TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

March 21, 1978

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. Pardee, Deputy Manager for Foreign Operations
Mr. Kichline, Associate Economist
Mr. Sternlight, Deputy Manager for Domestic Operations
Mr. Axilrod, Economist

3/21/78

Meeting of Federal Open Market Committee

March 21, 1978

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, March 21, 1978, beginning at 9:00 a.m.

PRESENT: Mr. Miller, Chairman
Mr. Volcker, Vice Chairman
Mr. Baughman
Mr. Coldwell
Mr. Eastburn
Mr. Jackson
Mr. Partee
Mr. Wallich
Mr. Willes
Mr. Winn

Messrs. Balles, Black, Kimbrel, and Mayo, Alternate Members of the Federal Open Market Committee

Messrs. Guffey, Morris, and Roos, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist
Messrs. Burns, J. Davis, Ettin, Keir, Kichline, Paulus, Truman, and Zeisel, Associate Economists

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

Mr. Coyne, Assistant to the Board of Governors
Mr. Smith, Chief, Financial Markets Section, Division of International Finance, Board of Governors
Mrs. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Balbach, Boehne, Eisenmenger, Scheld, and Sims, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Philadelphia, Boston, Chicago, and San Francisco, respectively
Messrs. Brandt, Broaddus, T. Davis, and Fousek, Vice Presidents, Federal Reserve Banks of Atlanta, Richmond, Kansas City, and New York, respectively
Ms. Clarkin, Securities Trading Officer, Federal Reserve Bank of New York

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March 21, 1978

MR. BROIDA. Governor Coldwell isn't here.

CHAIRMAN MILLER. Well, he can join us when he arrives. First, we can start on some of the procedural matters, if I can find my agenda. This is the [annual] organizational meeting, as I understand it. The first order of business, therefore, is the election of officers to serve until the election of our successors at the first meeting after February 28, 1979. Governor Wallich, you seem like the likely one [to start us off].

MR. WALLICH. Well, I'll be glad to put in nominations for Chairman and Vice Chairman of the Committee. I would nominate you, William Miller, head of the Board, as Chairman and Paul Volcker, President of the New York Federal Reserve Bank, as Vice Chairman.

SPEAKER(?). Second.

CHAIRMAN MILLER. There's a motion and a second. Is there any dissent? That is approved. For the other officers, I would like to nominate Arthur L. Broida as Secretary and call upon Mr. Broida as Secretary to put before you the additional slate of officers.

MR. BROIDA.

Deputy Secretary, Murray Altmann;
Assistant Secretary, Normand Bernard;

General Counsel, Thomas J. O'Connell;
Deputy General Counsel, Edward G. Guy;
Assistant General Counsel, Robert E. Mannion;

Economist, Stephen H. Axilrod;

Associate Economists from the Board:
Edward C. Ettin, Peter M. Keir, James L. Kichline, John E. Reynolds, Edward M. Truman, and Joseph S. Zeisel;

Associate Economists from the Reserve Banks:
Ira Kaminow--suggested by Mr. Eastburn;
Richard G. Davis--suggested by Mr. Volcker;
John M. Davis--suggested by Mr. Winn;
John Paulus--suggested by Mr. Willes; and
Joseph Burns--suggested by Mr. Baughman.

CHAIRMAN MILLER. If any name has been omitted, it would be an embarrassment later. Are there any additions or corrections? May we consider this slate approved? Hearing no objection, it is approved.

The next item of business is the selection of a Federal Reserve Bank to execute transactions for the System Open Market Account, and the New York Bank has volunteered. Are there any contenders for the assignment?

MR. BLACK. Was that with or without duress?

CHAIRMAN MILLER. Well, hearing no dissent we will approve that. The third item is the selection of the Manager of the System Open Market Account, the Deputy Manager for Domestic Operations and the Deputy Manager for Foreign Operations. The incumbents in the respective positions, as you know, are Alan Holmes, Peter Sternlight, and Scott Pardee. We would propose to redesignate them if that meets with the approval of the Committee. Hearing no dissent, we will consider that approved.

Next is the approval of the minutes of actions taken at the FOMC meetings of February 28 and March 10, 1978. I believe these minutes have been circulated. Are there any comments, corrections, or additions? Then, Mr. Secretary, those would stand approved.

The fifth item of business relates to foreign currency operations, which have been of more interest recently than in prior years. And we have Scott Pardee here to give us the report on the operations since the last Committee meeting.

MR. PARDEE. Thank you Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN MILLER. Thank you very much, Scott. Are there any questions or comments? Henry.

MR. WALLICH. Scott, could you give us an opinion as to what the Treasury's views are on the scale of operations? You receive some guidance from them, don't you?

MR. PARDEE. During this period they have been in full agreement with what we've done. I have not had any pressure from them to do any more or any less. Their view has changed with the atmosphere, too. But currently I've had no difficulty.

MR. MAYO. Does the initiation, Scott, come essentially from the Desk rather than the Treasury?

MR. PARDEE. Oh, yes.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Scott, you didn't buy anything at anytime during this period?

MR. PARDEE. We bought marks from correspondents rather than--

MR. PARTEE. Would you anticipate, on a rising market, buying some marks?

MR. PARDEE. Oh, yes. If I have a rising market, I would like some marks.

MR. PARTEE. You said there was one period in which [the dollar] went up 5 percent.

MR. PARDEE. If I had walked into the market on those days, I would have given the market an indication of a policy.

MR. PARTEE. The market was very thin, I take it.

MR. PARDEE. It was thin. But there were policy discussions going on and [activity by the Desk] might have given a misleading statement to the market. I wanted to stay on the sideline because if I had been either a buyer or seller I would have added to the market confusion as to what official intentions were.

CHAIRMAN MILLER. Paul, you had strategically placed yourself in Basle for this announcement. Would you like to make any comment?

VICE CHAIRMAN VOLCKER. Yes, just in terms of the reaction there. Some of the governors were briefed just before the announcement and the rest of them at the time of the announcement. I would say that in general they welcomed the initiative. They didn't know what the market reaction was at that point. I think it's too much to say that they were enthusiastic in terms of the content of the announcement. There was a certain degree of skepticism as to what result it would have. There was some concern expressed rather generally--concern may be too strong a word. The observation was made repeatedly that it would have been nicer to have the initiative less bilateral and more multilateral. They were somewhat satisfied by the comment in the statement at the end, which you may recall referred to multilateral forms. And most of them took the occasion to urge that, indeed, these multilateral forms be utilized. But I think, in general, the statement was welcomed.

The staff tried very carefully to put this in the context of a step as part of a continuing process and not the end of all problems. And [those at the meeting in Basle] certainly viewed it in that light and welcomed that it was viewed by the United States and Germany in that light. indicated his own view that this represented some attempt at political reconciliation and, of course, that was welcomed as well.

Let me make one other observation if I may, while I have the floor, Mr. Chairman, in terms of this market. I don't know what it means, but I find it interesting. This market has been very depressed in tone, very uncertain, and technically in poor shape for some time. If one looks back to early January when the U.S. announcement was made, that triggered a little different intervention at first but over the [subsequent] 2-1/2 month period the rates have changed very little. I don't know what that means, but I think it's a fact, though [the dollar] has had some ups and downs of course during this period.

MR. PARTEE. With less intervention overall?

MR. COLDWELL. On the part of the Germans.

VICE CHAIRMAN VOLCKER. I don't know about less intervention.

MR. WALLICH. It has been sporadic intervention.

CHAIRMAN MILLER. It has been less in a period of time.

MR. PARTEE. In a quantitative sense.

CHAIRMAN MILLER. More by us--double by the United States.

VICE CHAIRMAN VOLCKER. In the previous 2-1/2 months.

CHAIRMAN MILLER. I might make a few comments. I would just observe that from my point of view, or from the Federal Reserve's point of view, the handling of this particular package was not ideal, and that teaches us a lesson. Premature disclosure of discussions did take the edge off the ability to present a package that could have been analyzed a little differently. The terms or the contents of the package became fairly well known before the official announcement. We anticipated in any case that the package had certain limitations--that it was not powerful. And we took a view that the Federal Reserve should have a very low profile about this package on the proposition that if you come out with a step that is not a powerful one then you certainly shouldn't look to give it a great deal of emphasis in the media. So, we were not surprised at the market reaction. I think it's a fair statement to say that we felt that we might have to marshal resources to deal with the disappointing reaction. And we might have been more fortunate [in that regard] had the announcement come as an announcement without [prior] disclosure.

There were some conditions [proposed] by the FOMC at its meeting of March 10 that I'd like to mention. One was that we continue the same terms on the new $2 billion addition to our swap line with the Bundesbank with regard to rates and risk sharing and those were worked out. Alan, you worked those out very nicely. There was also a desire to maintain the participation of

the Treasury, and with some backing and filling we have received the commitment of the Treasury to stay on a 50-50 basis until they exhaust their original resources from the January program and then to shift to a 60-40 ratio. We would do 60 percent and they would do 40 percent, which is what we discussed in the FOMC telephonic conversation. They have agreed to that, which means that if we continue to intervene, at some point they will run out of resources before we do. It is our view that it would be better to keep them in this in a fairly substantial way rather than trying to scale back further. After all, there are additional resources that the Treasury could call upon. One item that we were to endeavor to pursue was the repayment matter--whether we can pay the Bundesbank directly and on what terms--and that will take some time with the Germans. We have had guidance that any repayment program would certainly not be stretched beyond the year; at least that's the [indication] at the moment.

Another part of [the Committee's guidance on the negotiations] was to seek a takeout from the Treasury and that is under discussion. But the Treasury has so far indicated they have, in their view, both legal problems and policy problems in responding to that in the short term. Their legal problems I cannot assure you that I understand, but they are related to whether or not they have the authority to take on new risk at this point without Congressional action or without some cleaning up of their [Exchange] Stabilization Fund position. We are going to try to find out more about that. The policy issue is their fear that assuming more currency exchange losses in the near term will bring on Congressional limitations because there are some political problems. So, we are pursuing that but we have not resolved it yet. I believe those are my comments. Henry, would you like to add anything?

MR. WALLICH. Could I ask Paul a question? When you got these responses in Basle that they would have wished for more multilateralism to the action, do you think they were, among other things, referring to the use of swap facility drawings on others than the Germans--maybe the Swiss?

VICE CHAIRMAN VOLCKER. The comments were pretty general and it was the kind of reaction you would expect in a multilateral group where some of them were left out. I think in some specific cases--yes, the Swiss in particular--they would like us to be a little more active in their currency. Some of the others referred very vaguely to the point that the sale of SDRs could be spread around a little more than just selling in Germany. But it was not pressed, really. The comments were fairly general.

CHAIRMAN MILLER. We have viewed all these things as temporary or bridging actions and fundamental issues need to be addressed. That's why you probably read in the press some of our comments about inflation and the necessity to do something that would show more decisiveness in that area and to do something about energy. The problem with energy is something beyond our purview, but it's one that is being looked at. I don't know what the outcome will be in terms of alternative action by the President in case an energy bill acceptable to him is not passed.

As you know, the statement with the Germans did reflect the willingness to take action along these lines, but that still has to be determined.

On the relative rates of growth, the communiqué indicated that the Germans would look one quarter earlier at their rates of growth. But again, a realist will recognize that looking doesn't mean action and that they have their own internal problems about the speed of recovery of their economy in terms of their inflation and budgetary deficits and so forth. This is by no means--and it should not be viewed as such--anything that constitutes coming to grips with significant action on the substantive fundamental issues. They still remain to be resolved.

VICE CHAIRMAN VOLCKER. Let me just report one other impression at Basle that just struck me personally, Mr. Chairman. It's not directly related to this package but it is related to the fundamentals. One European country after another is making progress now on the inflation side. They are not doing very well on the growth side but their rates of inflation are coming down quite decidedly. You can see this in the statistics but hearing [the European representatives] one after another cite the progress was rather impressive as I was sitting there. And it's at a time when we are concerned about precisely the opposite. To some extent that is affecting the exchange markets; it helps account for the present uncertainties.

MR. JACKSON. Was there any comment about the fact that their oil now costs them less as a result of our dollar exchange rate?

