be used unequivocally if the change is only 1/4 point at the present time. Another observation I would toss in, I would qualify it before doing it as possibly not being very significant. We've had 19 banks make arrangements for seasonal borrowings this year. Fourteen of them have borrowed, but as the differential between the market rates and discount rate has widened, the numbers dropped off. We have three [banks] borrowing at the present time. Now, of course, that's not the only reason, and probably not even the preponderant reason, for the change in the number of these little country banks that have been borrowing, although information available to us from surveys indicates that there is a pretty strong demand for credit out in the country down there. So, as I say, I would argue as vigorously as I can that we move the [discount] rate 1/2 point. Thank you.

CHAIRMAN BURNS. All right, thank you, Mr. Baughman. Mr. Lilly now, please.

MR. LILLY. Well, there's been a lot of conversation here, and some of the remarks [indicate] that businessmen think the rate structure is too high. I agree with that, and the reason that I do is that, in the short-term rates, it's part of the cost of the product, and it's too high. It's related to cost of sales, and if it came down, it certainly would have some impact on pricing the product. The long-term rate is related to capital investment. The lower that long-term rate is, the more likelihood there is of a surge of capital investment. So, on that kind of a basis, I would like to see the funds rate at 4-3/4. How you get there, I don't know. I kind of liked Phil Coldwell's 4-1/4 to 5, and I concur in Henry's and Chuck's M1 and M2 numbers.

CHAIRMAN BURNS. Thank you, Mr. Lilly. Now, Mr. Volcker has, well, he's preempted the last place.

MR. ROOS. Second from last.

MR. EASTBURN. Third from last.

CHAIRMAN BURNS. Mr. Volcker has preempted the last place, and therefore that place is reserved for him. And the question is, who else would like to speak now? Mr. Eastburn and then Mr. Roos and then anyone else who wants to speak again, because Mr. Volcker definitely speaks last. Mr. Eastburn.

MR. EASTBURN. Well, Governor Partee has expressed my views. I think the economy needs some stimulation and that monetary policy ought to play a role in that. I find it difficult to accept the idea that there isn't [anything] that monetary policy can do. We don't have a liquidity trap operating in the economy at the present time, and I think some modest easing is in order. I would prefer alternative A as far as the aggregates are concerned, and I would prefer a funds rate of 4-1/4 to 5-1/4 administered on the asymmetrical downside. And I would like to see the discount rate cut [unintelligible].

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

MR. ROOS. Mr. Chairman, if one of our purposes is to throw out signals and to affect sentiment, I think it's terribly important that we do not adopt a posture of very recognizable ease. Regardless of what we do, I think the primary attention of the economic community will be on what the incoming Administration is going to do. I think the confidence of the business community basically will depend on the determination--should the incoming Administration move toward ease--[of] the willingness or a demonstration of the fact that the Federal Reserve is going to stick by its guns. For us to feel that there would be a constructive reaction to a recognizable easing by this [Committee], I think, is misjudging the ball game. I think that if we were to signal something that amounts to significant ease, it would destroy confidence and would be a deterrent to positive activity on the part of the business community.

Structurally, I think that alternative A is less than acceptable if we believe in our long-range targets, because if we do accelerate the growth of M1 over the next two quarters, and if we're going to stick within our target range, it's going to mean a substantial deceleration of M1 growth in the second and third quarters of next year. And a corresponding rise in the fed funds rate--if we take this action today, if we do go the [alternative A] route, I think we could at least say to ourselves that we will be prepared to bite the bullet in the middle of next year to correct this course. I wonder whether we're really prepared to do that.

CHAIRMAN BURNS. Thank you, Mr. Roos. Does anyone want to speak before Mr. Volcker? You won't [have] another chance after Mr. Volcker. A promise is a promise. I made Mr. Volcker a promise. There are a few things that I could ever do for Mr. Volcker or, for that matter, for anyone else. It's within my power now to make him the last speaker. I've given him that promise. I must deliver on it.

VICE CHAIRMAN VOLCKER. I'd rather trade being the last speaker for some other things you gave me.

CHAIRMAN BURNS. Mr. Partee.

