TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

April 19, 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.

Staff Statements Appended to the Transcript

Mr. Kichline, Associate Economist
Mr. Zeisel, Associate Economist
Mr. Sternlight, Deputy Manager for Domestic Operations

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<u>Meeting of Federal Open Market Committee</u>

<u>April 19, 1977</u>

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, April 19, 1977, beginning at 9:00 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Coldwell
Mr. Gardner
Mr. Guffey
Mr. Jackson
Mr. Lilly
Mr. Mayo
Mr. Morris
Mr. Partee
Mr. Roos
Mr. Wallich

Messrs. Baughman, Eastburn, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. Black, Kimbrel, and Willes, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and Minneapolis, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist
Messrs. Balbach, R. Davis, T. Davis, Ettin, Kichline, Reynolds, Scheld, Truman, and Zeisel, Associate Economists

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

Mr. Hudson, Assistant to the Chairman, Board of Governors
Messrs. Coyne and Keir, Assistants to the Board of Governors
Mrs. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Boehne, J. Davis, and Eisenmenger, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Cleveland, and Boston, respectively
Messrs. Brandt, Broaddus, Burns, and Keran, Vice Presidents, Federal Reserve Banks of Atlanta, Richmond, Dallas, and San Francisco, respectively
Mr. Sandberg, Assistant Vice President, Federal Reserve Bank of New York
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis

Transcript of Federal Open Market Committee Meeting of
April 19, 1977

CHAIRMAN BURNS. Good morning, gentlemen, we will get our meeting under way. President Balles is home and unable to attend--he's ill, but mildly. And his first vice president, a similar situation, so that San Francisco, one part of our country, is eliminated for this meeting, I am sorry to say. However, we are very glad to welcome you, Mr. Willes, to this meeting. You've been a member of our family for a long time, and we are very glad to have you seated and have you participate in our meeting. The fact is that we all wish you well in your new position.

Now, Tom O'Connell is going to report to us on two of the lawsuits that we are involved in.

MR. O'CONNELL. Thank you, Mr. Chairman. This constitutes a statement of current status of these suits, the first of which, the Committee will recall, is Merrill v. FOMC. That suit against the Committee was brought in May 1975 by a public interest group, and the Federal District Court issued an order involving two mandates: One, with respect to the Committee's Record of Policy Actions, that it be released to the public under the Freedom of Information Act promptly upon its adoption by the Committee. And second, that with respect to the demanded Memoranda of Discussion of the January and February 1975 meetings, that such be searched for reasonably segregable facts and that they be turned over to the plaintiff.

As of the last meeting, the plaintiff's and the Committee's counsel had signed a stipulation that would have dismissed from the District Court its jurisdiction [with regard] to [the] issue of the Memoranda of Discussion--the plaintiff evidencing their satisfaction with that. The court has to approve that; the court has not yet done so. We've sought some [unintelligible] status determination; we have received no information, we don't know what the court is doing with that. It could sign, and that portion of the suit [would be] dismissed.

The Court of Appeals item has been argued before the Court of Appeals. We are hoping that a decision will soon be rendered by that court. That is on the Record of Policy Actions and the promptness with which the Committee must release it. At this time, no action from the Court of Appeals.

With respect to the Reuss suit, Mr. Chairman, as the Committee knows, that's a suit brought by Mr. Reuss against all [Reserve Bank] Presidents, particularly those serving on the Committee [as voting members] at a given time, alleging that their service on the Committee, not being subject to Presidential appointment [and] confirmation by the Senate, is unconstitutional. That matter was briefed and argued before a District Court, and a decision was rendered by the District Court in favor of the defendants, representing the Committee.

The matter was immediately noticed for appeal by plaintiff Reuss. He filed his brief; we in turn were to file our reply brief as of yesterday. We are still resolving some issues of law with the Department [of Justice]; the Department has obtained two or three days' continuance for our filing. So hopefully, not later than Wednesday, Mr. Chairman, we will file the reply brief on the part of the defendants. We're thoroughly satisfied here with our version of that brief, and hopefully the Department will coincide with our judgment in that regard.

Finally, a note of current status on the minutes of the [Reserve Banks'] board of directors meetings for the years 1972, 1974, and 1975 that were requested by Mr. Reuss through our Chairman. Those materials were submitted in December to Mr. Reuss, and to this date, neither I nor my associates here at the Board have heard anything with respect to the [Reuss] committee's actions or [its] staff's review of that material.

I should say that one of our Banks, the Federal Reserve Bank of New York, has received an inquiry from a member of that staff, indicating knowledge of copies in the minutes of that Bank's submission to Mr. Reuss. The request was reasonably innocuous; it doesn't forecast, I think, any problems per se. The inquiry--staff to staff--was made last Friday or Thursday, to the best of my knowledge, Mr. Chairman. It could be handled as a matter--the material which was inquired of, the physical material, was such as to almost be obtained under a Freedom of Information request. But he did ask questions about the so-called employees emergency loan fund, wondering what was the nature of that and did other Banks have it, etcetera.

CHAIRMAN BURNS. The significant thing about all that is the date--that means that this is still alive. I was hoping it had died by now.

MR. O'CONNELL. I, too, Mr., Chairman; that is the significance of it. May I suggest, Mr. Chairman, that--pursuant to a direction, I believe, earlier given within this Committee--if other inquiries or questions are put to the Reserve Banks by members of the House staff, may I urge, Mr. Chairman, subject to your affirmation, that they be referred, at least conversationally, to the [Federal Reserve] Board here and to members familiar with those minutes so that we can have a single source of judgment.

CHAIRMAN BURNS. Oh yes. Let's be more specific. If any one of you [receives such a request], or if a request goes to any of our Reserve Banks, please advise Mr. O'Connell promptly.

MR. O'CONNELL. Thank you, Mr. Chairman. I have nothing further to report.

MR. COLDWELL. This particular request has one element of difficulty in it because of the supplement to the operation [unintelligible] which the New York Fed highlights the rate change from a very low rate to the discount rate presently. I would suggest that the Bank would not comply with this request--that they limit their compliance only to [unintelligible] report and not the supplement.

MR. O'CONNELL. Mr. Chairman, if I may, that direction is given. That is the understanding I had with Mr. Guy yesterday afternoon. He will send both to myself, not the supplement.

CHAIRMAN BURNS. Any other questions or comments pertaining to the lawsuits? All right, thank you, Mr. O'Connell, and we now proceed.

A motion to approve, if we so desire, the minutes of the March meeting--such a motion would be in order.

SPEAKER(?). So moved.

SPEAKER(?). Seconded.

CHAIRMAN BURNS. The motion is before you to approve the minutes; the motion has been seconded. I hear no dissent. Let's turn to Mr. Pardee.

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

CHAIRMAN BURNS. By what points has the yen appreciated over the past months.

MR. PARDEE. Now by a net of 1-1/2 percent ,and that's from the December figures. We started at around 279, got down to 271.

CHAIRMAN BURNS. Any questions or comments on Mr. Pardee's report? Well, thank you, Mr. Pardee. A motion to approve all the good deeds of the foreign Desk?

SPEAKER(?). So moved.

CHAIRMAN BURNS. Motion has been made.

SPEAKER(?). Seconded.

CHAIRMAN BURNS. Motion has been made, and I think it's been seconded. Do you have any recommendation? Thank you very much.

We are ready now for your report, Mr. Kichline.

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

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

CHAIRMAN BURNS. Well, thank you very much, Messrs. Kichline and Zeisel. We are ready now for the discussion of the economic and financial outlook. And I think that we probably will need to spend more time on this subject today than we have in previous meetings. There's a new development in the governmental sphere, as well as in the private economy. There is a change in the federal government's fiscal policy; there is a new anti-inflation policy announced by our President; and there is, perhaps most important of all, a new energy policy that will be explicated by the President on Wednesday--there has been a good deal of comment on this subject already in the press, and apparently much of what has been published in the *Wall Street Journal* and elsewhere is approximately accurate. Who would like to speak first on the economic outlook? Mr. Black, please.

MR. BLACK. I wonder if I might ask for some clarification on these revised projections. I was interested in noticing that the result of the deletion of the rebate issue had changed your estimates for personal consumption expenditures and inventory investments pretty significantly but that you had showed practically no effect on business fixed investment--it [actually] had been negative. I would expect the effect on the first two--most any model that used multiplier accelerator principles [would show it]. I wonder about effects on expectations and interest rates and what this might do to business fixed investment. I would expect a positive effect from the abandonment, which is not what you show.

MR. KICHLINE. Judging from the behavior of the stock market, certainly last week, and bond markets as well, financial market participants looked upon this action as quite a favorable step and associated it with somewhat less upward pressure on interest rates and a lesser inflationary impact. In our own staff forecast, we did have a slight impact on business investment spending; in part that came later on from the removal of the business investment tax credit as well as a somewhat slower pattern of consumption. I think we have not generally allowed [for] much of the impact of an expectational sort within this forecast. Indeed, what we've done is try to strip out the explicit impact of the rebate that was in our earlier forecast, which to us seemed to be reasonable and on the moderate side.

MR. PARTEE. That's offsetting then--I mean, you've got the effect of somewhat lower interest rates to stimulate, but you have the effect of a lower investment tax credit to hold back.

MR. KICHLINE. That is correct.

CHAIRMAN BURNS. It is hard for me to believe that the original investment tax credit proposal would make an appreciable influence in the market for capital equipment--the difference of going from 10 percent to 12 percent, meaning a 2 percent difference in the price of equipment in a world in which prices are advancing 6.8 percent annually. If I were making a forecast myself, that would be one of the factors I would ignore because I would consider it so very, very small relative to--

MR. PARTEE. Of course, I don't suppose the interest rate effect is very large either. The interest rates are maybe a quarter lower than the other.

MR. KICHLINE. On percentage terms, it's probably just about a wash, certainly after taxes.

CHAIRMAN BURNS. The major effect, one way or another, is the effect upon confidence.

MR. JACKSON. We noticed from Bob Black, in the directors meeting last time, some evidence that the [sentiment was positive] as a consequence of the reaction of financial markets

MR. BLACK. That's what I really would expect, but I may be wrong, but everyone I see seems to be much pleased by the fact that the rebate was withdrawn--at least the business sector.

MR. WINN. On that same point, to what extent does a consumer confidence index reflect pessimism as a result of the elimination of the rebate?

CHAIRMAN BURNS. Well, it would be too early to tell.

MR. ZEISEL. I've seen no results; it would take a while before we get that kind of report.

MR. KICHLINE. I have not seen recent Sindlinger reports. In the last three months or so, he has been reporting a decidedly bearish attitude; but that coincided with an exceptional surge in retail sales, which is very difficult to sort out.

CHAIRMAN BURNS. Well, I find it easy to sort out.

MR. PARTEE. All you have to do is reverse what Sindlinger says.

CHAIRMAN BURNS. Mr. Kimbrel, please.

MR. KIMBREL. Question, this to Mr. Zeisel. In your report, you make reference to the change in minimum wage. What sort of projections are you using with regard to your expectations of what the minimum wage will be?

MR. ZEISEL. We have taken a position which is something of a compromise between the proposal made by the Dent bill and the Administration's proposals. We are assuming a July 1st, 1977, increase to $2.65. The Carter proposal was $2.50 on July 1st. The Dent bill was for $2.85. In talking to some people on the Hill, they fear that some modest increase above the Administration proposal would probably be worked out. This should apply to about 4-1/2 million people. And its effect on compensation is to raise it by about 3/4 percent for that quarter.

CHAIRMAN BURNS. All right, thank you, Mr. Kimbrel. Mr. Eastburn, please.

MR. EASTBURN. My comment is a question on price indexes. In our exercises before these meetings, we project on through 1978, and we have the deflator ranging around a 6-1/2 percentage increase in that period. Your projections don't go that far, but they'd been starting out at a much lower base. Have you done anything through 1978 that you would--it seems to me that one of the big problems with the equation is 1978 rather than 1977?

MR. ZEISEL. No, we haven't gone beyond midyear, and as we say, our projections for the first half of 1978 are about 5-1/2 percent for the fixed-weight index. It varies slightly from the deflator because of variables, items such as pay raises. Certainly the problem in the nonfood sectors [is that the] underlying [trend in these prices] is likely to be much more serious. We intended to utilize basically the trend in cost that we see--unit labor costs--in describing the pattern of price projections as we move that far out. Corporate profits have recovered rather well, and in that kind of environment we still feel that prices will track reasonably well with costs. We don't see any explosion in wage demands developing at the moment at that point. And we've taken a rather moderate view of the outlook for productivity. We have increased our wage projections slightly, to slightly over 8 percent, and with about 2-3/4 percent increase in productivity, that gives us a unit labor cost increase of about 5 or 5-1/4 percent. This is our projection for prices.

CHAIRMAN BURNS. All right. Mr. Mayo, please.

MR. MAYO. I have several questions for the staff, Mr. Chairman. First of all, I don't want to phrase this too crudely, but the President's anti-inflation program came out Friday. Did this influence--is there any allowance for this in the revision of the projections?

MR. KICHLINE. No, there is not.

MR. MAYO. Second question, there has been a lot of talk about people having spent their rebate already, in anticipation of its coming. Did staff find that persuasive enough to make any allowance in your revisions?

MR. ZEISEL. It's extremely difficult to assess that. Obviously, retail sales would be very strong, and that would be consistent with some anticipatory buying, but we are unable to evaluate that. We've made a small allowance for that, assuming that some spending occurred in the first quarter. But not a great deal.

MR. PARTEE. You did cut back the second quarter consumption increase, didn't you?

MR. ZEISEL. Yes.

MR. PARTEE. Even though the rebate wouldn't have been paid out until very late in the second quarter?

MR. KICHLINE. Well, we were working with assumptions that the rebates would begin about mid-May.