VICE CHAIRMAN VOLCKER. They don't comment on it very frequently but it is clearly recognized--though maybe not enough. But that's part of the reason the Swiss talk about possibly having an actual decline in prices this year internally.

CHAIRMAN MILLER. Gee, if they could just export some of their deflation!

MR. PARTEE. It's their domestic tax level. That [and the fact that their] exports are much less expensive.

MR. WALLICH. That may mean that real wages will rise significantly.

MR. BAUGHMAN. Mr. Chairman.

CHAIRMAN MILLER. Yes, Ernie.

MR. BAUGHMAN. May I ask a question either of you or Paul? Have there been any suggestions emanating from other countries that we consider selling gold in this situation?

CHAIRMAN MILLER. Yes, from other countries. Paul can speak to that.

VICE CHAIRMAN VOLCKER. Well, I was just talking about the setting of that meeting. I don't think anybody really pressed that point. There was a little discussion that it might be in the background and some would welcome that, I am sure, in coming weeks. There was more suggestion of the foreign currency bond idea, although that was not pressed strongly. But it was mentioned by a number of people.

MR. MAYO. Was it more than mentioned, Paul, or was it embraced with any degree of enthusiasm?

VICE CHAIRMAN VOLCKER. Well, I'm sure that several of them would embrace it with great enthusiasm if you gave them the chance. I didn't encourage this avenue and they had the statement in front of them, in effect. They knew the statement was coming out and knew it wasn't included. They didn't want to queer the atmosphere by pressing and they did not press but it was obvious that a few of them would like to see it.

CHAIRMAN MILLER. John.

MR. BALLES. Mr. Chairman, since we are on this matter of the foreign currency bond, where does the Treasury now stand on that?

CHAIRMAN MILLER. The Treasury has severe reservations about it. Originally, two weeks ago, they were taking the position that they would not be in favor of it--that it raised too many problems for them. Since then I think they have become a little more open minded about it. However, I think the first avenue is apt to be the sale of gold. Sales of gold were under consideration and were deferred partly because of the French elections, which are now over. So I think it's likely that the Treasury will start a program of selling gold, which I personally would favor. There are a lot of advantages in using gold because at least then we don't end up with debt and the currency risks that go with it. So I think that's an avenue that should be pursued. There has been a discussion about the level of gold sales that are possible--what the market can absorb and that sort of thing. Henry can correct me, but I believe the Treasury feels that they could sell about 300,000 ounces a month.

MR. WALLICH. That would be a very moderate amount--something like less than 60 million. And bear in mind that unless they can develop a means of selling the gold for foreign currency in a way that doesn't cause holders of dollars to buy that foreign currency in order to buy the gold, it could be completely counterproductive. Then there isn't going to be much of a net effect. There is some because after all we are importers of gold, which may reduce the imports of gold and may make the trade balance look a little better. There is some portfolio shift when there is gold in portfolios instead of dollars, so I wouldn't say it's without effect but there are lots of qualifications on the possible success.

CHAIRMAN MILLER. The nice thing about this problem is that it's surrounded by dilemmas! Everything you do has an adverse effect on something else. Nothing is ideal. I might add that we live in a situation where the market is very realistic, very factual. That's why the possibility that gold would be sold caused the gold price to drop by $5. You don't have to sell gold, you just have to breathe [that you may] one day. Dave.

MR. EASTBURN. A question to Scott, please. One of the factors expressed in the disappointment of the market was that there was no element of exchange controls in the package. How hip is the market on this question and is it likely that nothing very constructive will be done absent some action on exchange controls?

MR. PARDEE. It's one reason why people were so disappointed. Nobody really wants exchange controls; it's just that people felt that this would be the next move on the German side. And the Germans have rejected controls very forcefully both publicly and with our counterparts in Basle. So, as I say, people were watching what the Swiss have done, which actually forced money out of Swiss francs. And they are afraid the Germans might have to resort to similar controls. There is a lot of talk in the market about the United States imposing controls and I think that has been firmly rejected by everyone I know on the official side. The great disappointment, I know, was more over these bonds. The German banks and Swiss bankers--I have talked to some of these fellows--said they sold dollars out of anger that they did not get the bonds they wanted. They thought [such bonds] were going to be very attractive for them to hold and to market and they were looking for those to be in the package. When they didn't see [any reference to them], then they just sold dollars.

CHAIRMAN MILLER. Henry.

MR. WALLICH. I spoke to of the Bundesbank and he said that, sure, they'd love to sell these bonds just as you say, but I don't think he thought it would be a very helpful operation for you. That's because people with dollars would go and buy the D-mark bonds and in the end there wouldn't be much effect other than that there would be a little more D-mark bonds and fewer dollar bonds in the world, a rebalancing of portfolios.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Scott, if my arithmetic is correct, there's $50 million of Treasury money left. What happens if you hit a big day?

MR. PARDEE. Well, Alan was going to cover this question.

CHAIRMAN MILLER. Phil, do you have a question?

MR. JACKSON. That was exactly my question.

CHAIRMAN MILLER. Yes. We have all these policy dilemmas we are speaking about. Relative growth rates are such that we are going to continue to have these large current account deficits. Then our choices are going to narrow down to whether we'll take a lower growth rate in our economy, because it doesn't look like we are getting the relative speedup in other economies. [A lower growth rate] is something that I think many of the economic advisers in the Administration are now willing to accept because the alternative is to continue to see the dollar under pressure, and our resources to change it are not great. And that in itself feeds inflation into our economy and creates a whole series of other [developments] that lead us down an unhappy trail. So there is at least some thinking about whether we have to have a willingness here to shade our growth rate somewhat.

MR. PARTEE. [Accept a] lower growth rate in the domestic economy in order to keep the dollar up? Is that what you are saying?

CHAIRMAN MILLER. No, in order to hold down imports and to improve the--

MR. PARTEE. I'm amazed that that would be a view in the Administration.

CHAIRMAN MILLER. It is.

MR. WALLICH. I've heard this and it's influenced, of course, by the rapid decline of the unemployment rate.

MR. PARTEE. What if it goes up again?

CHAIRMAN MILLER. This is the current situation. Now, unless there are more questions on that, we have to ratify the transactions of the Desk since the previous meeting. I assume this [report] has been circulated. Is that correct? Any comments or questions? [I take it] then that we approve and ratify the transactions of the Desk.

The next item is the report of the ad hoc subcommittee on the subject of currency matters. Henry, I believe you are reporting on this today.

MR. WALLICH. I'm reporting now and Alan Holmes will have something more to say that takes off from the report of our subcommittee. I would like to remind you that this ad hoc subcommittee--which will go out of business today--must be distinguished from the Foreign Currency Subcommittee, which is a continuing body. We had three charges: [To make recommendations on] (1) revisions in the procedural instructions, which govern the limits on what the Desk can do in a day or over an intermeeting period; (2) options for the repayment or renewal of maturing swaps with the Bundesbank and, (3) the appropriate scale of System exchange market

intervention. I think you all have seen the report, so let me just highlight what the subcommittee came up with on the three charges.

One, we did have two suggestions for the daily and the intermeeting limits on gross transactions. Bear in mind that we have two kinds of limits. One is on gross transactions in a single currency, simply the dollar amount of [the total volume of our] trading even if it leads to no net change in the overall position. The second is on the overall open position, often referred to as the net position, which is the risk exposure. We may be long of something and short of something else, and it doesn't matter which way the exposure goes; the risk depends on the magnitude, not on whether one is long or short in a foreign currency.

Now, the Desk has found that the gross transactions limit of $100 million a day is somewhat confining. If they engage in "in and out" trading, making a market on both sides, they may not be changing the risk exposure at all, or just very little, but they may be engaging in large transactions, and that limit may become confining. So, we have suggested that this be raised to $200 million per day and to $500 million for the intermeeting period. The Foreign Currency Subcommittee has the power to raise both limits. At present that Subcommittee can raise the $100 million to any level--in effect waive the limit if the Subcommittee doesn't want to set a new limit--and it can raise the $300 million intermeeting limit. It is now proposed that the same powers be given to the Foreign Currency Subcommittee, taking off from the proposed new limits of $200 million per day and $500 million from meeting to meeting. There's no ceiling on what the Subcommittee can do because the Subcommittee cannot cause the incurrence of a higher degree of risk by these particular transactions.

There is a minor matter relating to the purchase of foreign currencies for the purpose of buying another currency with which a swap is to be repaid. That [involves] three transactions, and if you add them all up, they cut pretty heavily into the daily transaction limit. That was not the intention. It was discovered that that was indeed what would happen if, say, the Desk buys D-marks, then buys Swiss francs with the marks, and then gives [the francs] to the Swiss National Bank in repayment of a swap. As I say, the money has moved three times, but it doesn't make sense to take that out of the limit. So we are proposing to ignore these transactions for the purpose of that limit. Well, Mr. Chairman, since this would take a vote, I think I will just stop at this point and let [you proceed on that].

CHAIRMAN MILLER. Perhaps there will be questions or discussion. Frank.

MR. MORRIS. Henry, it's not clear to me why the daily limits should be established on a gross basis in the first place.

MR. WALLICH. Well, there is an explanation of this here in the paper. There are essentially two reasons and not everybody considers them equally important. One is that, given the nature of the definition of the net exposure, it is possible for the Manager to perform a very large

operation which completely reverses the existing situation but comes out with the same exposure on the other side. You can have a plus exposure that you eliminate and make it a minus exposure, and you haven't changed the net exposure at all. Yet this would be a sizable operation and, of course, policy wise, very different. While one would not expect the Manager to do that, nevertheless it seems that there's a defect in the way the net position is defined and that ought to be cured. When the subcommittee discussed this, there didn't seem to be an easy and obvious way of curing that defect. Paul Volcker suggested that he would work on trying to find a better formulation for limiting the net exposure and I'm also doing more work on this. But I have to say that we did a great deal of work some years back trying to accomplish just that and we didn't make any headway.

There's a second reason, which I think the Desk weighs much more heavily, but I do not. And that is that the Desk can be going in and out in small amounts with, say, the Bank of Canada or the Bank of England. If this is done to excess, then the whole market moves into the central bank; the central bank preempts the trading that goes on with the nonbank sector, and that is not desirable from our point of view. We want to have a market with, as you remember, breadth, depth, and resiliency--to coin a phrase. And this limit tends to inhibit excessive trading of this kind. Bear in mind that the limit can be removed any time by the Committee or by whoever can be reached from the Foreign Currency Subcommittee.

MR. MORRIS. Well, it just occurred to me that perhaps we might be limiting the discretionary action of the Manager. If we had this kind of limit on domestic open market operations, it would have to be enormous. Is this $200 million satisfactory to the Manager?

MR. HOLMES. Well, President Morris, I guess I'd say we could live with it. I, too, feel that maybe a redefinition of the open position is a proper solution. Gross transactions to me are not important, although I must say that the Desk would never consider a huge move from a short position to a long position staying within a net, let's say, of a couple of hundred million. Nor would we want to take over the market and become the market for foreign currency. We may have to do that for half an hour on a very poor day, but day in and day out absolutely not. We would be very much opposed to that. But I think we can live with these limits with the provision that we can have them raised if we see the need. It's time consuming and if we are very busy with market operations, we know we have a lot of little numbers to remember on the side, and that's a little annoying. But we can live with it, I think, at this time.

MR. MORRIS. I must say, Mr. Chairman, that I don't find the argument for a gross limit very persuasive.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Well, I think I feel the same way. I understand, Alan, that to the extent $200 million is twice $100 million it will be less limiting than before. But it doesn't seem a very

satisfactory solution to just say that the limit has stopped us so we will raise the limit. I can't understand--but I don't know all of the details--why we can't measure in algebraic terms. That is, [we could measure] from a net short to a net long or from a net long to a net short position in the course of a day and leave the limit at $100 million.

MR. WALLICH. Well, we are trying to find a way of accomplishing that. It means that you then say to the Manager you can reduce the exposure from $100 million to, let's say, zero exposure and that's the limit of what we allow you to do. That's not a meaningful guideline.

MR. PARTEE. Why?

MR. WALLICH. What you want to do is to limit the additional exposure that the Manager can create. So it's fine if the constraint limits him from going from $100 million to $200 million or above $200 million. But it seems to me that something that increases the protection of the System account ought not be constrained.