MR. PARTEE. Well, I just want to say, in response to President Roos's last comment, that I think he's referring to the fact that alternative A, given the long-term ranges that we have adopted, implies a firming later next year. And I would just want to point out that that presumes that the staff projection of nominal GNP growth is correct. If, in fact, the staff projection of nominal GNP growth was too high and it came in lower, you wouldn't have as much money growth and there wouldn't necessarily need to be a tightening--so, that sort of a construct in the way the Bluebook is put together. If that staff projection comes out right, and if we should hold [for] four quarters to the ranges that we adopted in the telephone meeting, then you would need to tighten some, later on in the period. But only under those conditions.

MR. JACKSON. Conversely, if they are low, we'd tighten earlier.

MR. PARTEE. Yeah, sure.

CHAIRMAN BURNS. For the sake of symmetry only, if the staff projection is too low--

MR. PARTEE. Then we would be faced with the issue sooner.

CHAIRMAN BURNS. Sooner and on a larger scale; and/or on a larger scale.

MR. WALLICH. Provided there's no base drift.

CHAIRMAN BURNS. Gentlemen, we are ready for Mr. Volcker.

SPEAKER(?). Do you wish to stand up?

VICE CHAIRMAN VOLCKER. So I could pronounce the benediction, maybe I should. The advantage of coming last, of course, is that everything you agree with has already been said, but a few things you may not agree with have been said too, so you're still forced to say something.

One way or another, we've all been talking about how we can sustain a more satisfactory pace of economic expansion next year. And I would just say, as a preliminary to the comment on monetary policy, that [as] I look at the situation, and following some of the analysis that Governors Partee and Wallich had earlier, the case becomes stronger for some fiscal action in terms of weaknesses and personal income and declines in savings rates and feedback effects we may be getting on the rest of the economy. I do [think] that case is growing [stronger], and I suspect we may get some [fiscal action]. I hope it's not of a rebate type, for the reasons you suggested, Mr. Chairman. I once testified that I thought it was a bad precedent when it was done by a Republican Administration before--this idea that you just give away the money without any relation [to] a tax burden itself. It doesn't seem to me to be very helpful.

But in that context, we have the question of monetary policy at the moment and how these two fit together. And partly for the reasons that Mr. Roos has just described and that you described earlier, I think, it should be a measured move and not a feeling that we are now embarking on a rather aggressive course of ease. And I quantify that, in my mind, anyway, that through open market operations, I wouldn't want to see the federal funds rate pushed down by something like 1/2 percentage point, prospectively, over this next month, based upon what I know now. I don't particularly want to see it pushed down 1/4 percentage point right away. On the other side of it, I share the view of those who don't want to see it go above 5 percent, either. I think that would give entirely the wrong signal at the moment.

On the particular questions that you asked about liquidity, I don't think there is any certain answer. Frank Morris has spoken my piece about that. I think, really, it's all relative to what you want. The kind of action that I would talk about isn't going to produce any very substantial change in liquidity anyway. But I think what we are looking for is a little encouragement for long-term financing and a little encouragement perhaps to [get] some of the longer-term rates down a bit to help the investment and housing side of the economy. And that point has already been made.

I end up on the open market side of the thing--right about where you began all this, Mr. Chairman, with the focus on the federal funds rate--contrary, I guess, to what some other people have said. What I don't quite understand is why we emphasize the aggregates at this particular time, a point I want to pick up in a second. It seems to me this is a time when we are particularly sensitive to what the federal funds rate is doing, and I came in with the kind of spread that you suggested, of 4-1/2 to 5-1/4. I don't really want to use the upper quarter of that, but I would move to 4-7/8, and pretty promptly here, based upon what we know now. I really don't want to go down to 4-1/2 either, as I suggested earlier. So I'm symmetrical in the sense of not wanting to use either side of the range, but get a little easing pretty promptly.