MR. ZEISEL. And between the last month and this month, while we still had rebates, we had changed our assumption to incorporate some of the rebates in the third quarter, some with payments to nontaxpayers, so that the earlier projections that we said incorporated--

MR. MAYO. My third question relates to the projection of real GNP in your latest revision, which shows an increase in real GNP with the rebate out for the fourth quarter, and first quarter and second quarter next year. I guess I am a little surprised that you have introduced a negative effect of the rebate--if I may put it backwards--in that projection. Am I correct in that assumption?

MR. KICHLINE. That, in a sense, falls out of the arithmetic. The rebate is assumed to have a temporary impact on the level of GNP, and in the early quarters, quarters two and three in 1977, it boosted activity to relatively high rates of growth. Stripping that away, what we find is that the rebate was having a dragging influence later on as the effect is wearing off. So we take out--what is implicitly happening here is the underlying level of GNP is returning to its longer-run trend rate of growth.

MR. MAYO. I see, so you really have to look at the real dollars here, rather than the rates, to completely understand.

MR. ZEISEL. The levels [without the rebates] remained below what they would have been with the rebates, despite the fact that the rate of growth accelerates.

MR. MAYO. We tend to do this elliptically, to make it simple, but sometimes it gets more complicated.

MR. PARTEE. If I might, it seems to me that's consistent with what you would think the interest rate effects would be. I imagine you've got more housing than you did last time. And that would fall late this year and early next year because interest rates would be lower than they would have been had the rebate been paid [by financing out of the market]. I am not sure. I have not looked at it in detail. Is that right?

MR. ZEISEL. We didn't change housing projections, but we did raise total construction expenditures slightly.

CHAIRMAN BURNS. Were you surprised by the housing report yesterday?

MR. ZEISEL. Yes, we were--quite surprised.

MR. KICHLINE. As indicated by the fact that our forecast is too low for the first quarter.

CHAIRMAN BURNS. The reason for my question is that, if that figure had been available, the staff might have raised slightly the estimates for residential construction.

MR. ZEISEL. Definitely, we will revise them upward.

CHAIRMAN BURNS. Thank you, Mr. Mayo, for your questions. Mr. Coldwell, please.

MR. COLDWELL. Mr. Kichline, would you repeat to me the odds on the scenario for higher interest rates, please?

MR. KICHLINE. The odds on the scenario?

MR. COLDWELL. Yes.

MR. KICHLINE. If one were to look at our track record, you know what the odds would be. But ignoring the past and simply going on, this is a conditional forecast, as you know, and it's premised upon the underlying GNP package, which we view as quite strong.

Second, it is premised upon alternative B in the Bluebook longer-run path of 5-1/2 percent M1. As you go on later this year and on into 1978, you get exceptionally large increases in money velocity, which we have had in the past, obviously, but we are anticipating that the effect of the downward shifting money demand function will gradually wear off. And looking at it from the money demand side, I think the odds are quite good that you have an increase in interest rates.

The Treasury bill futures market anticipates roughly what we anticipate in terms of rising rates [and the structure of the yield curve is telling us the same thing]. Outside forecasts that I am aware of generally anticipate rising rates. And our flow of funds forecast is consistent, looking at it from the credit market side, with rising rates. I think the question isn't so much, Will rates rise? The question is, How much? And I guess my own feeling would be that rates may not rise as much as we have in here. If we're wrong, that would be a more likely outcome than that it would be higher. And that, in a sense, reflects my own judgment about the uncertainty regarding money demand functions.

MR. COLDWELL. Well, your words, I believe, in the Greenbook reflect a "balance" or "equilibrium," I forgot the word you used, of demand and supply of credit largely through the third quarter of the year. My question is, what upsets that balance?

MR. KICHLINE. Well, in our forecasts, we have continued high governmental borrowing in the second half of the year. This quarter, as you know, is the quarter in which the Treasury is not expected to raise any additional funds, or in fact may be a net repayer of debt. But it will raise substantial funds in the third and fourth quarters. Secondly, we do have both private business credit demands and household credit demands rising in line with projections of our GNP. Third, the assumption in the Greenbook of the sustained 5-1/2 percent M1 growth--we assume that there will be strong underlying demands for cash given nominal rates of GNP growth in the double digit range. So it falls out, essentially, from our underlying assumptions.

MR. AXILROD. Governor Coldwell, I might add one other. In the second quarter, if our projections are correct, you'll have M1 growth on the order of 7 percent, or something like that. Assuming a 5-1/2 percent midpoint of the Committee's target, which is now in place, that would imply increasing rates of growth over the next three quarters. With GNP very strong, that implies an increase in the rate of increase in velocity.

Velocity was very high in the first quarter. It will be very high in the second quarter. By the fourth quarter of next year, on these projections, it will be even higher, increasing around a 7 percent rate. And it's this--this could be one influence on our expectation that interest rates may rise. Of course, in 1975, we had such increases in velocity without increases in interest rates. But that is the principle effect, along with the associated credit market demands, that we would expect, and with the economy so strong.

MR. COLDWELL. Do you give any credence to the idea that the stock of liquidity [is] available to absorb it?

MR. AXILROD. There is a large stock of liquidity available to absorb it, but if people don't want to hold that liquidity, and they want to use it up, the way they use it up is to sell the securities, or increase their borrowings, and those are the factors that tend to put upward pressure on interest rates.

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

MR. JACKSON. On your nonfinancial corporation capital expenditures, is it fair to say that you have not included the inflation budget as part of these projections?

MR. KICHLINE. That is correct.

MR. JACKSON. It strikes me, though, that perhaps one aspect of that inflation budget that could impact on this projection is an alleged commitment to speed up the approval process, through which planned expenditures--starts--could be made--construction permits. If we get that--

CHAIRMAN BURNS. Do you expect to get it this year?

MR. JACKSON. I said, *if* we get that. The consequences would likely be that you would have an acceleration as a result of those that are already in the pipeline, going on the slow process, together with those that could get added to it in the speeded up process. Together with perhaps even a third factor, those that weren't quite committed to go forward because of the expected long delays, those might be encouraged to come along and do something.

And so it could well be that, while these projections here look to me like they are very strong, it's possible that they could be strengthened even further, which would increase that gap between internally generated funds [and expenditures]. And it strikes me that those components of the so-called inflation package that might have a real prospect of taking place, this could well be one of them that would be more under the control of the Administration rather than require a more massive legislative package. And would that more likely take place and have an impact on the interest rate factor we just talked about and get translated into the market?

The other question I had is this. We've seen automobiles be so strong for so long, and the figures would indicate that that has been assisted by a lengthening of the maturity schedule on automobile debt by consumers. And of course our consumer credit figures begin to look like there's a lot of it taking place. To what extent would you guess that this is borrowing from the future, rather than being a sustainable pattern of investment?

MR. KICHLINE. I think it is really borrowing from the past. I think our analysis of the auto market suggests that, during 1974 and 1975, with the recession and with consumer attitudes depressed, the scrappage rate of autos declined very sharply; that is, consumers held on to their autos much longer than usual. And in our view, a good deal of current strength is attributable to replacement of cars that were not replaced on a normal cycle. And to that extent, it is a transitory influence, and we should catch up. But in any event, I don't think it's so much borrowing from the future as much as a catch-up phenomenon.

CHAIRMAN BURNS. Which still seems to mean that lower sales may be expected next year.

MR. KICHLINE. Well, it takes a long time for this process to work through. We were talking about, really, two years in which car sales were postponed. It is hard to sort out to what extent that's influencing the February-March numbers, and it might well go on [for] the balance of this year. But you're right, at some point that argument evaporates; then you're talking about that influence alone having a depressing factor on overall auto sales.

MR. JACKSON. How does that tie in with the continued increase in the prices of used cars? Is that a function of the price of the new rather than the scrapping rate or the trade-in rate?

MR. KICHLINE. Car sales were depressed in 1974 and 1975, and apparently there have been substantial increases for full-size cars for 1974-1975 model years, and there are relatively few of those available because that was a poor year for large-size cars to begin with and for total cars in general.

CHAIRMAN BURNS. All right, thanks Mr. Jackson. Mr. Baughman, please.

MR. BAUGHMAN. Mr. Chairman, I guess I'm finding it rather interesting and somewhat puzzling that the [unintelligible] items are still being made in support of the fiscal stimulus goal. It's fairly common, I think, for Administration spokesmen to suggest that real GNP growth rate would be affected possibly by as much as 1-1/2 or 2 percentage points if the program were not put in place. It seems to me that we are [calculating] here that the effects of withdrawing would be substantially less than that.

CHAIRMAN BURNS. I think the Administration spokesmen are no longer speaking quite the same way.

MR. PARTEE. I don't think we ever added anything like that into our projection's fiscal package.

MR. ZEISEL. At the maximum, we had about a point, and that was before the--some of it was stripped away last month, so the effect of withdrawing all of it becomes quite a bit less.

MR. BAUGHMAN. The employment figures on the states in the Southwest, and I suppose in other states also, have recently been revised, and these revisions are shockingly large. For example, in the period from February 1975 through November 1976--and November 1976 was the last [period] in which the old series was available--in Texas, the old series showed a total increase in employment of 2.3 percent, and the new series showed an increase of 9.1. For New Mexico, the old series showed an increase of 6.5, and the new series 13.5 percent. For Oklahoma, 3.2 and 5.3; and for Louisiana, 1.7 and 8.0. Now when we inquire of the state offices from which these data flow, we seem to get a little less than a completely satisfactory explanation. One of the reasons, of course, is that the sampling process does not adequately pick up and record the effects of new firms being established. But they do not attribute all or even the main part of these changes to that. These increases compare with about 5 percent for the U.S. during the same period.

CHAIRMAN BURNS. What was it before the revision?

MR. BAUGHMAN. For the U.S.? I don't have that; I am not sure.

CHAIRMAN BURNS. This is all strikingly new to me, and I don't know about these revisions. At least I haven't been informed, or if I have been, it may be one more paper lying on my desk that I haven't gotten to.

MR. ZEISEL. Well, you certainly haven't been informed by me, Mr. Chairman. There have been no revisions at the national level of this magnitude. There was the usual revision last year of the benchmark, but it was not a very large revision. There will be another one coming out later this spring. But I have heard nothing to suggest that there was going to be anything of this magnitude at the national level.

I think that the local data and state data are subject to substantially greater revision. And there is an awareness that those data are not adequate. There has been a congressional commission established to study the employment, nonemployment statistics, and one of their major emphases is going to be on trying to improve the collection process of local and state data.

CHAIRMAN BURNS. Now the figures that Mr. Baughman is referring to, are they figures from the Bureau of Labor Statistics?

MR. ZEISEL. They come from the state employment services through the Bureau of Labor Statistics.

MR. PARTEE. These are the state data on employment and unemployment.

CHAIRMAN BURNS. I think it would be very helpful to have a full report on these revisions. Well, this is all new to me. I interrupted you, Mr. Baughman. Would you continue, please?

MR. BAUGHMAN. I guess it occurred to me that, assuming they are, in fact, errors, I guess it leaves a question whether the pre-revised or the current series gives you the greatest confidence. Presumably, if there has not been much change in the national figures, there must be somewhat similar offsetting adjustments elsewhere, and it does tend to raise the question as to the confidence in the national figures. I guess these are based on establishment payrolls. So it shouldn't be a matter of wrong numbers but of firms covered. But the coverage of firms should be the important question.

With respect to what retailers are expecting from the change in the fiscal package, for whatever it's worth, at a recent meeting of our board of directors, where we have a representative of the national retailing firms as well as local, they seemed to be in agreement that the expectation is for about 1-1/2 percentage points in the year-to-year percentage change in the second and third quarters and might be attributable to a change in the fiscal package. And they are not talking in particularly bullish terms, although the percentage change figures that they seem to be expecting appear to me to be fairly significant. They tended to be around the 10 percent level, which is roughly consistent with what we're seeing in the consumer spending change--a reflection of the reports from a number of the Districts in the Redbook of the tightening up of credit conditions in the agricultural areas. We see [it] in the Eleventh District also, and we're told that the U.S. Department of Agriculture is in the field with a quick survey as of April 11 to try to get a better picture of that situation, which would seem to be in the context [of] anticipating some additional federal program in support of agriculture.

CHAIRMAN BURNS. No, I don't think that's the case, and when you are through, Governor Gardner will comment on farm credit.

MR. BAUGHMAN. I think that's about all I have to mention. There is still an unenthusiastic expectation on the part of large banks in Dallas, in particular with respect to the prospects for business loans. They apparently are having real difficulty rounding up business loans, and they don't see the situation improving. And this notwithstanding the fact that loan-to-deposit ratios are rising at the smaller banks around the District. And they seem to have quite an active demand.

MR. COLDWELL. How much of that is the falloff from expectations?

MR. BAUGHMAN. Their expectations were not very bullish for a period of months. So I think very little, in this particular instance. Now the Houston situation is a little different.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Would you, Mr. Zeisel, want to comment further on what Mr. Baughman's had to say about the farm figures and the like?

MR. ZEISEL. Well, I really don't--I'm not familiar with those numbers, as I indicated. We will look into it and try to get a report to you on what they mean and what their implications are for both the national--

CHAIRMAN BURNS. I think that would be a report that would be of great interest to all members of the Committee, because regional variation would be brought out in such a report.

MR. ZEISEL. We'll do that, Mr. Chairman.

CHAIRMAN BURNS. Mr. Gardner, you might want to comment on the farm credit problem that has been brought to our attention, now that you've done some intensive work recently.

MR. GARDNER. Mr. Chairman, I want to first disclaim any expertise in the agricultural lending field. On the other hand, I have talked to Roger, I've talked to some of our Branch directors in the agricultural area.

