TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

January 17-18, 1977

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.

Content last modified 01/11/2011.

Meeting of Federal Open Market Committee

January 17-18, 1977

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 Monday and Tuesday, January 17-18, 1977, beginning at 4:00 p.m. on Monday.

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

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

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

Mr. Broida, Secretary
Mr. Altmann,1/ Deputy Secretary
Mr. Bernard,1/ Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist (Domestic Finance)
Mr. Gramley,2/ Economist (Domestic Business)

1/ Attended Tuesday session only.
2/ Attended part of Tuesday session only.

Messrs. Brandt,1/ Davis,1/ Keran,1/ Kichline,1/ Parthemos,1/ Reynolds,3/ and Zeisel,1/ Associate Economists

Mr. Holmes, Manager System Open Market Account
Mr. Pardee,3/ Deputy Manager for Foreign Operations
Mr. Sternlight,1/ Deputy Manager for Domestic Operations

Messrs. Coyne, Guenther,4/ and Keir,1/ Assistants to the Board of Governors
Mr. Gemmill,1/ Adviser, Division of International Finance, Board of Governors
Mr. Truman,4/ Associate Adviser, Division of International Finance, Board of Governors
Mrs. Farar,1/ Economist, Open Market Secretariat, Board of Governors
Mrs. Deck,1/ Staff Assistant, Open Market Secretariat, Board of Governors

Mr. Van Nice,First Vice President, Federal Reserve Bank of Minneapolis
Messrs. Balbach,1/ Doll,1/ Eisenmenger,1/ and Scheld,1/ Senior Vice Presidents, Federal Reserve Banks of St. Louis, Kansas City, Boston, and Chicago, respectively
Messrs. Burns 1/ and Kaminow,1/ Vice Presidents, Federal Reserve Banks of Dallas and Philadelphia, respectively
Mr. Hall,1/ Assistant Vice President, Federal Reserve Bank of Cleveland
Mr. Duprey,1/ Economic Adviser, Federal Reserve Bank of Minneapolis
Mr. Ozog,1/ Manager, Acceptances and Securities Department, Federal Reserve Bank of New York

1/ Attended Tuesday session only.
2/ Attended part of Tuesday session only.
3/ Attended part of Monday session and all of Tuesday session.
4/ Attended part of Monday session only.

Transcript of Federal Open Market Committee Meeting of
January 17-18, 1977

[Executive session]

CHAIRMAN BURNS. Gentlemen, this meeting will now come to order, please. There are several items that I thought would be best taken up in executive session. And one of them is the agreement concluded by the central bankers in Basel concerning the establishment of a facility for handling official sterling balances. The agreement has been distributed to the members of the Committee. I hope you've all had an opportunity to review it. I'll call on Governor Wallich to summarize the essentials of this agreement in a few sentences. And then we will discuss it, and at the end of our discussion, I hope that someone will be good enough to move ratification of the agreement. Mr. Wallich, please.

MR. WALLICH. The purpose of the agreement--which exists in principle, and its main components remain to be finalized in a few details--is to reduce official sterling balances. These have been a disturbing element due to their volatility. The agreement provides that the BIS [Bank for International Settlements] will finance the Bank of England to the extent that these balances are reduced, except by bond funding and to the extent that the British reserves simultaneously go down. The details are to be worked out. If the BIS cannot fully carry through that financing, it has a fallback with respect to the participating central banks.

Now, the Bank of England is committed to use its best efforts to reduce official sterling balances to working balances. First, by a funding operation offering some of the major holders of official balances 5- to 10- year bonds, 75 percent of which, at a maximum, would be in dollars, the rest in nondollar and nonsterling currencies. Second, whatever is left of the total balances after this operation, [the goal would be] to bring that down to the level of working balances. The detail of that is not described, but it could consist of various administrative measures. Broadly speaking, we're talking about something like £2 billion sterling, or $3.4 billion [equivalent]; maybe half a billion pounds of that could be funded. Maybe something like £1 billion might remain as working balances, and the other half billion would have to worked off over time.

This is to be done in cooperation with and under the supervision of the Managing Director of the IMF [International Monetary Fund]. The Managing Director of the IMF will confer with the U.K. jointly with the governors of the participating central banks to observe the progress made. Should it turn out that progress is not satisfactory during the two years during which the stand-by agreement is in effect, or if the U.K. should become ineligible to draw under the IMF's stand-by during these two years, then the facility can be suspended. In that case, also, the amounts already drawn will be required to be repaid within 120 days unless the agreement is reconstituted. These are the principle parts of the agreement. Do you want me to go into the Treasury side of this?

CHAIRMAN BURNS. No, not at this point. We want to deal solely with the agreement drawn up at Basel by the central banks. Thank you, Mr. Wallich. Mr. Holmes, you worked hard on this--would you like to add any comment?

MR. HOLMES. I won't go into any details, but at the Basel meeting preceding the most recent one, a group of experts was set up that met in Paris on December 20 and 22, then again in Basel last Sunday. We started out with why there is disagreement, and ended up in the meeting last Saturday to agree on what we couldn't agree on and to give that to the governors to decide on. And we ended up with a very short document, rather than the usual lengthy report of experts, which I hope was useful to the governors.

More importantly, though, with the bilateral discussions between the United States and the U.K., which were very intense--we met twice in London and once here and at great length to really work out to see if we couldn't narrow our own range of disagreement. And a lot of it was--it was a hard road, a tough road, but it was all done in a cordial sense. And that's all I need to say Mr. Chairman. Except that I would like to point out, I'm not sure Governor Wallich emphasized that the [IMF] Managing Director will be acting in a personal role in this, with the approval of the Managing Board and informing them of what he does. But with no role of the Managing Board of the IMF in making decisions.

CHAIRMAN BURNS. Thank you, Mr. Holmes. The only additional comment that I would make is that the present expectation--and it's an eminently reasonable expectation--is that the BIS will be able to meet any funds that the British may wish to acquire because of a rundown in the sterling balances. All the BIS has to do is enter the market and bid for deposits and make those funds available to the Bank of England. And therefore, the chances are that we at no point over the next two years will have to put up one penny. But, of course, it's a contingent liability, and we must be entirely clear on that. But the present expectation is that the BIS will be able to meet whatever credit needs Britain may have under this agreement, and the BIS will not find it necessary to call on us or on the other central banks that are parties to this undertaking. All right, are there any questions?

MR. PARTEE. Mr. Chairman, a clarification--our loan would be to the BIS rather than to the Bank of England, in case we're called upon?

CHAIRMAN BURNS. In case we're called upon, well, Henry would you answer that?

MR. WALLICH. That is correct. However, the BIS is obligated to repay only to the extent that it is being repaid by the Bank of England, except for its own small 4 percent share.

MR. JACKSON. It doesn't [unintelligible].

MR. WALLICH. Yes.

CHAIRMAN BURNS. Which means, in effect, we'd be lending to the Bank of England.

MR. PARTEE. We would lend at our discount rate? Or our bill rate, or what? What would be the interest rate?

MR. WALLICH. Well, the first question is how the BIS establishes its rate with respect to the Bank of England. Then we would normally lend at the Treasury bill rate for swaps. If, for some reason, that's inappropriate because it would give the BIS, for instance, too large a margin, I'm sure we could adjust that.

MR. HOLMES. It would come under our regular swap agreement with the BIS.

MR. PARTEE. Which is ordinarily at the bill rate?

MR. HOLMES. At the bill rate.

MR. MAYO. But there will be a uniform rate from the BIS to the British.

MR. WALLICH. Yes.

CHAIRMAN BURNS. The rate may vary over time, depending on three-month--

MR. MAYO. I was thinking about the countries.

CHAIRMAN BURNS. Well, the other countries don't enter into the picture until the BIS has to draw on other countries. And as I said, that is really not at all likely to occur. The BIS will enter the market and will borrow funds, or attract deposits at a certain rate of interest. And the BIS will charge the Bank of England the rate of interest that it has to pay plus a certain commission, which may be 1/4 of 1 percent, maybe a little higher.

MR. MAYO. I see.

CHAIRMAN BURNS. Any other questions? Well, if there is no other question, would someone be good enough to move ratification of this agreement.

SPEAKER(?). So moved.

CHAIRMAN BURNS. Motion has been made. Any objection. I hear none, and let us pass now to an internal agreement, that is, a separate agreement that we at the Federal Reserve have with the U.S. Treasury. And that agreement is written out in a letter from Secretary Simon to me, dated January 14, 1977, along with my reply to the Secretary as of the same date. And this agreement is very simple, really. It's unequivocal. If the BIS draws on us, we could extend credit for up to a period of one year. And if the loan has to be extended, then the Treasury will take us out and assume that loan at the end of one year. Henry would you want to add to that description?

MR. WALLICH. Well, I don't think there's much to add. What we are doing is protecting ourselves as a central bank to make sure that this remains a short-term operation. We have a clear take-out.

CHAIRMAN BURNS. In this regard, you may recall the provision that we had for a take-out under an agreement with the Treasury--back in 1968, was it? Well, there was an obligation assumed by the Treasury in that year. And that undertaking by the Treasury has been subject to interpretation and misinterpretation; there were elements of ambiguity. [This] is an unconditional arrangement. Mr. Volcker.

VICE CHAIRMAN VOLCKER. There is one aspect of this that I just feel I ought to comment on because as a matter of form it concerns me. In form, we have a take-out here after a year, but since the risk-sharing arrangement in the third indented paragraph here extends beyond a year, in substance we're left with the risks of the credit and, therefore, in substance to credit beyond a year.

MR. PARTEE. For half of this.

VICE CHAIRMAN VOLCKER. For half of it, that's right. For half of it.

CHAIRMAN BURNS. Well, I think that's true, but let's be clear about the risk. The risk is the Bank of England declares itself bankrupt, and I think that risk is a minimal risk.

VICE CHAIRMAN VOLCKER. No, I think the risk is minimal--I would think the risk existed whether or not they were bankrupt. The loan may not stand for more than a year at the exchange rate--no, there's no exchange rate risk here.

CHAIRMAN BURNS. No exchange rate risk whatever.

VICE CHAIRMAN VOLCKER. No, that's right. That's right. No, I agree, the risk is very remote.

CHAIRMAN BURNS. There would be a loss on this loan only if the Bank of England goes bankrupt.

VICE CHAIRMAN VOLCKER. That is correct.

MR. PARTEE. Or repudiates its debt.

VICE CHAIRMAN VOLCKER. Correct.

CHAIRMAN BURNS. Or repudiates its debt without going bankrupt. After all, that's been done by Communist countries.

VICE CHAIRMAN VOLCKER. I think this contingency is extremely remote. I have no doubt at all in my mind about that. But in form, the obligation really is for more than a year. I don't think we can kid it. I mean, I would have wished that the Treasury would have just taken over the thing at the end of the year in view of this very minimal risk, and it would have been much cleaner and reserved our one year as being much more--

CHAIRMAN BURNS. The Treasury wanted this paragraph since the agreement otherwise was entirely unconditional. And since I regarded the risk as minimal--and if the Bank of England repudiates its debt, then I think we'll be living in a very different world from any that you or I have known--I saw no reason to quarrel with the Treasury, since I had other quarrels on more important matters that were already resolved satisfactorily.

VICE CHAIRMAN VOLCKER. Well, the risk is certainly minimal, and I don't want to suggest anything else, but as a precedent for the future and in form, I'm just a little unhappy about that particular aspect of it. I will desist, but I just wanted to record some unhappiness over that aspect of it.

CHAIRMAN BURNS. Well, I'm very glad that you've become--that you've thrown off your old Treasury garments completely, since you no longer even remember that no matter how this last paragraph is written, if there is a loss, well that's going to come out of the U.S. Treasury.

VICE CHAIRMAN VOLCKER. That is correct, too. Put on my old clothes, and I would have been in the Treasury arguing that we should have taken all this risk after a year. I think it's entirely appropriate that they would have done so.

CHAIRMAN BURNS. Are there any questions about this side agreement with the U.S. Treasury.

MR. COLDWELL. I move ratification, Mr. Chairman.

CHAIRMAN BURNS. A motion has been made to ratify the agreement with the Treasury. Are there any questions or expressions of dissent? I hear none.

And now I want to turn to the third item, which is a proposal for a warehousing agreement. And this is described in a letter from the Secretary of the Treasury, dated January 14, and a proposed reply under my signature dated January 17, which is today. And what the Treasury is suggesting is a warehousing arrangement for the Exchange Stabilization Fund of $1-1/2 billion, half of which would be available for a period of up to six months and the other half for a period of up to one year.

Now I don't know if members of the Committee have received a document prepared by Mr. Morton of our staff, which gives the history of our warehousing of foreign currencies in the U.S. Treasury. It was first authorized by this Committee in November 1963, and in September 1968, the warehousing authorization was fixed at $1 billion for, I believe, a period of up to one year. The present requested or recommended authorization is larger, up to $1-1/2 billion. However, the period on the average is shorter, half of it for a period of six months, and half for a period of 12 months.

Now, in discussion of this suggestion with Governor Lilly at the luncheon table, Governor Lilly raised the question about the period of agreement. And then, in the course of the discussion, it became clear that this Committee reviews its foreign currency directive, among others, annually in March, I believe. Therefore, any year in March, if there is some question about this warehousing arrangement, its extension into the future, any modification of it--that would be the time [for this Committee] to take it up, and that could then be negotiated with the Treasury in accordance with the wishes of the Committee. Would you like to add anything by way of explanation, Governor Wallich?

MR. WALLICH. I'm sorry, Mr. Chairman, I've been focusing on a problem which just came up and I didn't follow the discussion.

CHAIRMAN BURNS. Mr. Holmes, I hope you have followed the discussion. Would you like to add--

MR. LILLY. Mr. Chairman, I hope the record will have your comments written in.

CHAIRMAN BURNS. --would you wish to comment on it?

MR. HOLMES. No, it's quite obvious, Mr. Chairman, if we warehouse foreign exchange for the Treasury, that has a reserve impact. But we have no problems in offsetting that through domestic operations, and obviously this would be small compared to the normal swing in the Treasury balance. I think from the domestic side there is no problem, and we had no problem in warehousing before, so I have no problem all the way through.

MR. WALLICH. May I add something, Mr. Chairman? I think one has to be aware that this is not only an operation that has been performed before and, therefore, is not innovative. [But also,] it is not the kind of operation where the central bank makes a loan to the government, which typically gives concern. It is an operation performed under the foreign currency authorization, a purchase of currency, and in that respect, I think, does not carry the kind of connotation that a loan to the Treasury would.

CHAIRMAN BURNS. Well, as the first sentence in Mr. Morton's memorandum indicates, System warehousing of foreign currency involves simultaneous spot purchases and forward sales of foreign currency by the System with the U.S. Treasury.

MR. BLACK. These at identical rates? Spot purchases and forward sales at identical rates?

MR. PARDEE. Yes.

CHAIRMAN BURNS. Always at identical rates.

VICE CHAIRMAN VOLCKER. You involve the foreign currency in this case, though.

SPEAKER(?). What?

VICE CHAIRMAN VOLCKER. We [unintelligible] involve the foreign currency in this case.

CHAIRMAN BURNS. Why not?

VICE CHAIRMAN VOLCKER. It belongs to the BIS.

SPEAKER(?). No, no it doesn't.

CHAIRMAN BURNS. Forget entirely the--

MR. JACKSON. This is not linked to that [unintelligible].

CHAIRMAN BURNS. This is not linked as such with the Basel agreement. The Treasury may find that the Exchange Stabilization Fund [ESF] is short of money for a great period.

VICE CHAIRMAN VOLCKER. For other purposes, for any purpose?

CHAIRMAN BURNS. It may arise out of the new Basel agreement or any other purpose. And then the Treasury will turn to the Federal Reserve as its banker for short-term financing. I say "would"--may turn to us.

MR. LILLY. It's almost a repurchase agreement.

SPEAKER(?). Yes,

SPEAKER(?). It's what it is.

MR. PARDEE. It's using a different instrument.

MR. LILLY. It has the same effect.

MR. COLDWELL. Enlarges the assets by 50%.

MR. WALLICH. It's not even tied to the sterling as such, although that may be the main asset at a given time in the ESF, but if the ESF has other currencies--any currencies [on which] there is an authorization to purchase can be made the object of the transaction.

MR. COLDWELL. This would require, however, the Committee's authorization for purchase of this specific currency? In other words, it has to be a swap currency?

MR. WALLICH. Well, it has to be a swap currency for which a swap is authorized. Now, within the limits of the swap authorization, that is a do-able operation.

MR. COLDWELL. It would not be possible for the Portuguese whatever, then?

MR. WALLICH. No, not without a new authorization.

MR. PARTEE. It has to be a swap currency?

CHAIRMAN BURNS. Of course.

MR. PARTEE. The peso as such?

CHAIRMAN BURNS. To come under the law, it has to be a swap transaction, according to our lawyers. And as Mr. Broida points out to me in the projected letter that I would send to the Treasury, that projected letter says, "the Federal Reserve will be prepared, if requested by the Treasury, to warehouse eligible foreign--"

MR. PARTEE. Eligible.

CHAIRMAN BURNS. Any questions about this warehousing arrangement?

MR. BALLES. How is this made known to the public? Is this released?

CHAIRMAN BURNS. This has been considered. We reviewed the 1968 undertaking, and that was disclosed fully to the public. That would be our intention now, subject only to some conversations with the Treasury. If the Treasury has cogent reasons for not disclosing it, we would have to take them into account. Now, I believe, Governor Wallich, you have discussed this question with Mr. Yeo of the Treasury.

MR. WALLICH. I had a preliminary conversation with Sam Cross. Mr. Yeo is travelling. The view is that as a general principle, they would like to publish. However, they would first like to see the final text, and second they'd like to touch base with the appropriate members of the Congress before that is done.

CHAIRMAN BURNS. Well, I think that's clearly appropriate because the members of the Congress like to know about these things before they read about it in the newspapers. And that presents no difficulty from our viewpoint because--Mr. Broida, am I right in thinking--it has 30 days?

MR. BROIDA. We have 30 days to publish the explanation in the policy record. We could at any time earlier put the text of the letters on file downstairs, but it need not be done before 30 days.

CHAIRMAN BURNS. We could do that if the Treasury's made its clearing with the congressional--?

MR. BROIDA. We could do that immediately.

CHAIRMAN BURNS. Any other question about this arrangements?

MR. COLDWELL. Well, my only question is something which we've talked before, and that's the enlargement of the ESF divorced from the Basel agreement. But given the restudy of this, or specific re-analysis in March, then I'll subside.

CHAIRMAN BURNS. Well, I think we ought to be careful about one thing. I spoke about the March date, but if we enter into an agreement today, I think that this agreement ought to be good until March 1978. I don't think we could very well go back to the Treasury--not this March.

MR. COLDWELL. No, I meant March of next year.

MR. LILLY. That will be in a written record?

CHAIRMAN BURNS. It should be written-in that, in the normal course of events, as we consider our various directives, we'll take this up, among others. That should be reported to files.

MR. LILLY. Would you like a motion?

CHAIRMAN BURNS. Yes.

MR. LILLY. So moved.

CHAIRMAN BURNS. A motion has been made that this agreement be entered into. Is there an objection? I hear none, and therefore, I'm going to sign it now and dispatch it to the Treasury since they're very nervous over there. I hope they've got somebody in the mail room.

MR. COLDWELL. I wonder where it goes--

MR. GARDNER. Opinion has been expressed by expert members of this Board that this isn't a loan. I just want to say that I'm going to withhold any such determination. It is in effect a loan. Until I talk to, if necessary, to experts whether this is a loan or a purchase of foreign currencies that the Treasury--

MR. LILLY. I use "repurchase agreement," you don't criticize that.

MR. PARTEE. For 15 years we've been trying to--

CHAIRMAN BURNS. The only way I've ever understood the whole swap network is in the language of loans.