CHAIRMAN MILLER. Bob, you had a question.

MR. BLACK. I wondered if I might ask Alan: Do you have in mind a particular change in the net open position that would do the trick, Alan? I believe we've talked about this at length and I know a lot of people have worked on a definition and encountered the difficulty that Henry described.

MR. HOLMES. We would have come up at the Desk with a higher number than that [proposed] but, as I say, I think for the time being we can live with the proposal and perhaps we can get around to a better definition of the net position.

MR. WALLICH. Well, I think it's fair to say that the Desk came up with a proposal of $300 million per day and $1 billion for the intermeeting period.

MR. HOLMES. That's right.

MR. WALLICH. That seems to me too large, but it's something that perhaps should be discussed.

MR. TRUMAN. Mr. Chairman, I think it should not be called a net limit. Everybody is using "limit" as shorthand. It is not a net limit; it is a limit on the change in the open position. It's a measurement of the open position done exactly the way banks do it to measure their exposure. One should not, I think, confuse the gross limits that we are talking about in terms of these kinds of transactions with the open position limit, which is a question of the System's exposure. It's a quite different animal. I think that is essentially the point that you were trying to make, Governor Wallich, of why it's difficult to capture the points that you're concerned about with respect to the

gross and at the same time trying to use the open position limit to control the System's exposure in transactions. Those are quite different animals.

CHAIRMAN MILLER. May I make a suggestion? I think we are in an area we could probably discuss all day and have different opinions. If we can live with this for a month, can we come back with another suggestion? Would that be all right with the Desk? If we can find a better way to express this in net terms and so forth, let's do it.

MR. JACKSON. What is the difficulty of living with our present limits--we've been living with them for a year--if we are going to come back to this question?

MR. PARDEE. It's taking a lot of time.

MR. JACKSON. Why not live with our present ones before we change them?

MR. PARDEE. On days in which we are active in the exchange market we may spend up to an hour or more discussing where we stand under these various limits and it's taking up the time of the people who actually have to make the decisions and evaluate the movements in the market. And to the extent we are discussing matters with people here in Washington, we want to discuss the policy implications and not whether we have $5 million left under this limit.

CHAIRMAN MILLER. My experience the last few times would verify that. I think the Desk has acted responsibly and I think the more time spent on substantive issues and the less on mechanics helps make the Desk work better. So I would certainly support the idea of giving them a little running room and then looking at the situation.

MR. WALLICH. May I make two points there? One is that it raises the question of whether the ad hoc subcommittee should be continued to work on this. Second, I'd like to emphasize that any increase we might allow now or subsequently in this particular limit shouldn't be understood as a suggestion that the scale of operations should be raised. It's simply for the convenience and better functioning of the Desk, not as a hint that they should double our operations.

CHAIRMAN MILLER. I think that message has been [given].

MR. JACKSON. That's what concerned me about the proposal; the inference was that we should become much more active.

MR. PARTEE. Well, the net position limits are not being changed.

CHAIRMAN MILLER. That's correct. That's why it turned out just to be practical. Well, if we're going to re-examine this, should the ad hoc committee stay in being until next meeting just for this purpose?

MR. WALLICH. For this purpose and there's also a minor issue in that we may wish to define the nature of "disorder." There's work going on in the subcommittee on that.

CHAIRMAN MILLER. Why don't we do that then? Let's continue it for a month. Now, what is the pleasure of the Committee as to the proposed changes in the gross transactions in the daily limit and the limit between meetings? The proposal is to change them from $100 to $200 million and from $300 to 500 million. Is that correct?

MR. WALLICH. That's correct.

CHAIRMAN MILLER. Is that a motion?

MR. WALLICH. That's the proposal by the [sub]committee and I move it.

CHAIRMAN MILLER. Would that include the reaffirmation of the other instructions that we've had? We're just changing those [limits].

MR. WALLICH. The second motion that I'd have to make involves these purchases leading to the repayment of the swaps. That is all in paragraph 1[B] of the procedural instructions and I move that it be amended as proposed here.

CHAIRMAN MILLER. Is everybody clear on what you're proposing? Is there a second?

SPEAKER(?). Seconded.

CHAIRMAN MILLER. The motion has been seconded. If everyone is clear on what the motion is--I have it before me and I assume everyone else does, too--is there any further discussion? All of those in favor, say "aye."

ALL. Aye.

CHAIRMAN MILLER. Opposed? So voted. Henry, you have other items to discuss.

MR. WALLICH. Yes, the second topic we dealt with--the repayment or renewal of the maturing swaps--I have no immediate final proposal to make, with one exception which Alan Holmes will talk about subsequently. Essentially there are four options: (1) to repay quickly; (2) to repay with a short rollover of 3 or 4 times for a total 9 to 12 months; (3) to renew for a total of perhaps 2 years; and (4) to use a device by which the existing swaps are consolidated into a

different kind of paper which is amortized over a period of 2 or 3 years, along the lines of the Swiss model. We've done the latter with the Swiss swaps that are outstanding. We have tried to set forth here the considerations pro and con.

From our point of view immediate [repayment] is, of course, in many ways best because it reduces the risk. It's true that we [realize] the loss and we forgo the chance that the dollar may appreciate and reduce the loss, but that is uncertain. All that is certain is that if we renew in any form we continue to have a risk, which is shared 50-50 with the Bundesbank--provided they go in on the 50-50 [risk-sharing agreement] on all these [drawings]. Conversely, from the point of view of the Bundesbank it is quite frustrating to have us repay immediately. The only way this can be done, practically speaking, is to draw on the Bundesbank to get the D-marks [necessary to repay]. We give them dollars, get D-marks, and then give their own D-marks back to them in payment of the swap. If the market should turn around dramatically we might still, in the course of a few months, be able to go in and buy the D-marks in the market. That's what the Germans hope and would like to see. But if we say now that we can pay when the swaps mature, namely in April after 6 months--[and some mature in] May and June after 6 months--there is very little time for a turnaround before repayment. The Bundesbank is very sensitive to our getting D-marks from them. I think it is basically a sense of frustration. They thought that they had what's in there with them and now they're getting the dollars just as if they'd bought them to begin with except that we share 50 percent of the loss during the period the swaps [exist]. But ultimately, it's just as though they had done all the intervention and are running all the future risks on dollars. Alan will explain this.

So from [the Bundesbank's] point of view, they lean toward a longer arrangement, extending the swap for 2 additional years perhaps--the Swiss type slower amortization approach--because that lengthens the period, postpones the [time] when they've got to take dollars, and increases the hope that we'll be able to go into the market and unwind [this debt] without taking D-marks from them. And we'd have the additional advantage that they would not have to make permanent the monetary expansion that came when we first drew on them and they had to issue marks. If we give them dollars now, then that monetary expansion is permanent; if we buy the D-marks in the market and give them to the Bundesbank, then there is a monetary contraction at that time, which the Bundesbank would probably like although they can offset it one way or the other.

Well, this needs a very detailed and thorough explanation and we didn't have the time to do that. Alan and I talked in Frankfurt and Basle, as he pointed out, and persuaded the Germans to be a little more forthcoming on the length of time we would have for these discussions. What the Bundesbank suggested in their proposal for a new $2 billion swap was that we roll over the swaps maturing in the next three months--in April, May, and June. These are all swaps that have run for 6 months and, therefore, have been renewed once. That is the limit, unless we take special action with respect to the German swaps. They propose that we renew these swaps for 3 months and our response to them was that we took note of this proposal; we didn't agree or disagree. The

Committee has to decide whether as a first step in dealing with these swaps it wants to [proceed] in the proposed way

The subcommittee recommends that the Committee do these 3-month renewals and give guidance for negotiations with the Bundesbank, which would lead to the formulation of a recommendation or possibly alternative solutions that could be submitted to this Committee for approval. The Bundesbank would be willing to accept that [based on our] intensive discussions in Frankfurt, Basle, and elsewhere. So, we do have a recommendation here. I wonder if I may defer now to Mr. Holmes, Mr. Chairman, so that he can make his formal recommendations.

MR. HOLMES. Mr. Chairman, during the month of April, the System has sixteen maturing swap drawings on the Bundesbank, totaling $584 million, and one drawing on the Swiss National Bank of $18.9 million. Ten of these sixteen German mark drawings and the single Swiss franc drawing are first renewals. And that would create no problem under our swap agreement. As Henry has pointed out, second renewals require the mutual agreement of the Bundesbank and the Federal Reserve. Governor Wallich has indicated that his ad hoc subcommittee agrees with the Bundesbank suggestion that swaps maturing in April, May, and June be subject to a second renewal. And I recommend that the Committee approve the Bundesbank's suggestion.

CHAIRMAN MILLER. Any discussion, questions? Yes, Phil.

MR. COLDWELL. Mr. Chairman, I would second that proposal but only if in the interim period we are seriously negotiating a long-range repayment procedure. I gather that was the intent of the renewal, Alan. So given that clear understanding that we will come out with some sort of repayment program within this time frame, I would be willing to support that proposal.

MR. HOLMES. Mr. Chairman, I should also note that this agreement for a second renewal will in no way impede earlier repayment if the market turns and we are able to acquire marks in the market--in other words, if we're lucky.

MR. EASTBURN. You have the right of prepayment.

MR. HOLMES. Yes.

MR. COLDWELL. Yes, or if we make an agreement in that interim period for prompt repayment.

MR. HOLMES. That's right.

CHAIRMAN MILLER. Any other comments or questions? You've heard the motion, the second. All those in favor say "aye."

ALL. Aye.

CHAIRMAN MILLER. Opposed? So voted. Alan, I think you have other [comments to make.]

MR. HOLMES. Yes. I think Henry has given a good review of the four options that the ad hoc subcommittee had in mind. While the immediate problem of the swaps maturing over the next few months is solved for the time being, as the ad hoc subcommittee report notes, and as other members of the Committee have noted, the Germans feel a need for further discussion and early resolution of the issues toward agreement on some longer-term solution. As Henry noted, I did have preliminary discussions with Bundesbank officials in Frankfurt on March 9 and 10 and then again in Basle on March 14. During these meetings, it was obvious that the Germans were very much interested in settling the outstanding swaps on a longer-term basis, as Henry said, either through a sale by the U.S. Treasury of, say, 2-year foreign currency bonds or by extending the maturity of our swap line. Should such an extension or funding be undertaken, the Bundesbank made it very clear in its proposal to increase the swap line to $4 billion that if outstanding swaps are repaid or refunded, the total line that would be open to the System would be reduced by a corresponding amount. At that time our drawings amounted to about $1.6 billion. If we had funded them, we would have had available to us $2.4 billion under a so-called regular swap line.

Our discussions were, of course, very preliminary and no positions were taken. There was a useful discussion, however, of the various issues, some of which are technical and some are of a policy nature that will have to be resolved. Under technical issues, which I believe can be resolved without great difficulty, I would include: the decision as to the exact amount of outstanding drawings to be refunded; the exchange rate to be applied to the refunded swaps; the settling of losses incurred at the time of the funding; and provisions for prepayment, which we certainly should insist on in any swap arrangement. During the discussions it was obvious that the Bundesbank officials had not really given serious consideration to the possibility of direct purchases of marks from the Bundesbank by the Federal Reserve. I indicated to them that there were strong feelings among the Committee members that such a procedure was both desirable and necessary and I referred to our special arrangement with the Swiss National Bank. They promised to consider this possibility carefully, as well as their attitude toward purchases of marks in the market for repayment of outstanding drawings at times when the market impact might be considered adverse by the Germans. These are our two options--buy in the market or buy from the Bundesbank. It was my impression that they would not look very favorably on direct purchases of marks from the Bundesbank by us to repay outstanding drawings at the end of six months but would at least be prepared to consider the possibility, if a longer-term swap arrangement were to be agreed on. With such a swap arrangement, obviously there's a longer period of time over which the swap drawings might be reversed in the market. And I think they have that very much in mind.

We discussed options available on profit/loss sharing should an extended swap be undertaken. The Bundesbank officials were not sure whether the present 50-50 arrangement could

be carried out on a long-term swap; they agreed to consider that possibility. The other alternative would be for us to share equally any profit or loss that might exist at the time of the funding and then the System would have to agree to take the profit and loss itself from then on. I would assume that this Committee would prefer a continuation of the 50-50 arrangement. We also discussed various options in regard to repayment schedules, should an extended swap be agreed on, and I believe the Germans are prepared to be very flexible in this respect.