All of this was inspired by significant interest recently in Washington about the problems of grain farmers and feed-lot farmers--[in the case of] the grain farmers, in carrying over crops because of low support prices and the need to [take] additional crop financing loans or operating loans for this season. There is clearly a very large overhang of wheat in the marketplace. Many farmers are heavily committed to carrying old crops, and smaller banks, particularly in the rural areas, have shown a counterseasonal or a larger-than-seasonal increase in their loan portfolios. Their deposit growth has not kept pace because of the backup in grain.

As a result, there have been some protestations made in Washington by various groups, including authorities in Nebraska and the like. And the Agriculture Department, in order to provide an immediate short-term picture, made a quick survey, or is in the process of making a quick survey, Ernie, as you may know, of some 400 banks. They sought our help in designing a questionnaire, in selecting the banks; our agricultural economists here at the [Federal Reserve] Board participated in that endeavor. Now that process is still going on, and I don't know that we have any report on this yet, Jim, at all.

But in addition to this, we have the aggravation, which you're very familiar with in the District, of low moisture in the soil and semidrought conditions in the grain-growing areas. I talked to the Iowa groups yesterday, and they don't seem to have the same problem in corn. But this is probably in large part an economic problem, because if foreign demand for grain--if grain prices were buoyant in the marketplace--at least you would remove this piling up of credit and stored grain. We think many of these actions were designated to focus the Agriculture Department's and the Administration's attention on the support price structure, hoping perhaps--and this is speculation on my part--that the new Administration would provide some short-term carryover bridge, higher support prices or loan values, for the grain. I'm not sure that's going to happen.

We're still getting information here, and we can use any and all information, as Roger knows--he telefaxed to me most current material that he had, and some additional material that was quite interesting concerning the classification of loans in small banks and showing a rise in the classified loan portfolios for this very reason.

Now, there have been some very abnormal events; a small bank in difficult condition began foreclosing on farmers. In so doing it made *Newsweek* or *Business Week*. This is what our media tend to do--highlight a problem with a dramatic example; and some fairly large farm operations were sold out because this bank needed to restore its proper financial condition. Incidentally, that bank applied to us a year ago to become a one-bank holding company, and we declined because of the condition of the bank, but that was an exceptional case. It just happens to be a newsworthy case.

So, in general, there is clearly a pileup of bank credit, a pileup of inventories of grain. The best estimates given to me by others is that maybe 10 percent of the farmers are seriously disadvantaged by this problem in their area. Roger, I'd appreciate any additional information. In other words, I'm not suggesting there's a national crisis here but that there is clearly a problem, a visible problem because farmers have not marketed the last one or two grain crops, and they're growing another one now. Roger, would you care to add to that?

MR. GUFFEY. Well, I can only say, Governor, that we are in the midst of another survey of 62 rural banks. Only 38 of them have reported so far, and I'll give you a memorandum that interprets those--with some caution, you can be sure. But, by and large, I believe that the credit situation in the rural small banks is tight, and there is some evidence of bankers asking farmers to dispose of their carryover crops of 1975 and some of 1976.

CHAIRMAN BURNS. This applies to what state?

MR. GUFFEY. Pardon me?

CHAIRMAN BURNS. This applies to what state?

MR. GUFFEY. Generally, Mr. Chairman, it would be Nebraska, Kansas, eastern Colorado, and some parts of Oklahoma, and that's basically the drought area that we're looking at. But, at least in my judgment, what has occurred is probably a normal function of the financial intermediary in requiring some of these excesses to be turned in order to move into the next crop season. We see a tight situation but not one in which, absent a severe drought, there are no crops growing of any substantial amounts for 1977, that there is any crisis situation in this part of world.

MR. PARTEE. Roger, why didn't they get CCC [Commodity Credit Corporation] loans?

MR. GUFFEY. Pardon me?

MR. PARTEE. Why didn't they get CCC loans?

MR. GUFFEY. Well, they do. I think, Governor Partee, to the extent that the banks are not willing to accommodate any further extensions of credit, for example, for a new crop year, they do go to the PCA, Production Credit Association. Now, these are the farm credit types of loans. They are picking up, and have in the last year or so--rather substantial sums. In checking with the farm credit agencies out in the Midwest, we find that they are at very large levels of lending, and they are really concerned about the creditworthiness of some of those loans, simply because they have picked up what the banks wouldn't pay. So that's a secondary-type credit. And they do have a concern that they may get caught with some bad loans. But I think the banks generally are in very good shape, [whereas] bad loans are [rising] among the farm credit [types of loans].

MR. JACKSON. Does this influence land prices upwards or downwards?

MR. GUFFEY. It has not. And I might say that the continual increase of land prices is [supporting the use of land as] collateral for the additional extension of credit, not only by the banks but PCAs. If something were to occur, such as a mass selling out of farmers, for example--that might affect those prices on the downside. You may find the farm loans without sufficient collateral even if they chose to foreclose, because the increase in farm land prices is what's supporting these additional extensions of credit. But for that, they might be broke already.

MR. JACKSON. Are those loans based on the market value of the land or based on the income-producing value of the land?

MR. GUFFEY. Essentially the market value. And that may be established by "Indians trading with Indians," but nonetheless there is a transfer of land establishing market value, and that's what's being used as a broad base for these [loans].

MR. BAUGHMAN. Mr. Chairman, if I might just add one gratuitous comment here. In granting that the recent severe drought situation does not reach into the Eleventh District in any significant way at this point in time, it seems to me that this agricultural situation is one which can easily be exaggerated and could easily touch off governmental actions which would be difficult to withdraw from rapidly when they should be withdrawn.

MR. GARDNER. It contains the seeds of that, Ernie, in my judgment. It could develop, but it needs some more external unfavorable forces at this point.

MR. BAUGHMAN. I'm trying to say, I think it deserves being played down a bit, rather than up.

CHAIRMAN BURNS. I take it that we've made it clear in the agricultural area, through our regional [Reserve] Banks, that seasonal credits at the discount window are available, and that we're encouraging--that is, that's my impression, that--

MR. GUFFEY. It is correct. As a matter of fact, we analyzed the figures for all banks and notified those banks that actually have a seasonal privilege as we see it. And we have set specific communications with those banks, asking them to come in and to arrange for that seasonal credit. I might also add, however, so long as the discount rate remains substantially higher than the fed funds rate, we [haven't seen] a great deal of interest in seasonal credit [from us] other than as a lender of last resort, if you will. They look at us, but they can acquire those funds from a correspondent at something in the neighborhood of a 1/2 percent less than we're willing to lend them. They are going to go get the funds there or in the market.

MR. MAYO. Very few seasonal loans, Mr. Chairman, even fewer than Kansas City. Maybe we haven't marketed it as well as they have. But there's very little interest in the seasonal loan program even with the liberalization on selling fed funds.

CHAIRMAN BURNS. Have we liberalized sufficiently on seasonal credits? Any view on that?

MR. MAYO. Well, I think this is part and parcel of a much broader subject, really, Mr. Chairman. Perhaps liberalization of adjustment credit generally. The line between the two is extremely difficult for our banks to perceive.

MR. GUFFEY. I might make one additional comment with respect to that. The seasonal borrowing is based upon a five-year experience of the bank that you're looking at. When you have unusual situations, such as are occurring this year--sometimes you have a bank that has a real bulge this year, but, because you lay it against the past five years, you cannot find the seasonal borrowing privilege for them.

CHAIRMAN BURNS. Well, that raises the question about the validity of those criteria.

MR. GUFFEY. That's correct.

MR. JACKSON. I've also heard some suggestions that perhaps our use of seasonal borrowing at what we otherwise call reserve-city banks, or the denial of the use of seasonal borrowing for that size bank, has hampered the delivery system of crops in some sense. And I heard this in Memphis, Larry, that the people there were talking about their [being the] focal point for the delivery system [for] agricultural products, which produces seasonal pressures on the banks, but they didn't have the privileges that the country banks have. And that this was hampering their capacity to serve the agricultural system

MR. MAYO. We've not heard this, Phil, in Chicago.

MR. BLACK. Mostly that's a matter of the relative rates on federal funds and the discount rate, though, don't you think? You get complaints if they were more competitive elsewhere.

MR. BAUGHMAN. Mr. Chairman, just a couple of additional observations. There had been a substantial interest in the seasonal loan programming in our District, but we only have one borrower at the present time, and it's this rate situation, where if you get funds at a cheaper price than elsewhere, you'll use them. With respect to the liberalization of the program, there were a couple of small changes in the program fairly recently, about a year ago, which made it easier to administer and, we believe, made it somewhat more attractive to the bank.

CHAIRMAN BURNS. Well, I think, Governor Gardner, you've been looking into this problem. I think that you might well want to take steps to reexamine the seasonal borrowing privilege and see if it cannot be usefully liberalized--this five-year formula obviously cannot cope with the kind of situation that appears to be developing in some of the grain-growing states.

MR. AXILROD. Mr. Chairman, there are other provisions, of course--Regulation A, which could be readily applied. In any case of emergency, there are provisions for loans at the regular discount rate independent of seasonal needs.

CHAIRMAN BURNS. Well, but this may possibly call for a conference of the discount officers, particularly in the farm areas. There may not be sufficient sensitivity to our regulations--

MR. AXILROD. What I was trying to say is that I don't believe there's anything in the regulation that will impede this kind of lending, seasonal borrowing or otherwise. It may be a question of rate, but there's nothing in the regulation.

SPEAKER(?). That's right.

CHAIRMAN BURNS. Maybe a question of attitude on the part of the discount officers.

MR. AXILROD. That is possible, Mr. Chairman.

MR. GUFFEY. I would make one comment, if I may, Steve. It is true that declaration of an emergency situation would permit us to lend and at the basic discount rate. It isn't that kind of a situation, I think, that we face. Rather, if they do not qualify for the seasonal, and if they do not qualify for emergency, than we have to go under the adjustment provisions of Regulation A, which essentially limits us [to] about a 30-day [period], and for an agricultural bank looking forward to a crop growing season, 30 days is--we'd tell them that and they'd laugh at us--you provide nothing for this.

MR. AXILROD. It very well may be you need [an allowance for] more judgment in the seasonals; it's quite possible.

MR. GUFFEY. Yes.

CHAIRMAN BURNS. Well, I get the impression that this is something that ought to be looked into, reexamined rather promptly. Well, I think this has been helpful. Let's move to Mr. Partee now, please.

MR. PARTEE. Well, coming back to the standard projection, you know, I was particularly impressed by the flow of funds projection that was included in the material that we got over the weekend. And I note there that on line 2 of table 1, the percentage of GNP of total funds raised is rising from, it looks like, about 14 percent in the first half of '76 to roughly the 16 percent level, which would be consistent with rising interest rates. And I notice on line 13 that household purchases of credit market instruments on a half-year basis go from negative 4 to an 18 billion, to a 26 billion, to a 38 billion annual rate, which I think is also very consistent with rising interest rates. Indeed, that may show quite a bit of strain developing, and I suppose there is a certain amount of circularity in that, but it's associated with the fact that loans of banks are growing more rapidly so that they'll be able to buy less governments. And I guess the same will be true of the thrifts, that mortgage loans are growing more rapidly, so they'll be able to buy less governments. So in effect, the public has got to buy the governments, and that almost always means rising interest rates, and they would bring them about. So totally ignoring any money supply analysis, Phil, I think that the flow of funds numbers come to bear out prospects, a tightening up of--

CHAIRMAN BURNS AND MR. COLDWELL. If you accept those numbers.

MR. PARTEE. Well now, the flow of funds numbers are consistent, of course, with the GNP projection, and that's the thing you have to ask yourself, whether the GNP projection is likely to be about right or too low or too high. I can't find a great deal to argue with in the GNP projection, except that it seems to me that there might be exposure to a somewhat higher rate of price increase than is in it. And if there is, why, the nominal GNP rise could be larger than the staff is projecting, in which case this pressure in the flow of funds would be greater than it's being shown to be here. So I think that the probabilities are on the side of more straining in the markets than is here projected.

CHAIRMAN BURNS. When you say the flow of funds estimates are consistent with the GNP estimates, you certainly cannot mean that, assuming the GNP projections, there's one and only one set of flow of funds estimates that is consistent with that, and that we have it on this table. But you didn't mean that. If you do, that's a strange kind of--

MR. PARTEE. Well, I don't think you can be quite that precise about it. But I don't think that there's much variation. If the GNP pattern, as well as the projection, is right, [unintelligible] so much investment, so much consumption, why of course, the whole thing isn't generally consistent and it tends to break up. Now you might have, for example, corporations borrowing less than Jim has indicated that they would do. But if they do, they'll buy fewer liquid assets than Jim has indicated they would buy, and it would tend to net out both sides of the flow. So there are lots of tricks in this, but I always felt that it was an alternative way of approaching the question of the possible [unintelligible] of credit markets to money supply analysis. And all I'm saying is that this strongly suggests to me a tension in markets developing in the projection period.

MR. WALLICH. If I may interject here. The overall figures, percent of GNP, do point in the direction that you say, Chuck. I look upon them the same way. I'm struck by the fact that the acquisitions by households, which are usually the marginal element--the regular sources don't produce enough, then the procedure used here squeezes it into household--do not increase their share as a percentage of disposable income over the quarters following the second half of '76. It remains pretty flat at a little below 10 percent.

MR. PARTEE. Well, no, I think the proper figure to look at, Henry, is the credit market instruments.

MR. KICHLINE. It would be line 16 on this table.

MR. WALLICH. Well, those go up because they assume some disintermediation.

MR. PARTEE. That's with squeeze. That's where they squeeze it. It's similar to Solomon Brothers' residual line in their analysis of supply and demand for funds, I think. Isn't that right, Jim?

MR. KICHLINE. That's right.

MR. WALLICH. So we do assume that some more credit instruments have to be pushed into the household sector?

MR. KICHLINE. Correct.

MR. WALLICH. But in lieu of what they would otherwise put into thrift institutions, so that the aggregate demand of their savings doesn't increase.