MR. BALLES. Mr. Chairman, I wonder if I could ask, in wrapping up on this subject, any overall evaluation you might have of the combination of the IMF and BIS facility to the U.K. in terms of the prospects of getting them out of their trouble. What the outlook is and how they got these two major new facilities?

CHAIRMAN BURNS. My apologies to you. My attention was diverted; it seems Mr. Wallich set a precedent. Would you be good enough to repeat your question?

MR. BALLES. I was simply asking if you would care to give us your evaluation of the prospects for the U.K. now that they have both the IMF and the BIS facility?

CHAIRMAN BURNS. Well now, look, they have the IMF loan [at] 3.9 [percent]; they have a commitment from us and the Treasury amounting in the aggregate to $500 [million], they can draw on that. They have a supplementary commitment for $300 million by the Bundesbank. They now have this standby sterling balance facility of $3 billion. What does all this mean? Well, it means that their ability to borrow is enormous. How the markets will respond, I don't know. Now, there's been no great upsurge in the value of the pound sterling in the foreign exchange market. However, the sterling has strengthened, and the British have taken in recent weeks some $800 million.

What are the prospects for Britain? If the figures that I have seen concerning revenues to be derived as a result of North Sea oil, [then] the balance of payments position of Britain starting next year should improve dramatically. Does that mean that the pound sterling will strengthen? It doesn't mean that at all because if Britain continues to inflate at a rate which exceeds the inflation rate of the rest of the world, the pound sterling will continue to depreciate in the foreign exchange markets.

Now, the British along with most of the rest of mankind see borrowing more as a solution to their problem. That is a solution that our politicians and our economists and even our businesspeople these days turn to when we consider our own domestic affairs, and the same is true around the world. In my judgment, Britain will not be able to restore its economy until its budget is brought under control, until the present confiscatory taxation is drastically modified, and until all the nonsense about nationalizing industry comes to an end. These changes, I don't believe, will take place in Britain, and therefore, I can't be very sanguine about the prospects of the British pound, which is very sad, and I hope I'm wrong.

MR. BALLES. Thank you.

CHAIRMAN BURNS. Well, if there are no further questions about these foreign items, we have to return to consideration of the Government in the Sunshine [bill]. A question has arisen whether the FOMC is or is not covered by the Government in the Sunshine legislation. As of today, I'm not prepared to make any recommendation to the Committee because certain conversations that are under way with members of the Congress interested in this legislation are as yet uncompleted. And I will not be able to make a recommendation until I've gone further in consulting with members of the Congress who are following the Government in the Sunshine Act closely.

Now, Mr. O'Connell will set forth the pros and cons as he now sees them. I hope the members of the Committee will listen very closely, and I shall want to get into the act at a certain stage, but I am not ready to make any recommendation because these conversations with congressmen, which bear critically on a decision, as I said, have not yet been conclusive. Mr. O'Connell, would you be good enough to proceed?

MR. O'CONNELL. Yes, Mr. Chairman. The issues to which I think attention should initially be addressed, Mr. Chairman, relate to the definition of "agency" as it's set forth in the statute [and] the question, Does the law apply to the Federal Open Market Committee?

In essence, the requirement of the law is that every agency as defined in title 5 of the United States Code, the Administrative Procedure Act, must, after a stated date--March 12 of the next year--conduct, with certain stated exemptions, all of its meetings in open session. The exemptions, I think, are to be considered only after a body has determined whether it meets the statutory definition of agency. Now, as the Committee knows, Mr. Chairman, [the FOMC] has for purposes of other statutes assumed historically the status of an agency. Thus, under the Administrative Procedure Act, the Federal Open Market Committee is an agency, and we have thus taken that position. Under the Freedom of Information Act, the FOMC is an agency. So the question would arise, Would it not thus be the same under the [Government in the] Sunshine Act?

Well, if I may, the term "agency" means any agency, as defined in the statute that I've identified, headed by a collegial body composed of two or more individual members, a majority of whom are appointed to such position by the President with the advice and consent of the Senate, and any subdivision thereof authorized to act on behalf of the agency. On the basis of a thorough study of this statute--of the legislative history, including the committee actions [and] committee reports from both the House and the Senate and [from] the conference committee that reported out this bill before its enactment into law, we have given a definitional judgment that the statute does not apply to the FOMC for the very simple reason that the definition of agency requires that the collegial members to whom reference is made be appointed to such position [by the President].

Now as the Committee is aware, this Committee is composed of the Board members and five Presidents of Reserve Banks. The members of the Board are appointed to the Board by the President with confirmation of the Senate. They are ex officio members of the FOMC. By that I mean they are members by statutory grant, not by direct appointment of the President. They are appointed to the Board and then statute makes members of the Board members of the FOMC. The issue of ex officio status was directly addressed by the sponsors of this bill, particularly Ms. Abzug, who was asked this question with respect to the National Security Council, the [Joint] Chiefs of Staff, and one or two other agencies. And after going through the same definition I've now discussed, she reached the decision, and stated as reported in the legislative history, that such members were not the collegial--appointed to such position--members called for in the statute, and thus such a group would not be an agency within the meaning of the statute.

The question arises, Well, what about the phrase "or subdivision of an agency, authorized to act on behalf of the agency?" I think, immediately and clearly, the Federal Open Market Committee is not a subdivision or subsidiary of the Board. Obviously, the Committee is composed of its membership with its statutory functions directly in the language of section 12(a) of the statute. It is not a derivative of the [Board] by statute, although its membership is partly composed of members of the Board. That issue was discussed in the legislative history, and Ms. Abzug, again, who was the sponsor of the bill, made clear that the fact she referred to what is a happenstance of law, that membership is identically composed, does not fit the meaning of this term. And that therefore, such happenstance does not constitute a mandate of coverage by the statute.

Mr. Chairman, the alternative, of course, is to assume this Committee had the question put to it [unintelligible] assume the status of a covered agency. I would raise [unintelligible] question as, not only to the desirability of such assumption, but of the ability of an administrative agency, as this Committee is for other purposes, and of the statute to assume coverage of a statute. One of the reasons I say this is that there are provisions in this bill that affect venue, jurisdiction, the right of courts of review, the methodology of review, the impact of timing on the agency to respond to suit, and even the right to bring suit on the part of a party. I don't know of the authority in a federal agency who has [unintelligible] question under an interpretation of the law to say as a matter of decisional act, let's apply the law to us with all of its benefits and with all of its adverse consequence.

For instance, normally, if this agency were sued without stint of [the] Sunshine [Act]--just a suit brought, for instance, for declaratory judgment--I think a court of law might properly ask, how much time would the agency have to respond? The answer would be 60 days. It's an agency of the federal government, and under title 28 of the code, it has 60 days to respond. How many days did you take here? We took 28 because of this law. Therefore, you, by pulling the law over your shoulders, you've deprived your agency of roughly 32 days' time to answer.

Who is your counsel? Well, the Department of Justice is our counsel. Did the Department concur that they were deprived of 32 days' time? No, they objected and said that we had 60 days. But since we assumed the status of an agency covered by this act, we were deprived of those 30 days. I raise this as an example of a jurisdictional "pullover." I question the right of an agency, be it this Committee or any other government agency, to deprive courts of other jurisdiction it might have, including appeal and other derivative procedural rights that are either granted or forbidden by the statute.

I bring this to your attention only in the decisional basis. It is my belief that there is good, strong, statutory language reference, as well as the legislative history, to support the position that this agency, as an agency, is not covered by Sunshine. I've given you an example of the trouble I would have with a voluntary assumption of that status. There are a number of practical reasons, that I won't at this time take the Committee's time to discuss, that I think argue strongly not to legally take the position that the statute covers this agency. Now I say the latter for the simple reason that, I must advise, there is legislative history that, [it] can be argued, supports the legal position that this Committee is covered by [the] Sunshine [Act].

When I say that, I mean there are exchanges on the floor of the House and on the floor of the Senate in the nature of colloquy. They are not contained in committee reports officially reported on the statute. They are colloquy exchanges in which one member of the House asks a series of questions, for instance of the sponsor of the bill, and in asking the question [will make] reference specifically [to] the FOMC. And Ms. Abzug, in replying, used the term "the FOMC," saying the FOMC would have no trouble, it could close all of those meetings. I am sure that these exemptions would cover the FOMC. So I bring to your attention my judgment that these discussions mark an assumed coverage of the FOMC status. [The colloquy exchanges] then answered other questions that [were] relevant to the inquiry then being made. In fairness, that's the reference I have to the fact that the legislative history does bear some suggestion of coverage, if you start with the assumed position that I have identified. On balance, I believe that the better position is that it is not covered and that there are good, salutary, functional reasons for following that position. And Mr. Chairman, these roughly are my comments on the background, and I'll go any length further that you wish.

CHAIRMAN BURNS. Thank you very much. I have unavoidably become involved in the study of this problem in extensive conversations concerning it. And I don't have a single reason to question anything Mr. O'Connell has stated. But I do think we have a congressional problem, one that I'm trying to test. I'm not using the word resolve, because I don't think the question is of a sort that can be resolved--but it can be tested, and it can serve as a guide to a rational decision by us.

What is the congressional problem? Well, it so happens that there are some members of the Congress, and particularly staff members, who are following the Sunshine legislation--what is being done under it--very closely, and who are concerned about any decision that we may make concerning the FOMC. Now if the conclusion were reached, by this or that influential congressman concerned with this legislation, that we're engaged in the circumvention of law, or that we're following the law strictly but that the law contains a loophole, then this or that interested congressman might propose an amendment to the Sunshine Act. And if that amendment is on the floor, an amendment designed simply to encompass the FOMC in the course of debate--as things happen in the Congress, we stand a chance of losing the two exemptions that we won last year and which make it really possible, at least as I see it, for the Federal Reserve System to function.

And therefore, I have begun a series of conversations with key members of the Congress. I saw Congressman Fascell, who is the author of this legislation, or if not quite that, the chief intellectual exponent of it, in the House of Representatives. He's friendly, and he has no desire as such to present an amendment. But I now have to see Senator Chiles, Senator Ribicoff, Congressman Brooks, and, on the Republican side of the House of Representatives, Mr. Horton. I don't anticipate any difficulty, except perhaps with Senator Chiles. Senator Chiles, I hope I'm being fair to him, was the author of this legislation on the Senate side. He felt very unhappy about the amendments that we achieved in the Congress last year. He felt very strongly about the legislation as it was passed by the Senate originally. He might be described, perhaps unfairly, as being the theologian on this issue.

If I succeed in persuading him that without coming formally under the Sunshine legislation we are not only adhering in full to the principles of the legislation, but going beyond it--I'll explain that in a moment--if I succeed in that mission, which I've set for myself with Senator Chiles, then I think Tom's recommendation is clearly the right one. If I fail, I'm not sure of a conclusion, but that is where my problems begin in making a recommendation to this Committee, and I'm not at [that] point.

Now, in this Committee we are living strictly, I think, within the spirit of the Sunshine legislation. The exemption under the Sunshine law, I think, would make it possible for us to close every meeting. The law as written requires that a verbatim transcript of every meeting be kept or that carefully prepared minutes be written out. Well, certainly our secretarial staff is discharging the latter function--preparation of minutes--in exemplary fashion. Not only that, but the law does not require publication of the minutes, and we do publish the minutes. Not only do we publish them, but we publish them as promptly as is technically feasible. That is, within a period of something like 30 days. Therefore, we not only are living within the spirit of the Sunshine law but going beyond it.

Now if a little speech like that will warm Senator Chiles's heart, and it's a factual statement, then I believe that we need not fear an amendment to the Sunshine law being proposed in the Congress. And we can adopt Mr. O'Connell's recommendation very comfortably. But as I stated, if Senator Chiles feels that here is a loophole in the legislation that must be closed, that he is going to propose an amendment--that raises a difficult political problem for us, a problem I've already stated. Namely, once an amendment comes to the floor, other amendments might be added; we might lose one or the other or both of the exemptions that we won last year after a most arduous battle in which all of you participated. And who knows, other burdensome amendments might be added. There is an element of hazard there. That's all I can say on the subject as of today.

MR. MAYO. Mr. Chairman.

CHAIRMAN BURNS. Yes.

MR. MAYO. If the Congress were to support the position that you've just outlined, isn't it still possible that suit can be filed by some people who aren't happy with that and take it to the courts? Or is that not a--

MR. O'CONNELL. May I address that, Mr. Chairman? It's a very good and realistic possibility that, at the time the Board of Governors issues its proposed regulations under Sunshine, which will be forthcoming within a very short period now to meet the March 1 deadline, that publication of those regulations and the absence of similar regulations on the part of this Committee could well draw an inquiry, then a demand, then a lawsuit, either to compel the issuance of regulations, as if this Committee were covered, or a suit to declare that the Committee is covered. Yes. And at a point in time the Chairman may perhaps wish to discuss a possible publication by this Committee of a document paralleling a regulation that would offset such a desire on the part of someone who would otherwise bring suit. Yes.

CHAIRMAN BURNS. The suit might still be brought.

MR. O'CONNELL. It could. Certainly, Mr. Chairman. Yes?

MR. GUFFEY. When does the statute require that the regulation be published by an agency?

MR. O'CONNELL. There has to be a publication within a framework of 30 days for comment, then a review of the comments and a simultaneous oversight review by the Administrative Conference of the United States under the terms of the statute. [Conforming], then, to a 30-day statutory comment period, a 10- to 15-day period for the staff to review those comments, review by the Administrative Conference--you're into a two-month period. That means, then, if the regulations must be in effect by March 12, [then] at or about mid-January to the 20th of January is about the terminal date for getting them into the public arena.

CHAIRMAN BURNS. Which means that, if the decision of the Committee should be to come under the legislation, that we might be a little late in doing so, and this possibility was discussed with Congressman Fascell, who saw no difficulty.

MR. GARDNER. If we did publish a regulation and presumed that we were subject, the regulation would be of a very modest nature, is that correct Tom?

MR. O'CONNELL. At present, that is correct. The draft that I've drawn to date is much more modest then you might otherwise assume.

MR. PARTEE. That's because of the exemptions? Is that what makes it modest? The two exemptions?

CHAIRMAN BURNS. No, no, the exemption is written into the Sunshine law. The basic exemption, that is, exemptions under which you can close meetings.

MR. PARTEE. Perhaps I didn't understand Governor Gardner's question. What do you mean "modest"?

MR. GARDNER. Well, if we were by some mischance to be subject to the Sunshine, our regulation concerning open and closed meetings would almost be entirely closed meeting.

CHAIRMAN BURNS. I would like to think that it would be entirely, rather than almost entirely, even if we decide that we come under this act.

MR. LILLY. But what would be the difference between being under Sunshine? You make the assumption you're under it vis à vis the way we're operating now. Forgetting all of those [unintelligible], what would be the basic difference?

CHAIRMAN BURNS. They are the legal questions, or possibly legal difficulties, that Tom will refer to, but I think we better go with that [assumption].

MR. LILLY. But those I don't--the ones that he listed in his opening remarks--

CHAIRMAN BURNS. Let Tom address them now, and then we'll return to your question.

MR. O'CONNELL. Addressing the question as I understand it, Governor, What would be the difference between being covered totally and technically under the law, and not being covered but adopting a position as though we were covered? Is that correct? The difference between these two positions?

MR. LILLY. That isn't my question.

MR. O'CONNELL. All right, sir.

MR. LILLY. My question is, is there some fundamental operating difference--like the release of the minutes. Assuming that we could close the meetings, either being under the law or not under it, which I gather, is the fundamental difference, then in the one case we can wait 30 days and in the other case we couldn't?

MR. O'CONNELL. Addressing specifically the issue of the minutes, if we are covered by the statute, the makeup of the minutes in some respects wouldn't be as full as they presently are in our Record of Policy Actions. In other [respects], the law requires, for instance, that you identify every document that is before the Committee by name and title. Not so with respect to the minutes we now use. Once identified and in the record of the minutes, they are subject, of course, to FOI [Freedom of Information Act] demand for production of those documents. That's one distinction, or difficulty.

Secondly, we believe that more-timely issuance of our Record of Policy Actions--30 days--might be accomplished than [for] the minutes under the statute. Under the statute, we probably could withhold publication of those minutes for much longer than 30 days--four months, five months--because of their still-sensitive nature. So, as it is presently, the minutes are so written as to not make specific disclosure of the name of the document, and we have no problem issuing in 30 days.

There are other procedural impositions of the statute, Governor, that would facilitate lawsuits demanding certain documentation and opening of previously closed minutes that we would not [be] subject to were we not covered by the statute. There is item after item that I could take you through, were we covered, that make more difficult, more burdensome, [our] operation under the statute than if we were not under the statute but, in our own way, almost fully comply with the spirit of that statute. Does that respond to your question?

MR. JACKSON. If we decide that we are not an agency covered by the statute, but do decide to publish as a public gesture the Committee rules of procedure, we are then not constrained as to time by the Administrative Procedures Act or the Sunshine Act, and therefore, we could publish our own voluntary and gratuitous disclosure any time prior to the effective date without having any time constraints otherwise. Is that correct?

MR. O'CONNELL. As I understand your inquiry, we can have up until the eve of March 12 to issue whatever form of statement we intended to issue with respect to our proposed practices, that's correct. Thus, we could await the Board [of Governors] action in publishing a finally adopted set of regulations in final form, which might, say, come out the week before March 12, to issue our FOMC statement at the same time.

CHAIRMAN BURNS. Gentlemen, let me just interrupt. I don't know why I was favored with this cup of coffee, but I was so favored, and therefore, if any of the rest of you would like coffee, you will not be so favored, but the coffee is right there. And let's take perhaps a short break, coffee break, if you so wish.

[Coffee break]

Gentlemen, the coffee break is at an end. We'll defer the question of the appeal until we've taken up on the Sunshine legislation, and then return to that. Well, I'm sorry, first, [about having] to bring Sunshine legislation back to the Committee; and second, [about] not being prepared to make a recommendation. I think we need to know more before we act. But any advice that you may have, any thoughts that you may have, would be very helpful at this time.

MR. BALLES. Could I ask a question, Mr. Chairman? Would you feel you are able to describe what the [Federal Reserve] Board is going to do with respect to the regulation on its own? The Sunshine Act--you're not prepared to do that yet?

CHAIRMAN BURNS. No, that's a very good question, and I've issued instructions to the staff, and the instruction has been--draw up a set of rules and procedures. And work with it hard--the procedures should be such that Sunshine will be neither audible nor visible at the Board table. Or it'll be audible and visible only to the absolute minimum. Now and then, members of the staff have reported their progress, and I've expressed dissatisfaction in [unintelligible] way because they were drawing up rules of a kind that I thought would involve the Board in too much discussion, too many rules. And the rule of being inaudible and invisible was not being [observed] scrupulously or meticulously enough.

Apart from these warnings that I've made repeatedly when I've heard about these rules, I don't know where they are now. Whether I, for one, am satisfied with them or not, I don't know. However, Tom O'Connell has worked on these rules, and perhaps you can indicate where they stand. This may or may not give me an opportunity to say that they are insufficiently inaudible.

MR. O'CONNELL. Under the circumstances, I should say we started with this and we're now about this [business]. That's about all I can say, Mr. Chairman. More directly, the Board has legal--

CHAIRMAN BURNS. But we have to live within the law. But, you know, there are ways of turning this into a grand ceremony or [instead] dealing with it in a way that satisfies the law [while] not obstructing Board business, in taking Board time, on minutiae of procedures.

MR. O'CONNELL. I trust that the document that is finally before the Board, subject to some continuing amendments to make more simple and less obtrusive the provisions of that regulation, will soon be considered by the Board. The regulations, I think I can say, President Eastburn, pretty well follow the exact mandated statute. What we've done is to put into regulatory form the substantive and procedural requirements of the statute as they apply particularly to the Board and its mode of meeting operation, providing for open meetings, closed meetings, and the parallel requirements of the preparation of transcripts of minutes, depending on the type of meeting that's closed; and otherwise providing for the procedural identified step of the advance requirement for notice of the meeting, the votes, and so forth. I hope that they closely adhere to the statute and that they don't go beyond that, thus following the mandate the Chairman has given in the adoption of them.