So far as the aggregates ranges are concerned, I should point out I don't attach any great weight to any of these estimates, but the New York Bank estimates for some reason are substantially lower this time than the Board estimates, which are already, at least in M1, fairly low. Partly that seems to be for reasons--they don't believe the seasonal, and they think we may be entering a period where, without reflecting any basic weakness, we may be running into some fairly low M1 figures and M2 figures relative to what we've been having--and really significantly lower than the Board's projection. Well, I don't know what importance to attribute to that, except it lends a little weight to Mr. Partee's feeling. They may come in on the low side rather than the high side. It is a reason why, consistent with my feelings about interest rates, I'd like the [alternative] B specification; and I thought the M2 one was a little high, as you did, Mr. Chairman, relative to our longer-term objectives. I was prepared to suggest even a percentage point lower there. You suggested a 1/2 percentage point lower. I'm perfectly content with that. I do get a bit frightened as to the public reaction in terms of our general posture if we begin publishing 10 to 14 percent figures after the rate of growth that we have had there.

One of the objects of the strategy we ought to have now--and this is where the discount rate comes in--is to, in a sense, [jawbone] institutions. I'm not sure they're right on the edge--as much on the edge as I would like to see them--but I think there is some possibility of getting a reduction in the administered deposit rates here. And a discount rate change could help in that connection by putting our own feelings in the matter a little bit more out in the open. I think the time has come for a change in the discount rate. I even find the arguments rather persuasive for going 1/2 on technical and other grounds, if, in fact, the open market policy was as moderate as I am suggesting. If we gave a much louder signal to open market operations, as some people have suggested, I guess I would want to mute the signal on the discount rate. And I think the other combination might be a little more helpful--not really go overboard on the open market operations but bring the discount rate more into line with where the federal funds rate is in fact.

It seems to me a more logical combination of moves, but I still find myself with a somewhat open mind about whether that should be 1/4 or 1/2. But in any case, the effort here, and I think the major contribution we can make, is providing a little incentive to get some of these interest rates down without really drastically changing our policy and without arousing fears that we are going overboard with increasing the liquidity of the economy against the prospect of a possible tax decrease shortly following. I think there is some real danger of overdoing it, in fact, and maybe more so psychologically in terms of the balance of concern about inflation and expansion.

CHAIRMAN BURNS. Well, thank you, Mr. Volcker. I think we've had a very interesting discussion. The main conclusion I've developed from this discussion is that the differences that have been expressed within and by members of this Committee are preponderantly very small indeed, so there is a substantial degree of unanimity on the part of the Committee. And all that we have to do now is refine these numbers slightly, recognizing that very little sanctity attaches to any of these numbers.

Now, the thinking of the Committee, as I read it, is as follows with regard to our numerical specifications. There is a slight preference for a range of 3 to 7 for M1, over against 2-1/2 to 6-1/2; there's more dispersion with regard to M2--very few would want to go above 13-1/2, and some want to go below 13-1/2. I therefore, on balance, think 9-1/2 to 13-1/2 is perhaps fairly representative [for M2]. With regard to the federal funds rate, there is a margin in favor of the 4-1/2 to 5-1/4 percent range as over against 4-1/4 to 5-1/4.

Now that's my reading of the views that have been expressed by the Committee. If any members of the Committee have changed their minds because of what they've heard from their colleagues, you might advise me of that at this time. In the absence of that, I think we should vote on the following specification: the 3 to 7 percent for M1; 9-1/2 to 13-1/2 for M2; and 4-1/2 to 5-1/4 for the federal funds rate.

MR. PARTEE. That last rate, the midpoint would be 4-7/8, is it, rather than being skewed?

CHAIRMAN BURNS. Well, that is--we could discuss that--

MR. BLACK. Mr. Chairman, what would you read as the consensus on where we would move the federal funds rate, say, in the next week--4-7/8?

CHAIRMAN BURNS. Well, I would say yes, that is to say, the only thing to hold it up would be--well we don't want to move immediately after the meeting. Now, on Thursday our figures will be in, and unless the figures are outside the range very high, I think the Desk definitely would want to move toward 4-7/8 on Friday. Whether they actually get there or not, I think that's something we ought to leave to the Desk. If you don't get there on Friday, you ought get there next Monday.

MR. PARTEE. I have expressed the preference for 4-1/4 to 5-1/4. I would be prepared to buy 4-1/2 to 5-1/4, but if so, I'd like to have it understood that the midpoint is 4-3/4. That is, that we move in a timely way down to 4-3/4 and then look for further reductions from that point. So in that sense, I would shift it.