The Bundesbank representatives agreed to consider all of these [items on our] check list, and we're quite anxious to continue exploration at, before, during, or after the next Basle meeting. I think they really would like to see us reach a conclusion as early as possible. Pending those further discussions, I think it's premature to make recommendations to the Committee. I hope, however, to be able to present a written report to the Committee prior to the April meeting. That's not much time but I would hope to be able to do so, and I certainly would appreciate any guidance members of the Committee would like to provide at this time.

CHAIRMAN MILLER. Gentlemen, you've heard the invitation. Any guidance? Paul.

VICE CHAIRMAN VOLCKER. I might just comment very briefly, Mr. Chairman. Among all the options that are before us, none of which will be very happy I think from the standpoint of the Bundesbank, I would guess that the most practical one will be to follow the so-called Swiss model. That's where we would space out [the repayment period] a little and in return, I hope, we'd get the Bundesbank's agreement for direct purchases as necessary in paying this debt off. It doesn't really seem to me possible that they're going to say that they want us to pay it off with a direct transaction three months from now or six months from now. That would be my only comment. Also, looking at the other side, I would prefer the Swiss-type arrangement to a new precedent for the Committee of just extending swaps for 2 years. So, I find myself leaning in that direction.

CHAIRMAN MILLER. Yes, [Henry].

MR. WALLICH. I share Paul's view that among the various evils if we cannot get a repayment after 12 months [by] drawing on the Bundesbank, which I think would probably be preferable to the Swiss type of arrangement, then certainly the Swiss model is better than a rollover for 2 years or more. The latter would set a precedent with respect to the length of swaps and weakens our own position with countries that might borrow from us on swaps [in terms of] insisting that they have to pay them off after 1 year. There's one improvement we could do on the Swiss model and I think Alan has indicated it. The Swiss model leaves all the loss below a certain level to us; we could go 50-50 with the Bundesbank, if we can persuade them. Whatever the final loss is, the first recognition of losses when you fund the swap into another instrument is at the exchange rate of that day. Then there will be further gains or losses as time goes by. There may be a gain that eventually offsets the original loss--anything is possible--and there may be further losses. It would be good to have the Bundesbank stay with 50-50 and I think we should negotiate

these things all as a package, and particularly our right to draw from the Bundesbank rather than be forced into the market or forced into an undesired rollover. We shouldn't give on one before we know what we're getting on the other.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Thank you. I think I would agree with what Paul and Henry have been saying--that the worst of the possible alternatives is nothing but continued rollovers for 3 years. I think that leaves us with a very large outstanding financing that I prefer we not take on. I would hope, though, that if we're going into a Swiss type of approach to this that we could accelerate the repayment. But my real preference is to pay these off right now.

CHAIRMAN MILLER. Phil.

MR. JACKSON. It's my belief that we would be wise to sacrifice any other repayment terms for retention of the loss-sharing because if that is reversed, the consequences are an immediate doubling of our exposure. It strikes me that, with the level of exposure that we have now and may end up having to continue to carry, anything that effectively doubles our loss exposure in the consequence of funding it and then staying in that position is a mistake. And alternative methods of repayment are not nearly so important as that one.

MR. HOLMES. Governor, the only thing I'd say is that we also have a profit exposure and as you recall in '75 we were way in the hole on a billion dollars worth of German marks and came out of the [situation] with a profit. So, I remain a little optimistic.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. Just a request of Alan. In your paper, Alan, I would personally find it helpful if you would go back a little bit and review the basic principles and the experience in other currencies. That would serve as a background for us.

CHAIRMAN MILLER. I agree that the 50-50 sharing [of losses] is quite important, because you can't tell which way it's going to go. They've been with us all the way to this point; they ought to continue with us as this is liquidated. They may well gain, as you say, as a result of it, rather than lose. I also agree with Phil Coldwell. I have the impression that that Swiss debt is being paid off in a very leisurely way. I don't really recall what the terms are. I know we pay off a little bit every week, but it seems to be with us forever. So it would be nice to be able to negotiate a shorter period of amortization than we have on the Swiss debt case.

Any other comments? Alan, do you have any other technical matters you need action on?

MR. HOLMES. Yes, Mr. Chairman, I have another recommendation. At the last meeting of the full Committee, the Committee increased the authorization for our open position in foreign currencies to $2 billion. We now have a leeway of about $171 million under that open position. Under the procedural instructions, an increase of up to $500 million in the open position--to $2.329 billion--would be permitted without recourse to the full Committee. Since this would bring us above the authorized amount, I recommend that the Committee increase the authorized amount not to [$2.329 billion] but to a round number of $2.25 billion.

CHAIRMAN MILLER. Any discussion? Phil.

MR. COLDWELL. Mr. Chairman, I'm looking down the pike at this and I want to come back to the question that you asked us to defer until the Manager reached this position and that is the question of what do we do with the fact that the Treasury has only $50 million available.

MR. HOLMES. That's my next point.

MR. COLDWELL. Forgive me, Mr. Chairman, but I think it becomes an important point here. If we're going to authorize an additional $425 million--or whatever the figure comes out to be--for a net open position and the Treasury only has $50 million, we could be in a position where we are expending sizable amounts and have continued exposure without comparable Treasury operations.

MR. PARTEE. Without sharing it.

MR. COLDWELL. Without sharing it.

MR. HOLMES. Mr. Chairman, the Treasury does have only $50 million left under its $1 [billion] swap line with the Bundesbank. But it has agreed, as we all know, to sell the equivalent of $740 million of SDRs to the Bundesbank. The Treasury would prefer to wait until the final ratification of the pending amendment to the IMF rules since it would make the SDR transaction much simpler. They're expecting that by month end. But since the Belgians are involved and we've had experience with them before, I guess there's really no guarantee. If the Treasury does not have the arrangements to sell SDRs in perfect order--and there's a period of 3 or 4 days before that can be done--it seems to me that it would be quite reasonable for the System to take whatever market intervention is needed, with the understanding that the Treasury will reimburse us for their share as soon as they draw on SDRs. They are now prepared--I believe our people are working on the technical details today--to sell SDRs even if the amendment is not put in place in time. So I think this is something that can be worked out. I would suggest that a few days, if that's all it is, where we take the whole [amount of intervention] and then get reimbursed by them in some way should also be satisfactory.

MR. COLDWELL. A period of a few days doesn't bother me; months would [bother me].

MR. HOLMES. I would say an absolute maximum of one week. The time may run out.

CHAIRMAN MILLER. There are several things you should know. The Treasury proposed originally that we intervene for a period, [doing] 100 percent and then they would intervene for a period using the 60-40 [ratio]. And when they had used up 80 percent of the amount we'd done, we would come back in again. I think that's a very poor procedure. I think it is much better if we go 60-40 all along and I think the technique of having them reimburse us is much more preferable and the only one that makes sense here. I really think we shouldn't be in there alone and then leave it to the Treasury to come in later.

MR. COLDWELL. My hesitancy on this, Mr. Chairman, is that I know how some of these things get deferred and delayed. I am concerned that the Treasury might end up actually not selling these SDRs. If I recall [the reference to selling SDRs] that was in the press release, that says "if necessary" or "if desirable" or something like that.

CHAIRMAN MILLER. Governor Coldwell, you've been in Washington too long; you're becoming cynical. You need some R&R. Obviously, we can count on the Secretary of the Treasury when he tells us he's going to do this. Can't we?

MR. COLDWELL. You added "can't we."

MR. PARTEE. Would this agreement be written down as we understand it? Will we have an exchange of letters or what will it be?

CHAIRMAN MILLER. We can certainly confirm by letter what we've already agreed to verbally.

MR. PARTEE. You can lose the Secretary of the Treasury overnight.

CHAIRMAN MILLER. Yes.

MR. WALLICH. If we do this, I'd like it understood that when they reimburse us they reimburse us in marks so that any exchange rate fluctuations in the meantime are not against us but against them.

CHAIRMAN MILLER. Oh yes, that should be for their account, really. We shouldn't be taking the risk even for three days. They should just bear it with us all along.

MR. HOLMES. I have a suspicion that the Treasury will probably prefer to go ahead and sell SDRs without the amendment rather than get into this reimbursing problem. But I really don't know that.

CHAIRMAN MILLER. Henry, would you just confirm it? Tony has understood this clearly and I think we just want to make sure there's no lapse here.

MR. WALLICH. Whether we like it [or not], an exchange of letters is a very laborious affair with the Treasury.

CHAIRMAN MILLER. Well, just send them a letter confirming it and [add] a place for them to [sign it and ask them to] send back a copy. Ernie.

MR. BAUGHMAN. Where and for what purpose do we shift from 50-50 in our dealings with the Treasury to 60-40?

CHAIRMAN MILLER. Their resources are shrinking in relation to ours. Therefore, when the original billion dollars runs out, [and they have] $50 million more--is that right, Alan?

MR. HOLMES. Roughly.

CHAIRMAN MILLER. At that point we would shift to 60 percent for the Federal Reserve and 40 percent for the Treasury because we have larger resources.

MR. BAUGHMAN. For the purpose of--

CHAIRMAN MILLER. Sharing. Remember, our swap line is 50-50 risk-sharing with the Bundesbank so all the intervention has been under an arrangement where we take 50 percent and the Treasury takes 50 percent. So we've had 25 percent of the risk. Now that will shift to where we will have 30 percent of the risk.

MR. WALLICH. I might say that this leaves open what is going to happen down the road. If we go 60-40, then the Treasury will run out of their SDRs before we run out of our $2 billion. Of course, we hope that we're not going to go to the limit for either of them. But if that were to happen, then the Treasury has to look for additional funds.

CHAIRMAN MILLER. To the IMF.

MR. WALLICH. The IMF, for instance. Or we have to change the ratio. I would much prefer the former, but we should not be there naked and alone; we should have the Treasury with us whenever it happens.

MR. PARTEE. I certainly want to second that, Mr. Chairman.

CHAIRMAN MILLER. I certainly agree.

MR. PARTEE. I think there is real public exposure here because we're using public money without a Congressional authorization. Just as the Treasury indicated that they were concerned about that--

CHAIRMAN MILLER. I think we all agree on that and if we come to the point where they have no resources, I guess we'll have to face the issue of whether we end the intervention.

MR. PARTEE. Well, as you say, they can borrow from the IMF.

CHAIRMAN MILLER. They made a point in the communiqué that they have the resources of the IMF, and I think that means they should have a commitment to use them. Any further discussion? Yes, Bob.

MR. BLACK. Maybe just a gratuitous comment: The Treasury is rather concerned about possible losses and I would say that we as a central bank are subject to more criticism in terms of the amount of losses than they are because constitutionally the Administration has more responsibility in the foreign area than we do. [Unintelligible.]

CHAIRMAN MILLER. That's why we want to continue to pursue some take-out from the Treasury.

MR. WALLICH. In a sense, of course, our losses fall on the Treasury.

MR. BLACK. But our critics will not mention that at the time [they occur].

MR. BALLES. They're on our books.

VICE CHAIRMAN VOLCKER. I think there's something to that politically, Mr. Chairman, but the fact is that the Treasury has a very limited capacity mechanically to take losses with--

MR. PARTEE. But without Congressional authorization.

CHAIRMAN MILLER. The question before the house is Alan's suggestion--I don't believe we acted on it--on the $2-1/4 billion. Is that correct?

MR. HOLMES. Right.

CHAIRMAN MILLER. Is there any dissent from that change? Hearing none, we will approve that. Henry, I think you have one final item?

MR. WALLICH. I have a final item from the ad hoc subcommittee report, which deals with the scale of intervention. As you know, after the Treasury came in, [our] intervention was more forceful and of a technically different type also--that is, going in part to the banks directly with bids or offers. The question is how long we should continue at this higher scale of operation. The subcommittee felt that in the absence of more fundamental policy measures by the government, continuation of the recent large scale was undesirable. The subcommittee in a somewhat ad hoc form took this matter into its hands and suggested to the Manager that the Desk think in terms of a $300 million limit in the period between meetings--a limit which could not be observed. The ad hoc subcommittee, of course, is not the party that controls the intermeeting or daily limits; that is the Foreign Currency Subcommittee. And on a couple of occasions the latter Subcommittee did authorize the Desk to exceed its limits.