MR. KICHLINE. Well, the total acquisitions of deposits and credit market instruments does decline over this period. It coincides with the period where households are also taking on large amounts of mortgage debt and consumer installment debt. But I think the important message is that the way in which households are induced to acquire additional market securities is through the interest rate process, that market rates rise relative to deposit interest rates, and hence they are induced to acquire less deposits and relatively more market securities. And that does show up in these tables.

MR. JACKSON. How does the flow of funds projections predict interest rates over the past few years?

MR. KICHLINE. Actually, quite a bit better than our other assessment. We would have gotten much looser credit markets than the money supply analysis would have given. But that's a track record which doesn't always hold.

MR. PARTEE. I don't think it does very well for level, but it does well for the direction of change.

MR. KICHLINE. That's right.

CHAIRMAN BURNS. All right, thank you. Mr. Wallich.

MR. WALLICH. I have two questions. We're going through a period of very rapid changes in the picture: first the snapback from the cold spell, now the withdrawal of the rebate, thereafter possibly the impact of the energy message, so that one cannot expect a very smooth evolution of the cycle. But is there reason to think that the expansion is less well balanced now than it appeared a year ago or so, the main imbalancing to be a rather slow advance of business capital spending? Everything else was coming along pretty well, in balance. Now, my impression is that housing is very strong, automobiles are very strong--and that raises the question of whether there are some imbalances developing here. This is my first point.

Second relates to my favorite subject, capital needs. There was a piece in the *Wall Street Journal* a little while ago which suggested that pressures for acceleration of capital spending tended to develop in recent cyclical periods at higher and higher levels of capacity utilization. Originally they used to begin, that is an acceleration of capital spending, in the low 80s of capacity utilization. Now they have moved up to the upper 80s, and in fact were getting into the area where capacity pressure shortages were typically beginning. Is there anything to that kind of analysis?

MR. KICHLINE. Mr. Zeisel will answer the first, and I'll take it my hand at the second.

MR. ZEISEL. In terms of the balance of the economy, we still are obviously running with capital spending significantly below what it should be, given past performance in an expansion period. And the outlook is still somewhat unclear in that regard. We anticipate moderate rates of growth, but it will be some time before the rate of capital spending would be in reasonable balance with other components of the economy in terms of historical relationship. But in terms of other sectors of the economy, inventories are in good position at this point, and in fact probably a little on the low side, so that there is room for expansion there. Housing has moved along at a very good clip recently.

But we are not in a position where we are impinging in any very significant way on production capacity as yet. Looking over the materials producing sectors, production as a proportion of capacity has moved up significantly, but there's still a fair margin to move there, and we don't expect any significant shortages developing into at least the first half of '78, unless the economy moves much more rapidly than we're assuming. So in that sense, I would say that the expansion has not developed any severe distortions as yet.

CHAIRMAN BURNS. But you're overlooking the very sharp turnaround that has occurred in our foreign trade balance. And this is a drag on our economy. We not only have a deficiency in business capital investment but also in our net foreign trade. And the outlook, at least for this year, is for some further deterioration in this regard. So there are these two major imbalances, if you take past cyclical expansions as a yard stick.

VICE CHAIRMAN VOLCKER. Any further deterioration from the current level? Further deterioration this year certainly, but I--

CHAIRMAN BURNS. I don't know. Mr. Reynolds, would you comment on that?

MR. REYNOLDS. I didn't hear the question.

VICE CHAIRMAN VOLCKER. The question is whether we would expect the trade balance to decline further from the level we've reached in the first quarter, not from last year.

MR. REYNOLDS. No, I don't think so.

CHAIRMAN BURNS. But from last year.

MR. REYNOLDS. But from last year, certainly.

CHAIRMAN BURNS. All right, now, Mr. Kichline for the second.

MR. KICHLINE. The second question as I understand it relates to the performance of investment and whether we're getting good gains in investment only when we tend to get much higher rates of capacity utilization. I think that [idea] is drawn generally from the performance of the early '70s to date, and I would hesitate to make a forecast relying on that alone. I think what's more important is that business attitudes have changed, and we are not getting a typical cyclical recovery in business investment, and hence we will find later on that one could say the excess capacity was a drag on activity.

I think that's important, but more important, I think businesses are quite concerned about their financial positions, about the uncertainties regarding the economic outlook--importantly, about the uncertainties regarding prospective profits in an environment where we do have price performance that has varied a good deal in recent years, and we have on the horizon the energy program. All of these sorts of things, I think, track into an environment of uncertainty which would mean that you would tend to find businesses more reluctant at this point in the cycle to extend themselves on major investment programs. But I'm not sure that this recent performance represents more than a change in attitudes and the performance of the economy overall.

CHAIRMAN BURNS. I think your answer is very helpful, but it doesn't deal sharply with the question that Mr. Wallich has put to you.

MR. KICHLINE. Well, it's very clear in our forecast that we do not--

CHAIRMAN BURNS. Let me just elaborate for a minute. I want to make a suggestion. You were referring to the so-called Eickhoff phenomenon, and that is a very interesting piece of analysis. And it calls for, I think, empirical study, and has the staff done that?

MR. KICHLINE. We have not.

CHAIRMAN BURNS. I think it would be extremely worthwhile to look into that with very great care.

MR. KICHLINE. I might note that we are quite concerned about the whole investment area in a variety of ways and that we're undertaking--

CHAIRMAN BURNS. I know, but I'm talking specifically about the so-called Eickhoff phenomenon.

MR. KICHLINE. That's right. That's part of it. What I was saying is, we're taking a broader tack in our research program, focusing on the business investment sector, and this is one part of the answer. We do not have any independent staff analysis to contribute at this point.

CHAIRMAN BURNS. I think it would be very instructive, as a part of that study, but as an isolated part, to start with that theory and try to determine to what degree there is a good empirical basis for it, to support the theory.

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

MR. ROOS. Early in the meeting, the Chairman referred to the energy package and to the possible effects of it. And as we discussed your projections, obviously automobiles sales and similar factors were cited as reasons for positive interpretation of what may happen. Are we going to get into any significant discussions on the effect that the energy package, at least as anticipated or reported, might have on all of these factors? Or has it been taken into consideration in--

MR. KICHLINE. We have not included it in our forecast. We have not had an opportunity to analyze the program in detail. In fact, we don't know all of the details and the critical parts regarding rebate schemes, for example. It presumably would have a substantial impact on the economy. The only other comment I can make, I guess, at this juncture is, one, I think there is a risk of increasing uncertainty on the part of the business community, depending upon how the proposals are perceived, and that would impact back on business investment. And second is that it's my understanding that the Administration is taking a longer-run view, so that the immediate impact, aside from expectational influences, might be moderated by tracking the proposals over a longer time horizon. But I don't have any further comments at this time.

MR. MAYO. Legislative action is almost certain to postpone the need for detailed analysis too, I think. It's going to take them a long time.

CHAIRMAN BURNS. I'd like to comment on that a little. I don't have much to say, but I am troubled. If this meeting had been held a week ago, I would have made a very bullish statement about the economy, and I have, fairly consistently for some time, with perhaps renewed emphasis. The President's renunciation of the rebates strengthened my judgment in that regard. The anti-inflationary message went a little further in the same direction, even though the strongest part of the anti-inflation message was not mentioned, the strongest part being the dropping of the rebate itself. The very fact that the Administration has shifted its emphasis is, I think, of very considerable significance. I would have said so [last week] and argued that point.

But now we have the energy message coming along, and my impressions of that are poorly formed, but I am deeply concerned about this energy message. It's extremely complicated, and therefore I think it will be very difficult to grasp what the proposals [will] come to, intellectually--extremely difficult. Now, it will be difficult for members of the Congress, it would be difficult for economists. And even if you assume that what the President proposes, that Congress will accept--and that's quite an assumption--I think we'll be in the dark for some time. The economists will go to work, and some already have in the Council of Economic Advisers, and they will make calculations, and they will tell you what the effect may be on real GNP and on the price level. But I think they will also tell you that they're very uncertain about the validity, significance, degree of accuracy of all these calculations. I think that we'll be going through a period of very considerable confusion. A legislative proposal that consists of several dozen different items, each of which raises numerous questions--I think it will be so difficult to comprehend, that Congress will be at this for months. And there's no way of telling where or how the Congress will end up.

Now there's one thing that I know, or I think I know, about the legislative process. If you come forward with something that is difficult, comprehensive, covers very many fronts--members of the Congress are confused, and they don't know what it comes to, just as the rest of the population, including professional economists, will be confused. But secondly, when you have such a comprehensive legislative proposal as this is going to be, different interest groups will find something that is of great importance to them, which they will object to. And then you may well have a coalition, an accidental coalition, in opposition to the proposal, and what may come of all of this, I find no way of knowing. My present impression is that the great element of uncertainty will be the immediate result of the Presidential message on energy and that this will be a negative influence on economic activity. I, for one, cannot as of today make the bullish pronouncement that I would have made a week ago, or a few days ago.

I was briefed yesterday on the message in very general terms, and what I learned raised dozens of questions in my own mind. Now, in saying all this, I don't mean to be critical of the President, the Administration, the energy message. The purpose, I think, is profoundly right, that this country has a very serious problem, and I think the President is courageous in attending to it. Whether he's going at it in the right way or not I think is a fair question. And all that I can add is that when you try to bring up the oil price to the world level in a series of steps, [unintelligible] one will be effective upon passage. When you have numerous provisions designed to speed the conversion of industrial facilities and public utility operations to conversion from oil and natural gas to coal, when you impose a new gasoline tax, when you impose a tax on automobile guzzlers along with some rebate scheme on purchase of small cars, and when you do a dozen other things of lesser significance, you're releasing forces--I'm repeating myself.

Our staff will get busy to analyze this, and after our staff is through, I can predict that our staff will say what economic staffs generally say about all these things--there will be a small effect on real GNP and a small effect on the price level, and I won't believe a word of it. And that's where I am as of today. Confused. Gladdened because the President is speaking out on the subject. Confused by the economic effects that may be invoked.

MR. BLACK. Mr. Chairman, I gather, from what you're saying, that there are not really any surprises in there that we haven't pretty well read already.

CHAIRMAN BURNS. I'm told that the article that appears in the *Wall Street Journal* is more or less right, but of course, some changes have taken place, and other changes may take place within the next two days. Well, the President will be addressing the Congress, I believe, tomorrow evening, and then the legislation will be sent up a week later, when further changes will take place. But the shape is more or less determined.

MR. EASTBURN. Isn't it possible that, in addition to creating uncertainty, which would have a negative effect on real output--[it would] enhance price expectations--higher price expectations?

CHAIRMAN BURNS. If I were to make a judgment at this time, and it's obviously premature, it would be that the effect on economic activity would be negative; and the effect on prices will be negative in the sense of prices moving higher. But I'm not ready to make a judgment.

MR. PARTEE. You say there is an initial price increase of energy, that is not [unintelligible].

CHAIRMAN BURNS. No it doesn't.

MR. WALLICH. If it is the way it's been described, at least there is the advantage that [it] does work through the price mechanism, mainly taxes and rebates, and--

CHAIRMAN BURNS. Well, I would not describe that as working through the price mechanism; I certainly would not. I would say "work through the price mechanism" if you leave things pretty much to the market and leave taxes and rebates pretty much alone.

MR. WALLICH. Well, that would be very difficult in today's conditions if you want to achieve those objectives.

CHAIRMAN BURNS. That I'm not sure of, by that I'm not implying any criticism. I was just getting the terminology here.

MR. PARTEE. Well, it's a price-rationing effect--it may not be a supply-inducing effect.

MR. WALLICH. Yes.

CHAIRMAN BURNS. I--

SPEAKER(?). It's a manipulation of prices.

MR. COLDWELL. Your description reminds me of the FIA [Financial Institutions Act].

CHAIRMAN BURNS. Well, that's exactly what happened. You have a coalition defeating the Financial Institutions Act. And the coalition consisted of commercial banks, to some degree the S&Ls, the homebuilders, the AFL-CIO, the Federal Reserve--

SPEAKER(?). Strange bedfellows.

CHAIRMAN BURNS. And I think it was very similar because nobody really understood the Financial Institutions Act.

MR. COLDWELL. It seems like you described them as individual [unintelligible].

CHAIRMAN BURNS. But, individual interest groups, not excluding the Federal Reserve, understood specific parts of it, or they thought they did.

MR. GARDNER. I have to add, you were talking about the Financial Reform Act, gentlemen.

CHAIRMAN BURNS. I think that's a valid comment, yes, but I personally would say that with less emphasis with respect to the Financial Institutions Act. My own reaction to the Hunt Commission Report was, I couldn't understand it because it had so many recommendations. I could grasp 1, 2, 3, 4, 5, but when you have 100 recommendations, it is beyond my intellectual grasp.

MR. GARDNER. Mr. Chairman, we had an energy program proposed to the Congress that lived [unintelligible] for 12 months. And it went through almost exactly the process you described. The one key difference was that Congress was never persuaded to seriously consider it. But your comments about the uncertainty that this kind of process inspires is particularly germane, in my opinion, because of the effect on business investment. The uncertainty of how to proceed.

CHAIRMAN BURNS. Any other comments on the economy? Well, it's almost 11, and therefore it's time for a coffee break.

[Coffee break]

CHAIRMAN BURNS. Gentlemen, as I think you know, we will have to testify on our 12-month monetary ranges on May 3, 1977, and therefore we need to deliberate today on setting the ranges for the next 12 months. In view of the uncertainty connected with the energy problem, there is a chance that we may possibly want to reconsider before the testimony is given, in which event we will have a telephone conference on the subject. I have no way of judging the probability of that, but we must keep ourselves in a flexible position.