CHAIRMAN BURNS. You might indicate what kinds of meetings will be open to the public.

MR. O'CONNELL. At this time the regulations clearly contemplate that matters dealing with consumer affairs, by their nature, will be open to the public. Otherwise, the Board's regulations announce its intent to close such meetings as are allowed in the other 9, really 10, total 10 exemptions of the statute. It is contemplated that, on the whole, more meetings of the Board will be closed than will be open, although there are specific matters that, subject to approval or adoption by the Board, will be open to the public, the OSCA [Federal Reserve Board's Office of Saver and Community Affairs]-type meetings, being an example of them.

CHAIRMAN BURNS. I think the Bank Presidents would be especially interested in the question of whether matters that come before Mr. Coldwell's committee [the Federal Reserve Board's Committee on Federal Reserve Bank Activities, or BAC] involving Federal Reserve Banks in general [and] Reserve Bank budgets in particular would be handled in open or in closed session--could you address this range of thinking?

MR. O'CONNELL. I could, Mr. Chairman--taking the specifics, for instance, of a personnel action, within a Reserve Bank, that is normally presented to [the] Board [of Governors] for confirmation or approval. It is hoped that, by definition of the exemption for personnel matters, which is found in the statute, such discussions by the Board could be closed.

The issue of a Reserve Bank budget: There is no straight exemption for an agency's budget, or for a Reserve Bank budget, as would be the case here--[no provision] for closing such a meeting. However, depending on the nature of the item in the budget being discussed, for instance, if it involved or contemplated the acquisition of a building site, and so forth--items such as that, we believe, could [be covered] under one of the exemptions, such as section 9(b), [because] premature disclosure could place the agency at an operating disadvantage. We will look for such closure possibilities.

CHAIRMAN BURNS. Let me indicate this, too. If Federal Reserve Bank budgets were to be handled in an open meeting, then our public image, if nothing else, would require that we devote a good full day to consideration of those budgets. Otherwise, we're simply rubber stamping what a committee had done, and we're not doing our job.

MR. JACKSON. It is mostly likely that the [Bank Activities] Committee meeting would be open, too, under those circumstances.

CHAIRMAN BURNS. Now, I hope you would do more research on that question, because the Board does not have that much time. It's largely the [Bank Activities] Committee's job. The Board traditionally has not spent a day on the budget. Now maybe we should, but we don't have too much time. You know that this is a very hard-working Board.

MR. O'CONNELL. Well, Mr. Chairman, I believe that Governor Jackson's point was that if that particular budget examination were done by a committee of the Board, that if the Board were required to have an open session, so would the committee. I believe that was the point he was making.

CHAIRMAN BURNS. Well, then, maybe the [Bank Activities] Committee ought to be a smaller committee?

MR. O'CONNELL. It's possible. If it were, for instance, a one-man committee associated with staff of the agency, rather than three members of the Board, I believe that it escapes the definitional impact of the statute and would not be subject to the Sunshine Act.

CHAIRMAN BURNS. Suppose that we have a recommendation such as we had from the New York Bank, the Kansas City Bank, concerning new computers--now, would that have to come before the Board in open session?

MR. O'CONNELL. Mr. Chairman, the matter presently to the best of my understanding is delegated to the Bank Activities Committee for initial determination and a recommendation to this Board.

MR. COLDWELL. The final determination if it's within our limits?

MR. O'CONNELL. Final determination by the subcommittee within a certain dollar limit. If it came within that dollar limit, the decision could be made on delegated authority by the committee, [and] the committee would first have to ask, "Must this be open to the public?" It's the matter of the purchase of equipment. If there were nothing in that consideration, Mr. Chairman, the disclosure of which at that time would jeopardize the ability of the committee to direct and achieve a purchase within a given dollar amount, and it wouldn't adversely affect the competitive thrust of such proposal, it would have to be open to the public.

CHAIRMAN BURNS. What about the question of the general level of salary increases or a guideline for salary increases within our Federal Reserve Banks?

MR. O'CONNELL. Two possible exemptions from open meeting, Mr. Chairman. Very briefly, one under exemption 2, relating solely to the internal personnel rules and practices of an agency. We would have to urge that a discussion of that matter, insofar as it relates to the Banks, would come within this exemption because we're a unified system, and that, this being a Bank personnel matter, [it] is also an agency personnel matter, namely of the [Federal Reserve] Board.

If that were to fail, I would next turn to section 9(b) that says, you may keep a meeting closed if, in the case of an agency, disclosure would be likely to significantly frustrate implementation of a proposed agency action. If, by open discussion of this issue of salaries, namely, the level at which we are going to establish them, we [brought] into play competitive forces [acting on] what we perceive to be the market level, [and] that made it necessary for us to raise those salaries or otherwise adversely affected our action, [then] it's possible we could close the meeting; otherwise, it would have to be open.

MR. JACKSON. The best answer to this, Mr. Chairman, is to have one open [meeting], and then nobody would show up after that.

MR. GARDNER. Well, we haven't discussed regulatory matters, and a good deal of [the Federal Reserve] Board's time is spent on regulatory decisions. Tom, I believe that, because of the nature of such decisions, we could close those meetings.

CHAIRMAN BURNS. Except in consumer areas.

MR. GARDNER. I'm talking about a bank holding company application, some matter involving individual institutions.

MR. O'CONNELL. I have no reason to believe, Governor Gardner, that in almost every case, such items could be [unintelligible] closed meetings. There is a requirement in the statute that goes beyond the conduct of the meeting itself, namely, either [a] transcript is prepared or, [if] the meeting is closed pursuant to one of four specific exemptions, you have minutes instead of a transcript. Any meeting that is closed pursuant to sections 7, 8, 9(a), or 10, you may have minutes. If those minutes or the transcript are later found to contain nonsensitive items, that is, conversations, references, or inclusions that were not subject to closure, that portion of the transcript or the minutes must be made promptly available to the public. Now that contains caution for the [Federal Reserve] Board and for the FOMC, should they come under the statute. The result would be, you could close the meeting, but immediately you must review the transcript to determine whether portions must be made available to the public.

MR. PARTEE. Tom, you didn't mention transcript when you were talking in terms of the possible implications [for] the Committee--is that because the exemptions make the minutes possible?

MR. O'CONNELL. That's correct.

MR. PARTEE. In both cases?

MR. O'CONNELL. The nature of our closing exemptions would make minutes the name of the game.

MR. PARTEE. But again you'd have the question of sensitive and nonsensitive parts in the minutes.

MR. O'CONNELL. Yes, you would.

MR. COLDWELL. You have another question, which I probably can answer myself, but maybe I'd better get some guidance. If you have a consent calendar item, that is just as much a decision as a regular calendar item?

MR. O'CONNELL. Under the present format of the Board's operation, Governor, that is correct. It's possible, and this would be up to the Board and the Chairman, it's possible that consent calendar items can be [exempt] because [of] their nature, largely a circularization function as much as what was formerly known as a consent calendar. That [function] could thus remove those from any form of Board agenda.

MR. COLDWELL. So you don't have a Board meeting?

MR. O'CONNELL. That's correct. If they were the only items, and the Board adopted that method of circulating to the Board members for reading and for initial approval, the discussions in Congress indicated that this is perfectly appropriate.

MR. COLDWELL. Also dangerous.

CHAIRMAN BURNS. Mr. Coldwell, have you given any attention to these rules that the staff is working on?

MR. COLDWELL. Yes.

CHAIRMAN BURNS. Have you been involved?

MR. COLDWELL. Yes. Governor Gardner, Mr. Allison, and I spent a couple of hours on this subject just prior to this meeting.

CHAIRMAN BURNS. I hope you will find ways of dealing with Federal Reserve Bank problems so that as few of them as possible need to be handled in open session.

MR. COLDWELL. I think we have.

CHAIRMAN BURNS. You think you've already done that.

MR. COLDWELL. Well, we're headed in that direction. I'll let the Vice Chairman [of the Federal Reserve Board] speak on that subject.

MR. GARDNER. We have a plan. The problem, Mr. Chairman, as you know, is that if a committee, regardless of its size, is delegated to act for the Board, then it becomes subject to Sunshine by that delegation. So we are working on alternative ways. Now, a number of the Board committees--in fact, the majority--do not have delegated authority, and they can meet without violating any law in closed session because they're only advisers or what have you.

CHAIRMAN BURNS. You see, this question about Federal Reserve budgets disturbed me because these budgets are worked out very extensively by our staff. They're worked on very extensively by Mr. Coldwell's committee. I work on it to some degree with Mr. Coldwell outside the Board Room. The amount of time that has been spent by the Board as a whole on Federal Reserve Bank budgets hasn't been large because of all of these preparatory steps. All right, now you have an open meeting, and there may be some newspaper fellows there, and Mr. Gardner's Common Cause, and--what's this?--Ralph Nader's crowd, and what not.

Here, let us say, we take up a budget coming to $600 million plus, and we do that within an hour, and, well, we'd look very bad. Therefore, if that were the case I would consider it my duty to just stretch it out over a day. Well, that's terrible. Then we'd look good or reasonably good in Mr. Nader's eyes, but we'd destroy or reduce our effectiveness. Now, there must be an answer to that. Well, we have enough ingenuity in this room, I think, to find the answer, but I don't think we have found it yet.

SPEAKER(?). In the process, too, Mr. Chairman, you end up publishing the budgets of the individual Federal Reserve Banks, which has never been done.

CHAIRMAN BURNS. Well--

MR. O'CONNELL. To the extent that those budgets can constitute documents before this Board.

CHAIRMAN BURNS. Well, if it's an open session?

MR. O'CONNELL. Then they are exposed.

CHAIRMAN BURNS. We consider the budgets--well, of course, they're before us. Well, gentlemen, Sunshine brings us blessings, it also brings us problems, and the problems do not all lie with the legislation. We've got several weeks, but this may still prove to be a very heavy burden on us. I hope that the staff will continue to be resourceful and that Messrs. Gardner and Coldwell and the rest of us will continue working on the problem, and I will try to dig in myself.

Well, let's come back to the FOMC problem as far as Sunshine is concerned. Any thoughts the members may have that we ought to bear in mind? Now, we may have a telephone conference on this issue because of the calendrical constraint--that is March 12, is it?

MR. O'CONNELL. Yes sir.

CHAIRMAN BURNS. Well, we may be unable to reach that deadline, but we don't want to be too late--

[Secretary’s Note: The raw transcript for the January 17 session ends at this point. It seems that the meeting recessed here, but there may have been additional discussion.]

January 18, 1977

CHAIRMAN BURNS. Gentlemen, our meeting will get under way now, please. We need to act on the minutes of the December meeting. Is there a motion to approve? Motion has been made and seconded. Any questions? Let’s move on, then, to the report by Mr. Holmes on market operations.

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

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

MR. WALLICH. The Germans are still in surplus. [Otmar] Emminger [of the Bundesbank] said that they are willing to accept a deficit, as was stated in the press. And my question is, does the German intervention suggest that they are merely trying to iron out minor market fluctuations, or are they positively resisting a upward trend in the D-mark?

MR. HOLMES. I can’t answer that question with great certainty. I think two things were involved. They were disturbed when they were seeing the mark appreciate by nearly 1 percent a day. This, I think, was an effort to calm down the markets, and they recognize, too, that there have been several large orders coming out of individual banks, probably representing diversification--$100 million orders--and they took parts or all of those orders out of this market. In addition, I do think they felt that the dollar market rate was becoming inappropriate in some sense. I think there is an element of that in their thinking. How far that is an element, I’m really not prepared to say. They were concerned, of course, when they were having such huge inflows into Germany of the liquidity consequences of that, and so they were delighted to be eventually able to get the mark turned around and not face further inflows.

CHAIRMAN BURNS. Anything else?

MR. JACKSON. We’re increasing how often we intervene in marks. Do you think we need larger working balances, or is the swap an adequate substitute--

MR. HOLMES. I would be delighted to build up our working balances. You know, many months ago the Committee suggested that $150 million might be a proper level. We built up close to $100 million in all foreign currency balances at one time, and then the market turned against us and we had to spend them to keep our market in New York orderly. I would hope, if market conditions permit, that we can build up more-respectable balances. If we ever get anywhere near $150 [million], I certainly will come back to the Committee for further guidance on where we should go from there.

CHAIRMAN BURNS. Any more? If not, a motion to confirm the transactions carried out by the Desk--the motion has been made and seconded. Any objections? There are none. Mr. Holmes, do you have any recommendation with respect to the operations of the Desk?

MR. HOLMES. Mr. Chairman, there is just one recommendation. Two drawings made last November by the Bank of Mexico, in the amount of $75 million each, come up for renewal on February 10 and February 17. The new Administration [in Mexico] has provided a boost to confidence. The peso has firmed a bit in the market, and the Bank of Mexico has been able to recoup reserves. We expect the drawings to be paid in February unless something goes wrong. On the chance that that can always happen, I would like to recommend to the Committee that the Committee agree to a first renewal if that is requested, although the likelihood is that the swap will be paid off.

CHAIRMAN BURNS. Do we have any advice from the Bank of Mexico on the subject?

MR. HOLMES. Yes, I believe we have, Mr. Chairman.

MR. PARDEE. I talked to the Deputy Governor last Friday.

CHAIRMAN BURNS. All right, a recommendation by Mr. Holmes is before the Committee.

MR. COLDWELL. Is this to be in any way tied to the Treasury action on our part?

MR. HOLMES. Well, they have a similar swap with the Treasury that they will be paying down pari passu, I assume, [with] the two.

CHAIRMAN BURNS. Any objection to the recommendation? I hear none. Thank you very much, Mr. Holmes.

We will turn now to Mr. Gramley for his report on the economic outlook.

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

CHAIRMAN BURNS. Thank you very much, Mr. Gramley. Your reports are always good technically, professionally, but today's report was not only excellent professionally but it also brought a little cheer to some of our hearts. We are ready now for Committee discussion. Who would like to be first? Mr. Lilly, please.

MR. LILLY. Well, as you know, since last summer I have been the bear of the outfit. I have been quite concerned [about] the course the economy was taking, partly as a result of the actions of the Committee this last fall and other factors. I've now become very bullish, and I feel that we are about to see a marked improvement in the capital expenditure area. I suspect that those requests for investment approval are just now moving through the industrial hierarchy, and in about 60 days you'll see a substantial improvement. I'm now concerned that the economy may heat up a little faster than we would like it to.

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

MR. BLACK. Lyle, do you have any inkling as to what other parts of GNP may show? How about real final purchases--do you have a feeling on that?

MR. GRAMLEY. Yes, I have the figures. I just got them a few minutes after I came down this morning. Real final sales are precisely the figures that we had projected--76.8, up 4.8 percent.

CHAIRMAN BURNS. 4.8 percent. Is that the highest for any quarter of this past year?

MR. GRAMLEY. Yes, it is, to the best of my recollection.

MR. BLACK. That is a pretty significant margin, really--4.3 was the highest in the third quarter.

CHAIRMAN BURNS. All right, thank you, Mr. Black. Mr. Baughman, please.

MR. BAUGHMAN. I would ask Lyle, would he care to express a view as to whether a larger increase in wage rates would likely be restrictive or expansionary as far as economic activity is concerned--regarding total employment and production? As to larger than what, well, larger than otherwise. Or if there was some way of reducing the increase in hourly wage rates that apparently will be coming along--as to whether that will be an expansionary or contractionary economic input?

MR. GRAMLEY. I believe that in the short run, a larger increase in wage rates would tend to have a larger stimulative effect on consumption than an adverse effect on business fixed investment. But I think the longer-run implications would more likely be adverse. If you have in mind a time period of two years--a horizon that long--then I am inclined to think a larger increase in wage rates would [have] an adverse implication for economic activity.

MR. BAUGHMAN. I assume that you have noted that the oil companies have apparently negotiated contracts with a 9 percent increase for the first year and apparently--

MR. GRAMLEY. For the second year also; this is a two-year package. As I understand, it is roughly 9 percent in each of the two years and no cost of living adjustment.

MR. BAUGHMAN. --and apparently this will be kind of a pattern for that industry. Whether it will extend into other industries, I wouldn't know.

CHAIRMAN BURNS. All right, thank you, Mr. Baughman. Mr. Winn, please.

MR. WINN. I'm sympathetic to Governor Lilly's view in terms of the turnaround, but just one word of caution on that score. To what extent are future capital expenditures related, as they have been in the past, to local and state government activities? We've put the financial position of these firms in better shape so that they can move ahead. But to what extent is heavy equipment and construction and all of this related to the big role that local and state government has played--roads, sewers, hospitals, schools, and the rest of it? I don't see that coming back.

MR. GRAMLEY. We have a projection of a fairly moderate increase in real state and local expenditures for 1977. I think most forecasters anticipate that the state and local sector will not be showing much strength. Well, I think Governor Lilly is talking about business fixed capital, and that is independent in the way we look at the statistics. But that is segregated in the national income. There is an offsetting consideration to be taken into account. I think Governor Lilly's point is one that needs to be kept in mind--that is the implication of the remarks that I made at the end of my prepared statement.

But again, I would remind you, Governor Lilly, that that's the sort of thing that we anticipated last year, and it did not happen. I would remind you also that the [Department of] Commerce December survey of plant and equipment outlays for the year, which doesn't have a long history--we've had the record now for about six years--generally speaking does not tend to underestimate capital outlays. Now it could happen this year. That is the sort of thing we need to keep in mind and keep watching for over the next few months.

MR. LILLY. Well, I don't want to get into a long argument about the future, because it is too unpredictable, but I do think, when you have a very strong retail sales stream here that we didn't have before--it goes back to Thanksgiving--that's my basis for my feeling on capital expenditures.

CHAIRMAN BURNS. You know, on that point, I wish I had the document before me, but perhaps Mr. Mayo can help me. I was reading last night a report of the Chicago businessmen--that is an excellent group, Bob. One of the men commented that the rather flat trend in retail sales that we had between March or April and September was due in part to faulty seasonal adjustment. Remember that, Bob?

MR. MAYO. Yes, I can find that. Well, "this firm" refers to one of the economists for one of the retail firms--"this firm" is in an excellent position to know. "This firms believes that the Department of Commerce sales data that show a flat trend in summer and early fall reflect an erratic seasonal adjustment and that sales did not really level off. Also, it is believed that government data understates sales of specialty stores, in apparel, appliance, furniture fields." Lyle, do you have any view on that?

MR. GRAMLEY. I don't have any feeling for that. Generally, though, my feeling would be that retailers were disappointed in the pace of sales during the late spring and the summer months.

CHAIRMAN BURNS. You know, some retailers [are] like the rest of us--we have our own feelings and attitudes, we look at some statistics, which may be faulty, and the statistics have an effect on our views and our judgments.

MR. GRAMLEY. That could be.

MR. PARTEE. They weren't looking at seasonally adjusted figures, they were looking at the year-over-year, as I recall, which narrowed very appreciably, and made them gloomy.

CHAIRMAN BURNS. Well, this is true of the retailer. I would like to think that their economists do both. I know, in one of the very large retail sales chains--

MR. PARTEE. I know of one retail economist who looks at seasonally adjusted--

CHAIRMAN BURNS. Federated.

SPEAKER(?). Yes.

CHAIRMAN BURNS. That's the one I was thinking of. This may merely mean that we know so little about what economists in other retailing firms do. Lyle, would you be good enough to get ahold of this economist--he'll be easy to locate--and find out what he thinks he knows? He may have some valuable insights in statistical practices.

MR. JACKSON. How did that information compare with inventory accumulation in nondurables at retail?

MR. GRAMLEY. Well, I think it is a question of whether or not the rate of accumulation was too high in the minds of retailers. And since their sales were not performing as they had thought--since they were gloomy about them--they took actions to try to get rid of those excess inventories. And the pattern fits in that respect, but it still could be true that retailers had unrealistic expectations.