We've been trying to grope for some kind of definition of a proper scale of intervention and cannot say that we've found something that is very satisfactory to the members of the subcommittee, or at least to me. But there seemed to be two determinants of the proper scale. One is the degree of disorder. When there's more disorder, then presumably more intervention is needed to counter that disorder. Second, however, for a given degree of disorder one can, of course, operate more or less forcefully. And the definition of that degree of force eludes us. But it's clear that when we have a limit of $100 million per day for changing the overall open exposure, that sets a scale. The Foreign Currency Subcommittee, of course, could take an action to reduce that scale if it wanted to. It's this range of questions that concerned us. There was one suggestion that to me at least seemed to give some help on this issue. And that is that when there has been a package deal or when some special unsettlement due to a very unusual event has occurred in the market, this justifies stepping up the degree of force of intervention relative to the degree of disorder. But once that has been done and an immediate short-run objective has been accomplished--whether it has created order or whether it has held the rate or not--we should wind down [our operations] quickly, within a few days. Otherwise there is a great danger of spending money limitlessly. That concludes my report.

CHAIRMAN MILLER. Bones.

MR. KIMBREL. Mr. Chairman, it seems to me that maybe that's an extreme effort--trying to decide the extent of disorder and the [scale of operations needed to counter] the disorder. The final statement suggests that there's going to be close consultation at all times. I guess I find some difficulty in trying to distinguish [the degree of] disorder and would be more inclined not to try to get to that point. Won't this be a difficult operation--to try to describe or distinguish the disorder as you contemplate?

MR. WALLICH. Well, I would hope that eventually we can get to definitions of types of disorders. You seem to imply the types of disorder are limitless. There can be wider spreads, jumpier rates, fewer participants in the market, more rapid movement in the rates--

MR. KIMBREL. That's exactly what I am talking about.

MR. WALLICH. Nevertheless, it ought to be possible to describe the market in those terms because essentially the Manager has to make up his mind whether that is one of the conditions of the market and whether he wants to operate. So, the decision can be made on the spur of the moment or presumably it can be made once the excitement has died down. Now, how closely can we monitor the Desk? I think our Desk is doing a fine job and we should allow the judgment of the man on the spot to prevail. But the Committee, I think, does need to maintain some kind of oversight of the operation because the amounts to which the Desk could go if it operated badly are very considerable. In three days the Desk can go through $300 million, and then they must say--unless the Foreign Currency Subcommittee raises the limit from $300 million to $500 million, which it can do--we're out of the market. That could be very damaging. And once the limit has been raised to $500 million, then again when it is used up, the FOMC is on the line and has to make up its mind whether to go out of the market or increase the limit. So, I think we do want to have some control over the approach to all these decision points.

CHAIRMAN MILLER. Paul.

VICE CHAIRMAN VOLCKER. Just one comment, Mr. Chairman: I do think the emphasis here should be on consultation. I don't disagree with the flavor of what this paragraph is trying to say, but in the end we can only judge these things in specific circumstances. And I think I can say--correct me if I am wrong, Mr. Holmes--that the Desk has never come close to spending $100 million in a day without consultation with the Chairman or the Committee or both, long before the $100 million was reached.

MR. HOLMES. The consultation has been rather complete.

CHAIRMAN MILLER. John.

MR. BALLES. I'd like to ask Henry what [his subcommittee] had in mind in the first sentence of this paragraph on the scale of intervention, where it says "in the absence of more fundamental policy by the United States." Could you give us an illustration of what you had in mind there?

MR. WALLICH. Well, the most cited things would be energy legislation and action on fiscal and monetary policy and, therefore, on inflation. These are the fundamentals. Then there are bridging actions, which aren't very fundamental, but nevertheless go beyond intervention. That would be to sell SDRs, draw on the IMF, sell gold, or maybe issue foreign currency bonds.

MR. BALLES. Obviously, you can do the latter a lot quicker than the former.

CHAIRMAN MILLER. So far. Phil.

MR. COLDWELL. Mr. Chairman, I would agree with the thrust of this. I do think, however, that we can easily get led down a primrose path month by month by month to the point where we again are using up in full-scale intervention the nearly $2 billion of additional authority. I would hope that before we move much further down this [road] of continuously intervening each month--this is the reason I'm a little resistant to going much further than we're going here--that we have a full-scale debate here in the Committee as to whether we want to go on with any further intervention or just stop it without Congressional authorization.

CHAIRMAN MILLER. Well, thank you. These comments are very helpful. We've spent one hour and twenty-five minutes of our valuable meeting on a subject that I hope will wither away. But I'm not very hopeful. We'll be discussing it at the next meeting and I hope to be of some [unintelligible].

MR. ROOS. On that point, Mr. Chairman, this morning we've been primarily on the German mark problem. Speculators, I've observed, are quick to move in other directions. Are we prepared to use the same techniques in other areas if--

CHAIRMAN MILLER. The main one, of course, is the yen. And I personally am not prepared to suggest that we get involved. The Japanese are extremely upset. It's a very serious political problem with the Japanese. I'd want to send high level people [there] to try to get some similar arrangements. I don't think that we really have the resources to deal with it. And I don't think the yen in international money markets represents the same kind of problem. I think the Administration is going to have to deal with the Japanese from a foreign policy point of view; I don't think we can really deal with it. As you know, their interventions are massive and even if there were some psychological basis for us having a $2 billion swap line with them, it could be used up so quickly. It wouldn't really make good sense; it doesn't seem so to me. But it's a very serious problem in terms of international relations; in terms of realities it's something else.

MR. WALLICH. If I may add a comment: Even though we do now have a strong concern about the value of the dollar and the desirability, if it can be avoided, of keeping it from depreciating--short, of course, of pegging a rate--the yen is a pretty special proposition. The Japanese have such a large surplus and it is projected to continue at such a level into the future that I think here lies the exception from the thought that it is undesirable to see the dollar go down against any [currency]. Against the yen, I think it may very well have to go down.

CHAIRMAN MILLER. Phil.

MR. JACKSON. Are there any prospects that the Canadians will want to draw [on] us?

MR. HOLMES. Well, as you know, they've come to our capital market and have a large Eurodollar loan. I think they would probably use those resources--

CHAIRMAN MILLER. They're taking $750 million against--

MR. JACKSON. I just wonder whether the next round might be with us.

MR. HOLMES. No. I think they have still [available] in their Euro loan and they have not yet drawn on the New York line. So they've got quite a few resources. Although who can tell over time?

CHAIRMAN MILLER. Gentlemen, I think we better move along. Now this subject has taken an hour and a half of our time. The next subject returns us to the world that will be more familiar to some of us, and that's the economic and financial situation here at home. Jim, I think you're going to lead off our discussion of this subject.

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

CHAIRMAN MILLER. Thank you, Jim. Discussion? Larry.

MR. ROOS. Mr. Chairman, may I ask a question? Jim, in your analysis, you make frequent reference to the price changes and wage trends and things like that. Unless I misunderstood it, there was practically no reference in your report to past rates of monetary expansion. When you do this [analysis] relating to prices, do you give any consideration to monetary expansion in the past year or two?

MR. KICHLINE. Well, not in the direct fashion of simply looking at the rate of growth of the aggregates and tracking it through. It does, in our view, show up in wages and costs with a lag. So, in our own judgmental approach, we pick it up in an indirect fashion. In our quarterly model, which we also use in developing our price forecast, it does have an impact, although the lags are fairly long. But it does feed through and right now the quarterly model is showing rates of price increase that are just about the same as those in our judgmental forecast; there's no major difference. So, yes, we do look at that. But I think it has a long lag phenomenon that is implicit in our own view.

CHAIRMAN MILLER. Frank.

MR. MORRIS. Mr. Chairman, I think it would be well for the Committee in this context to keep a fairly open mind on the question of how strong the economy really is because I don't think we have a very good fix on the underlying strength of the economy. We're looking at numbers, some of which show great weakness, and we're dismissing them--as we probably ought to--as a function of the weather and the coal strike and so on. God knows, coming from Massachusetts, where the whole state was shut down for a week, I know that there has been an impact. Nevertheless, I would hate to see us get into a fixed feeling of certainty that the second quarter is

going to be very strong. I think most of our historical experience shows that when we have temporary interruptions of this nature, the previous underlying trend picks up after the effects of the destruction are gone. But I can recall at least one incidence, in 1960, where we had a long steel strike in the last half of 1959 and we had a general expectation that as soon as the strike was over the economy was going to take off like a rocket. Business Week was featuring in its January 1st [issue] "the sizzling '60s." The '60s did sizzle, of course, but not in 1960. We came out of that strike and had a 6- or 8-week rebound and then the economy went into a recession. I'm not predicting this is going to happen. I don't think it is going to happen, but we ought to keep it in mind as a possibility. In looking at the very weak rates of growth in the aggregates, I think there's potentially a 10 percent chance, say, that they may be telling us that the underlying economy is a lot weaker than we're projecting.

MR. BAUGHMAN. Is the expected continued rapid growth in the labor force based in part on an expectation of continued strong increases in the participation rate of women or is it pretty much just a pickup in population?

MR. KICHLINE. We have a drifting up of the participation rate, but at a slower rate than we have experienced in the last several years. Our view is that we will begin to see a somewhat slower rate of growth in the labor force compared to what we experienced the first three years into this expansion.

MR. ZEISEL. The rate of growth in the labor force is at about 2-1/2 percent or slightly under that, as opposed to slightly over 3 percent for last year. It has moderated somewhat.

MR. BAUGHMAN. The large projected decline in unemployment seems rather strong given the projection of the labor force and given the prospect of some slowing in real growth.

MR. KICHLINE. Well, that's true. I think one of the big surprises relates to the recent performance, more so than our projections. That's particularly true for the third and fourth quarters. In the latter half of last year, real growth slowed substantially and the unemployment rate came down by over 1/2 point, and that is quite unusual. One of the things we're investigating further is some of the rather strange movement on the unemployment side. There is a strong belief on the part of some of our experts on the staff that the expiration of extended benefit programs may indeed be a major contributing factor to the sluggish growth in the labor force we've seen recently and also to some of the increase in employment. The turning on and off of these benefit programs seems to be impacting importantly on the unemployment rate. So, over the future, we have a bit more optimistic view on the unemployment rate than we had a couple of months ago, in part reacting to what has happened.

MR. BAUGHMAN. Do you have any particular reason to be skeptical of some of the changes in the BLS data programs?

MR. KICHLINE. I'm not aware of any. Jerry, you may be.

MR. ZEISEL. Not particularly. They have increased recently the size of the sample for collecting labor force employment and unemployment data but that should have improved the data, if anything. They have changed the pattern slightly, but basically there seems to be no significant deterioration in the quality of those data.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. Thank you, Mr. Chairman. Just a comment: I'm still thinking about the remark you made about the need to slow growth [to improve] the balance of payments [and] the dollar.

CHAIRMAN MILLER. I'm not sure I said that. I said there was some sentiment that that may be the choice.

MR. EASTBURN. Yes, some sentiment about the need to do it. I detected some sentiment that it goes even further than that and that it really may be necessary to have a recession and that the thing to do now is to try to choose the kind of recession we'd like to have. This gives me some concern, partly because coming from the area that I come from--

MR. PARTEE. You never came out of the recession.

MR. EASTBURN. This gives me some concern because we haven't come out of it. We have some banks that would have a good deal more difficulty than they are having now if we had a recession.

CHAIRMAN MILLER. Is this a local comment, Dave?

MR. EASTBURN. Yes, it is. It's just a comment that I think we need to emphasize inflation, as we have been, but preferably stress the point that more and more we're coming to believe that inflation does lead to recession--that there are built-in factors that lead from one to the other. So the posture that we ought to have is to work persistently on the inflation front but to indicate to the public that we're clearly going to avoid overkill in doing this.

CHAIRMAN MILLER. Thank you. Henry.