Now I have asked Mr. Broida to distribute the memorandum that he prepared. That memorandum should have been distributed earlier. I had given Mr. Broida a very simple assignment, and that assignment was designed for my own instruction, and I didn't have the opportunity to read it before this weekend. And after reading it, I found that Mr. Broida had gone beyond my initial instructions, very wisely. And I thought it was such an instructive document that it would be helpful to all members of the Committee. It's too bad it reached you so late, but the fault there is mine.

Now, let me say a few words, and I don't want to repeat what is in Mr. Broida's memorandum. But let me say only that we embarked on our 12-month--let me use the term "target," though I try to avoid that in public utterances, and it's perhaps a little easier to say targets now and then instead of ranges. We embarked on this new approach just two years ago. And during that period, we have lowered the midpoint of M1 from 6-1/4 to 5-1/2 percent, and the midpoint of M2 from 9-1/2 to 8-1/2 percent, and the midpoint of M3 from 11 to 10 percent. During that period, the actual growth rates have not diminished, and as we examine M1 alone for the past 12 months, the growth rate is higher than for any other 12-month period, starting with

April 1975. For M2 and M3, we're almost at the peak as well. Now I don't consider that a failure on the part of the Committee. We set ranges very deliberately, and we wanted flexibility, and I would draw the following conclusion, only--that those critics of ours who feel that we've not been liberal enough, the record hardly justifies that. And perhaps, on the other hand, the praise that we've gotten from many on the kind of monetary policy we've pursued--we deserve neither the criticism nor the praise that we've gotten. That's my own appraisal.

Mr. Broida points out, and I have said this previously, that at the pace that we've been going, it will take something like 10 years to get the monetary growth rates down to a level that is, or appears to be, reasonably consistent with general price stability. And it would be excessively optimistic to believe that we will necessarily keep to anything like this pace, because over the next 10 years we will surely have moments of hesitation when we'll not make any adjustments. And there may be periods of recession. It would be surprising if we didn't have one or more recessions over the next 10 years, and during such a period, we are not likely to lower our monetary growth ranges. The good thing about our procedure is that we at least have a goal. We've set a goal for ourselves. We've moved in the direction of that goal, though perhaps we've moved rather slowly, and that is argued.

Now, before I learned about the energy message that would be forthcoming, and this was late in the afternoon yesterday, I was still struggling between two choices that I was going to put before the Committee, or rather I was still struggling between two choices and hadn't yet made up my mind firmly, and I expected to do that before this morning. And the two routes I was struggling with were as follows: first, to lower the lower limit of the growth range of M1 by 1/2 percentage point, and second, to lower the upper limit of the growth range of M2 and M3 by a full percentage point. I am sorry--no, the second was to lower both the upper limits and the lower limits of M2 and M3 by 1/2 percentage point. Now in view of what I have learned about the energy message and the uncertainty that that introduces to my own mind, I am inclined to make a much milder recommendation to the Committee. I think that we should make another small move toward reducing our monetary growth ranges today. But I think the move should be small indeed, and of the kind that would arouse a minimum of controversy [that would add] to the uncertainty that is likely to prevail.

And therefore my recommendation to the Committee, without arguing the case at the moment, would be to lower the upper limit of M2 and M3 by 1/2 percentage point [and] leave M1 unchanged--do nothing about the lower limit of M2 and M3, but simply lower the upper limit by a half percentage point. That is a minimum adjustment. We would still be working most gradually toward the objective of bringing the monetary growth rates down so that in time they will be consistent with general price stability. Now, one argument that I would make in this direction for making some small move, is that it is entirely consistent with what the President has stated, [unintelligible] bringing the inflation rate down by something like 2 percentage points by the end of 1979.

Well, that's all I want to say at this time, and the question before us, these decisions, are never easy. There is never a good time to lower the monetary growth ranges, yet unless we work at it, at least just a little, I don't see much future for straightening out our economy and for helping to set a standard for much of the rest of the world, which is continuing to suffer from the ravages of inflation.

Who would like to be first? Mr. Mayo, please.

MR. MAYO. Well, Mr. Chairman, I agree completely with your recommendation on M1 for the very same reasons, this area of uncertainty and the potentially serious misunderstanding of our objectives if, [at] the moment the rebate disappears, it seems that we are about to tighten up. I think that would not serve us well in our administration of an even-handed policy. I feel, in looking at our own charts on this, that to keep the 4-1/2 to 6-1/2 is actually a little more conservative from the present base than it was from the base that we are leaving--in other words, the fourth quarter.

On the M2, I was prepared to propose that we go the half percent on both ends. I don't think this would be damaging, because whether we like it or not, the basic emphasis is still on M1 and will move only very slowly into M2. I think it does put us into a position, if we use 6-1/2 to 9-1/2, of supporting our basic thesis of reducing the ranges over a period of time. And yet I think it would be quite acceptable on economic grounds and quite acceptable in the area of analysis that relates to some tightening of interest rates, which I think would be a reasonable expectation coming out of the energy discussions.

But the principle element in my reasoning is still the element of uncertainty we have dispelled. One uncertainty with regard to the rebate, we are substituting another one, perhaps even more serious, on the energy costs side, and I would prefer to bide my time on M1.

CHAIRMAN BURNS. Thank you, Mr. Mayo. Yes, Mr. Roos.

MR. ROOS. No sir, I don't mean to go on--

CHAIRMAN BURNS. Yes, please.

MR. ROOS. I would disagree with my good friend, Bob Mayo. It seems to me that the time couldn't be better for a more meaningful reduction in these aggregates figures. The President has enunciated a desire to get to 4 percent in a couple of years in terms of rate of inflation [and] dropped the stimulus package. It is almost unanimous that what the economy needs, or at least what business needs to move it ahead, is an indication that everyone is serious about dealing with the problem of inflation. It seems to me that if we were to follow in this direction, that if Congress took unwise action which would have a detrimental economic result in the sort of energy legislation that it passed, it seems to me that by our doing this, there would be less of a reason for Congress to do anything that would artificially stand in the way of stable economic growth.

And I just feel that this would reinforce confidence in the economy, it would reinforce what the President and the Administration said they want to do, and would reinforce the confidence that the public might have in the fact that we're really serious about what we want to do. It is a matter of degree, but I don't really see the reason, or at least I can't reconcile myself to anything but a compelling reason to take the step that you felt a few days ago before the energy problem arose, or before the program was brought to your attention. I'd like to see us go more strongly.

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

MR. PARTEE. Well, I disagree with Larry, and I agree with Bob, except that I feel that we really shouldn't make any move at all in the aggregates ranges at this time, in M1, M2, or M3. First of all, it seems to me that what has happened with regard to the rebate is perceived by the public and will be perceived by the Congress as a step back from a stimulative program. At the same time, we also seem to be tightening up monetary policy a little bit. I think that it's a very bad impression that would be left because we still do have a great deal of unemployment in the country. And it doesn't seem that there ought to be, in all areas of governmental macro policy, a stiffening at this time.

Secondly, although one can agree in principle with getting the ranges down over time, I do think you have to have enabling conditions. And enabling conditions just aren't there if one believes at all in the staff projections. In the staff projections, we have an increase in nominal GNP over the next year of about 12 percent--some quarters a little higher, some a little lower. I have criticized the projection as perhaps understated in the rate of inflation that is likely. It certainly is true that the projection hasn't taken into the account the energy program, which would probably raise the rate of inflation to some degree. So it seems to me that we are stuck with the rate of inflation of at least 5-3/4 and perhaps more over the next year, and we need to have real growth in the economy so we'll make some progress in reducing the unemployment rate over this period.

If one looks at the implied velocity figures from the midpoints of the ranges that we have had, what you find is that we will need to be entering into one of the steepest rises in velocity of this episode in M1 figures over this next year in order to validate the projection. Far steeper than has occurred in earlier recoveries and steeper than we've had over the past year. It is about a 7 percent increase in velocity required over the year. The interesting thing to me is that it would also require an increase in velocity of M2 and M3 to validate this staff projection. And, indeed, I've looked at the previous five recoveries, and at this stage in previous recoveries, the velocities of M2 and M3 have generally declined, not increased, at this stage. That is to say, M2 and M3 have grown more rapidly than the increase in nominal GNP. What shows up on the charts is a year delayed. The kind of an increase in velocity--again taking the midpoint for M2 and M3--the kind of an increase in velocity that in past recoveries has stopped the housing route, because if we look at this recovery versus past recoveries, you also find that housing is still increasing, whereas it had leveled off and to some extent was declining in previous recoveries.

So I think that we already are dealing with very, very restrictive numbers in the Ms relative to what we expect in terms of the performance of the economy and relative to maintaining a reasonable, gentle rise in housing starts from this point on. And therefore, the way I see it, we are going to need the upper end of that range in M2 and M3 in order to make this system work over the next year. If we were to cut anything, I think it ought to be the lower end of the range because I don't think that will be effectively utilized over this time.

But I would prefer as a matter of appearance, following right on the heels of the rebate withdrawal and right on the heels of an energy program that is perplexing the public, I would prefer to leave the ranges just exactly where we have had them in the last period.

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

VICE CHAIRMAN VOLCKER. Let me say first, Mr. Chairman, I just read this memorandum of Mr. Broida's during the break, and I found it a very interesting and persuasive document in terms of the difficulties of bringing these numbers down. I was also a little concerned as I read it. It seemed to put the Committee entirely in a rather passive voice, so to speak, to do what you can, when you can get by with it--until I get to the bottom of page 8, where I think it expressed the philosophy that we have to follow: that progress should beget progress as you succeed. And if what we're doing here makes some sense in affecting the economy as we succeed in bringing down these growth rates, the economic conditions that permit us to bring them down more will be facilitated.

I hope that's true. I think maybe that's a matter of faith, but I think that's the faith upon which we're operating. If that suggests that I've become increasingly enamored with this aggregates approach during the past couple of years, I think that's true in this period of uncertainty. I think it has been one little beacon of reassurance, perhaps. I do think we now have a lot of uncertainties, and I don't think the [President's] inflation message does much, for better or worse, to eliminate the very deep-seated feeling that I seem to be getting from the business community and elsewhere, that the Administration isn't serious about inflation, and the Congress is less serious.

CHAIRMAN BURNS. Well, the one good thing about that message--there are two good things about that. First, that there was such a message concerned with the inflation problem, never mind this specific program. The second good thing about it is that the President indicated that it would be the objective of the Administration to reduce the inflation rate and bring it down to 4 percent by 1979 or the end of 1979. Now, these two things are of some significance. The specific program, well, the less said about that, perhaps the better.

VICE CHAIRMAN VOLCKER. I agree with what you're saying. I think the business community has almost gotten neurotic in their concern about the Administration, and over time, that may be dissipated. I think they are misreading. I hope they are misreading it to some extent. And I think this message may go in that direction. But I still think there is a need in a sense to look toward the Federal Reserve as confirming that more hopeful approach [as] the real bulwark.

Against all that kind of background, if I really had my druthers--if we were really living in an apolitical climate, I suppose--I would have bought both ends of your initial thinking. I would have liked to see the M1 range reduced by half a percentage point, just on the low side, and some reduction on both sides of M2 and M3. I am also conscious that it comes very rapidly on the heels of this rebate decision. I think that's perhaps more important in my thinking than the energy issue, which I agree is a very large question mark. But it's more a question mark than a fact. And I think you could argue, since that is bound probably to have some inflationary implications, that an offsetting action in some sense on our part could be reassuring.

Putting all this together, I do think we ought to have some reduction in something. The easiest thing is the upper end of the range. And the most meaningful thing, as minor as it is--the upper end of the range on M2 and M3 by a half as you suggested. I guess I end up in a mood that I would accept anything between half a percent on both the upper and lower end of the ranges of M2 and M3 and half a percent on the lower end of M1--a kind of extreme program and the limited program. It's not very extreme in the context in which we're talking, but just half a percent on the upper end of M2 and M3 is my margin of being satisfied that we have taken the minimum steps that we should take at this time.

In a way, I wish this meeting were a month later, one month removed from the rebate decision. I think we would not then be clouded by that psychological circumstance.

CHAIRMAN BURNS. Fortunately, the decision, whatever decision we take, will not be announced until May 3rd, and both the business and political community has a way of remembering only what happened yesterday or during the preceding week. So there will be a little distance between the two.

VICE CHAIRMAN VOLCKER. Well, that's the range of my indifference, I guess. Not quite indifference, but tolerance.

CHAIRMAN BURNS. Well, I think that's a good a way of describing it. Thank you, Mr. Volcker. Mr. Coldwell, please.

MR. COLDWELL. Mr. Chairman, I have a little difficulty today. I listened to what others have said about this. I am really more concerned about the performance than I am the ranges. And while we can jiggle the ranges around, we have taken some steps, as was pointed out, to reduce the ranges, and yet you point out our actual performance was somewhat higher, on average. I have a great deal of sympathy with Chuck's position that this is kind of a poor time in life to be changing something as visible as the ranges. On the other hand, if we're really going to live with this range business and make it meaningful to Congress and to ourselves, I think the latter is more important than the former. We ought to be doing something about it.

I am bothered about the kind of philosophy behind this. If I understand this, and there is a high question about that, but if the prognosis is for a major increase in business loans, which puts some pressure on things around here, then it seems to me that much of that pressure ought to come through on the M1, not the M2 or M3 category, in the sense of building up the pressure. Now if M1 is the principle target here, and I think it might become one under such conditions, then we ought to be looking for the change in M1 or some more restrictive element.

I am a little bothered, though, because I still have some sympathy, if not almost outright allegiance, to questions of interest rates and money market conditions. And I am a little concerned that this would appear to be a time when we're taking a step in emphasizing the aggregates which kind of prejudges what the interest rates will do. I'm not yet convinced that this long-range forecast of interest rate increases will come to this happy land yet.