CHAIRMAN BURNS. Well, the pattern fits qualitatively, not necessarily quantitatively.

MR. GRAMLEY. Yes, by all means.

CHAIRMAN BURNS. All right, thank you very much. Mr. Eastburn, please.

MR. EASTBURN. Mr. Chairman, my forecast agreed, for the most part, with the projection of the Board staff. One possible difference has to do with inventory. Once a month we survey manufacturers in our area, asking them their intentions [unintelligible]. And although they're not doing much right now with respect to either reducing or adding to inventories, our survey indicates a considerable accumulation for the months ahead, and I just wondered whether your increase in inventory is enough. In your projections, do you think the risk on inventories is on the downside?

MR. GRAMLEY. I think there's some possibility of a downside risk in the first quarter. We had a little better inventory clean-up than we had anticipated, and as I look at both our figures and those of the Commerce Department today, their figures are not a lot different than ours. I really think that the revised GNP figures for the fourth quarter are likely to show a yet lower rate of inventory accumulation. And so I think that would imply some pickup in the rate of inventory accumulation, perhaps early in the year. But we have the rate going up to $19 billion--1 percent of GNP--by the fourth quarter, and that seems to me to be in the right ball park if our estimates of final sales are right.

MR. EASTBURN. Yes, but my figures would be for the shorter run.

MR. GRAMLEY. Yes, I think that's a point well taken.

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

MR. PARTEE. Well, Mr. Chairman, I agree with the first part of Governor Lilly's statement, but I don't think I really agree with the second part.

CHAIRMAN BURNS. What is the second part?

MR. PARTEE. The second part is that he is concerned with the possibility of overheating in the course of this year. And I would certainly agree that the best-guess projections appear to have changed markedly for the better in the last several months, not only the retail sales. Now, Dave, those retail sales could be a little bit chunky; that is, we might find ourselves kind of down, now, for a period of time, but it did have the very desirable effect of reducing observed inventory levels and changing attitudes, and I think it is a real shot in the arm. And I think housing looks to me as if it has sustained strength--you mentioned that too. And I agree that this all ought to have an effect on capital spending as the year goes on, and it ought to be stronger than we were previously worrying it might be. However, the staff projection for the four quarters of 1977 averages a little less than 6 percent--I guess 5.9, 5.8, something like that.

CHAIRMAN BURNS. For what period, again?

MR. PARTEE. For the next four quarters. And so, even if that were, say, a point higher than what's projected, it would not be an extraordinary number. It could be a point higher if we get a little more capital spending, a little more inventory than suggested. But even with that, it seems to me that, as you reach the end of 1977, you wouldn't be talking about really high utilization rates, you wouldn't be talking about, well, an unemployment rate that would be down even to anyone's objectives. So I don't think there is that much difficulty if there should be some moderate overrun from staff projections in the actual results of the economy in the course of the year.

There is another point, though, that I would like to bring to the Committee's attention. Some few of us have continued to watch the full employment surplus and deficit numbers, and I want to point out that the concept of potential GNP has been revised to reduce, I think, to a more realistic objective the rates of growth that can be expected in the real economy based on productivity and labor force growth. And also [it has been revised] to adjust for structural changes in the labor force so that the unemployment rate associated with full employment is no longer 4 [percent] on the nose but, as a matter of fact, for the year 1976, is 4.96 because of structural changes--almost 5 percent. And that, also, is a desirable change.

But the result is that, even with the proposed fiscal program--which I would think is more apt to be altered in the direction of being more liberal than less liberal as it goes through Congress and as the new Administration considers it--with that program, there is, on these new figures, a rather high full employment deficit for 1977, calendar '77. Our staff estimate is [for a] \$26.3 billion full employment deficit in that year. And related to potential GNP, on the new measure of GNP growth, this is the highest proportion of potential GNP in more than a decade with the exception of only one year, 1967. In 1967, the full employment deficit, on these new figures relative to potential GNP, was a bit higher than is now projected for '77.

Well, it's a very considerable increase from calendar '76 to calendar '77, from a \$12 billion full employment deficit to a \$26 billion full employment deficit. That gives me pause and concern about financial market conditions as the year goes on because, although I never believed much in the idea of crowding-out on the basis of just the actual deficit figures, I noted long ago that if you look at the full employment deficit figures and you see a sharp shift toward deficit which is associated with tighter conditions and higher interest rates, it is going to be a problem as the year goes on.

It also does contain the possibility, this kind of a full employment deficit--which I'm pretty sure will be the highest in the postwar period, although the figures were taken back only to 1964-- may have psychological effects on inflationary expectations in the economy.

CHAIRMAN BURNS. Full employment deficit will not have any psychological impact.

MR. PARTEE. But it has a real effect, Mr. Chairman, that's what I guess I want to imply to you.

CHAIRMAN BURNS. A psychological effect will come from the actual or prospective deficit, over time.

MR. PARTEE. Well, that would be $70 billion or so, and that's a very large number, too. But it also could have some effects that we can't fully anticipate. So I think, although I am not concerned about overheating things for the year immediately ahead, that the trend in these fiscal numbers does give me real pause. And I think it also may cause very considerable pressures for the central bank if in fact it brings some crowding-out, if it brings some tightening in the market--which is likely, I think--and higher interest rates. The usual kinds of difficulties we have when interest rates are rising and housing people can speak out about that kind of effect. Since it hadn't been mentioned by Lyle, I just wanted to bring it to the attention of the Committee.

MR. GRAMLEY. May I make one comment, Mr. Chairman. A fact which I think the Committee should keep in mind in thinking about Governor Partee's comments--and that is, this $26 billion includes a $10 billion rebate-type payment. If it would be your judgment that rebate-type payments don't have much effect on economic activity, then you ought to mentally subtract that as you think about the size of the full employment deficit. That part would be gone the next year. On those grounds alone, the full employment deficit would revert to $16 billion in '78.

MR. PARTEE. I wouldn't subtract $10 billion. I've never felt that a refund didn't have any effect on the economy.

MR. GRAMLEY. No, I don't either.

MR. PARTEE. It does have a rather high spillover into the saving flows, but I wouldn't say it's a zero effect on the economy. And the other thing, the point that I would make, Lyle, is that this is just the opening gambit by the Administration. The Congress has not yet dealt with this, and the spending programs that are people's pets have not yet been brought to the floor. The chances are that this number will be exceeded--not falling short--in actual practice as the year goes on.

CHAIRMAN BURNS. I would agree with Mr. Partee. I would also point out that what happened in the market for long-term interest rates last week, partly as a response to the new fiscal package announced by the incoming Administration, is a warning of what may be ahead.

While I'm speaking, let me add one fact. At 2:00 or 2:30 there will be an announcement on housing starts, and I don't feel free to disclose the figure, but I can say it's quite an optimistic report.

Thank you, Mr. Partee. Mr. Wallich now, please.

MR. WALLICH. Well, I share what Mr. Partee says about the full employment deficit. In addition to the financial consequences, it also shows the greater limitations in the way of capital expenditures that we face once the economy is operating at a high level again and the problem, therefore, of getting an adequate amount of capital spending.

Well, the other point I wanted to make is the stimulus that is being proposed to be put into the economy, not in fiscal '78 but in the following year. The program is divided in those two parts. The second part is more iffy than the first, but they seem to be of about equal size--$15 billion apiece. And I'm asking whether we're not repeating the mistakes that have been made in the past--of overstimulating late in an expansion. In putting in a two-year program, are we in danger of getting into the fourth year of expansion and overheating, and if so, what is the proper stance for monetary policy? So, my question really goes to what is the likely effect of this second part, the second year of the fiscal program, to the extent that one can now assess it?

MR. GRAMLEY. Governor Wallich, I think that's a genuine concern. I think, in answering that question, one should start by noting that, while we're in a fairly advanced stage of the recovery, we still have an ample amount of underemployed resources, both on the labor side and on the industrial capacity side. I would note also that in terms of the--

CHAIRMAN BURNS. Is that true of skilled labor--

MR. GRAMLEY. Well, it's less true of skilled labor, Mr. Chairman, but if you look at the unemployment rates for adult men, I've always tended to use the rule of thumb that, when the adult male unemployment rate gets down to about 3 percent or somewhere around there, we've got tight labor markets. It's now above 5, 5 to 5-1/2. I think there are particular skills which are in short supply--there always are except in massive depressions--but, generally speaking, we have an adequate supply of labor and of capacity to move up significantly further. Governor Partee has noted that the real potential GNP level has been moved down by almost 4 percentage points. Well, what that does is to move down the gap between actual GNP and potential GNP from 11 percentage points to 7.3 percentage points. There's still an awfully long ways to go yet, an awfully long ways to go.

We have run some simulations, and I put them out without assigning a great deal of credibility to what the model can produce in this respect. What we did was to take the judgmental staff projection and then extend it through 1978 by keeping the same monetary policy and then making the fiscal package for 1978 as close as we could to the spirit of the new

Administration's recommendation, in the sense that we add some more for expenditures and we don't repeat the rebate. And what happens when you do this is that you get a growth rate of real GNP which stays fairly high--it stays in the 5 to 5-1/2 to 6 percent range, somewhere around there, but it does not lead to any buildup of inflationary pressures. Actually, the rate of increases in the fixed-weight index goes up somewhat less for 1978 than it does for 1977. It does give--

CHAIRMAN BURNS. How good has the model been in predicting inflation?

MR. GRAMLEY. Recently it's done quite well. But not over the longer term.

CHAIRMAN BURNS. How good was it in 1972, 1973, the first half of 1974?

MR. GRAMLEY. During those periods we had most unusual influences affecting the price--

CHAIRMAN BURNS. No, that wasn't my question.

MR. PARTEE. It missed by an order of 2, I think.

MR. GRAMLEY. Pardon me?

MR. PARTEE. It missed by an order of 2, I think.

MR. GRAMLEY. Well, it's a very large factor, but I don't think one can evaluate a comment of that kind without recognizing that we went into 1972 with price controls. And the model was not running on its own. We were making adjustments to the model to try to take that into account.

CHAIRMAN BURNS. How good was it in 1970?

MR. GRAMLEY. I'd have to go back and look. The model's price performance has been one of its weaker elements. As I said in the beginning, I don't know how much credibility to assign to these comments that I'm making about the model's results.

MR. PARTEE. Of course, if you continue to make adjustments because the model has been weakened at the moment, it will finally get to the point where it overestimates the rate of the price inflation because of adjustments that are made [judgmentally]. But I don't know that we've reached that point.

CHAIRMAN BURNS. Are you satisfied, Mr. Wallich? Okay, Mr. Kimbrel now, please.

MR. KIMBREL. Mr. Chairman, I don't know about the numbers, but I think the discussion with our own directors and the consensus [among] businessmen comes out pretty close to that expressed by Governor Lilly, and it's not optimistic. I think also that they have a concern that the cost may be indirectly associated with unusual weather conditions [and will] provide an opportunity to pass through energy costs and labor costs. They're enormously concerned about the prices and the potential for inflation. I think, though, that the expectation of our people is that prices are sure to escalate, but that the mood is going to continue [being] very good.

Now, I wonder if the staff has given some thought to the possibility that some capital spending has been delayed, waiting for the determination of possible tax advantages this year, and it may be we have some [spending] coming on stream that was waiting for the possibility of taking tax advantages.

MR. GRAMLEY. We have thought about that question, President Kimbrel, and our view would be that, based on what businesses have seen in the past when tax incentives have been put in place--and I mean by that the tendency for new bills to be retroactive to the first time big business was beginning to think about this, perhaps the first time they were suggested seriously. So this would not likely be a significant factor in holding up capital spending. We think that the hold-up in capital spending has been more an aggravation of the uncertainties with which businesses were looking at the economic and financial climate during 1976--an additional uncertainty generated by the pause [and] generated also perhaps to some degree by concerns about where the new Administration might be going.

CHAIRMAN BURNS. When was the Department of Commerce survey taken, the results of which were recently announced?

MR. GRAMLEY. November and early December. And that could be still, you see, quite a bit out of date in terms of where thinking has gone since then.

CHAIRMAN BURNS. All right, thank you. Mr. Coldwell now, please.

MR. COLDWELL. Mr. Chairman, I've been listening. I think I agree with much of what I hear. To me, the tone of things has improved considerably; perhaps we've lost some of the threat of inventory change. I have a feeling that this year ahead isn't going to be quite as smooth as this staff forecast shows. I guess you could say that about any year, but I have a feeling that this one's going to be a highly erratic year. We may get some heavy fiscal stimulus that runs up one quarter or a couple of months and then runs back down the stream. I can see possibilities of the same sort of arguments and data that we faced in early '75 on the money supply and aggregates data and maybe on some interest rates, too. I can see some very sharp run-ups in consumer spending right after a rebate, if that's the way the Congress goes. I can see as a possibility that there may be another--if there is such a thing--midcourse pause somewhere down the line, too. So I guess I'm a little more cautious about taking all this and converting it into a very bullish year ahead--but on the other hand, not much in the way of a bearish year, either. I think it's going to be a highly erratic one.

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

MR. MORRIS. Mr. Chairman, I'd like to follow up on Governor Partee's comment on the crowding out issue in '77. The staff has an estimate of corporate external financing in '77. How does that compare to '76?

MR. AXILROD. President Morris, we have not projected any greater net external need for funds on the part of corporations in ’77 than in ’76; they’re virtually the same. And thus we have room for corporations to increase their [holdings of] government securities in somewhat the same fashion as they purchased them in ’76. In fact, we’ve actually projected somewhat higher acquisition of government securities by corporations in ’77 than ’76.

We don’t have a lot of the traditional features that you see in the government securities market from crowding out. That is, we don’t project at this moment any increase in consumer purchases of government securities. We have the government securities that are added being purchased by foreign and official institutions and by businesses and pension funds. We don’t see any particular need for sizable consumer purchases over the year, which are the traditional source of interest rate pressures when looked at from the flow of funds, but we do see that picking up in the second half of the year. So if you were going to locate a problem area from these figures--and it’s hard to locate--it would come about in the second half of the year through the beginning of pressure of selling securities outside the banking system.

MR. MORRIS. But to have a major problem you would have to have a substantial upgrading in the corporate investment numbers.

MR. AXILROD. Or diminishment in their profits. A reduced profit flow.

CHAIRMAN BURNS. You know, Mr. Partee commented on psychological reaction to one or another kind of deficit. I think that once the business community becomes aware of what is an emerging fact, namely, that the deficit this fiscal year will be substantially larger than during the preceding record-breaking year--once the business community becomes aware of the emerging fact that large fiscal deficits are ahead for several years, this may well have a profound effect on inflationary expectations. Mr. Mayo, please.

MR. MAYO. Just a question to Lyle. Several months ago we heard quite a bit of discussion on the corporate side that tax liabilities were being piled up in ’76, payments were low in ’76 based on ’75 profits, and the place where this would begin to pinch was in the spring of 1977. I haven’t heard a word about that for a month or so now, and I noted nothing in the discussion today, either written or oral, on the subject. Does that mean, Lyle, that this was blown out of all proportion and really isn’t significant?

MR. GRAMLEY. I think maybe Mr. Axilrod is better prepared to answer that. We’ve been thinking about that in terms of financial market projections.

MR. AXILROD. President Mayo, I think it has been blown out of proportion. Whether it isn’t at all significant--I think it has some minor significance. We did put our estimate of the magnitude into the first part of the Greenbook, in the outlook, buried in the footnote--it’s put in a complicated way there, but what it amounts to is you might get about $3 billion or $4 billion more in payments coming in because of this development than you would otherwise have had. So these business corporations are going to have to find $3 billion or $4 billion more to pay over to the Treasury. That could [generate] some very temporary money market pressures in the short-term market. But I don’t think it would have any lasting significance at all, and to the extent that Treasury receipts turned out to be a little higher than were expected in the longer-run, it washes out. So I don't see it as anything except a possible spot pressure around mid-March or mid-April.

MR. PARTEE. That's when it is, mid-March to mid-April?

MR. AXILROD. Well, in March and June they make up their payments for 1976, so that make-up of the payments in '76 occurs in mid-March and mid-June; and in April, it's the first of their 1977 liability [payments]. So, if the experience of '76 causes them to increase their '77 estimates, you get an effect in the beginning of that statement period.

MR. PARTEE. But it comes at approximately the same time that the Treasury would have to finance the refund, also.

MR. AXILROD. Well, the refunds of the '76 taxes to individuals--

MR. PARTEE. No, I mean the rebate.

MR. AXILROD. Oh, we expect the rebates will be in May. So, in coming through this whole period--

MR. MAYO. Thank you, Steve, I heard a figure in excess of $10 billion, which seemed awful high at the time. This reassures me.

MR. AXILROD. Well, we expect total payments will exceed their accruals by about $8 billion. That may be in that order of magnitude, but that figure is itself about $3 billion more than in '76.

MR. GARDNER. This is really not a synthesis [unintelligible]. I thought the pause was a pause; many of us did. I was very interested in the external factors--OPEC. December came and went, and we didn't get a 15 percent rise or a 10 percent rise; we got something else. I think I understand the reluctance of businesses to spend for long-term capital improvement and expansion. I think as long as that fund of private stimulus remains a possibility, it's a point of strength in the fact you [unintelligible].

I'm just thinking out loud. We've had a pretty good year in many ways. Inflation has come down. But there is one thing that deeply concerns me. That is 7.9 percent unemployment. I worry about [unintelligible] getting a little more comfortable with some of the statements coming from the Administration, but that doesn't necessarily mean that the Congress will not take off on many spending measures. Unemployment is a very difficult thing because we have had a pause and evidence that the pause is past. We are looking forward to improvements, but still, it's 7.9 percent unemployment, which has become such a campaign issue, such a psychological effect, that whatever conservatism may be inherent in the Administration's plans, I don't think it can weather for long a grudging slow reduction in this number. It's too visible a number.

I was disappointed with the amount, Lyle, [by which] it came down in the last report. And I am curious about the more rapid decline in unemployment that occurred early last year. That occurred in the first quarter or the second quarter, and unless that happens, those of you who have expressed concern about the size of the deficits and the like are going to be wise men--if unemployment were now 5 percent or 5-1/2 percent, we would all be smiling to see a good year ahead and perhaps one [in which] we could continue to make progress against inflation. Do you have any comments about what you expect unemployment to do in the next--

MR. GRAMLEY. I would want to talk mainly about what I think might be in store for the unemployment rate in the immediate future. Last year, during the spring season, the unemployment rate was going down rapidly, in part because GNP was going rapidly in the first quarter, but also in part because the seasonals were probably out of whack. The reported unemployment rate was really going down faster than the actual unemployment rate--if we knew what that really was. I think some of that seasonal maladjustment is showing up in the fourth quarter of 1976 figures. I think the actual, true seasonally unadjusted unemployment rate is probably a tenth or two lower than what we have recorded in November.

CHAIRMAN BURNS. When are we getting new seasonals?

MR. GRAMLEY. They normally come in February.

CHAIRMAN BURNS. I've already heard about a slight adjustment--that is, the 7.9 will be 7.8 for December on the basis of new seasonals. Do you know about that?

MR. GRAMLEY. I have not heard that yet. But that would not surprise me. That's the direction we would have expected. Now I think also that when you see a pickup in activity as we have seen in the last couple of months, you have to anticipate that it's not going to affect the unemployment rate in a substantial way for a few months. Initially what tends to happen is that businesses work their existing employees a little harder to get more productivity, then hours begin to lengthen a little bit, and then the new hirings begin. So I would anticipate that if this pickup has some durability, as I think it will have, we will see some better unemployment statistics in the fourth quarter.

CHAIRMAN BURNS. Lyle, yours is good classical analysis. But it leaves out of account a new factor that has been disturbing our judgments and our forecast, and that is what may happen with the labor force.