MR. WALLICH. I'd like to go back to the employment data once more, if I may. About six months ago, in the September Greenbook, I think it was estimated that for the first quarter of '78 the unemployment rate would be 6.8 percent and that by the fourth quarter of '78 it would be 6.6 percent. Here we are in March and the unemployment rate is not 6.8; it's 6.2 for the quarter and it's currently 6.1. And the Greenbook estimate is 5.9 percent for the fourth quarter of '78.

Granting all the uncertainties about the data, as Jerry Zeisel said, the present unemployment sample is a better and bigger one than we had in the past. So there is no strong reason to think that the data are wrong, although the rate might jump up again. The increase in payroll employment has been very strong, which confirms that there may be something to this sharp reduction in unemployment. Nobody knows why but it must be an expectation by businesses of strong activity ahead. In any event, we're now very close to what I would regard as the zone of full employment. You can say it's 5 to 6 percent or 5-1/2 to 6 percent, but I would be surprised if we could be in the 5 to 5-1/2 percent zone without generating significant wage pressures. I read in Dunn's Review that labor shortages are turning up in the Sun Belt in a number of skilled occupations. So we're beginning to have the first inkling of getting close to full employment--give or take 1/2 percentage point. I think that tells us that if we want to get ready for a soft landing, we've got to do it rather faster than I would have thought.

CHAIRMAN MILLER. Have a speedy soft landing?

MR. WALLICH. Yes, a speedy soft landing. I thought we had a year or two years, but I think it's probably less. The sustainable rate of growth is something like 3-1/2 percent, I think. We need to envisage getting to that within a year or so; there would be no great damage if that were attained around that time or even a little earlier. That does mean doing things that will allow the rate of growth to diminish--not because of the dollar but because of the internal situation and the need to avoid inflation and then recession. We certainly don't need a recession but we need to avoid the inflation that will bring a recession.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. I'd like to turn Frank Morris's comment to you, Henry. I think we shouldn't be too certain about what's going on in the labor force or the unemployment rate. I couldn't help but note when I looked at the Greenbook that over the last three months the civilian labor force has increased at an annual rate of 0.9 percent; over the last year it has increased at an annual rate of 2.9 percent. So I'm wondering whether the low indicated unemployment rate for the last month or two might not be a fluke. That is, to some degree I would expect a reversal. I don't think [the unemployment rate] is going to go down as far as in the staff projection. This has been a very unusual period and, as you say; the rate was totally unforecast--by everyone, I think. I'm inclined to think there are some oddities in these figures, perhaps because of the weather or some kind of seasonal aberration that has given us some difficulty there. At the same time, I'm not really concerned about the prospects for the immediate future, Frank.

Again, I'm looking at the employment data. I was interested in the large figures on payroll employment; I've felt that there might be an aberration in the last couple of months or that they might reflect the government programs. So I looked at the increase in establishment employment in the last six months in the BLS series and I find that over that period the gain for the total establishment series was somewhat larger--267,000 per month--than it was in the last year. Then I

looked at the private nonfarm data--to take out the state and local and the effect of these temporary employment programs--and I find that it was still larger over the last six months than it was over the last year, at an average monthly rate of 233,000 as against an average of 227,000 for 1977. Then I looked at it for manufacturing alone and I find that there, too, it has been larger over the last six months, on average, than it was over the past year. And it's larger for production workers within manufacturing. I agree with you that a lot of these indicators are no good right now. And in the absence of decent indicators, I'm inclined to think that when people hire employees they have something in mind for them because it's a big commitment. It's true that we haven't seen it in production yet, but I think that kind of sustained strength--not over a month or two but over the last six months, for the whole fall and winter period--in employment growth in what I consider to be the better BLS payroll series suggests that there ought to be good strength in the economy in the period immediately to come. So I certainly am watching, too. I very well remember that 1959-60 experience but for now I'd have to say that the outlook for the immediate term is pretty strong, even though I expect the unemployment rate to go up again.

CHAIRMAN MILLER. Bones.

MR. KIMBREL. Mr. Chairman, I'm sure [our view] is influenced heavily by the Sun Belt exposure but [based on] our recent swing around the District [talking] with community leaders, including ladies and consumer advocates, we are just unavoidably attached to the idea that inflation is rampant, and we are very, very much concerned. It's pretty difficult to find anything close, except their concern for an energy policy of some kind--even if it's bad as long as they know the rules. We hear this over and over: Inflation is the number one [concern], then energy, and then buildings. Sure, the Latins are very prominent in our area and are buying heavily but [it was] just announced [that] the Canadians are buying a 13,500 acre spot just south of Miami for a huge development. Employment, [in terms of finding] skilled people, is difficult so I guess we have to be very much concerned about inflation at the moment. This leads me immediately to ask Mr. Kichline how strongly he feels about the [projections for] unit labor costs. Looking at the projections for output per man hour and compensation per hour and relating them to the recent past, do you feel pretty good about those overall?

MR. KICHLINE. Well, I don't feel good about them in the sense that I wish they would be lower but you're looking at our best point estimate. So, yes, we do feel pretty good about those numbers as our best guess. But certainly in my view the risk is on the upside--that we'll have higher unit labor costs rather than lower.

CHAIRMAN MILLER. Mark.

MR. WILLES. Thank you, Mr. Chairman. I was impressed with Jim's comment that on the price side the risk would seem to be on the upside rather than the downside in the absence of some effective Administration anti-inflation policy. I'd like to ask you or him or anybody what the

chances are that we will have an effective Administration inflation policy and if we do, what that is likely to consist of.

CHAIRMAN MILLER. Well, confidentially, the Administration is examining what more aggressive anti-inflation program could be undertaken within the policy of moderation that has been indicated in the economic package. That action, if taken, would be both direct governmental action and would be inclined to marshal similar support in the private sector for holding down wages and prices. Whether it would be effective would depend on how much visibility is put onto it and how much real attention leadership would place upon it. In addition to that, the possibility of a very strong statement on holding [down] the budget deficit and the possibility of some action on the supply side in releasing things like timber for harvesting are being looked at. I cannot tell you whether any of this will lead to anything or whether action will be taken.

On the energy side you can go around this town and find anything you want but there's very little sentiment that an energy bill will be passed soon. So that leaves the President with a choice of whether any alternate action should be taken in the way of quotas or import fees, and if it is, when and how and so forth. I can't give you the answer whether that will be done either. There's a good deal of feeling that time is short and these things need to be done--that they need to be done as a step and if they don't work then something else should be done to keep an active program going. It seems to be a rather universal feeling that inflation is the number one problem. The employment situation has behaved better than the Administration planned, and better than our expectations, which means that the time is there to pay attention to this inflation [problem]. If we don't pay attention to it soon, inevitably we're going to bring about conditions in money markets, prices, and investment that will lead to a recession. And the larger the inflation bulge, the more difficult the recession will be, so it's looked upon with some seriousness. But that doesn't mean that there [will] be action.

MR. WILLES. May I just pursue that a little bit further? The businessmen that I have spoken with have read reports of most of these things that you've [mentioned] and greet them with a very high degree of skepticism. Even if the Administration tried to do them, the businessmen I speak with are very skeptical that [these programs] would have any salutary effect at all on what is happening with regard to prices. Do you share that skepticism or are you more optimistic that they might in fact work?

CHAIRMAN MILLER. I think they base their skepticism on experience because there have been a lot of toothless programs. I think the question is: Will people get serious enough and take real action? Is the President willing to veto legislation that breaks the budget? Is he willing to go into aggressive control of expenditures beyond the budget--asking all departments to scale down spending even below amounts that perhaps should be appropriated? Will the federal government in the face of the labor situation be willing to cut back the increase in Federal pay raises? I can't answer those questions. But if those things are done, I would be more optimistic that we could then have a case to expect the private sector to do its part. Without the government

sector leading the way with real [actions] and not just rhetoric, I think we're going to get no place. But if concrete things are done then I think that, at least in the next phase, we ought to try to sell the private sector on doing their share. What is the next level of action? It's even more difficult and a little more disruptive, so I think we have to proceed as best we can.

MR. MORRIS. Is anybody looking at the Okun/Wallich idea of the tax-oriented incomes policy?

SPEAKER(?) Yes, they're both looking at it!

CHAIRMAN MILLER. I would quote the father of the idea. He said of his child that it's a great idea but he wouldn't enact it into law today because it's premature. I don't think it can be a part of the action in the next few weeks. I think it can be looked at in terms of a more structural change over time, Frank. It needs to be studied. Is that a fair statement of the father?

MR. WALLICH. We'll have a conference on this at Brookings within a month. I have a 150-page analysis of the technicalities of it now, which says that it's bad but no worse than the income equalization tax.

CHAIRMAN MILLER. [Given] my knowledge of Congress, I'd say that 150 pages of technical details [translates into] about 10 years in Congress. So, I think it's going to be slow to come to that. And I think there are some reasons why we have to be cautious because there could be some effects in capital intensive industries that would have to be looked at very hard. The industries that are most in need of capital flows might be the hardest to [deal with] because they're also the ones that have the strongest unions and may not be able to resist the pressures. They might have higher wage rates plus higher taxes at the very time when we need capital formation for investments. So it is a tricky proposition and I don't think it can be implemented in the short term.

As an aftermath of a series of events over ten years, it's hard to coalesce leadership in the government. It's nobody's fault, but there has been a fractionalization of leadership after all these events. Therefore, Congress doesn't stick too much to anybody's program. They all have pet ideas, which is still good in many ways but bad in terms of getting action. And the Administration has many factions pushing it in this direction and that direction. I personally think time is very short for them to take some more believable steps in fighting inflation and if it's not done, inflation is going to be left to the Federal Reserve and that's going to be bad news. I don't think we really have the capacity to avoid the consequences of the inflation. We can do some things but they inevitably are not going to work out with a scenario that any of us will like.

MR. BAUGHMAN. Mr. Chairman, in terms of the difficulties of getting some kind of coordinated program which might have some appeal to the public--on the grounds that it would appear to have some chance of making an impact on inflation--would you see the major problem as

getting a consensus view in the Administration or getting support from the Congress if the Administration were to bring forth such a [program]?

CHAIRMAN MILLER. Well, I think an anti-inflation program will [require] Presidential leadership and action. If you consult with Congress about it, you will still be consulting next October! One of the problems with taking [action] is that everybody has his parochial view. Everybody wants to say well, in my parochial view I've got to consult this, and this, and this. Well, then you never get anyplace. So somewhere along the way, if [inflation] is perceived to be serious enough, I think it's an executive action that has to be taken. My guess is that such an action--a forceful and believable action--would be not unpopular, but would be popular.

MR. BAUGHMAN. I would second that. I sense a real demand for it out in the country.

MR. ROOS. Mr. Chairman, if I understood you correctly, I understood you to say that there are very limited things that we can do. If we were to gradually slow down money growth, as we have publicly said in the past we wanted to do, wouldn't this be a signal to the world and to this country and to everybody that the Federal Reserve is really serious about doing something [about inflation]? Don't you think that would possibly have some effect on correcting inflation?

CHAIRMAN MILLER. If other actions aren't taken, we would have to continue the process, which we will no doubt do. And if we do, inevitably that will lead to a slowing down in capital investment and in homebuilding and it will lead to a recession. That's why I hope that other actions can be taken, not just ours.

Let me ask you again please to treat these discussions very [confidentially] because if the Administration wants to do something, I think they should be left plenty of room to do it in their own way and their own time. We shouldn't start rumors of discussions that would impede their [success]. Like the arrangements with the Germans, too much discussion in advance I think did hurt the process.

Now, I have a couple of choices for you. We have a number of people who would like to speak; there are four more who have so indicated. Would you like to take a few more minutes to hear their comments and then have a break or would you like to break now and come back to their comments?

MR. WALLICH. Why not go through with it?

CHAIRMAN MILLER. All right, let's take the four who are listed so far. Bob Mayo.

MR. MAYO. Thanks, Mr. Chairman. I am mindful of Frank's point on the optimism and that we might get too enthusiastic about a rebound from the first quarter. I don't feel, however, that

the staff projection has incorporated an overly optimistic tone on the second quarter; the staff has toned down its figures for the year in a realistic fashion, I think.