A very modest change on the upper range of M2 wouldn't bother me a whole lot. I don't know that M3 gains me a whole lot, because I have a lot of sympathy for Chuck's position about the velocity side. So I suspect that I would be willing to accept something in the very modest change in the upper limits of M2 and M3, and it may be something in the neighborhood of an 8 to 11 on M3 and perhaps a 7 to 9-1/2, but we then start narrowing the range, and that gives me some cause for thought. M1--I don't believe I'd touch [it] right now.

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

MR. GUFFEY. Yes, Mr. Chairman, I agree with the philosophy that I think has been expressed, that we continue to make some movement. But as we took a look at the ranges that we've been operating within the past as a track record, and particularly focusing in on the midpoints, what has been projected is such that you're suggesting that there is only a 2-1/2 percent differential between the midpoint of M1 and M2, and the track record in the past would suggest that that's been a 4 to 5 percent differential. That suggests--

CHAIRMAN BURNS. That's the very recent past; that's not the long-range record, I believe. Mr. Axilrod, what are the facts?

MR. AXILROD. You go back as far as 1967, the differential between M1 and M2 is reading roughly 3-1/2, 2-1/2, 0, 2.3 but then it gets up to around 5 then 2-1/2, so I would say it's in the order of 2-1/2 plus or minus something--previous to the past three years or so.

MR. GUFFEY. I went back to 1975 and 1976, and it ranges 4.4--

CHAIRMAN BURNS. M2 and M3 recently have exploded.

MR. GUFFEY. I see nothing that would materially change that in the period ahead, so as a result--

CHAIRMAN BURNS. Well, but M3 and M2, there are indications of their slowing down.

MR. GUFFEY. To be sure, but projections of the staff would suggest that the interest rates that will affect those two aggregates are not going to start moving up until some time in the third quarter, which would affect the slowing of growth of M2 for example. If I read it correctly.

CHAIRMAN BURNS. That is, the rise in market rates would tend to bring M3 and M2 down.

MR. GUFFEY. To be sure, but I think that's not projected by the staff until some time into the third quarter, into the fourth quarter

CHAIRMAN BURNS. But that's already under way--under way not so much because of the rise in interest rates but because of a feeling on the part of thrift institutions and, to some degree, commercial banks that they are flooded with money and they are no longer advertising as they had for their certificates of deposit. Some are no longer issuing the longer-term certificates, the passbook rate here and there has been lowered, they have been moving like that--am I right?

MR. AXILROD. They have been for some months--some reduction in offering rates. And very recently we've had a slowdown in net inflows in time and savings deposits relative to what it had been in the fourth quarter. We are projecting, Mr. Guffey, further slowdowns in the summer and fall, when we believe interest rates would start rising. But as of the moment, there is a slowing also.

MR. GUFFEY. Well, just to follow this for just a minute if I may, whether it is believable or not, I would like to suggest that, because of the past track record and the fact that the slowdown may not come until later in this year, we not drop M2 or M3 at the upper rate; leave them the same, and to try to fulfill what I believe very strongly we should continue, a movement.

I would prefer the first suggestion the Chairman made, and that is to drop the lower end of M1 a half percent. My own feeling is that this would not have any serious impact in the marketplace, and as a result we would have continued the process--we would have dropped the midpoint of M1 a quarter percent, to be sure. But it would also, I think give better alignment in what you might expect between M1, M2, and M3.

CHAIRMAN BURNS. Without arguing the point, I just want to be clear about my own suggestion to the Committee. I had struggled and struggled with the idea of bringing the lower limit of M1 down and might well have made that suggestion to the Committee. But learning about the energy message, my present suggestion to the Committee is to leave M1 alone.

Thank you, Mr. Guffey. Mr. Lilly now, please.

MR. LILLY. You mentioned a couple of times the President's stated objective of the 4 percent [inflation] rate in '79. I guess I could have asked the staff a question long before the meeting, but the [President's speech] wasn't available all that time. What should the rate of growth of M1 and M2 be in 1979 and late in 1978 to have this kind of condition occur at the end of 1979? That's the question I have. Are we taking a step toward achievement of that objective?

CHAIRMAN BURNS. I would say, in view of the Committee's recent practice of assigning approximately equal weight to M1 and M2, that lowering the one or the other, either at the lower end or the upper end, we are making a move in that direction. Now, whether the magnitude is sufficient or not, or more than sufficient, is another question. But it would be a move in the direction of the President's goal.

MR. LILLY. I have no quarrel with the recommended course.

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

MR. KIMBREL. Mr. Chairman, I have labored with the thought that there's probably never going to be that ideal time for us to make these moves, but listening to our own people and observing events in our own area, I continue to be considerably impressed with inflationary expectations, the prices, businessmen who are still fearful that controls could come along. I accept the uncertainty that the energy message induces, but I also have to associate with that the at least reasonable expectation that [the energy initiatives] may contribute further pressures on upward price movement.

I recognize almost an abundance of liquidity, so I guess I am almost forced into feeling that we ought to move, and we ought to move in a fashion that would not shock the markets, to be certain, but would leave no question that we were attempting to restrain any inflation that would be forthcoming. Mr. Chairman, I would like to see us move the lower range of M1 to 4--down a half point. I would like to see M2, upper and lower, down a half, to 6-1/2 to 9-1/2. M3, a half point upper and lower, to 8 to 11.

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

MR. JACKSON. Mr. Chairman, one thing that hasn't been mentioned is the more recent environment of inflationary prospects and [unintelligible]. First, we have had recent price increases, and while the staff projection indicates that those will flatten out, and perhaps [during] the balance of the forecast period they may not be anywhere close to what they have been, we can view different opinions as to how likely that prospect can be. Each of us would have different [views].

I think there's a consensus around this table, as I hear it, and around the country, that any energy policy is likely to have a negative impact on the price situation--be likely to increase prices [unintelligible]. I think for that reason it's appropriate now for us to go ahead and lower slightly our future range. I recognize, Mr. Chairman, that we're in a funny situation. You have apparently some information about an energy policy that the rest of us don't have. And when all of us have that energy information, it might be entirely appropriate that we reconsider anything we do today. But unfortunately, for that reason, I think the judgment here should be based on what we know rather than what we think might occur. We have ample time to reassess our decision.

Getting to the point, I noticed that in the first quarter 1977, our actually experienced rates of growth were 4.2, 8.0, and 9.7 for M1, M2, and M3. And while I recognize that that's only a relatively short period as to what we're discussing today, I don't see any indication that we're going to see dislocations of the type that Chuck indicated are likely to occur. Second, if there's any validity in the staff forecast, I would say the chances of M2 and M3 growing at a significantly slower rate than we've experienced are probable. That's in the range of probability, not possibility. All of that added together, I would support a 4-1/2 to 6-1/2 for M1 and reduce the range for M2 a half a point on both ends to go to 6-1/2 to 9-1/2, and M3, 8 to 11.

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

MR. WILLES. Thank you, Mr. Chairman. My original predilection was to be very quiet today and listen and be instructed by the members of this Committee. But as I have listened to the discussion, it appears to me that the issues are sufficiently important that the District should at least be represented in deliberation.

One of the happy things that has happened to me upon my appointment is that I have been called by more than the usual number of businessmen and others to give me their greetings and well wishes. And that has afforded an opportunity to hear from what for me would be an unusually large sample of businessmen from around the country, and it has been interesting to me as they have discussed the rebate, their expectations of what the energy package would consist of, their expectations as to what the President might do in terms of inflation, and so on. And for better or for worse, the message that a large number of them have had is that, while they expect the energy program to be troublesome and somewhat disruptive and certainly to have a positive impact on price increases, and while they expect the President to try to do something with inflation, they are not sure how successful he will be with that. They are greatly relieved by the withdrawal of the rebate. And putting all those things together, they seem to give more weight as reflected in increases in spending plans and so on, than they had in earlier weeks and months.

All of which is just a way of saying that if there seem to be risks in the current forecast, they would all seem to be on the side of greater inflation rather than less. And if that's the risk that we focus on most intently when we think about what to do with these ranges, I think our District would very much support the notion of doing something.

I would take the arguments that Governor Partee made, and I guess I'd just almost reverse them in a sense that, given the expectation for additional inflation, at least the possibility of that, that would weigh in my mind to argue almost the opposite of what he did. I would be happy to go beyond those suggestions that you made, but fortunately I understand these discussions come up every three months, so that there is another opportunity relatively soon to reassess that when more information is in. So we would certainly go along with the suggestion you made, emphasizing that it is in large part more a signal that the System intends to continue to pursue the objective of bringing inflation in line. I think the comments that have been made that our actual performance over the months ahead will have more real impact on what happens [unintelligible], that's except for the psychological one, which I think is of real import.

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

MR. WALLICH. I'd like to set forth new considerations: First, I think when we set longer-run ranges we ought to look at the base drift which has taken place, and this is very usefully reflected in the appendix here. Over the last quarter or so, there hasn't been significant base drift, so we [do not] have much getting back on track to do. If we go back one quarter further [to a third-quarter base], we see that M1 is pretty much on track, but M2 and M3 actually overshot, so that [if] we wanted to go back to that track we have to come down somewhat for the actual higher aggregates.

Certainly, it seems to me, we've got to look at the general fact that inflation has accelerated as a result of outside forces, in a very small way the same as the oil shock. After many debates, I have come to the conclusion that such an event should not be fully accommodated by a monetary policy that would just build the price increase into the economy permanently as a continuing rate of inflation. Neither could it be ignored fully, because that might create a high degree of monetary stringency, and so I tend to feel that, other things equal, which in this case they are not, one should accommodate that in part.

The third set of considerations is that we have major changes on the fiscal side and on the side of the Administration. Fiscal policy has just given the signal that plans were too expansionary and they have been cut back. That to me seems to say we should certainly not compensate that but, if anything, either move in the same direction or stand still. The energy message--I find it hard to evaluate; a greater uncertainty does suggest doing less.

The President's inflation message, it seems to me, we ought to attach ourselves to very firmly and take this objective of getting inflation down by 1 percent or so per year very much to heart, and help the President by getting our aggregates down over time. I think that is an excellent point both of substance and a talking point.

Well--putting these things together, I've looked at what's going to be ahead. What seems to be likely to me is that interest rates have to go up and that we will be pushed into that by pressure on the aggregates on the upside. If we do not allow interest rates to go up, then the aggregates are likely to accelerate. I know this forecast has been wrong before, but it looks plausible to me now; it's the best thing one can go with.

So what matters are the upper ends of these ranges. It therefore becomes a relatively cheap shot to reduce the lower ends. I think it unlikely that those [lower limits] would be triggered. I would argue that we can go down with M1 a half percentage point without achieving much of a result. The trigger that is likely to be touched is the upper [end]. On M2 and M3, the same argument, same reasoning, would suggest that one again lowers the lower [limits]. I would be more inclined to lower the upper part of the range, on the grounds that I would like to bring a little closer the [triggering] that is likely to cause the rise of interest rates that somehow has to be distributed over the course of the year. It's also in conformity with the overshooting that has occurred over a longer period in the two higher aggregates. So, in summary, I would say on M1, 4 to 6-1/2; on M2, 7 to 9-1/2; and M3, 8-1/2 to 11.

CHAIRMAN BURNS. Thank you, Mr. Wallich. We'll hear next from Mr. Black.

MR. BLACK. Mr. Chairman, I guess I'm going to be the hawk today. I thought several times that someone was going to steal all I had to say, but I still come out a little further to the right on this. The question to me still is not whether we should cut the limits but really by how much. For a long time you have been testifying, and the rest of us have been taking every opportunity to say, that we want to work down the long-run rate of growth in the aggregates, and there always seems to be a reason why we can't do this. And Governor Partee has spelled out particularly well why this is not exactly the most advantageous time, and I am well aware of that. But at the same time, I think it's about as good a time as we are likely to get, and to make a long story short and not draw this out, I would cut the upper end of M1 by half a percentage point and the upper ends of M2 and M3 by a full percentage point.

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

MR. MORRIS. Mr. Chairman, I like your proposal, and I agree with Henry Wallich that the rebate was killed because the economy is performing much better than we thought it was at the time the rebate idea was generated. And for the same reason, it seems to me that this is exactly the kind of time monetary policy ought to respond. I think we got a strong full thrust in the economy, [and] perhaps our second quarter estimates are on the conservative side. I have an intuitive feeling that things are really moving, and that while the uncertainties over the energy policy are likely to have a drag on capital investment, that's not where we're getting the thrust at the moment, and I don't see any near-term concern stemming from that.

As I mentioned to you at the coffee break, I think, near-term, the energy program is going to be a drag on investment decisions--simply the uncertainty of not knowing what kind of rules of the game you're playing under--but I think, long-term, it is going to have a very positive effect on investment decisions. Once the program is adopted and people know what the rules of the game are, I think we are going to see a surge in energy-related investments.

I think that we can also defend your program on structural grounds. I think there is pretty clear evidence that we are returning to a more normal relationship between M1 and M2. And it could be defended--if for no other reason than I think that this combination is structurally better than the former one. And I also think Henry Wallich's base drift argument is a good one. I think in looking at ranges for the future, we ought to give some recognition that we have had overshoots--and undershoots--in the past, and clearly we have had an overshoot in M2. And to scale down the year ahead makes good logic.

CHAIRMAN BURNS. Thank you very much, Mr. Morris. Mr. Eastburn, please.

MR. EASTBURN. Thank you, Mr. Chairman. I came to the meeting with the notion that the M1 floor should be lowered by 1/2 percent, and I discovered, listening to the conversation, that it is a more complicated issue than I thought. There has been a great deal of discussion about the public impact, the psychological effect of what we might do--the appearances. And it seems to me that these cut so many different ways that they are very difficult to analyze. On one hand, the reduction of that kind would seem to be consistent with the President's anti-inflation program, but on the other hand it might seem to be inconsistent with the rebate situation. Because that is so confusing, I am inclined to resort to what I think is more basic, and that is the economic considerations.