MR. GRAMLEY. The labor force is a very erratically moving series, and it could be growing substantially next year. We have allowed in our projections for a sizable increase, an increase of around 2 million, in the labor force. That's less than what we have had over this past year. But it's far above what we used to think of as the longer-term trend. But you're quite right that an erratic movement in the labor force during the first quarter, a large increase, could hold the unemployment rate up.

CHAIRMAN BURNS. I would only question the word "erratic." It might be a systematic factor in changing habits and new pressures arising from inflation, as the factors impinge on families, women joining the labor force--well, because people like to live better, and they certainly don't want to see their standard of living coming down. And one of the illusions generated by statistical reporting is that wages go up for everyone. They go [up] on the average,

[but] tens of millions do not experience a wage increase in any six-month period, a year. Farmers' incomes may decline--they have declined during the past year; incomes of proprietors and so on. This may well be a systematic factor--partly [one of] changing cultural trends and partly the pressures on families arising from inflation, all of which causes an increase in labor force participation by women and, to some degree, by teenagers. Thank you very much, Mr. Gardner, Mr. Gramley. Mr. Balles now, please.

MR. BALLES. I'd like to ask Lyle a question about the velocity estimates that seem to be implicit in the Greenbook forecast this time. With the 5-1/2 percent M1 growth assumption, it appears that the velocity of M1 will be at the highest rate of growth in the third year of recovery of any of the post-Korean [War] cycles--namely 5.8 percent versus the previous average in the post-Korean [War] cycles of 3.4 percent--and about the same thing could be said for the velocity of M2. What I am interested in is, on what basis did your staff, Lyle, say this velocity growth is going to be this substantial at this [stage] of the recovery, when the normal pattern has been a decline in the rate of growth in velocity of both M1 and M2 during the third year of recovery.

MR. GRAMLEY. Mr. Axilrod, I think, is the person that would have the answers for that.

MR. BALLES. That's a good move, Lyle.

MR. GRAMLEY. I thought so too.

MR. AXILROD. One thing I would do, President Balles--we were well aware of the high velocity, of course--is reduce, to take a percentage point [off velocity] as reflecting the ongoing shift from M1 to other deposits or other money market instruments as people seek to economize--[a] trend that has been occurring over the past few years. We would have estimated last year somewhere over 1-1/2 percentage points as a rough rule of thumb. I would take at the beginning of this year something like 1 percent--it may prove to be more or may prove to be less. So that reduces the problem you're discussing to some extent.

Secondly, as you do point out, you had 3.4 percent in those particular periods. Trend since '61 has been on the order of 3 percentage points. The standard deviation around that trend has been about 1-3/4 percentage points; the absolute deviation around 2 percentage points. So you've got a certain random factor that's at work. And, finally, we do realize that it's a fairly large increase in velocity that's called for, and we would expect for that reason--as time goes on in the next year--for interest rates to rise as people try to get cash by selling assets and borrowing. So we wouldn't really expect at this point a sort of free increase in velocity of that magnitude but would expect the economization to reflect in part the interest rate pressures that might occur as the year goes on.

MR. PARTEE. Is it also a rather high real GNP increase for the third year of recovery?

MR. GRAMLEY. Yes it is, but it is certainly not unprecedented.

MR. PARTEE. That tends to add to this pressure on velocity?

MR. GRAMLEY. It's not unlike, as I remember the numbers, what happened in 1963, although I believe the pickup there, after the pause of '61, was even a little more rapid than what we have had.

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

MR. BLACK. Mr. Chairman, I wonder if I might ask you a question? A while ago you indicated that you did not think businessmen yet realized the extent of the federal deficit or the inflationary implication of that. Do you anticipate that this will have a significant impact on either the timing or the amount of business capital spending?

CHAIRMAN BURNS. I would not anticipate much response in that direction. I would anticipate protective measures by businessman: raising prices to the extent that they can--more than they would want to--

MR. BLACK. Any inventory buildup?

CHAIRMAN BURNS. Not really, because businessmen very rarely speculate on inventories, and the mood has not been in that direction. The only recent year when we've had significant inventory speculations was, I think, 1974 [and] to some degree 1973. Normally, speculation on inventory--I don't think [it] is a part of business practice.

MR. LILLY. In the longer run or shorter run?

CHAIRMAN BURNS. Shorter run. I'm thinking of 1977.

MR. LILLY. Most businessmen, if they think there's going to be a substantial increase in the next two quarters, will cover themselves. But you might call that a speculation or you might also call that hedging.

MR. JACKSON. That's true in materials and intermediate goods, not in finished goods. So you get a substantial disparity based on the stage in process.

CHAIRMAN BURNS. And I would expect that the inflationary expectations I spoke of are being reflected in prices, making their own forecast, to some degree, come true. And I would expect it in interest rates. The effects on capital spending, if any would come later, might come toward the end of '77, and my feeling is that it will come in '78. Mr. Jackson, please.

MR. JACKSON. I have a slightly different judgment on this question, Mr. Chairman. I would think that once the perception of these [large-]size deficits takes place, we are likely to see a continuation of what we have already seen--a desire on the part of businesses to get their long-term financing accomplished rather promptly, particularly refinancing, like the utilities are doing.

CHAIRMAN BURNS. That would depend on rate movements.

MR. JACKSON. Right. Second, I would guess that you see maybe a very, very short-term acceleration in capital spending as people try to get projects completed that are in process of construction, and an attempt to get under firm contract things that are committed but are not nailed down as to price. But over the long-term, I would think that into '78 it would indicate a reduction in capital spending because of--

CHAIRMAN BURNS. You and I are on the same track.

MR. JACKSON. Yes, I would have a slightly different judgment about the consequences for the economy for '77 to those expressed. I think my own judgment about the actually measured economic progress wouldn't be too different. My own judgment would be that the public perception of that progress would not be as strong as the actual measurement of it. I think [that members of] the public are poor economists is what I am trying to say, and therefore I think the consequences for unemployment, things of this sort, would produce a public attitude that would not reflect the progress that would actually be measured and be made.

However, I don't know whether to be awed or amused by the accuracy of the measurement you have been able to make on full employment, when you are able to measure unemployment levels at full employment down to the fourth decimal place. I wish we shared your capacities in much more important fields, because I think that's an amazing performance.

MR. PARTEE. Well, basically, this is based on a measure of capacity of the economy. The unemployment rate just happens to fall out. But it doesn't depend on a direct measure of unemployment.

MR. JACKSON. 4.96 percent is an amazing figure.

MR. WALLICH. And I think many people would say that 4.9 is lower than can be reached, actually for labor force reasons rather than for capital capacity reasons.

CHAIRMAN BURNS. Well, I don't think Mr. Partee intended to suggest that the second decimal had any significance; he might even question the first.

MR. PARTEE. I certainly wanted only to report to the Committee the figures. I think it is a good thing to allow for structural change in talking about what the economy would hope to accomplish, and in that sense I think this is a real move forward compared with the way we used to measure potential GNP and [with] a 4 percent unemployment rate as an invariant target.

MR. JACKSON. When we talk about structural change, I think that's true of the labor force, too, as we talk about the public perception of economic progress. When you see about 40 percent of the women as participants in the work force, I think our perception of an acceptable unemployment level for those participants in the work force is going to change.

CHAIRMAN BURNS. As a matter of potential output, I wrote a paper in 1935 in which I attempted to demonstrate by impeccable logic that potential output cannot be measured. I have lived during periods when this has become a habit. Well, I don't think I've changed my mind. Mr. Partee you were going to make a point?

MR. PARTEE. Well, I was just going to ask, following up on Governor Gardner's comments and also Governor Lilly. One of the problems is in this question of the political perception--and also your comment--[regarding] the rate of improvement in the economy. A little technical difficulty in the staff's projection, Lyle, is that the lowest quarterly increase is [for] the first quarter in the projections for the year--5 percent. And I was wondering if you had a view as to what the possibilities might be that in fact we could exceed that growth rate in the first quarter--that is, start out in the year pretty well? I note that you don't have much inventory accumulation in the first quarter, and I note also that you hold housing starts the same in the first quarter as in the fourth. Could those two areas perhaps turn out to be stronger?

MR. GRAMLEY. Yes, they both could. We have expected some decline in housing starts, largely on technical grounds, in December. I haven't seen the figures yet, but judging by the Chairman's earlier comment, it doesn't sound as though we made a very accurate decision in that regard. But I commented earlier, in response to President Eastburn's question, that I do think our inventory number for the first quarter may be too low. We put this together and froze it before we got the November figures on inventories, and they were really quite a surprising development. If it turns out that December inventories are also negative in real terms, as I think the November figures indicate was the case for that month, well, then, the prospects for a real pickup in industrial production and employment and inventory accumulation in the first quarter are quite substantial.

CHAIRMAN BURNS. Well, at this point I would join, to an attenuated degree, Mr. Coldwell's comment on erratic movement. We may well get an erratic movement of inventory change in the next year. Sharp buildup, slowdown.

MR. PARTEE. The point that I was trying to make with Lyle is that output could go up faster here. It would show up in a little more inventory accumulation.

CHAIRMAN BURNS. That would be my guess.

MR. GRAMLEY. I think it's a very real possibility, yes.

CHAIRMAN BURNS. For the year as whole, that's another matter.

MR. JACKSON. Would the weather, natural gas situation impact on this prospect?

MR. GRAMLEY. It might, yes. We are going to be contacting the Reserve Banks right after this meeting this weekend to ask them to help us ascertain what the weather may mean for production. But I heard on the radio this morning that there are at least four states that are quite worried: Ohio, Minnesota, Michigan, and Pennsylvania. And we have no experience in terms of trying to estimate how we are to adjust estimates for industrial production, and I don't think it would be wise for us to try. But that's certainly going to be a negative factor.

MR. JACKSON. It strikes me as a possibility--the inventory accumulation could be delayed even though it might be not be canceled at this time.

CHAIRMAN BURNS. Well, if you apply standard seasonals, you may find that activity shows a decline when the seasonals which you ought to be applying are of a different character, because we are having an unusual winter--an unusual January. And that will certainly have to be watched very carefully. I would use a standard seasonal, and then I would try to use a seasonal adjustment for weather factors. Now a good deal of research was done on that years ago, and I haven't kept up with it. Whether we know how to do it now or not, I don't know, but I'm sure we can do it roughly, you know, as a guide to the interpretation of the statistics. Well, we've had a good discussion of the economy. Yes, Mr. Mayo.

MR. MAYO. Just one other observation on the employment side, Mr. Chairman. I don't want this to be interpreted as expressing any lack of concern for the point that Steve mentioned, which I share, but I made the point before that I wondered what would happen if we just took civilian employment and related it to population in the United States--preferring on some occasions to take a gross measure because of all the difficulty we have in fine tuning all of these adjusted measures. I found it rather significant.

We didn't do [the exercise for] every year, but we took years that we thought would be significant back to 1929, and I am glad to report that civilian employment in this country as a percentage of population is at its highest point in history. Now that means conversely that that proportion of the population that is not employed is at its lowest point. Don't pursue this too far, but I think it is a rather interesting observation. We measure all sorts of things in international statistics on a per capita basis. This is a per capita basis in terms of civilian employment. Not a new record by a large [amount], but it's 40.7 percent as against 39 percent in '29--slightly over 40 percent but not as high as '74. Civilian employment divided by total population--it's a very simple statistic on an annual basis.

MR. JACKSON. Does your figure adjust for military and government workers?

MR. MAYO. This is just civilian, but it includes government civilians.

CHAIRMAN BURNS. What is the percentage ratio, Lyle, of total employment to the total population of age 16 and over?

MR. GRAMLEY. It's been going up. I don't have a figure in my head as to the precise ratio.

CHAIRMAN BURNS. I mean, is it at a record level?

MR. GRAMLEY. It is, it is.

CHAIRMAN BURNS. I thought so--at a record level. That, perhaps, is a more significant figure, Bob.

MR. MAYO. Yes, it's less gross.

CHAIRMAN BURNS. Less gross, less subject to some questioning or criticism one might make because the base there is the potential working population.

MR. MAYO. Of course, there are differences again, over time, as to what proportion of those slightly under 16 or slightly over 16 are working or aren't. This is merely a terribly simple-minded approach that anybody can look at. And, by the way, the *Wall Street Journal* yesterday had a column that approached this same point. It's not something to use in devastating the worriers about unemployment, but in terms of mouths to feed, in terms of standard of living, total population I think is quite--after all, we are all supposed to be equal in this regard, one way or another. It has some merit.

CHAIRMAN BURNS. Very good. Any other questions? Yes, Mr. Winn.

MR. WINN. Just to comment on the situation in Ohio and western Pennsylvania and the problem with information, we have checked--

CHAIRMAN BURNS. Would you also comment on natural gas?

MR. WINN. --yes, we had contacted the utility companies to get some feel [for] this, and we knew that one company had real problems with gas supply. The others assured us that it didn't make any difference what the weather was, they were going to be able to handle any kind of need, and at the moment they are all shut down. And a month ago, they told us--and this was good information, you know, the top of the companies--that they had no problem, and at the moment, plants across the state are closed. It's a real serious problem there.

CHAIRMAN BURNS. That's been predicted for Ohio for a long time.

MR. WINN. Well, that's because of one company that sold gas they didn't have, but many of the companies have got out and drilled their own wells, and we have had all kinds of scurrying for just this sort of emergency. But we're shut, there's no question. Perhaps this is good in the long run--that we will now, as a nation, face up realistically to some of our energy problems, because [we] are [in a] very weak [position]. We had brown-outs across the state on the electric side, and the gas companies are just providing a holding operation. Not operating.

MR. MAYO. We have had natural gas shut off to a number of large users, but they have been able to convert to other fuels, and there has been no big unemployment as a result of this, or plant closings.

MR. ROOS. Mr. Chairman, may I just follow up on John Balles's complications. Our people feel very strongly that the projections of growth in the Greenbook are impossible to achieve at the rate of money growth which is assumed in those projections. We feel that our model, although it probably has been frozen in recent weeks--I'm glad that John comes from a warmer climate than we--projects about 1 percentage point less in the rate of real growth in the year ahead than the staff here projects, and I think maybe it's just important to reiterate the possibility of differences of opinion on this subject.

CHAIRMAN BURNS. I think that's entirely valid, but I would have liked your comments better if you had not based it on the model. The St. Louis model does not get high marks for its predictive power. In fact, it gets very low marks in the economics profession. Am I right on that?

MR. GRAMLEY. You are correct, yes.

MR. ROOS. Fuel injection has been changed recently.

CHAIRMAN BURNS. Well, gentlemen, any other comments on the economy? Well, let's take a brief coffee break now.

[Coffee break]

CHAIRMAN BURNS. Gentlemen, we want to turn now to the discussion of our longer-term targets, and we will first turn to the monetary aggregates. I think members of the Committee know that the House Banking Committee will be holding a hearing on February 3 under the House Concurrent Resolution. I will be testifying on that subject on that day. And therefore, this Committee must today decide once again on our monetary objectives for the year ahead, that is, for the interval running from the fourth quarter of 1976 to the fourth quarter of 1977.

Now, in setting these monetary targets for the year ahead, we need to consider apparent conditions of the economy. We've done that. We need to consider economic prospects for the year ahead and their dependence on the monetary policy that we lay down, and we've done that. We know less about monetary policy, on our overall judgment, than about economic prospects. And finally, we need to consider the degree to which, if any, our monetary policy should contribute to unwinding the inflation from which our economy has been suffering since the mid-1960s.

Of these several considerations, the last, I believe, is peculiarly important for us at the Federal Reserve. I say this because no other branch of government, certainly not the executive, certainly not the Congress, has anything approaching an articulate policy for bringing down the rate of inflation. Now, if we at the Federal Reserve should fail to persevere in bringing down our monetary growth rates, which are far too high from the viewpoint of ever returning to price stability, there would be no chance whatever for reestablishing a foundation for economic stability in the future. Recognizing this basic principle, this Committee during the past 21 months has moved very gradually, but rather consistently, toward lower monetary growth rates. Our moves may have been much too gradual, but they at least have been in a salutary direction.

In approaching the problem of setting monetary growth rates for the year ahead, I start with the basic thought that, if at all feasible, we should once again make a small move in the direction of monetary growth rates that are tolerably consistent with eventual restoration of a stable price level. Now, in my own mind, this basic thought is clouded by other considerations, namely, unemployment is still unduly high. We have a new Administration; the new Administration has proposed a fiscal plan for reducing unemployment, and any lowering of monetary growth rates at this time would, I'm quite sure, be very widely interpreted--and not only in the political arena--as an attempt on the part of the Federal Reserve to frustrate the efforts of a newly elected President and newly elected Congress to get our economy, to use a popular phrase, "moving once again." I've tried--it obviously isn't easy--to bring these two sets of thoughts into some sort of harmony.

And accordingly, my recommendations to the Committee are as follows. First, that we leave the projected growth range for M1 as is--4-1/2 to 6-1/2 percent--for the coming year. Second, that we modify the growth ranges for M2 and M3--specifically, that the growth range of M2 be set at 7 to 10 percent instead of 7-1/2 to 10 percent, and the growth range of M3 be set at 8-1/2 to 11-1/2 percent instead of 9 to 11-1/2.

The proposal to leave M1 unchanged has at least this advantage: You would avoid any charge that the Federal Reserve is indifferent to unemployment or, and this is more serious, it would avoid the charge that we are seeking to frustrate the efforts of the new Administration. The proposal to lower the lower limits of M2 and M3 by 1/2 percentage point has, I think, the following advantages. First, it recognizes the recent tendency of various banks and thrift institutions around the country to reduce the interest rates paid to savers, and this tendency may well result in a lower growth rate of M2 and M3 in the immediately succeeding months. Later on in the year, higher market rates of interest may well slow down the inflow of funds to thrift institutions. And finally, the slight lowering of the lower limit of M2 and M3 would once again provide some evidence that the Federal Reserve is sticking to its repeatedly stated objective of gradually bringing down the monetary growth rates in the interest of restoring--not immediately, but over a period years--general price stability.

Now, I realize that the lowering of the lower limit of M2 and M3 might evoke some criticism. But on this point I would say the following. First, no matter what we do, there will be some criticism, and this is an inevitable accompaniment of central bank action. Secondly, I would say that, as we all know, far less attention is paid by the general public, by the Congress, even by economists, to M2 or M3 than to M1. M1 is still the magnitude that is widely followed and respected. And I would say, finally, that even after lowering the lower limit of M2 and M3, the midpoint of the range for M2 and the midpoint of the range for M3 would still be precisely what it was six months ago. Therefore, no lowering from where it was six months ago, and this would be duly noted in our statement to the Congress.

These are my best thoughts on a very difficult subject. Let us now have a general discussion and try to determine where we should come out. Who would like to speak first? Mr. Eastburn and then Mr. Black.

MR. EASTBURN. Mr. Chairman, I'd like to spend a little bit more time on the question of the degree to which monetary policy should work with fiscal policy in this coming quarter. I think this is a very difficult task.

CHAIRMAN BURNS. Coming quarter or coming year?

MR. EASTBURN. Well, in setting a long-term target, of course, we're setting a year's target, but since we do this quarterly, I think we do have another shot at it in a few months, and I think it would be in the near-term when the fiscal package would be going into effect. I find it helpful to go back and look at what happened in 1975, when we had a similar situation--had the tax rebate in the spring and, as you say, the Fed has been criticized since then for frustrating the fiscal action.

CHAIRMAN BURNS. It has been both criticized and applauded, with more of the latter than the former.

MR. EASTBURN. Well, it has given rise to some speculation that the Fed will try to avoid that kind of criticism by doing something different. Anyhow, I found it helpful to go back and look at '75, and I'd like to review that briefly. What happened was that the funds rate moved up somewhat to help keep the aggregates under control in the spring of that year. The aggregates, as you may remember, considerably exceeded the targets for a time: M1, for example, grew at an annual rate of 11 percent in one month, and 18 percent in another month--two successive months. The Committee did not change the long-term targets to accommodate those overshoots. And so, in effect, the Committee permitted some increase in rates, it permitted some overshoots in the aggregates temporarily, and it held the long-term target.