CHAIRMAN BURNS. Let's have a show of hands on that.

SPEAKER(?). That's a 4-3/4 midpoint.

CHAIRMAN BURNS. Well, we'll call it a midpoint. We put quotation marks around it and we will have a show of hands on 4-3/4 versus 4-7/8. That is the midpoint--they're in quotation marks. Those who prefer 4-3/4 will kindly raise their hands.

MR. BROIDA. Seven.

CHAIRMAN BURNS. Well, that's the way we'll do it. That is to say, we still have to vote on it. Let me repeat what we will be voting on.

MR. STERNLIGHT. Mr. Chairman, could I ask on that whether, in going for a 4-3/4 target within this range, we contemplate the similar timing--

CHAIRMAN BURNS. No, you would want to do it more gradually.

MR. PARTEE. 4-7/8 Friday, maybe, and then 4-3/4 midweek of next week--something like that.

[LAUGHTER]

CHAIRMAN BURNS. Well, that isn't very gradual. I think the way to do it gradually is to do [the first] one within a week, and the other within two weeks. So if you do it by Friday, let's say by the following week--

VICE CHAIRMAN VOLCKER. My question about this whole thing, Mr. Chairman, would be, obviously there's very little difference in these ranges, whether you move them up or down 1/2 percentage point on paper. But I am looking at at least one set of projections that says we're going to come straight in under the low point anyway, as it is. Now, I don't know what the reliability of these projections are, but what happens--

CHAIRMAN BURNS. Yes, you do. You know it's low. The hour is late Paul.

VICE CHAIRMAN VOLCKER. Do you go to 4-1/2, is what I'm asking, under those conditions? Fairly readily, that's a--

CHAIRMAN BURNS. We have to live by rules or we have a communication, an interchange, by telegram or otherwise, between meetings. If you're saying that you would be uncomfortable going down to 4-1/2, so would I. But I would think this is--the rule now, we could now choose another limit, and--well, there are circumstances you know, with regard to the economy that might clearly make it undesirable to go as low as 4-1/2 so promptly, if the figures do come in low. That's the rule we operate under, and this is not the time to change the rule.

Should I specify what we'll be voting on? All right, M1, 3 to 7 percent range; M2, 9-1/2 to 13-1/2 percent; and the federal funds rate, 4-1/2 to 5-1/4, with the understanding that 4-3/4 will be interpreted as the midpoint in quotation marks.

MR. PARTEE. And which directive?

CHAIRMAN BURNS. Yes, we still have to decide that, and let's have a show of hands. Those who would prefer a monetary aggregates directive will kindly raise their hands.

MR. BROIDA. Six.

CHAIRMAN BURNS. Those who would prefer a money market directive?

MR. BROIDA. Five.

CHAIRMAN BURNS. Well, I will join the monetary aggregates group. Now, and the language, well, the language, yes. The staff has given us no choice of language in the monetary aggregates directive. Well, I think we're ready to vote. Any further comment?

MR. JACKSON. I gather we'll have the revised version of our testimony on the new [monetary aggregate ranges]; that the Committee will discuss it?

CHAIRMAN BURNS. Well, no, we really ought not to. We're not ready for that.

MR. PARTEE. This would say moderate monetary growth.

MR. JACKSON. This is the old-style version, Chuck.

CHAIRMAN BURNS. Still, we're not going to change any rules this meeting. However, I assure you, we'll change it at the next meeting, and I'll have a word to say about that presently. Would you be good enough to call the roll.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
President Black	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
President Guffey	Yes
Governor Jackson	Yes
President Kimbrel	Yes
Governor Lilly	Yes
Governor Partee	Yes
Governor Wallich	Yes
President Winn	Yes

Unanimous.

CHAIRMAN BURNS. All right, now, item 7 on the agenda, we will not take up today. The date of the next meeting is Tuesday, but I think we need a little more time, and I would suggest that we make personal plans for a late afternoon meeting on the Monday preceding the Tuesday meeting. Then we'll take up item 7 and a few other matters--a foreign currency directive--and there's much more we'll be ready for at that time. Thank you very much for the meeting, gentlemen. Have a good week.

END OF MEETING