In that sense, it seems to me that we do have a much stronger economy than we had the last time. There is, to be sure, an uncertainty about the impact of the energy program, and that is an uncertainty in my own [mind]. My own hunch is that that will [be adopted], and it will leave higher inflation expectations in its wake. As I indicated earlier, our own projections for 1978 indicate a higher rate of inflation. And I think it could be quite possible that, a year from now, we will find ourselves looking back on this period having committed excessive growth in money.

For those reasons, I'd be inclined to bite the bullet and lower the M1 floor by half a percent. I am less concerned about M2 and M3 because, as you indicated Mr. Chairman, I think these growth rates have been coming down, and they are likely to come down further. So I would concentrate on M1, and I think that this would stand us in good stead for the future.

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

MR. BAUGHMAN. Mr. Chairman, I guess it seemed to me that, in the review of Mr. Broida's document, it is essentially a report card, [and] he gives us, at best, about a "C" in terms of what we might characterize as classroom performance. But the document does not grade us on what we might call our lab performance, where you observe the results of the experiment, and there it seems to me at the present time the grade would come in a little better.

But we now seem to be looking into a situation where that lab grade, at least on the inflation side, may start slipping back. And I reconciled myself, I think pretty much because of what I judged to be the politics of the situation, to a stand-still posture during a couple months of high uncertainty with the fiscal stimulus program coming in. [But] it seems to me that, with that big uncertainty set aside, we should be moving a little further to try to improve the classroom performance. And I come out with the prescription that Governor Wallich came out with, which I believe, Mr. Chairman, is the same as yours except a small move on the bottom of the M1 range as well.

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

MR. WINN. Mr. Chairman, I feel quite inadequate in trying to assess the psychological aspects of many of the current developments, but I feel rather strongly that the economic underlying factors are quite strong, and we may even see them stronger as the inventory scramble adds on to some of these other efforts here, as the inflation psychology builds to even a greater extent. I'd be inclined at this moment to indicate some decline in all of the items, and I would join with Mr. Wallich and Baughman.

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

MR. GARDNER. I hope to be brief. The economic [situation], as Willis has just indicated, is clearly buoyant. It has rekindled more specific fears of inflation. We have to expect that. That was bound to happen whenever the economic data became clearly positive. It seems remarkable to me that with the dispensing of the rebate program, we've gone from fears of too much stimulus to fears based on the yet unannounced energy program, which clearly will have some significant impact, depending on its reception and development in the Congress.

I often have taken the position of staying in place. I think clearly it is appropriate for us to continue reducing our targets or our ranges. I would support the reduction in M2 and M3 that is proposed; I would support a reduction in M2 as shown in alternative B, and M3 a half point on either end.

But I think the principle is more important. I think we should make some changes. We are asked to do this tentatively, subject to our afterthoughts after the President's program is announced, and for that reason I would be happy with leaving M1 alone at the moment. We do have to look, in a minute, at where we are with M1 and where we will be in the next quarter with M1. And so I would support either a 7 to 9-1/2 or 6-1/2 to 9-1/2 for M2. Commensurately, an 8 to 11 or 8-1/2 to 11 for M3. I think that is the important action to be taken today--a one-year adoption which we will of course review again in three months.

CHAIRMAN BURNS. Well, all members of the Committee in attendance have now expressed their views about the lower range in targets, and before I jump to summarize and make a suggestion to the Committee, would any member of the Committee perhaps want to say an additional word at this time? Mr. Volcker.

VICE CHAIRMAN VOLCKER. I'm afraid I left myself with a range. I'd rather retract, after listening to everybody here, with the idea of going down half a percent, as you suggested, with M2 and M3 and also a half percent on the lower end of the range of M1, as I take it Governor Wallich first suggested and others did. It has some minor symmetrical advantage of putting all the ranges at 2-1/2 percent, or all the same.

MR. ROOS. Mr. Chairman, may I just inquire the impact that the Chairman sees--the possible impact of the energy proposal would be inflationary--could you just reiterate that? I'm a little lost as to why--

CHAIRMAN BURNS. Well, it's really too early for me to speak on the subject. My guess is that the energy message will tend to slow down business capital investments. Or more accurately that, as a result of the message, some projects that are now being discussed within the business community, and where business managers, boards of directors, are on the margin and might well have [gone] forward, [they] will continue to hesitate. And possibly some who have crossed the margin, [but] not by much, may reconsider.

As for prices, the longer-range effect I think will unquestionably tend to raise prices. And I see no escape from that, but I don't think that will happen for this calendar year. But these are impressions. They're not judgments at all, they are intuitive opinions and don't deserve any significant weight on the part of the Committee. Would anyone else like to speak?

MR. PARTEE. Well, I don't think--maybe I made clear the association that I draw between the long-range targets and the rebate; it's partly the impression of increased restraint in both areas, which I did mention. But in addition, there's a real effect, and that is, the Treasury will be borrowing some $10 billion less in the period immediately ahead than they would have been had the rebate gone through. And so I think we may have a period yet of stable or even lower interest rates. And there is a good possibility that the time deposit inflows will be quite strong over that period because of a favorable rate relationship. So my preference because of that rate relationship, which affects my preference, would be to wait until we can see if pressures begin to develop, which I think will be [a quarter from now] rather than now, to reduce what will certainly in the longer run have to be a reduction in the ranges for M2 and M3.

CHAIRMAN BURNS. Any other opinion or comment? If not, one conclusion is very clear, and that is that the Committee is nearly unanimous in believing that some reduction somewhere in our monetary growth ranges is indicated to be proper, appropriate at this time. The Committee is nearly unanimous on that, the consensus is quite clear. Now, otherwise, a range of views have been expressed, and a clear majority of the Committee is in favor of leaving M1 alone at this time, a thin majority is in favor of lowering the upper limit of M2 by 1/2 percentage point, and as far as M3 is concerned, one-half of our membership is in favor of lowering the upper limit of M3 by 1/2 percentage point, and the other half are at opposite ends, wanting to lower it more, or both ends, or leaving it unchanged.

And in view of the opinions or judgments that have been expressed, I think I'm justified in putting the following to a vote at the present time: namely that the M1 range be retained at 4-1/2 to 6-1/2 percent; the M2 range be lowered at the upper end by 1/2 percentage point, namely 7 to

9-1/2; and the upper end of the range for M3 be likewise lowered by 1/2 percentage point. And unless there are questions or comments, I will now call on the Secretary for a vote.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
President Guffey	Yes
Governor Jackson	Yes
Governor Lilly	Yes
President Mayo	Yes
President Morris	Yes
Governor Partee	No
President Roos	Yes
Governor Wallich	Yes

Eleven to one.

CHAIRMAN BURNS. Well, we still have time to do a little more formal business, and I shall now call on Mr. Sternlight to report on operations of the Desk.

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

CHAIRMAN BURNS. Thank you, Mr. Sternlight. Any questions for Mr. Sternlight?

MR. WALLICH. Is the change in the shape of the yield structure in your opinion indicative of a substantially different expectation of the market about short-term rates in quarters ahead?

MR. STERNLIGHT. I would say yes, Governor. I think that what we got was a partial reversal of the swing in the yield curve that had come about in January, which had come, as you recall, just about when the Administration was announcing its fiscal stimulus plans, and this has now reversed a good proportion of that as a major part of that plan was modified.

MR. WALLICH. Thank you.

CHAIRMAN BURNS. Any other question or comment? If not, a motion to ratify action that the Desk [has taken would be] appropriate.

SPEAKER(?). I so move it.

CHAIRMAN BURNS. The motion has been made and seconded; I hear no objection. We’re ready for you, Mr. Axilrod.

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

CHAIRMAN BURNS [interrupting Axilrod statement]. You mean that in the absence of the special factors, the monetary growth rate would be 5 to 6 percentage points?

MR. AXILROD. Those three that I listed. Some of which were unanticipated.

CHAIRMAN BURNS. I see.

VICE CHAIRMAN VOLCKER. You said 13, and you said these were 5, but [what] did you do with 8?

MR. AXILROD. Yes. I didn't hear it. [Statement continues.]

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

MR. WALLICH. The growth rates in appendix 4 for V1 and V2 are intended to be over the first quarter?

MR. AXILROD. Yes, it's the growth rate in velocity from the first quarter on average to the second quarter on average at annual rates.

MR. WALLICH. Yes.

MR. AXILROD. And similarly for other quarters.

CHAIRMAN BURNS. Yes, Mr. Morris.

MR. MORRIS. Steve, do we know in advance that the Social Security Administration is going to issue checks early?

MR. AXILROD. Yes, we made an effort to allow for that. Of the three special factors I mentioned, that one we allowed for possibly not enough.

MR. MORRIS. You mean the seasonal adjustment factor was changed, or just how did you?

MR. AXILROD. When a Saturday or Sunday is the third day of the month, they put out the Social Security payment on the preceding Friday. Ordinarily, they pay it out on the third day of the month. And that puts it in M1 for a couple of extra days for the monthly average. So you get about a 1-1/2 to 2 percentage points impact on a month from that. That, we made an effort to allow for. I don't really think quite enough. And the other two factors, we did not allow for at all as I look at our weekly projections as they evolve. In any event, we would have been too low, but not--in any event we wouldn't have had as high a month, but we wouldn't have been as badly off.

CHAIRMAN BURNS. Any other questions?

MR. COLDWELL. Steve, is the timing and magnitude of the tax returns giving you any problem this year?

MR. AXILROD. Well, they may be. I can't explain why, in the week preceding the tax period, M1 ought to be relatively strong. It doesn't make sense to me that people have accumulated deposits in order to pay their taxes in advance. That seems to be something of what's happening.

CHAIRMAN BURNS. Why doesn't that make sense to you?

MR. AXILROD. Because it hasn't happened in earlier years. In the abstract it makes sense, but then I would not have expected the phenomenon just this year and last year. That's the problem I have with it, and I don't have enough information to say that the tax payments are becoming larger, or how people might be varying their payment patterns. But aside from that, that's the thing that's giving me trouble at the moment.

MR. COLDWELL. It could be also on the other side of the extreme, people may be filing returns and you're getting the rebate--

MR. AXILROD. Well, the refunds are coming in. We may not be allowing for them properly, but the refunds are coming in pretty much exactly as we have projected.

MR. COLDWELL. The magnitude and timing?

MR. AXILROD. Yes, and there is no extra. Refunds in this early week in April were almost exactly as we projected and are not substantially more than they were last year. [They are] about the same as last year. So the refund pattern is not in itself causing us to go off in the sense that we--what is occurring is what we had expected. We may not have allowed for it properly, but at least what is occurring is what we had expected. And the special factors--I pointed to two of them--we really hadn't expected.

MR. PARTEE. Wouldn't that wash out right away, the tax effects?

MR. AXILROD. Refunds?

MR. PARTEE. No, no, the tax. If people were accumulating for the taxes, now IRS separates those checks and [the money balances are drawn down]?

MR. AXILROD. That's right. We are projecting a drop in the money stock of some magnitude after the week ending April 20. We did not project a drop in the week of April 20 because of the averaging effect, presuming these aren't paid until the end of the week and a little more mobilization occurs. But we are projecting a drop, and that's what gets us the low May growth rate. I mean that they are coming down.

CHAIRMAN BURNS. Any other question or comment?

Gentlemen, we still have to make our decision with regard to our two-month ranges and the domestic policy directive. The clock is not supposed to be accurate. What is the time? Well, at 6 minutes to 1 there is a chance that if we stayed until 1:30 we could finish this meeting. Now what is the sentiment of the Committee? Is it to break now or try to finish our deliberations, and we may or may not succeed?

SPEAKER(?). Let's go ahead and finish.

CHAIRMAN BURNS. Let's go ahead. Is that the sentiment? Well, let's try. In the interest of preventing pangs of hunger on the part of members of the Committee--that would be a short-run misfortune, but still a misfortune--in the interest of preventing that, let me make a suggestion to the Committee. By and large, I find alternative B attractive. I would recommend only a somewhat narrower federal funds range--namely 4-1/2 to 5-1/4, with an asymmetrical midpoint, namely 4-3/4--for the time being, and then the Desk to move as it normally does according to our procedure. Who would like to speak first? Mr. Coldwell.

MR. COLDWELL. I was ready until you did that last thing. I was going to buy alternative B all the way across the board because I thought it was reasonable, as we've done in the past with the rise in [unintelligible] stability at this time of considerable uncertainty, and the impact of the rebate program. All of which I think is more immediate than the longer-range question we adopted. I would prefer that we stay with 4-1/4 to 5-1/4, and I'm perfectly willing to take the center range just as it's normally handled--4-3/4. I gather, Peter, that's where we are now?

MR. STERNLIGHT. That's where our aim's been.

CHAIRMAN BURNS. The difference between us is very small really. In view of my suggestion of an asymmetrical midpoint, the 4-1/4 strikes me as unrealistic. That is, we're not going to get down to 4-1/4--that played some role in my own thinking. Well, let me not elaborate, but move on. Mr. Partee.

MR. PARTEE. Well, I think I would find this acceptable, your suggestion. I think you're right. It's hard to imagine us getting down to 4-1/4 with an April number, but this, I think, is likely to hold up and be quite a high number. So even if you had indications on a very low May number, why, putting the two together, the chance [is] that we wouldn't come down any more. I would hope that we would use the top half of the range, that is, the 4-3/4 to 5-1/4, as part of the range, if in fact it doesn't turn [out] that the aggregates immediately quiet down. Because, I don't know, I think it's a very mysterious business. I can't quite credit Social Security having that much effect over the monthly, and I'm a little uncertain about this income tax payment thing. And it could be that we've had an increase here, some durability in the demand for money, and if we have, we ought to begin to move. And so if we are prepared to use the top half of the range, I think that's a little acceptable.

CHAIRMAN BURNS. Well, we function under a rule which requires that. We might want to modify it, but that is the rule.

MR. PARTEE. No, we didn't move very much when we got evidence that the aggregates were beginning to strengthen.