I think this is a good model to follow because it does have the advantage of supporting the fiscal action, of being careful to hold any increase in interest rates to moderate amounts--to only those amounts it would be necessary to prevent the aggregates from getting completely out of hand. It would permit the Committee to explain that its main concern is with the longer-term growth of the aggregates, and I would prefer, I think, to see us hold to the long-term target in that kind of a model.

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

MR. BLACK. Mr. Chairman, I've struggled with this dilemma that you described so well, and I reached pretty much the same sort of conclusion that you have, that despite the political problems that do arise from adjusting these rates down, that we ought to make a small move. I was a little surprised, really, that you knocked down the lower limits of M2 and M3. My feeling would be that those are probably all right. We need that much expansion, probably, and my preference would be to knock 1/2 [percentage point] off the upper ends of those two. But otherwise, I come out about where you do.

CHAIRMAN BURNS. Well, there's a lot to be said for that. I struggled with that issue, and I'm not at all sure that I came out correctly. The effect on the midpoint is the same.

MR. BLACK. I think that's important.

CHAIRMAN BURNS. And in that sense, the two are interchangeable. By leaving the upper value where it is, we would be less likely--that was my reason--to attract, or to encourage, or to excite criticism. Now, the troublesome figure is the high point, you see, the high value. And it's that high value that is outside the range of historical experience, and that would be a more direct way of approaching the point. I didn't, for the reasons that I've stated. The midpoint, which is the effective value, is identical; and by lowering the lower limit, we're less likely to incite criticism. I don't consider that a decisive argument, and I've great respect for your suggestion.

MR. BLACK. My feeling was sort of that they're saying, "My gosh, they're willing to tolerate only 7 percent growth in M2 with an inflation rate such as we've got, that's just not adequate." But your reasoning may be better on that. I don't have a great deal of trouble with one or the other. Some move, I think, should be made.

MR. LILLY. May I ask a question? In the past construction of the long-term rates, did you assign a weighting to the three Ms for the longer-terms?

CHAIRMAN BURNS. No, but in our shorter-term targets we've been operating under the general rule for some months now of giving approximately equal weight to M1 and M2. And since there is some relationship between the short-term and the long-term, even though it's a somewhat tenuous relationship, there is some carry-over--but only to a very mild degree, you see--of this Committee's short-term weighting. Mr. Kimbrel, please.

MR. KIMBREL. Mr. Chairman, I particularly appreciate your willingness early to give some evaluation of your reading of the possibility of thwarting fiscal policy by any action of ours. Candidly, I would feel somewhat reluctant to raise the M1 ranges, but I continue to be, as expressed earlier, very much attentive to inflationary possibilities--they continue to be unsatisfactory--and expectations, from my vantage point, are even more disturbing. Nevertheless, I think we need to demonstrate our concern for that expectation, and I am impressed with the prospect for maintaining a gradual lowering of the long-term target. So with that I think I would be very happy with exactly the prescription you have suggested.

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

MR. JACKSON. Mr. Chairman, I think the one thing we need to recognize in the discussion we're having, particularly in the M2 and M3 measures, is that the retention of approximately the same targets [assumes] a substantial reduction in the rate of growth in time and savings deposits, both in commercial banks and in thrift institutions, because the actual rate of growth in M2 for '76 was 11.3 [percent], which is out of our present range, and M3 was 13.1 [percent], which is even more substantially beyond. And I think we need to recognize that even retention of our present targets over time will constitute a substantial change from the present environment in which those types of saving activities are taking place.

Now, of course, the next question is, to what extent is a substantial change appropriate for the economic and inflationary prospects that we have before us? I personally feel that these aberrations, as I've said before, are to a large measure the product of this silly price-fixing mechanism called Regulation Q, and that the underlying fundamentals of the monetary policy that attaches to these are clouded by the shifts from one type of liquidity to another type. And we've seen some indications of that. I feel that, given the perspective of '75 that we had, and given the impact on economic activity that will take place--and there will be some real impact taking place as liquidity shifts from these types of savings forms to other types of savings forms if our long-term objectives are reached--that this will produce a salutary effect on inflationary prospects, but it will also produce some effect on real economic activity.

So therefore, I share the fundamental objectives that you outlined. And I think this perhaps will be much more real in [the effort to control] inflation and inflationary expectations than perhaps we recognize from the action taken today. And so I would support the proposals that you're making, but I think the impact will be much more dramatic if they are carried out.

After all, these are current objectives [unintelligible]. But I think the result, perhaps, is more dramatic than has been outlined in your statement because I think they would be very real, and probably even dramatic, in some of their economic ramifications.

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

MR. BALLES. Mr. Chairman, in some of your earlier testimony, it seems to me, you've done an outstanding job educating Congress as to the change in financial technology that's going on, and why M1, therefore, doesn't mean as much as it used to. And in fact, if adjusted for earlier conditions, [it is] perhaps as much as a couple of percentage points below where it otherwise would have been if these changes in financial technology had not come about. That's one point I'd like to get laid on the table as a background for my own personal views as to what ranges we ought to adopt.

And the second key consideration in my thinking was one that Governor Jackson has just alluded to, and that is, for some time now, we have had inconsistent ranges, I'm afraid, for M1 versus M2 and M3. The big overshoot we've seen in M2 and M3, we all know about, and I'm concerned that that will continue to go on; and that really, to be consistent with our M1 growth range, we have needed--for some time now--a higher range of growth for both M2 and M3.

The third consideration in my thinking is that, for some time, my staff has been calling my attention, and increasingly so in the very recent past, to the fact that, as they looked at the historical record, M2 has now emerged as a superior measure of monetary influence on the economy since about mid-'74, if you go back and make all the tests--from, say, 1960 to '74. The forecast of GNP through the third quarter of last year, using both M1 and M2--the M2 forecast is now showing a lower error than M1. In short, I hope that, if you feel you can help educate both the Congress and the public about that fact, [then] we perhaps ourselves [will pay] even more attention to M2 than we have. Perhaps weighing it even more heavily than the 50 percent that we've been giving it.

Before I came in and heard your persuasive remarks--and I'm impressed by all of the caveats that you've mentioned, about reaction to the Administration's new fiscal package to stimulate employment and a fear that we may be frustrating their objectives--I prepared a different set of numbers that I think might get around the problems which you mentioned. And that would be first of all to reduce the M1 growth range to 4 to 6 percent, based on another of your good statements about how financial technology is changing. And if you agree with the analysis that I've just gone through, to stress even more the importance that we now attach to M2--to make those growth ranges consistent--to up the growth range of M2 to 8 to 10 percent, and the M3, 9 to 12.

So if we did all those things, we would be, on the one hand, seeming to reduce the M1 range--not seeming to, we would be--by half a point in both the upper and lower boundaries. But assuming a satisfactory explanation, at which you are very adept, of why we're doing this--in view of the change in financial technology and the growing importance of time and savings deposits--we would be on the record as increasing by half a point the lower range of M2--that is going from the present [range of] 7-1/2 to 10, [up] to 8 to 10. And with regard to

M3, increasing by half a point the upper range, going from the present [range of] 9 to 11-1/2, up to 9 to 12.

I'm equally concerned about the danger of inflation that's been discussed at length around here this morning. And I'm quite concerned that if we in this year ahead were to experience the same sort of large overshoot on M2 and M3 that we had in 1976, we might well be setting the stage for significant inflationary pressures by 1978. Well, for that rather complex set of reasons, I would therefore suggest a possible alternative for the three ranges that I just mentioned.

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

MR. PARTEE. Well, Mr. Chairman, I believe I would support the ranges you proposed, recognizing in each case that they're pretty tight. With regard to M1, I'm a little surprised to hear President Balles suggest a reduction in the range, when earlier he commented that the implied velocity increase was extraordinarily large [on the order] of the 5-1/2 percent--that is where we were--in the projection. And I want to comment on that because I think that's true.

I believe that a 4-1/2 to 6-1/2 M1 range [is appropriate], given what I think are fairly optimistic views on inflation by the staff and a real growth rate which--it's all right, but just--is at the lower end of a range that people would seek, I think, in the abstract, for 1977.

It's a tight objective, 4-1/2 to 6-1/2. I'm not at all sure that there won't be people who will say that, "Well, in view of the fiscal program and the needs of the economy, the Committee should have increased its M1 ranges." But I think I wouldn't want to increase them, certainly not at this point, anyhow. I just would be afraid to make a further reduction, John, because of the implied velocity rise, even allowing for Steve's 1 percentage point for shifting definition. You still have a large velocity rise--if I understood you right, you said 5.8 percent for the year, and if you take that point off, that would make it 4.8, and that's still above the usual experience.

Also, although I agree with what the Chairman said about the poor predictive results of the St. Louis model, I think the St. Louis model must have said about the same thing, given President Roos's statement that we can't make that real growth [projection] with the money supply range we have. Therefore, I am a little uncomfortable with 4-1/2 to 6-1/2--I think that the needs of the economy might be for more rather than less--but I would support the 4-1/2 to 6-1/2.

Now M2 and M3--I think we need to recognize that what we're doing essentially is projecting interest rates. Given the M1 growth rate and the performance of the economy, M2 and M3 will be largely a function of interest rates. Governor Jackson is quite right that the upper ends of the present ranges for M2 and M3 imply a considerable increase in interest rates. Because throughout 1976, we produced numbers a good deal higher for M2 and M3; and in the fourth quarter of 1976, we've produced much higher figures for M2 and M3 given the interest rates we had at that time. I'm inclined to think there will be some increase in interest rates, but I can't support President Black's suggestion that we reduce the upper end of that range, since I think it's already a tight squeeze. It implies that we anticipate a considerable increase in interest rates as the year goes on to get down within the present ceiling on M2 and M3.

I would, however, be prepared to support a lower limit of the range, and the reason I would is that we've been so miserable in our interest rate projections that, in fact, there could be a lot more interest rate rise than we expect as the year goes on, which would tend to produce low-end numbers for M2 and M3. And I doubt that, on those grounds alone, the Committee would want to loosen up on policy. That is, [if we get], let's say, a very high federal deficit or a shift--as I said before--in the full employment deficit number to a much higher number, you [will get] considerable upward pressure on rates, and those savings inflows [will start] to recede significantly. I doubt that we would want, on those grounds alone, to pump a lot more money into the economy. In fact, I think we'd probably be inclined to go the other way. And therefore, I think it's consistent to have a lower low end, Bob, on M2 and M3, rather than to reduce the high end, even though historically you're quite right that those numbers are a little bit on the high side.

CHAIRMAN BURNS. They're very much high.

MR. PARTEE. Well, but with a 5 percent inflation rate, and the desire for real growth [to move] from 6 to 7, it requires quite a sizable number I believe.

CHAIRMAN BURNS. The average rate of growth of M3 for the period 1966 to 1975 was 8.8 [percent]. The average for the period 1971 to 1975 was 10.8. The average for 1976 was 12.4. The corresponding figures for M2 are 8.3, 9.5, and 10.9.

MR. PARTEE. And you're suggesting an upper limit of 11-1/2 on the range for M3, and of 10 for M2, which is less than last year's result in both cases.

CHAIRMAN BURNS. That's correct. Last year's result was very much out of the ball park.

MR. PARTEE. My point, simply, Mr. Chairman, is that I think the Committee must be aware of the fact that--because we're talking about relationships among the family of aggregates--it's basically projecting interest rates. It may be that, sometime in the year, Regulation Q could give, which would hold the number up. But I hate to predict that, because of the difficulty in negotiating those changes. So, altogether, I find myself prepared to accept the numbers you have suggested. But I do want to note that I think that in each case, the range is tight relative to what we expect the economy to do.

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

MR. BAUGHMAN. Mr. Chairman, I've wondered how we're going to handle this situation in the environment that we apparently will be in, and I hadn't been as resourceful as you have been in terms of how it might be handled, because I had tended to think in terms of some change in the top instead of the bottom of the ranges. I'm prepared to support your proposal. It seems to me it's probably about as optimal a suggestion as could be, of the proposals that could be put together, given the prospective environment that we're going to be in. I would go with you.

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

MR. MORRIS. Mr. Chairman, I guess I'm in a minority position in this, but it seems to me that there are advantages in the present situation of staying with the present ranges. I think you're quite right that we must have a policy of gradually moving down the ranges. But I don't think we ought to get an [unintelligible] policy--to have a feeling that we've got to make a change every three months. It seems to me, given the state of the economy, that on pure economic grounds, a case could be made for staying with the present ranges until the leading indicators of capital spending start showing some strength, which they don't at the moment. And my second reason is that, it seems to me, this is not a change. The change you're proposing is not a change in substance. This seems to me to be a questionable judgment.

I would prefer [waiting] until the next meeting of the Committee, [which] would be in May. It seems to me that would be a better time to make changes. I think we would be better off to stay with the present set in this particular context.

CHAIRMAN BURNS. I would only make one comment. There's never a good time. I've learned that from very long and hard experience. Secondly, the next time we turn to this subject will be in April, and the Congress may just have passed the fiscal bills recommended by the President, or be on the point of passing. That isn't going to be an easy time for us, either, in terms of what Mr. Baughman euphemistically described as the environment.

MR. MORRIS. Well, I think you're quite right, Mr. Chairman, but I think that if we were making a change in substance here, and [if] I thought we had the economic case to make it, I think it would be quite different. But to make a change that I don't think is substantive in this climate--I don't think that it makes a lot of sense.

MR. WALLICH. On the fact that there was an overshoot in M2 and M3, I would like to explore this a little. If we were to continue with the same ranges for M2 and M3, we would be doing nothing to correct for that overshoot. In other words, we would be allowing base drift to proceed. Now this is a convenient way of dealing with a past event, but it does not reflect the intentions that we had three months ago when we set this target. If, on the other hand, we bring down the range for M2 and M3, we would be making a correction of this overshoot, and I think that should carry some weight.

Now, as to whether to reduce the upper or the lower end and whether these reductions should involve a change in the midpoint with respect to six months ago, is a more complex matter. There is some logic in bringing down the upper end, precisely because of the overshoot element. On the other hand, we've learned, I think, from the experience of past hearings, that Congress is more sensitive to the upper than the lower ends.

Now let me comment for a moment on M2 and M3. I don't feel like giving much weight to M2 and M3 in the short run. In the long run, M2 has turned out to have been remarkably stable--over the last 15 years. I can only think at the present time that this is the result of two conflicting trends. The M1 component has all the instability that M1 has, and the time and savings deposit component has instabilities which we are familiar with, namely the intermediation process that occurs because market interest rates are low. So, stability here is, I think, [a] balance [of] conflicting forces, either of which could change, and for that reason M2 in the short-run does not impress me as a very valuable guide.

I think the logic of the situation is that M2 will tend to move more slowly as interest rates go up, and in that sense, my concerns about base drift will be allayed. Also, the inconsistency that has been observed on the M1, M2, [and] M3 targets--the trends are just not in line with the way our ranges are set up. That, too, I think is likely to come more into line [if], over the years, interest rates go up.

One last concern--the targets ought to be flexible. We want to be able to change our minds. The only consistent action we have taken is to lower them over time. This, too, is an element where flexibility or inflexibility can play a role. I agree with you, Mr. Chairman--there is never a good time. I suspect that now is perhaps a better time than three months from now to do it. I would like to caution us that we may run out of half percents, which [unintelligible] to reduce over time as we go, if we operate on the fringes as we have to, if we do that on a quarterly basis. So--

CHAIRMAN BURNS. Proceeding as we have, Henry, I've made some calculations--it will take us ten years. Ten years if we're lucky, if we don't have any recession, and if we just persist in doing pretty much what we've been doing.

MR. WALLICH. Well, I feel apprehensive about quarterly changes. This one, it seems to me, has a good deal of logic, and I support the reductions in the lower ends of the M2 and M3. So I do not arrive at a different conclusion. But there are some considerations here, I think, that at some time might need to be examined more in depth.

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

MR. WINN. I'm a little bit of the devil's advocate today. I'd like to refresh our memory as to where we set our target three months ago, when we were faced with a pause. We were concerned about the outlook, and we were not nearly as positive as we are at the moment; yet we took a stand for cutting back at that time in view of our concern about inflation and so forth. It seems to me that we've got a much more positive economic environment at the moment but more legitimate concerns about the inflation problem, and therefore I think we have to make some sort of a gesture, although I get uneasy as to just exactly where that should be. But I think we have to persist at this time. And I would follow Dave's advice to be a little more tolerant of an overshoot or a miss here in this first period as a way of both maintaining a posture of concern and target and at the same time adjusting to the realities of the situation.

MR. PARTEE. That's a question of short-term targets.

MR. WINN. That's correct.

MR. EASTBURN. It is a question as to what we mean by targets.

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

MR. COLDWELL. Mr. Chairman, I've been debating this matter in my mind for several days, weeks, months as to where to opt for standstill or some modest lowering of targets, and I agree with you that, if we are going to lower targets, M2, M3 [offer] the better logic than M1.

The arguments that I devised in my mind went something like this for a standstill: We do have adequate range [from] where we stand today to probably come within that. We certainly exceeded the M2, M3 this past year; I believe we came within the targets for M1.

I don't believe it is absolutely necessary for us to move every time, and perhaps when we see something very strong in the way of a move, it might be worthwhile to knock a full percentage point off instead of a half percentage point, and maybe cut your years to 5 instead of 10. But the lower growth rates, I think, can be reached within our current stance. Certainly if we're looking at a 5 percent inflation, we're going to have to accommodate some of that in our aggregates.

But I look at the primary function of these annual rates, [and] as I see them, [there are] basically two. First, the public perception of what we're doing and the congressional oversight position. And second, some very broad Committee guidance--I would emphasize very broad--because I don't hear many Committee members, perhaps excluding President Balles, who keep reminding us that our short-run [targets] ought to be somewhat consistent with our long-run targets. And consequently, while we get some very broad guidance out of [the annual rates], our performance really hasn't been tied very well to the long-range targets.

I think the possibilities over the coming year are interesting--almost a possibility of a reversal of 1976--in that we might get greater M1 growth and lower M2, M3 growth, especially if we really believe that this economy is going to move up strongly and interest rates advance with it. To lower the targets comes down to a point, really, of the degree of harassment you want to take at your hearing, because I think you will get harassed by a Congress that says, "Well, you are trying to frustrate us, and you're not going to provide the funds necessary to make our fiscal policy work." Now that doesn't bother me, because I'm not on the stand now. It may bother you considerably before your hearing's over.

But assuming you can get away with this without too much harassment, and I believe you can because of the particular points you picked, I'm perfectly willing to [reduce] the [lower end of the] range [for M2] to 7 and [for M3 to] 8-1/2. I would like to point out to the Committee that we do have a different spread in these three aggregates. M1 at 4-1/2 to 6-1/2 is a 2-point spread, and I have heard some around this table [who say] that it ought to be a single-point number and others who want a 3- or 4-point spread, including those who said it doesn't matter a bit whether you're talking 4 or 8, it means the same figure.

CHAIRMAN BURNS. That comment touches one of my nerves. I have made that comment repeatedly with regard to our two-month targets. I've never made it with regard to the long run.

MR. COLDWELL. No, I recognize you have not made it for the long run. Nevertheless, M2 and M3 are presently on a 3-point spread. Now, I haven't got any strong feelings about this because I am not much of a short-run believer in these things. But [for] the long run, I have some belief in these figures, and I would like to see if maybe we could talk some day about a little narrower spread on the long range in the upper end instead of the maintenance of the 3[-point spread]. And, unfortunately, what you're suggesting enlarges the spread instead of narrowing it. We did narrow it before; we enlarged it last time by raising the upper end, and now we're going to lower the lower end, which enlarges the spread again. Well, this long diatribe will come to a halt. I am willing to accept the M2, M3 change. I would have been willing to accept a standstill because I don't think it is absolutely necessary for us to move every time.