We have had what has now officially been declared the worst winter in Chicago's history. We haven't done it quite as spectacularly as Boston and Providence, but we've had the worst winter in our history, both from the standpoint of cold and from the standpoint of snow. However, the coal strike has not impinged on most of our area. Illinois relies 35 percent on nuclear [power] and this has been our salvation. Michigan has bought at least that much of their needs from Ontario Hydro and that has added to our balance of payments problem, but it has been their salvation. Indiana has been hurt more than the other states.

But I find that there is a thread of solid optimism that is pervasive even in Indiana and in the other states, too, as I move around the District. [People] feel that the figures are something to be taken with a grain of salt because they really don't mean anything in this particular period. Most of our retailers, although not all, are optimistic on the rebound that has already taken place. And I think there is a general feeling among those who are in the market for additional capital spending that this is coming along very, very slowly but that there will be continued growth through this year and through the end of 1979. So, I find the staff's projections very reasonable but I think we could all agree that they are inadequate if they are interpreted as goals of our policies. Certainly none of us likes to see the inflation rate move up even a couple tenths of a percent at this point. Also, I think our agricultural people feel that the Department of Agriculture estimates that agricultural prices will be up 4 to 6 percent this year are now out of date. I think there's a general consensus that retail food prices will probably be up more like 7 percent instead of 4 to 6 percent. And that, of course, is bad news for inflation, too.

CHAIRMAN MILLER. Thank you, Bob. Phil.

MR. COLDWELL. Mr. Chairman, let me ask one question first. Jim, in working out your forecast for the remainder of the year--well, let me state it as an assumption. I assume you knew of the downgrading of the fourth-quarter GNP--the recent announcement--before you went into this [projection exercise].

MR. KICHLINE. No, that became available to the staff yesterday afternoon. We had suspected a small downward revision, and on a revised basis it went from 4 percent real growth at an annual rate to 3.8 percent. But the data became available after we had prepared the projection.

MR. COLDWELL. If you had known this, would you have shaded your figures down?

MR. KICHLINE. No, I don't think so. We anticipated a small change in business fixed investment as one of the areas of downward revision and we cheated a little bit by trying to link our forecast to our suspicions of the way that the revisions would take place. Similarly, net exports

were revised down and we had a bit of a lead on that so we really have incorporated, we think, pretty much what they've done.

MR. COLDWELL. Mr. Chairman, I guess I'm seconding Henry's comments in a way. It seems to me that we're faced with a difficult problem here of slow growth in two consecutive quarters. One is theoretically because of the coal strike and cold weather. The other one has now become less than expected--at the 3.8 percent level [for the fourth quarter of] last year. I'm still optimistic that the second quarter is going to show a major rebound, and perhaps even more than the staff is indicating. Although I really wonder if the 3.4 percent [preliminary estimate] for real growth for the first quarter is as low as it will [turn out to be or if it will] be cut back by the events of January and February. I'm more concerned as I look in the future, however, because there is a significant rebound in the second-quarter [forecast]. And if inflation continues to move up, as I expect it to, I think we're going to be placed in a position of resistance--with higher interest rates, slower construction, and consumer buying weakening as debt increases. I would parenthetically add that I've been questioning bankers as I go in and out of these meetings here and I find more and more of them are saying now that their consumer credit delinquencies are rising and that they are starting to see evidence of excessive debt on the part of the consumers. I haven't yet gotten enough answers in that vein to call it a nationwide trend by any means. But if this were to be developing, then consumer buying would also weaken and we could face a further reduction in real growth in the latter part of the year. It doesn't mean, however, that we won't have a great inflationary problem to attack; and, unfortunately, I think it's going to be left to us to attack it.

CHAIRMAN MILLER. I don't say thank you to that. Willis.

MR. WINN. It would be my guess that the wage settlement is really causing unrest in public service groups, [with] other people feeling that this was endorsed here and they're entitled to the same sort of [increase in wages]. Second, I think we shouldn't underestimate the amount of time that it's going to take to rebuild stocks. Inventories are really way down. Summer is a period of even greater electrical consumption and to the extent they [shift] back to coal, then the problem of rebuilding is going to take much longer. I think then people may realize that this may follow through a little longer than one would normally expect. My chief concern, however, is in the fiscal policy area, and this is where I would quarrel, I think, with the staff estimates. I would focus primarily on the state and local areas. While in the national income accounts it looks as if we have a big surplus, when you start to break that down you realize that it's largely due to the revenue sharing side; that is bringing in this big surplus. I see in the legislatures great efforts both to cut taxes at the state and local level and to increase expenditures. So it seems to me that we're likely to find much more stimulus there than is [implicit] in the projection and I'm disturbed by the stirrings in Congress about wanting to do something at this level. Once they take the bit in their teeth we may get a much greater stimulus than firm leadership on fiscal policy would dictate. That is my comment.

CHAIRMAN MILLER. Thank you. Paul.

VICE CHAIRMAN VOLCKER. I'll be brief with a couple of random comments, Mr. Chairman. I don't think there is a great deal of informational content, as a number of people have said, in the recent statistics so far as the future is concerned. My own presumption is that [the economy] should be fairly strong after we get through this period, recognizing the possibility that President Morris first referred to that it could be something else. [But] we have to be able to make some decisions and my presumption would still be on the side that growth is going to be stronger and that the risk of more inflation over these projections is greater than the prospect of less inflation. That is a major part of our problem and I would hope the Administration comes out with more credible programs. I would just say, after listening to this colloquy earlier, that I would rather have them take a little more time and do it right. [I'd hate to see them] get so concerned that they put out something early that is really not very credible. If they could really do something right here--something forceful--and if they are willing to take the actions within government, including on government pay, that seem to me desirable, it may be pretty useful.

I was also struck, in terms of potential problems for the Federal Reserve, which have been [alluded] to in a couple of different ways by what Governor Wallich said about time for a slow landing and all this nomenclature that we have full employment someplace in the 5 to 6 percent or 5-1/2 to 6 percent area. That gets into the Humphrey-Hawkins bill. [Let's assume] we get the passage of the current congressional package on the Humphrey-Hawkins bill. If Henry is right, and there is a good deal in what he says, how does one go up there and testify how we are on the path and conducting policies toward whatever figure they have in there for Humphrey-Hawkins? [It] is not very far off. It seems to me that we are in a very awkward position. I don't know whether that bill is absolutely going to pass. It's very hard to oppose it. But the awkwardness of our position struck me, as I heard Governor Wallich speak.

MR. PARTEE. Well, if you believe those figures.

VICE CHAIRMAN VOLCKER. If I believe his figures?

MR. PARTEE. Yes.

VICE CHAIRMAN VOLCKER. I'm not sure I would go that far. But you don't have to [agree] totally with him to see the sizable discrepancy in that.

MR. WALLICH. If you contemplate what Humphrey-Hawkins implies, if anybody abroad thought this would be taken seriously, we would be disavowing all our anti-inflation effort.

VICE CHAIRMAN VOLCKER. Well, I agree with that. But what position are we put in by this bill when we have to go up there and in effect say that our policies are--

CHAIRMAN MILLER. We'll have to find an ingenious way to [indicate] that our policies are taking account of the other parts [of the legislation]. We also have to work toward price stability and fight inflation.

VICE CHAIRMAN VOLCKER. We'll have a division of labor.

CHAIRMAN MILLER. On those occasions, I will invite one of the other members to testify! John, I think we'll ask you to comment as the last speaker. Then I have an experiment I'd like to try.

MR. BALLES. Well, if I can just pick up on Paul's point, I think there is an answer. If we go on the Hill vis-à-vis a Humphrey-Hawkins bill [that says] full employment is 4 percent unemployment, there's considerable evidence in my view at least--and Dave alluded to this earlier--that inflation does cause recession, and recession causes high unemployment. Therefore, if you want to avoid high unemployment, you avoid high inflation. High inflation, high interest rates, and high unemployment go together and vice versa. The latest example of that surely has to be the 1974 experience. I have listened with great interest to what might be done across a broad front here, not only on the foreign exchange value of the dollar but with respect to inflation. And when I hear phrases like one of the fundamental policies that we need is an effective U.S. government anti-inflation program and consider what that might involve and what the prospects of getting it are, I must say it's a bit discouraging. It does some good, I'm sure, in some limited sense but perhaps no more than a band-aid sense to have moral suasion and voluntary actions to slow down price increases and wage increases. But when everything else is said and done, the most effective thing the federal government could do, in my view, on the inflation front, is a counter-cyclical fiscal policy. Yet the chances of getting that seem to me darn slim, in view of the size of the budget deficits that are pretty much set in cement now. They can be changed of course to some extent. But the message that comes through, much as I hate to say it--I have to side with Phil Coldwell and maybe go one step beyond him--is in effect that if an anti-inflation policy in the United States is going to start, it's going to have to start around this table.

CHAIRMAN MILLER. Thank you. I'd like to try an experiment. Jim, would you give me three numbers--and I want everyone to write them down. First, what is your objective or what does the staff have in mind for the real growth in GNP '78 calendar year over '77.

SPEAKER(?). Year over year?

SPEAKER(?). Or fourth quarter to fourth quarter?

CHAIRMAN MILLER. Okay, give me fourth quarter over fourth quarter.

MR. KICHLINE. 4.4 percent.

CHAIRMAN MILLER. Okay, write that down. Now give me your year-end unemployment rate.

MR. KICHLINE. Our fourth-quarter unemployment rate is 5.9 percent.

CHAIRMAN MILLER. That's the average for the fourth quarter, not year-end?

MR. KICHLINE. Right.

CHAIRMAN MILLER. Then write down your deflator.

MR. KICHLINE. Fourth quarter to fourth quarter, it's 6.6 percent.

CHAIRMAN MILLER. Now the experiment I would like to try: I will not use the data except to experiment, but during the coffee break or sometime today, would you write down individually what you think those figures would be within a range. Use a range. Do you expect GNP is going to be, you know, 4-1/4 to 4-3/4 percent or do you expect it to be 3-1/2 to 4 percent or what? On unemployment, give me exact figures or ranges. This is just for an experiment to see what this group would come up with if they had to make those personal judgments on top of the staff. I'll tell you later why. They're not to be used; this is private. Let's have a coffee break.

[Coffee break]

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

CHAIRMAN MILLER. Thank you, Peter. Questions? Comments? Yes, Henry.

MR. WALLICH. Peter, has it ever been pointed out to our friends abroad that when they buy Treasury bills so single-mindedly, that they have reduced the interest differential and, therefore, find themselves buying more Treasury bills?

MR. STERNLIGHT. We have pointed it out to them and have sought additional flexibility. Of course, they have to do something with their funds. They want to put them in some earning form and we have urged some of them to give us greater flexibility as to the maturity of bills that they can buy, stretching out to longer issues--stretching out to coupon issues and on occasion going into special Treasury issues for the time being. That has ameliorated the problem somewhat but a number of these accounts are pretty much locked in by their own internal rules to very short-term investments.

MR. PARTEE. They don't generally buy anything but bills or something shorter, right?

MR. STERNLIGHT. No, for some of the accounts, the initial step is usually to take what dollars they have accumulated and immediately buy bills. But some of them have been on programs of funding out some of their holdings. Germany and Japan have gone a considerable way in this direction and the United Kingdom has as well.

MR. PARTEE. We ought to encourage them.

MR. STERNLIGHT. We have pointed out the available range of investments to them.

MR. WALLICH. Are they aware that at the present time this great concentration of buying is actually pushing down the bill rate a little?

MR. STERNLIGHT. I think they are aware of that.

CHAIRMAN MILLER. Yes, Phil.

MR. COLDWELL. Peter, what's your reading of dealer attitudes these days?

MR. STERNLIGHT. I'd say it's one of great caution, with no great conviction about an immediate change of policy. There's a feeling that because of the performance of the aggregates and the economy no early move toward firming is likely. They are very much aware of the international situation. I think if that cloud were not hanging over the market right now, there would probably be a strong rallying move in the market because of the way the aggregates have slowed down recently. But given the uncertainties about the dollar and the feeling that the economy could rebound, there's considerable wariness. Still, the underlying feeling is that as the year goes along we are likely to see higher rates but that probably that move is a few months off.

MR. COLDWELL. Does that reflect even their coupon holdings?