CHAIRMAN BURNS. That came toward the very end of the intermeeting period. Mr. Jackson.

MR. JACKSON. That's one reason I'd accept your proposal, except I would go to the midpoint instead of having an asymmetrical midpoint. I'd go to the natural midpoint, if there is such a thing.

CHAIRMAN BURNS. Well, it's arithmetically possible. Mr. Volcker.

VICE CHAIRMAN VOLCKER. It seems to me we're in a little bit of a peculiar position here. These aggregates did go up at the end of the period; we didn't react to them--I think quite properly. But if we now take off from the top of the range we had last time--or even beyond it, I guess, in some cases--then we add to it some extraordinarily high ranges against our long-term range for this two-month period. The implication is, we could have quite a long period of excessive growth in the money supply without reacting at all. And I don't think it's time to react now in substance.

And in terms of the federal funds rate, I like the proposal you made, and I think we ought to probably stick around the 4-3/4 for a while and get evidence that the aggregates really are staying high before we react. But if they stayed even as high as projected, it seems to me we probably ought to be reacting before the next meeting in a modest way. And I would, I think, prefer--so that we don't get locked in too long with too high figures--the kind of federal funds range you have, with the expectation [that], unless something extraordinary happens, we're not going to move from that asymmetrical midpoint until we get quite a lot of confirming evidence to combine that with something like the alternative C ranges. So that we do react if these numbers come in that high before the next meeting date.

MR. PARTEE. What are the two months on M1 Steve? Are they 13 and 3?

MR. AXILROD. Yes.

MR. PARTEE. May looks like 3.

VICE CHAIRMAN VOLCKER. But combined, that comes out--well, in the Board's estimate--8.

CHAIRMAN BURNS. I don't know what May looks like.

VICE CHAIRMAN VOLCKER. Yes, I don't know what May looks like either, and I'd like to get a little closer before I do anything.

MR. PARTEE. Yes, but he said that if you came in as high as these numbers, and that would mean you come in looking like 3 for May.

VICE CHAIRMAN VOLCKER. But 13 for April, which leaves you an average of 8. Which is pretty high for a two-month period for no reaction.

CHAIRMAN BURNS. All right. Mr. Eastburn, please.

MR. EASTBURN. If I understand Paul's position, I think I can also support that. It seems to me that we should be prepared to let the funds rate go up. But had we had more time last time, we probably would have done so. And I can buy your range, Mr. Chairman, of 4-1/2 to 5-1/4, but I really think we should be ready to move that promptly as the figures materialize. And so far as the ranges are concerned, I'd combine that with the alternative C aggregates specification.

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

MR. MAYO. I like your prescription of 4-1/2 to 5-1/4 Mr. Chairman. I would keep the M1 and M2 ranges just where they are. I would prescribe though, a continuation of our idea of an asymmetrical inner range, and 4-3/4 to 4-7/8 appeals to me as permitting probably the degree of flexibility that we need. I would interpret it in the first week or so, however, broadly enough to encompass 4-11/16. I wouldn't set the fire engine out.

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

MR. BLACK. Mr. Chairman, I think we're presented with essentially the same problem we had last month in trying to separate out unusual seasonal factors from the underlying demand for money. In fact, we wouldn't be surprised to see these aggregates coming in somewhat stronger than the staff is estimating, but we believe that if this is true, then you've certainly got to strengthen the demand for money. So we'd come out where you did on your M1 and M2, and here the federal funds range sounds fine to me.

One thing I would like to throw out for consideration, however. I always like to go with the aggregates formulation if we can, but if you notice, on lines 46 and 47, it says "growth rates over the two-month period were deviating significantly from the midpoints of the indicated ranges." Well, I would prefer to change that to say "are moving beyond the limits of the indicated ranges." In other words, unless they go above these ranges, I wouldn't do anything for the federal funds rate because I think it's largely seasonal or special factors.

CHAIRMAN BURNS. I'm lost.

MR. BLACK. It's page 3, Mr. Chairman.

CHAIRMAN BURNS. Page 3. How would you have that read?

MR. BLACK. Lines 46 and 47, where it says "would deviate significantly from the midpoints" I would change that to "moving beyond the limits of the indicated ranges." Now that may not sound consistent with my hawkish--

MR. PARTEE. You are going all the way up to 10 before you move?

MR. BLACK. Yes, because of special factors at work, really. That's my feeling. Anything up there--

MR. PARTEE. You and Paul are taking exactly the reverse--

VICE CHAIRMAN VOLCKER. I'll apply his language for lower limits.

MR. BLACK. And I'm sure mine seems inconsistent with my earlier hawkish position, but I think you've got some special factors here that we ought not react to unless they turn out to be really a manifestation of strengthening demand for money. If it goes beyond that, yes, I think it clearly is, but up to that point I'm not sure. I would buy pretty much Steve's analysis on the thing.

MR. JACKSON. That's just the money market directive without saying it.

MR. BLACK. That's right. I have a bias in favor of the aggregates directives, is what it amounts to, and I just like to stay there in this particular case. With special factors at work, I'm willing to compromise my ideals to a certain extent.

MR. AXILROD. That's the same wording as in the money market directive, essentially.

MR. COLDWELL. I hadn't thought about making a suggestion, but as long as Mr. Black [is] talking about [it], our wording was to move toward the upper limit rather than deviate significantly.

CHAIRMAN BURNS. These are really very, very subtle nuances.

MR. BLACK. I think you may well be confronted with a situation where you've got to move up beyond 4-3/4 if you adhere to this language, and it may well not be warranted, maybe it will, I don't know. Whether that's [indicating] real demand for money or these special factors that Steve's outlined, I'm inclined to think [it would be] the special factors up to that point. But as I indicated, we think it's probably going beyond that.

CHAIRMAN BURNS. Well, we'll come back to the language later on. Thank you, Mr. Black. Now Mr. Kimbrel, please.

MR. KIMBREL. Mr. Chairman, I think the numbers are perfectly acceptable as you assigned them. Except at the midpoint, I guess I have to be more leaning away from asymmetrical. I'd like to see it [at the] actual midpoint, and maybe not too far away.

CHAIRMAN BURNS. Thank you, Mr. Kimbrel. Who would like to speak next? Mr. Guffey.

MR. GUFFEY. Mr. Chairman, I particularly like your proposal on the federal funds range. And it seems to me that the argument Mr. Volcker makes with respect to the M1 and M2 ranges is appropriate. I would also, I guess, like to speak to the point that Bob Black makes. I would like to see an aggregates directive, retaining the language that's proposed, which I understand to mean that you probably maintain a 4-3/4 to 4-7/8 range until we got something over 9 percent. And that seems to me to be appropriate.

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

MR. WALLICH. Well, I have no quarrel with the aggregates of B, given the uncertainties. I'm a little troubled by the long stability of the funds rate. I think we're in danger of accustoming the market too much to that. Also, I think that there might be more real pressure on the aggregates than we think and less of a noise element. So I would like to see the funds rate 4-1/2 to 5-1/2 but go up toward the midpoint of that very slowly. Certainly not the first and second week.

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

MR. GARDNER. Mr. Chairman, I have found some support for my concern about a 10 outer limit on an M1 growth. I'd like to see that range 9-1/2 or something. I guess it's a point of principle with me. I believe we do have special factors, but I believe they're also indigenous to April at the moment until proven otherwise. If we get a range of growth from that range of the size indicated in alternative B, I think we would all be disturbed. I can really be. I'd be glad to move up the bottom of the funds rate to 4-1/2 and to begin to take some action on the funds rate if warranted, but the idea that the outer limit of the range of M1 at 10 is deeply disturbing to me. We've had our huge burst. If we get no reaction in the next month or two, or no diminution of the size that the staff presently anticipates, I suspect we'd be having a meeting of this Committee. I just would like to see that range dropped a little bit.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Yes, Mr. Morris.

MR. MORRIS. Mr. Chairman, I support your proposal. Even though the difference between 9-1/2 and 10 is pretty small, as these things go, I think, given the fact that this bulge is the bulge of only one week at the moment, I wouldn't be comfortable [with] even that modest narrowing of the range. I would like to stay with the original proposal.

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

MR. WILLES. Thank you, Mr. Chairman. I hate to admit it, but I find I'm getting confused with this discussion and having a little difficulty understanding--

CHAIRMAN BURNS. The hour is conducive to that sentiment.

MR. WILLES. I hope that, when I go back to the clean air of Minneapolis, I can figure out what happened.

CHAIRMAN BURNS. You're casting aspersions on the air of Philadelphia, and I don't think it's being fair.

MR. WILLES. Lest that be the lasting impression, let me say that I find that I'm delighted to see that my former colleagues in Philadelphia and my former neighbors in New York seem to agree on the same prescription, and still being favorably under their shadow, I'd like to align myself with their comment.

CHAIRMAN BURNS. All right. Who would like to speak now? Yes, Mr. Baughman.

MR. BAUGHMAN. I haven't been to either Minneapolis or New York, but I'll have to admit I come out at the same place, which means concurring with your recommendation on the federal funds rate, but essentially alternative C for the aggregates ranges.

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

MR. ROOS. I'd just like to say ditto to that.

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

MR. LILLY. Well, I'd like to associate myself with alternative B and the 4-1/2 to 5-1/4 range. If we take seriously what we just disposed of not so long ago, I think this is an interim step, and I would hope that we don't restrict the growth of M1 by an increase in the funds rate at a very inappropriate time.

CHAIRMAN BURNS. Thank you, Mr. Lilly.

MR. MAYO. Mr. Chairman, it seems to me that it's flip a coin because our precision doesn't match our finite aptitude to focus on either one of them.

MR. PARTEE. The precision of our language?

MR. MAYO. Yes.

CHAIRMAN BURNS. Well, I think that there was a rough consensus within the Committee in favor of a range of 6 to 10 for M1, 8 to 12 for M2, and 4-1/2 to 5-1/4 for the federal funds rate. A rough consensus further for an asymmetrical midpoint of the federal funds rate, that is at 4-3/4. I believe also that not everyone has expressed himself on the directive. I believe that those who have expressed themselves are in favor of a monetary aggregates directive. There is a question of language that Mr. Black suggested previously, and if you'd be good enough to repeat once again your suggestion, Mr. Black, with regard to lines 46 and 47.

MR. BLACK. Yes sir. The words "will deviate significantly from the midpoints" would be replaced with "are moving beyond the limits."

CHAIRMAN BURNS. Would you accept the language "approaching or moving beyond the limits"?

MR. BLACK. Yes sir. Then we'd strictly have the money market directive, but call it an aggregates directive. I believe that's exactly the wording in the money market directive.

CHAIRMAN BURNS. Well, let's have first a show of hands on the language as it stands, on lines 46 and 47, by members of the Committee.

MR. BROIDA. Six.

CHAIRMAN BURNS. Now let's have a show of hands on Mr. Black's suggested language, paying no attention at this point to my suggested modification of the suggested language. Let's have a show of hands.

MR. GARDNER. Could you repeat your language Bob?

MR. BLACK. I'd be glad to, Steve. On page 3, lines 46 and 47, beginning with the words "will deviate significantly from the midpoints", replace that with "are moving beyond the limits."

MR. PARTEE. That means that you wouldn't move the funds rate unless M1 was at 10 percent.

MR. BLACK. That's right.

MR. KIMBREL. [Unintelligible].

MR. PARTEE. Below 2.

CHAIRMAN BURNS. Let's have a show of hands on Mr. Black's suggested language. Now let's have a show of hands on my modification of that, and that doesn't mean I'm endorsing it. I'm simply trying to determine the Committee's thinking. Then it would read "if it appears the growth rates over the two-month period are approaching or moving beyond the limits of the indicated ranges." Let's have a show of hands on that.

MR. GARDNER. Can you stand an editorial comment?

SPEAKER(?). No. Declined.

CHAIRMAN BURNS. If it adds to confusion, yes.

MR. GARDNER. Well, you're solving my problem. I wanted to reduce the range, and so if you approach it, why that satisfies me very well.

MR. PARTEE. You misunderstood me.

VICE CHAIRMAN VOLCKER. He hasn't widened it as much as Bob Black widens it from this language.

CHAIRMAN BURNS. It narrows --

MR. PARTEE. The other would mean you would move the funds rate if you were significantly above 8.

VICE CHAIRMAN VOLCKER. Ask Peter.

MR. GARDNER. I won't.

CHAIRMAN BURNS. Gentlemen, I think we're ready for a vote to employ the monetary aggregate directive, to leave the language as the staff has worded it, to have a range for M1 of 6 to 10, for M2 of 8 to 12, and for the federal funds rate 4-1/2 to 5-1/4, with an asymmetrical midpoint at 4-3/4.

VICE CHAIRMAN VOLCKER. Would it be helpful to the Manager to describe how we now interpret this thing?

CHAIRMAN BURNS. I hope the Manager will not be surprised by it. We do have difficulties at times.

MR. STERNLIGHT. No, what you're proposing now is just the standard language, now. I would have liked clarification had the Committee voted for one of those alternatives. I've no problem--

CHAIRMAN BURNS. The standard language is something you've lived with for a long time, and therefore you have--

MR. STERNLIGHT. That's right, I have no problem with that, just on the alternatives.

CHAIRMAN BURNS. I think we're ready for a vote, unless members of the Committee want to discuss the matter further. Apparently not. Would you be good enough to call the roll?

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Governor Coldwell	Yes
Governor Gardner	Yes
President Guffey	Yes
Governor Jackson	Yes
Governor Lilly	Yes
President Mayo	Yes
President Morris	Yes
Governor Partee	Yes
President Roos	Yes
Governor Wallich	Yes

Unanimous.

CHAIRMAN BURNS. Well, the final item on the agenda is the date of the next meeting, and I take it we're confirming it, and therefore we've beaten our own time and we're ready to adjourn.

END OF MEETING