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

MR. MAYO. I am quite willing to accept your prescription, Mr. Chairman. I started out going Frank Morris's way--no change. Then I began to worry that, just about the time that we come up for this three months from now--and I feel much surer [now] in my own mind--I wouldn't want to see us make a change [then]. And if we're going to pursue our longer objectives, I would rather see us do it now. Congress is either going to be in the process of passing a tax cut or will have just passed one when you go up three months from now. And I think the eagle eye will be placed on us 10 times--well, it will be 10 times as difficult to explain a change in our targets at that point than now, everything else being equal, which of course it never is.

But on the basis of what limited foresight we have at the moment, I would prefer to see us make some recognition of our desire to reduce the ranges over a period of time. I subscribe to cutting the lower [end of the] range on M2 and M3 because I think that, if you look at the maximums and minimums of all three of these ranges, these are the least sensitive ones in terms of what you might call our justification for going above or below, in a minor way, from the minimum of the M2 and M3 ranges. M2 and M3 ranges are in part a product of Regulation Q and the disintermediation process, and, unlike Phil Coldwell, I see no objection to eventually widening the spread a little bit on both M2 and M3 rather than narrowing [it].

CHAIRMAN BURNS. All right, thank you, Mr. Mayo. Mr. Gardner now.

MR. GARDNER. I think we've had a kind of good discussion about the prospects of the economy and we have at least a seeming consensus of what is ahead. I once spoke about the fact that it is not necessary to change at every meeting of this Committee. But when I see a road ahead that I generally perceive [as desirable], then I want to get about our business.

Now, we've had an overshoot in M2, M3. Henry, I take exception to your view that they've been remarkably stable over the years. Actually, I think you could build into the numbers evidence of a continuous expansion of growth and size.

MR. WALLICH. There is a lot of work done on this which shows that, over 15 years, M2 has been very stable.

MR. PARTEE. Relative to GNP.

CHAIRMAN BURNS. Starting around 1961. If you carry it back just a few years, it all collapses.

MR. GARDNER. Well, I have another view of M2, and M3 particularly, and that is that it isn't only [Regulation] Q; it's the technological change in the way transactions are handled, which you are all familiar with--telephone transfer, NOW accounts, and what have you. And I want to get about the business of this overshoot. We have had half again as much overshoot as we have range in M1, and almost in M2, and almost in M3. So I think it's wise for us to lower the bottom, reducing the midpoint by 25 basis points. Because, really, as Governor Jackson says, what we've got to do is to forget about putting these two aggregates somewhat closer to our targets. Quite a bit over on both of them. They aren't going to change and become less of a key in the economy.

The two--the velocity of money and the liquidity quotient of the economy--they are going to become more liquid, they are going to become more volatile. At least they're going to move more rapidly. M1 loses status in my mind. M2 and M3 are inevitably going to be more interconnected with the current state of transactions balances in the economy. So I'm perfectly happy widening the range a little bit, lowering the lower limit. I think that what we will be concerned with in the short range is our interest in the overshoots that we have had in the last year. And I even think this is consistent, or at least it takes cognizance of Dave Eastburn's admonition. If there is a rebate or what have you, I wouldn't lower the top of the range. I'd lower the bottom of the range.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Mr. Guffey now, please.

MR. GUFFEY. Yes, Mr. Chairman, in preparing for this meeting and sharing the desire to continue to move downward, I think we came to the judgment that whatever we might do should be principally cosmetic. And we came out, much as you did, to lowering the lower [end of the] range of M2 a half percentage point.

We had thought some [about] the M3 as well. Listening to this conversation, I wonder as to the wisdom of lowering M3, and particularly drawing the fire that may come from it [because] M3 figures [are] made up of savings and loan and other types of deposits, which may imply that we are indeed going to do something to housing very early in 1977 or through 1977. We need not draw that fire. So I'd stick with just going down on the M2 side.

CHAIRMAN BURNS. All right, just one point: Leaving the upper limit of M3 unchanged should, I think, protect us against that criticism, assuming that criticism is going to be rational, which it sometimes is, and often is not.

MR. PARTEE. Mr. Chairman, I wonder, did the staff do any estimates to see what that M3 would do to housing? Did you project it?

MR. AXILROD. I don't believe [so], Governor Partee. We didn't project for the lower limit.

MR. PARTEE. No, but for the upper limit--M3, well anything.

MR. AXILROD. No, we did not project. Because [M3] includes time and savings deposits at banks, which are going down, I don't believe lowering it a quarter of a point would be offset by additional lending by the Home Loan Banks. So I don't think you're going to get any significant impacts on housing from that minor change.

CHAIRMAN BURNS. You know, they've been flooded with money. If they have a problem, they can easily solve it through 1978.

MR. PARTEE. The question that I had in my mind and, I think, that Governor Jackson had in his mind is whether coming down from where we've been recently--not with the upper end of the ranges but where we have been--won't create quite a wrench in housing. And that is a matter of flow of funds projections.

MR. AXILROD. Of course, that's basic to the projection of GNP that we've already presented to you. And that working-down is built into that projection.

MR. PARTEE. So, do you have a rising level of starts with an M3 within the ranges that we're talking about?

MR. AXILROD. Yes, that's right.

CHAIRMAN BURNS. Thank you, Mr. Guffey. Mr. Volcker, may we hear from you now.

VICE CHAIRMAN VOLCKER. Just on this latter point, I would think part of the rationale--although I haven't worked the figures through very carefully--is that an awful lot of M3, in effect--certainly in the savings banks--is now going into the corporate bond market rather than in the mortgages. There's quite a lot of slack to be taken up if there was a real mortgage demand.

But more generally, you can't help but sit here and be struck by the degree of consensus around the table, which means that there is very little to add. The differences are very narrow. Certainly, in approaching this problem, I've been impressed by some points that have been made repeatedly, that these targets are so high relative to our ultimate objectives, and we've got to work them down. They're also high relative to historical experience, including '72 and '73, when the Federal Reserve had a lot of criticism for stimulating inflation. And both those factors are fundamental to my approach.

It's a little tricky to work it in with the present economic outlook and the question of whether we're consistent with the fiscal strategy of the Administration. As I view the outlook, I feel relatively comfortable, but I still do think there is a major problem in the investment area, which probably won't materialize in 1977 in terms of capacity restraints, but well could in 1978. And I don't see us making very much progress in that direction. And the possibility of greater congestion in financial markets, which was referred to this morning, on the surface at least, doesn't help.

Take that all together and, in a kind of theoretical way, you could say what the doctor orders here is a tight-fiscal-policy, easy-monetary-policy kind of approach. But there is an overwhelming argument against that. We ain't got the tight-fiscal-policy approach. That's quite evident. So you have to work within that framework. And I think expectational factors here are very important in terms of that potential congestion in the market as related to the prospects for inflation.

So I think it's very important that we do maintain a posture of not releasing the bands on inflation, and that may--through the expectational route--help avoid late, excessive congestion in financial markets and avoid inflational tendencies that we're all worried about. So I can rationalize, for my satisfaction at least, reversing the presumption of tight fiscal policy and easy monetary policy through that expectational route.

My feeling coming here was that I'd be perfectly happy to see some gesture, not very substantive, toward reducing the targets. But I was certainly prepared to support no change, in recognition of the enormously difficult problem of explanation at this particular juncture. If we were going to make a change for more or less technical reasons, I was a little more on the Balles side in thinking that maybe at least the lower limit of M1 ought to be reduced--this consistency point that other people have referred to.

But I think you can also argue that M2 and M3 have been moving at an exceptionally high rate with a change in the environment of the financial markets. And particularly without raising the upper limit, as you have suggested. This can be rationalized over a period of time. So I'm quite happy to go along with your suggestion, recognizing that you volunteered to take on the burden of explaining, which I think is crucial here, and I think you have the equipment, as you demonstrated here this morning and in the past, to do that. So on that basis, I'd rather follow the instinct to get at some small gesture, at least, toward reducing the aggregates in the manner you suggested.

CHAIRMAN BURNS. Thank you, Mr. Volcker. Would anyone else like to be heard? Yes, Mr. Van Nice, please, and welcome to our meeting, Mr. Van Nice.

MR. VAN NICE. Thank you very much. Since I haven't been here for 2-1/2 years, I would like to give you a fresh viewpoint, but I am rather disappointed to say that I find, as Mr. Volcker does, that there seems to be a reasonable consensus here this morning, and I share that consensus. I think the Minneapolis view of the economic outlook is remarkably similar to that projected by the Board's staff--that alternative B, which essentially is what you're recommending with the two modifications you mentioned, is consistent with the projected economic outlook. And that the short-term money market objective, or federal funds objective, is consistent also with no change, which I think is, for the reasons you have stated, the sort of prescription to me that we need at this time. So I would certainly support your recommendations.

CHAIRMAN BURNS. Thank you, Mr. Van Nice. Would anyone else like to speak? If not, I do think that we have a rough consensus as to numbers. There is a consensus in another respect, and this goes--I have only one quarrel with your comment, Paul--at one point, you refer to being quite happy. I don't think anybody is quite happy with this exercise; there is a consensus also of not being enthusiastic. It's very hard to be enthusiastic, and I share that light enthusiasm.

But in view of the rough consensus that has emerged, I would like to put to a vote now the following targets for the 12-month period from the fourth quarter of '76 to the fourth quarter of '77: 4-1/2 to 6-1/2 percent for M1, 7 to 10 percent for M2, 8-1/2 to 11-1/2 [percent] for M3. As for the credit proxy, I suggest that we follow the practice that we have in recent meetings and leave that to our staff. Any number determined by our staff as being rational will be accepted by the Committee.

Now, so we'd be voting on M1, M2, and M3 as I stated. Are there any questions before we begin the voting? Would you be good enough to call the roll?

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
President Balles	Yes
President Black	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
Governor Jackson	Yes
President Kimbrel	Yes
Governor Lilly	Yes
Governor Partee	Yes

CHAIRMAN BURNS. Yes, Mr. Winn.

MR. WINN. Could I raise a question? Steve, I got troubled on your Appendix 3 in the Bluebook in terms of your federal funds rate projection. Now, is the failure of that behavior [mean] that higher rates at the moment would indicate a less rapid rise in the future due to the fact that that should be projected out over a couple more years?

MR. AXILROD. Higher rates?

MR. WINN. Well, of the federal funds rate?

MR. AXILROD. It would indicate lesser growth in what over the future?

MR. WINN. The federal funds rate in the future. See, you've got the high rates currently--raise the rates currently--to get even higher rates at the end of the year.

MR. AXILROD. Oh, well, alternative A pertains to a longer-run growth path for M1 that is higher than the one adopted by the Committee. Alternative C pertains to a longer-run growth path that's lower than the one adopted by the Committee. So alternative A simply permits a more rapid money growth and thus a lower funds rate; and alternative C has a more restraining money growth rate and thus a higher funds rate. I'm not sure I'm answering your question.

MR. WINN. Okay.

MR. PARTEE. We should look at B as being the projection.

MR. AXILROD. B is the projection that would be consistent with what the Committee has adopted today for the long run.

CHAIRMAN BURNS. Any other questions?

VICE CHAIRMAN VOLCKER. Just one brief question of what impressions or facts the staff may have about the prevalence of a reduction in the passbook rate, or savings certificates rates, around the country.

MR. AXILROD. I don't believe we have anything more specific than we presented last time, and it's just scattered reports. You don't have anything beyond that, President Volcker.

CHAIRMAN BURNS. Mr. Black, please.

MR. BLACK. Steve, you may have answered this--I know you have skirted it very closely--but I was a little surprised when I remembered that, back in 1975, when we had that sharp jump in M1 and M2 in May and June, when we had the tax rebate--since we have larger refunds coming this year, we are going to have a rebate too. I would have thought your second quarter estimates of M1 and M2 would have been higher than they really were. Is there something that I'm missing there?

MR. AXILROD. In 1975, the first quarter rate of growth was very small, of course, 0.6 percent, and the second quarter, on average, was 7.4. And we have assumed this year, in our tentative working out of a pattern in the second quarter, that the rebates will move out of demand deposits perhaps faster than they did last time.

As you recall, last time, May was very high, and June was even higher. We are assuming a faster movement of the rebates out of demand deposits into other investment instruments or spending this time than [we did] last time, on the assumption that people learn. Now whether that will in fact develop, I can't be sure. Also, we are not really certain as to the size of the rebate--it could vary between $7 billion and $11 billion; we assumed 10, not too far different from last time.

MR. BLACK. You do have pretty large refunds, don't you?

MR. AXILROD. Well, again, the refunds come, and it depends on the pattern, because what goes in in March goes out in April, and it has a negative effect on the April growth rate. So you might get a high March growth rate and a low April growth rate, [and] a high May growth rate as the rebates come in; if they go out, move into deposits, you get a low June growth rate. And that's roughly the kind of pattern we have assumed. God knows whether it'll be fact or not.

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

MR. EASTBURN. Steve there has been some talk in the market about the uncertainties of seasonals, particularly at this time of the year. Do you have any feelings to whether they are more uncertain now than--

MR. AXILROD. We hope to have new seasonals by the next Committee meeting. We have held them up, waiting for the June benchmark; we do them both simultaneously. I am absolutely certain, from following past experience, that the weekly seasonals are going to be revised substantially. The large weekly variations that we have seen will be much dampened. I have no feeling at this moment about the monthly seasonals. I have no reason [to think] that they will be changed in any significant way at this point.

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

MR. WALLICH. Steve, we've chosen for the long-term ranges something close to alternative B. If we were now to choose something like alternative C for the two-month ranges, then, of course, the interest rates path of Appendix 3 will not apply. But there will be something like the usual pattern, which shows that C means a higher funds rate earlier on but a lower funds rate relative to the other alternative later on.

MR. AXILROD. Yes. If you choose the interest rate pattern implicit in alternative C, that is, a higher federal funds rate over the next few weeks, which is about 1/2 point, then our ending point on the funds rate would not be 6-1/2 percent, as it is under alternative B; it would be somewhat lower, on the thought that the Committee has put the restraint in earlier, and thus you wouldn't need it as much as time goes on.

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

MR. PARTEE. Well, going back to President Black's question, what we can look forward to with some confidence is a bulge, maybe as early as March, with the refunds of 1976 tax payments, certainly in May and June depending on the timing of the rebate. And so it puts us in sort of an odd situation; the January and February numbers are not extraordinary in any way, but we all look forward with anticipation to these bulges, and we can't do much about it.

MR. AXILROD. Yes, but I might add that it seems as certain as death and taxes in May and June. The refunds that we are projecting--and we could be off again on that projection of the amount of refund--but if it does turn out to be $3 billion higher, it's likely it will bulge in March.

CHAIRMAN BURNS. Thank you, Mr. Axilrod. We have to make a decision as to the procedure. It's 5 minutes to 1:00. And we could continue this meeting and perhaps reach a resolution as to our short-range targets quickly, or we could break for lunch and come back at 2:00. What is the pleasure of the Committee?

MR. PARTEE. I think we ought to break.

CHAIRMAN BURNS. The suggestion has been made that we break for lunch; I hear no protest.

[Lunch break]

CHAIRMAN BURNS. Now we are ready for item 4. Let me give you the housing figure. Here is the way they have been running, to give you a frame of reference:
August--1,537,000;
September--1,840,000;
October--1,814,000;
November--1,716,000;

December--1,940,000.

MR. PARTEE. Single or multifamily?

CHAIRMAN BURNS. Increase in both. Let me give you the multifamily:
August--366;
September--560; remember there was a sudden increase associated with special activity by HUD;
October--477;
November--479;
December--617.

On the other hand, building permits figures show somewhat different results:
July 1,215;
August 1,296;
September 1,504;
November 1,590;
December 1,513.

So there is a small decline in permits, a large increase in housing starts with a trend in both-- a favorable one, a rather strong one.

Gentlemen, we now have to turn to the decision on the domestic policy directive for the coming months. What I find particularly difficult is the specification for the federal funds rate this coming month. Now, in alternative B, I find myself really wrestling [with a choice between] the federal funds rate specified under alternative B, and a still-smaller range that is 4-1/2 to 5 percent.

Now, you know, these ranges have to be realistic. I thought for a time of a range of 4-1/4 to 5-1/4, and I asked myself a question: What would happen to the world we live in if the federal funds rate were to rise from 4-5/8 to 5-1/4? I would say that, for the coming month, it would be an unacceptable increase. So I brought it down to 5, and then I asked myself a question: What about the rate going down to 4-1/4? Well that's possible; 4-1/2 is perhaps better. I could live with one or the other. I think I would like 4-1/2 to 5 a little better. As for the growth rates, those under alternative B look all right to me; perhaps it might be shaded by a 1/2 point.

MR. PARTEE. That would put them at about alternative C, if you shade them.

CHAIRMAN BURNS. That's right. Well, that's the way I see matters for the month ahead. Who'd like to speak on the subject. Let's see if we can't go round the table and do it with reasonable speed. It's now 2:30, and there is a lot that all of us still have to accomplish before this day is over. Mr. Coldwell.

MR. COLDWELL. Mr. Chairman, I found myself in the same box you did because the only thing I really have much problem with is the federal funds rate range. I don't have any problem with the alternative B objectives. The federal funds rate range, though, I came out differently than you did. Although not differently in the center point. I just think if we are going to have an opportunity to make this work, we have got to have that range wider, and I picked the 4-1/4 to 5-1/4 range, which puts me exactly at the same center point of 4-3/4 that you have [put] down. Directive-wise, I take a status quo position.

CHAIRMAN BURNS. All right, thank you, Mr. Coldwell. Mr. Volcker, please.

VICE CHAIRMAN VOLCKER. My feeling about the interest rate range is exactly as you expressed it. I'd be hesitant to see it move from 4-5/8, but [a] 4-3/4 percent midpoint is okay. And I think in practice it should be narrower; however, as far as how we put the thing formally, I can't see what would happen to this market if it went above 5, or I think it would be very misleading if it went below 4-1/2.

Let me just make one point on ranges for the aggregates. Governor Coldwell raised the point this morning that we didn't relate them enough to the long-term targets--or, [remove] the word "enough"; we don't relate them [at all], usually. I think we should; that should be our usual point of departure, and I just want to make that point and associate myself with Mr. Balles--he's another one who's made it. Typically, these short ranges ought to straddle the long-range targets. There may be particular instances when we want to deviate, but we ought to be clear why we are [doing so]. And we shouldn't take as our point of departure these short-term projections, which are very erratic, anyway. Our basic point of departure ought to be the long-term range and then deviate if we have a good reason.

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

VICE CHAIRMAN VOLCKER. Oh, excuse me, let me just add [where] this leads me, I guess.

CHAIRMAN BURNS. Yes, I was going to ask that.

VICE CHAIRMAN VOLCKER. I was going to live with alternative B--I suppose I would be a little happier, particularly if M2, in the light of our decision this morning, was reduced by 1/2. I think there are some reasons to make it a little higher at the moment, in the long term.

CHAIRMAN BURNS. All right.

MR. PARTEE. Well, I don't exactly agree with President Volcker's "straddling" the long-term range. I think a lot of times you got a month, and the two-month average that we know is coming in pretty high or pretty low. And so it becomes just impossible, unless you just disregard it, to have something in that midpoint. This doesn't happen to be one of those times, although I guess generally [unintelligible], and tremendously so. I would rather have the lower ranges, too, for these two months, because I am concerned about the bulge. And if we could, I would like to save up a little room to accommodate the bulge when it occurs. Now I don't mean by that to make it a very low number, but 3 to 7 on M1, and 7 to 11 on M2 seem to me to be reasonably high numbers. And if could save a half point there, why, we are going to need it, I'm quite sure, if there is a [tax] rebate and if it's of the size people have been talking about.

And we should, I think, start now to plan our strategies so that we don't seem to [take an action] that people would imagine as a contradiction to the fiscal policy action--the kind of response we got in the spring of '75. So I would go for the short-range specs of alternative C.

As far as the funds rate is concerned, I can't really disagree with the Chairman--4-1/4 seems low and 5-1/4 seems high. But we are getting awfully myopic on this question of interest rates, and if the aggregates were quite strong, I could imagine us wanting to do this, perhaps as high as 5-1/4; if they were quite weak, I could then imagine us deciding maybe we ought to pull back a little bit--perhaps as low as 4-1/4.

So, although I don't have a great deal of happiness about the bottom quarter or the top quarter of that range, I would prefer the 1 point range--4-1/4 to 5-1/4. And I don't really think we have any good basis for continuing on a money market directive type of approach, as we had in the past month, since we are through that period of extreme uncertainty. So I think if you're going to have an aggregates directive, you need a point range. So I would vote 4-1/4 to 5-1/4, but use the 4-1/4 and 5-1/4 points sparingly.

CHAIRMAN BURNS. No--

MR. PARTEE. That is, well, you'd have to have a high number on both or a low--

CHAIRMAN BURNS. No, no, wait, wait--we have been through all of that. For a time, we would fix on a range and then we would say, oh no, let the effective range be smaller. That got us into difficulties. The range that we decide on, we've found through experience, is the range that ought to be available to the Desk to use in full. Now, circumstances may arise between meetings when the Chairman may seek the advice of the Committee on going beyond the range or not going up to the limits of the specified range. But if we decide on 4-1/4 to 5-1/4 today, that should be our decision and that should mean that the Desk is free, assuming there are no further instructions to the Desk, to use that full range, depending on the behavior of the monetary aggregates.

MR. PARTEE. If we got to the extremities on the aggregates. But we would have zones of indifference--

CHAIRMAN BURNS. Oh yes, oh yes.

MR. PARTEE. All right, then I'll retract: 4-1/4 to 5-1/4 straight--that will be my vote.

MR. COLDWELL. It'll take three weeks for the Manager to understand where he is anyway.

MR. JACKSON. Did you say "to the extremities" or "through the extremities"?

MR. PARTEE. I said "to the extremities."

CHAIRMAN BURNS. Well, "to" or "through"--

MR. PARTEE. If you were at the extremes on M1 and M2. One other point, Mr. Chairman. I sort of feel, as I think President Volcker inferred, that we're probably at the bottom, and rates are going to be moving up. We've been wrong about that before, and we could be wrong about it again, and I don't think we ought to make the judgment final. And therefore, if we did get extreme weakness, maybe we ought to let them drift down a bit.

CHAIRMAN BURNS. We'll move on now. Mr. Kimbrel now, please.

MR. KIMBREL. Mr. Chairman, I believe Governor Partee has phrased my honest feeling about this. If had my druthers, I [would] really prefer to see the funds rate with a somewhat larger spread. I recognize the problem that we face and am prepared to accept this narrower 4-1/2 to 5, but that doesn't mean I am overwhelmingly happy about it.

In M2, I would like to hope that we could not exceed the long-run targets, or maybe that's too much to expect at this moment, but I would like to see us shave at least a half point, to 7-1/2 to 11 if we could; but within that, the alternative B seems to be the most acceptable.

CHAIRMAN BURNS. Thank you, Mr. Kimbrel. Who'd like to speak now. Mr. Mayo, then Mr. Black.

MR. MAYO. Well, Mr. Chairman, I [do not have] a very decided preference, but I do have a preference for Chuck's prescription on a 4-1/4 to 5-1/4. I think a 1 point spread--I find it a little more comfortable than a 1/2 point. I think we are zeroing in a little too closely on the federal funds constraints if we make it only a 1/2 point spread.

On the M1 and M2, the differences between alternatives A, B, and C are minuscule, and I find that we've sort of become dedicated to a 4 point spread here. I see nothing wrong in this instance to have a 3 to 8 on M1 and a 7 to 12 on M2. Not with the purpose of embracing all three assumptions, which sounds sort of Machiavellian, but rather just to indicate that, again, we are not going to have trigger points that are really unreal here. And I think the spread both ways would give us a better feeling with regard to the way we are using the federal funds.

As far as the money market versus the aggregates directive, I have a slight preference for money market, but it's very slight.

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

MR. BLACK. Mr. Chairman, our projections for January, like those of the Board staff, suggest that M1, anyway, will come in a good deal stronger than we thought a month ago. But I think we've got particularly difficult problems this time of year, and we have been studying this pattern that develops around the Christmas season--beginning in November and ending in February. And it makes a whale of a lot of difference where the weeks fall; you have what appear to be pretty random factors that make a great deal of difference as to whether the rate of growth shows up in February or January. And we don't believe that either the monthly or weekly seasonal factors take very good account of this, and so in essence we really feel that you have got to take a look at the two months in tandem before you draw any very valid conclusions at this time of the year.

In essence, anywhere between 4 and 7 percent to us would not necessarily mean that you are getting off your long-run trend--that [it] was accelerating, in other words. So, what I am saying is, not that “4 is 8,” exactly, but “4 is 7” anyway you look at it now. So I think that I would value your suggestion on this. I never thought that I would want to go for a money market directive two months in a row, but because of the particular uncertainty about the aggregates this time of the year, I believe that’s the wisest course for the time being.

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

MR. BALLES. Well, a number of those who have already spoken have, in effect, given my speech. In view of the sustained overshoots we had in M2--given my own strange sort of view that M2 is probably a better predictor of what’s going to happen now than M1--I think it’s time to lean against that overshoot a bit, and hence I would like to see the federal funds rate edge up a little. And also because I am convinced that we should have a full-point spread in the federal funds range, I would join those who are commending a 4-1/4 to 5-1/4 federal funds range. But for the reasons that Governor Partee has already alluded to and my own concern about not getting clear outside of our long-term ranges in the short run, I would favor the alternative C specifications on M1 and M2.

CHAIRMAN BURNS. Thank you, Mr. Balles. Who would like to speak now, please. Mr. Wallich.

MR. WALLICH. I think the matter that should dominate our thinking is the prospective bulge, and that’s been very troublesome in the past. I therefore feel that Governor Partee has a very good point in suggesting we accumulate a little reserve. That leads me to alternative B, shaded downward by 1/2 point on each end. Once the bulge is within immediate distance, I would also go to a money market directive. This time, I would stay with an aggregates directive. And with that in mind, I do lean toward a wider funds rate specification and would like to go with 4-1/4 to 5-1/4, bearing in mind that we should begin to guard against the bulge at this time.

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

MR. LILLY. I have no problem with alternative B as far as M1 and M2 are concerned. If I’m right about the economy having bottomed out, starting out it may well be that we will need a 5-1/4 rate. If I’m wrong, it may well be that we need a 4-1/4 rate. So I would vote 4-1/4 to 5-1/4.

CHAIRMAN BURNS. Thank you, Mr. Lilly. Who would like to speak next, please. Governor Jackson now.

MR. JACKSON. I would be inclined to support the 3 to 7 M1 and 7 to 11 M2 ranges. It strikes me that, within the current environment of the money market, I would be more inclined to the 4-1/4 to 5 federal funds rate [range]. While I share the concern about the prospective bulge, I don’t share the opinion that near-term prospects of changes in the federal funds rate of the magnitude we are likely to undertake are going to produce a darn bit of difference.

CHAIRMAN BURNS. Thank you, Mr. Jackson. Who's ready to speak now. Mr. Eastburn.

MR. EASTBURN. If I understand what is referred to by "the bulge," then I guess I have some difficulties with it because it seems to me that, if it comes from a rebate, it's just a temporary cessation in the flow of funds [to which] we shouldn't pay all that much attention. So far as rates are concerned, it seems to me that rates are going to be moving up, and we should permit them to do so moderately. So I would have no objection to 4-1/4 to 5-1/4 percent. But I would stick with alternative B [for the] aggregates.

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

MR. GARDNER. I think we should shave the 1/2 point off of the aggregates. I think the range in the federal funds rate is important in view of the sensitivity in this current situation. I don't want to see the zone of indifference widened without some recognition. The size of the range is the inverse ratio of the amount of time Steve Axilrod [is] out of his office, and he is down at the same end of the corridor that I'm in. And I would just as soon have a narrow range, which means consultation. I wouldn't like to see a 4-1/4 federal funds rate or 5-1/4 federal funds rate without some reflection. I would accept your recommendation of 4-1/2 to 5, expecting that, should the situation require it, we'll have some consultation.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Who would like to speak now.

MR. BAUGHMAN. Mr. Chairman.

CHAIRMAN BURNS. Yes, Mr. Baughman.

MR. BAUGHMAN. I would find your recommendation acceptable, but with a preference for the 4-1/4 to 5-1/4 federal funds rate. And I guess I didn't hear you mention a preference on the directive, but my preference would be for the aggregates directive. I was a little confused with Governor Partee's saving up theory, but the ensuing discussion I guess has kind of clarified that really what this means is that you'd be a little more inclined to let rates go up now than if you didn't see that coming. Is that the context that you--

MR. PARTEE. And not have to adjust it so much when we have it at hand.

MR. BAUGHMAN. That's about the only context in which I could hang it together.

CHAIRMAN BURNS. All right, thank you Mr. Baughman. Mr. Winn, may we hear from you.

MR. WINN. Yes. I think the alternative C ranges for the Ms, and probably 4-1/4 to 5 on the rate spread. I'm not sure that's logically consistent.

CHAIRMAN BURNS. You say you're not sure.

MR. WINN. That it's logically consistent. I'm not sure of that.

CHAIRMAN BURNS. It's as logical as anything around this table.

SPEAKER(?). That's a new consideration!

CHAIRMAN BURNS. Yes, Mr. Guffey.

MR. GUFFEY. If I understand Mr. Winn correctly, I think I would adopt the same thing, that is, alternative C ranges on the aggregates with the fed funds 4-1/2 or 4-1/4 to 5--what is expressed as the range for B. It isn't clear to me, however, what would happen if we adopt a 4-1/2 to 5 range for the federal funds. Does that mean that we move fairly quickly to the 4-3/4 midpoint? That's an important question.

CHAIRMAN BURNS. That would be the judgment the Committee would have to reach. Normally, we move gradually; there have been times when the Committee wanted to move rather rapidly. Anyone else want to speak? Mr. Morris, yes, please.

MR. MORRIS. Mr. Chairman, I think that the differences we're talking about are quite narrow, but I think I would prefer to keep the present midpoint and use a 4-1/4 to 5 range.

CHAIRMAN BURNS. All right, thank you, Mr. Morris. Anyone else? If not, there is a narrow preference for the ranges of 3 to 7 and 7 to 11 for M1 and M2 respectively. There's more diversity with regard to the federal funds rate, but the divergences are quite small. I think a reasonable balancing of the opinions expressed would be a range of 4-1/4 to 5. I would suggest that to the Committee.

Or, I think if the Committee finds that suggestion agreeable, then I would suggest that we still consider the question of whether the midpoint be treated in symmetrical fashion or not. Symmetrically the midpoint would be 4-5/8, although the Committee might prefer a midpoint of 4-3/4, and that would accommodate the thinking of the plurality who wanted a range of 4-1/4 to 5-1/4.

Let me make this suggestion to the Committee, and then we will discuss this: that we vote on a range of 3 to 7 for M1, 7 to 11 for M2, and 4-1/4 to 5 for the federal funds rate but that the midpoint be treated asymmetrically--that is at 4-3/4 rather than 4-5/8. Does that shock anyone?

MR. JACKSON. Could I have Mr. Axilrod's judgment on the reaction in the marketplace toward a perceived slight firming in the federal funds rate given the recent emotional reaction to prospects of interest rates.

MR. AXILROD. I think you may also want to get Mr. Sternlight's judgment, but mine 250 miles further south would be that--

MR. JACKSON. That might be the reason I asked you--he's too close to it.

MR. AXILROD. --would be that there would be a further reaction. I would be hard-pressed to quantify it, but if I had to guess, I would put 10 to 15 basis points on the bill rate, maybe 10 to 20 basis points more on intermediate Treasury issues, and further rises from the corporate bond rate. I might add that I think the intensity of the reaction will partly depend on whether such a rise or such an indication of a rise occurs well before the Treasury financing is announced--which will be January 26--or occurs in the midst of the Treasury refunding without any, in a sense, prior indication or prior suspicion on the part of the market that it is likely to occur.

MR. PARTEE. Which would be the bigger reaction?

MR. AXILROD. The latter.

CHAIRMAN BURNS. All right, let's turn to Mr. Sternlight, and then we have Mr. Holmes.

MR. STERNLIGHT. Well, I think I agree that there would be a reaction, proceeding to a 4-3/4 [rate].

CHAIRMAN BURNS. Aren't you just about there now?

MR. STERNLIGHT. It's very close, Mr. Chairman. We are only talking about 1/8, but it's something that--

CHAIRMAN BURNS. Well, wait a minute now. Haven't you been closer than that recently? Weren't you closer than that yesterday?

MR. STERNLIGHT. Well, we're still aiming at 4-5/8.

CHAIRMAN BURNS. I didn't ask you what you were aiming at, I asked you where you were.

MR. STERNLIGHT. Well, yesterday's effective rate was 4.80, but I think the market still perceives us as aiming for 4-5/8. I think there's a difference--they've seen us resisting--

CHAIRMAN BURNS. Yesterday you were [at] 4.80, and if you move within a range of 4-5/8 to 4-3/4, the market might be relieved, instead of exploding with 10 to 12 basis points. You know, I'm not a market man, but I do follow figures. I don't know--

MR. PARTEE. Would you agree on the size of the adjustment, Peter--10 to 20 basis points?

MR. STERNLIGHT. It depends on how the market saw us implementing it; I think that might be reasonable. I think, if we moved aggressively to achieve 4-3/4, that it could be more of a reaction than that. Or if we were just sort of able to slide into it because, as the Chairman said, we were already there yesterday and funds just kind of stayed there and we didn't do anything about it, then it could be less of a reaction.

But I'm concerned about trying to implement something quite gradually because of this upcoming refunding. If there is to be a change, it might be well to have that atmosphere cleared just a little bit before the Treasury has to come in, or at least before its issues are bid on.

CHAIRMAN BURNS. All right. Mr. Holmes.

MR. HOLMES. I think I would stress Mr. Sternlight's last point, that it's how you get there that's really important. If we had to push aggressively in the market to push the funds rate up, I think the market would react one way. If it rather drifted into it and then we tended to keep it there, I think the market would have less [of a] problem. This is a very subtle difference, Mr. Chairman, but I think it is an important one.

CHAIRMAN BURNS. Well, I don't think there is any sentiment within the Committee that you do anything aggressive. You know what we have been talking about are such minute differences, and therefore, aggressive behavior is hardly being contemplated by the Committee.

MR. HOLMES. I don't mean aggressive in a real term but I mean in a market-perceived term, and in that case you don't have to be very aggressive to seem aggressive. This is a very subtle difference.

CHAIRMAN BURNS. Now, I can't speak for the Committee, but let me still try, and the Committee will tell me if I'm off track. Suppose that the instruction to you were not to be aggressive in any of the senses of the word that you have distinguished in our behalf.

MR. HOLMES. We would understand that, Mr. Chairman.

CHAIRMAN BURNS. Well, would you, in that case, cause trouble?

MR. HOLMES. No, I think we would have to watch what happened. If we got to 4-3/4 and found it was causing trouble, my inclination would be to back away, to come below--quickly.

MR. JACKSON. You would plan on moving to 4-3/4 with deliberate speed is the course you--

MR. HOLMES. Deliberate speed, but recognizing there is a Treasury financing coming up. If we are already closely there, we don't have all that much time.

MR. PARTEE. And they were at 4.80 yesterday.

MR. HOLMES. I don't know where we are. We were at 4-3/4 earlier today.

MR. EASTBURN. That effectively would be sort of stopping the downward drift and imperceptibly tightening up.

MR. HOLMES. One would hope that we would be that skillful.

CHAIRMAN BURNS. Gentlemen, let me try--I have to try something else. I have heard no dissent from my suggestion on the M1 and M2. Suppose we have a 4-1/4 to 5 percent federal funds rate and that the midpoint not be regarded as 4-5/8 and it not be regarded as 4-3/4 but that it be regarded as the range between 4-5/8 and 4-3/4.

MR. HOLMES. That's a good 16th, Mr. Chairman.

MR. PARTEE. I suggested that last time, and you said I was being too tough on the Desk.

CHAIRMAN BURNS. Yes, but I'm having more trouble today.

MR. WALLICH. I think that's highly desirable, also, in the interest of softening up the precision of these things a little.

VICE CHAIRMAN VOLCKER. Yes, I think that's a good technique.

MR. COLDWELL. Mr. Chairman, I don't want to put too much sand into this cogwheel, [but] I must admit you're narrowing the degree of available range within which the Desk moves from a--

CHAIRMAN BURNS. No, no, this is a definition of the midpoint.

MR. COLDWELL. Well, I understand that--

CHAIRMAN BURNS. Not a definition of the federal funds rate range.

MR. COLDWELL. Well, but you've got some range now.

CHAIRMAN BURNS. I've broadened the definition of the midpoint.

MR. COLDWELL. Well, against the 4-1/4 to 5-1/4 you have narrowed it.

MR. PARTEE. Then it's the whole range.

CHAIRMAN BURNS. The midpoint is no longer a point; the midpoint has itself become a subrange. If my motion is unsatisfactory, we will entertain any other and put it to a vote.

MR. BLACK. Try 4-5/8?

CHAIRMAN BURNS. That is to say, conventional procedure--4-1/4 to 5 conventional procedures. All right is there a--

MR. PARTEE. Are we giving preferences?

CHAIRMAN BURNS. What's that?

MR. PARTEE. Preferences? 4-5/8 as the midpoint, or 4-5/8 to 4-3/4 as the midpoint.

CHAIRMAN BURNS. 4-1/4 to 5 is the range. All right, but the midpoint could be 4-5/8, or an asymmetrically determined midpoint of 4-3/4. Those members of the Committee who prefer 4-5/8, would they kindly raise their hands.

MR. BROIDA. Four, Mr. Chairman.

CHAIRMAN BURNS. Those who prefer 4-3/4.

MR. BROIDA. Five.

CHAIRMAN BURNS. Well, we can't--we weren't voting. The wise men haven't voted, I think. Gentlemen, I will put this to a vote now, quite arbitrarily: 3 to 7 for M1, 7 to 11 for M2, 4-1/4 to 5 percent for the federal funds rate range, and the midpoint to be interpreted by the Desk in the light of our very illuminating discussion and the monetary aggregates directive.

MR. BALLES. May I ask you a question, Mr. Chairman, about that midpoint--how the Desk is to determine that. I'm not sure what that means.

CHAIRMAN BURNS. Well, Mr. Holmes, you're on the spot.

MR. HOLMES. Well, I'll [try to] interpret it, Mr. Chairman: If we could go a bit above 4-5/8 without causing any damage to the interest rates, or only a very little, that would be the preference of the Committee. Now, is that right? That would be my interpretation--I'm not sure it's right.

CHAIRMAN BURNS. Any quarrels with Mr. Holmes?

MR. PARTEE. When you say a very little damage, you mean some small rise?

MR. HOLMES. 5 to 8 basis points on the bill rate--we're getting awfully precise on that.

MR. PARTEE. I just wanted you to define damage.

CHAIRMAN BURNS. I think that the [proposal would be for a] range of 4-1/4 to 5, with the Desk to interpret the discussion that has taken place in this room, the Desk being managed by men of high intelligence and great integrity. I don't think we ought to go beyond that--give them just the illusion of a little flexibility and a little authority. We are ready for the vote. Would you be good enough to call the roll.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
President Balles	No
President Black	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
Governor Jackson	Yes
President Kimbrel	Yes
Governor Lilly	Yes
Governor Partee	Yes
Governor Wallich	Yes
President Winn	Yes

Eleven to one.

CHAIRMAN BURNS. Well, I think we’ve done all that we can.

END OF MEETING