MR. STERNLIGHT. I would say so. Those positions are quite modest at this time.

MR. COLDWELL. And yet positive as opposed to negative a couple months ago?

MR. STERNLIGHT. Slightly positive, but fairly close to even.

CHAIRMAN MILLER. Gentlemen, we have the question of action to ratify the transactions since the previous meeting. I believe [the Desk's reports] have been distributed. Is there a question? May I, in the absence of a dissent, record those as approved? At this point I call on Steve Axilrod for his comments.

MR. AXILROD. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN MILLER. Comments or questions? Yes, Frank.

MR. MORRIS. Steve, I seem to recall that last July we began to get a weekly sample of deposits at non-member banks. I was hopeful that this would mean that in the future the benchmark revisions would be negligible. Is this evidence that the sample is not adequate?

MR. AXILROD. September will be the first benchmark date we can compare with the sample, so we want to make that comparison. We really prefer to make two comparisons before we incorporate the continuing sample into our regularly reported data. We have not done so. Also, one strata of the sample--and I don't remember exactly which one--is wrong. The reporting is wrong and we're working on correcting that. We had hoped that by around midyear we would have everything straightened out and if our tests showed that the sample was giving reasonable results--and the only test we can have is to compare with the benchmark--to incorporate it at about that time. But we are not [yet] in a position to incorporate them.

MR. MORRIS. You haven't actually been using the sample?

MR. AXILROD. No, no. We have it and we've been trying to get it straightened out but we have not been incorporating it.

MR. PARTEE. Why don't you tell him what was wrong with the benchmarks? The FDIC just made gross errors in their calculations. They did it on the weekly samples, too.

MR. AXILROD. For internal reasons they did not edit the benchmarks. They stopped editing in December of last year. The edit they performed was not an edit in any sense of the word.

MR. WALLICH. Steve, I see that the nonborrowed reserves and to a lesser extent the base rose very sharply in the last three months. Do you see any significance in that for future money growth?

MR. AXILROD. Well, I have never been able to see any significance of past behavior of the base in relation to future money growth. We have a lagged reserve requirements system; that is, reserves today relate to deposits yesterday so that in itself says the reserves are quite passive. Secondly, we control the federal funds rate; we do not make an effort to control reserves and, therefore, future money growth will depend on what we, in fact, will permit to happen to the federal funds rate in the future as well as on what we have permitted to happen in the past. So I don't think in that context that the reserve base past has very much significance to the reserve base future. It's [relevant] only to the extent that it may reflect rapid money growth or something like that in the past, which feeds through and affects GNP, which feeds demands for money in future. It would be that sort of indirect effect but certainly not any direct correlation.

CHAIRMAN MILLER. Roger had his hand up.

MR. GUFFEY. Question to Steve. You are projecting into April another blip as we experienced in 1976 and 1977. As you made your seasonal adjustments to the 1977 data, can I translate that to say that when you are looking at 9 to 10 percent growth projected for April of '78 that that would equate to another 6 percent, roughly, if you weigh it against the '77 figure--unadjusted?

MR. AXILROD. Yes.

MR. GUFFEY. I'm just trying to lay experience against experience.

MR. AXILROD. Yes, we have reduced the seasonal factor. April's rate rose around 6-1/2 percentage points so the 2-month growth rate would be about 3 percentage points higher if we were on the old seasonal. On the other hand, we have raised January's and February's.

MR. GUFFEY. Another somewhat related question: The assumption in the Bluebook has been for the last couple of months that Regulation Q [ceilings] will be increased and I think it's scheduled for May. Are there discussions now going on with the other agencies and if so, is that a reality, a possibility, or what?

MR. AXILROD. Governor Partee may wish to speak to the question of whether there are discussions with the other agencies.

MR. JACKSON. He can't hear you, but the answer is no.

CHAIRMAN MILLER. That's a pretty good answer. Chuck and I like the length of it!

MR. AXILROD. I should add, President Guffey, that the staff has been developing its own contingency plans so that discussions, when they are ready to go, can be undertaken very promptly.

MR. GUFFEY. Well, we are running up on that May date, which is an assumption underlying all of your projections.

MR. AXILROD. Our staff projections are on a preliminary basis.

MR. PARTEE. Well, Roger, it's a little hard to do when market rates are drifting down.

MR. GUFFEY. Yes.

CHAIRMAN MILLER. Mark, you had a question.

MR. WILLES. He asked my question.

CHAIRMAN MILLER. Okay.

MR. MAYO. Steve, one of the intriguing aspects of the disintermediation dilemma this time is that there are, of course, two parts to it. An investor is faced with a choice if he has new money to invest as to whether he goes into a thrift institution or into a government security. That's reasonably easy to figure out--at least the arithmetic is. The part that's so intriguing is that such a large percentage of existing thrift accounts are in this wave that have gone into certificates that are longer-term and the penalty aspect does enter into the situation. There is a little different evaluation required on whether a man withdraws funds from a thrift institution or leaves the funds there. Have you done any analysis that would be meaningful on this?

MR. AXILROD. We have been assuming that people do not withdraw--that is, that the penalty is so great. In fact, it was that assumption that really got us to assuming a somewhat stronger inflow into thrifts in the first quarter than actually developed, given the interest rates.

MR. MAYO. That may be the wrong assumption, but I don't know just how to correct for it. I think there is a correcting factor that's necessary.

MR. AXILROD. I think that there has been more sensitivity on the part of investors to the interest rates. Greater sensitivity has developed as the years have progressed, and I think there has been a very prompt move into other securities and money market funds, at least with new money--money that would otherwise be invested. I don't have any evidence myself as to whether there have been withdrawals or whether our assumption is correct that there really haven't been many withdrawals.

MR. MAYO. The penalty isn't all that large; so if the differential spreads a bit more, you could get quite a bit of follow-up.

MR. KICHLINE. We've done a good deal of work on that and it's very expensive if you've been a holder for more than one year.

MR. MAYO. Oh, yes.

MR. KICHLINE. I think one of the catches this time around is that while a larger proportion of the thrift accounts are locked into what we perceive to be very expensive penalties, it's also the fourth year since they began to take on these certificates. So we have a very high volume of maturing certificates; I think it's something like $28 billion that matures this quarter.

MR. ETTIN. Yes, $28 billion with original maturities of one year or more matured this quarter; over half of those have original maturities of four years or more.

MR. KICHLINE. One of the other elements in our thinking is that the past experience has been that the institutions seemed to get good rates of gross inflows but it's the withdrawal side that's very sensitive. So I think the maturing certificates are probably the most difficult area this year.

MR. AXILROD. That's what makes me a little leery in a sense about the next notch up because thus far there has been a reasonably competitive relationship between long-term certificates at thrifts and Treasury securities. If you got, say, 25 or 30 basis points more in the 4- to 7-year area, then it might trigger a very large movement of these maturing certificates that were originally in the 4-year area--perhaps into Treasuries.

MR. MAYO. Or there may be people who would say I'll take a 90-day certificate and see what happens which, in effect, is a way out of the same situation.

CHAIRMAN MILLER. Paul.

VICE CHAIRMAN VOLCKER. I'd just like to make an observation and raise a question. The observation is about the size of these changes in seasonal factors alone in the revised money supply figures. It has been a long time since I've been in the business of calculating seasonal adjustments, but I don't ever remember year-to-year changes of this magnitude in seasonal factors. I think it just underscores the fragility of these statistics that we work with on a short-run basis from meeting to meeting and to which we attach a lot of importance.

The question is in connection with these various substantial statistical changes. Has any further consideration been given to the thought of redefining the money supply figures--and if not, why not--in ways that would seem off hand to make great sense [given] NOW accounts and demand deposits at savings banks?

MR. PARTEE. I missed the Board meeting on that subject.

MR. AXILROD. President Volcker, the staff at the moment has been giving this considerable thought and we are planning around midyear or before--I hope in late May or early June--to have a memo for discussion purposes which would propose changes in M1, M2, M3, and M4. We'd like to have discussion, of course, within the System and perhaps have it available for discussion outside the System. That's the state of our plans at the moment.

CHAIRMAN MILLER. It's inevitable that we will have to make changes before we proceed with the policy directive. Let me mention a couple of points. First, I'll report on your own projections for the economy. Taking the members of the FOMC--ten are present--for the ranges of growth in GNP, five would fall in the 4 to 4-1/2 percent bracket, against the 4.4 percent that was indicated by the staff, which would suggest a belief by the FOMC [as a whole] of a little lower growth rate than the staff expects. Three of the projections would fall moderately below the 4

percent; and two would be over 4-1/2 percent. So it looks like that bracket is more or less 4 to 4-1/2 percent. If we picked up the views of the seven additional Presidents who are here, three would fall below 4 percent and [the others] would go to 4-1/2, or within [the 4 to 4-1/2 percent] bracket [unintelligible], which again would indicate that the consensus is for slightly slower growth than the staff projection.

On the unemployment rate, the FOMC members fall in at a 5-3/4 to 6-1/4 percent range against the 5.9 percent projection. Two would be below the 5-3/4 percent on one of their figures and two would be over, so that [six] would fall completely within the brackets. If you add the other Presidents, you pick up five on the low side and three on the high side, which would indicate that the consensus is, if anything, that the unemployment rate will perform pretty well. It leans a little even below the staff projection.

On prices, the staff projects a 6.6 percent [deflator]; the FOMC [members] would be 6.6 to 7 percent, which would indicate that everyone expects inflation to be worse than in the forecast. Three would fall below the 6.6 in one of their figures, two would go over 7. If you add the other Presidents, you pick up two below and three over; again it looks like the leaning is to higher inflation than in the forecast. That is very helpful information.

I would say to you that one of the reasons I wanted to experiment--we will just use this here today--is that the issue I'm facing is as follows: For some time the Congressional Committees who have oversight and who invite us and by law now require us to testify quarterly on the monetary aggregates have also been pushing for more quantitative figures on prices, on unemployment, and on GNP. Those in the System have felt, and I certainly concur, that it would be an enormous mistake to begin to provide the Congress with staff projections because that would destroy the ability of the staff to be completely independent in their views and recommendations or projections to us. They would tend to be influenced by the fact that those views would become public. The law does not require quantitative numbers; the law now requires that there be a discussion on projected or prospective production, prices, and employment, but not [quantified]. The solution that has been used is that the Chairman has been giving personal views of the quantitative figures. I feel a little uncomfortable [with that] and I'd like to have help from the Committee. If I'm going to give personal views, I would prefer to have this sort of backup or something like it--or even see if the Committee might want to develop a consensus and authorize me to use this consensus figure so that we use something that the Committee has developed, not the staff.

I think to resist any kind of quantitative figures is going to be very difficult. I'm not too happy with using just the Chairman's personal estimates. Maybe that's because I'm not so well qualified to make them or maybe it's because I feel that more input would be a healthier situation. With ranges like this, I don't think it would be very bad if they were used in testimony. We don't have to face it now but at the next meeting I'll be preparing for [testimony in] April, so you all might think about this and whether you want an input into those figures or whether you want to leave it to me. Unfortunately, if it's left to the Chairman, the Senators and Congressmen and the

newspapers assume it is the Federal Reserve position. That's the problem. So, I don't like the Chairman giving his personal views, which really get [incorrectly] interpreted in the press. I was speaking to a Senator last evening and his comment was, "I didn't know those weren't the Federal Reserve's figures; I thought they were." Of course, it has been very carefully said that they were the Chairman's figures. So, just bear that in mind because next meeting we might deal with it. If you would like to comment on it now, I would welcome it, but there's no urgency to comment at this point. Ernie.

MR. BAUGHMAN. It seems to me, Mr. Chairman, it might be easier to build a fence against demands that individual members' figures be revealed--and thereby opening access of the [Congressional] Committee chairmen to individual members of the Committee--if the presentation is retained in terms of the Chairman's view without reference to a poll of members.

CHAIRMAN MILLER. It could be that that's the solution. It could be that we'd do this without names and, therefore, have a blind view. Or it could be that this would merely be guidance to me to make my personal decision. It could be any combination of those. Yes, Mark.

MR. WILLES. Personally I think it would be very desirable to have you use ranges of an expression of opinion on the part of the Committee because whether we like it or not various people look at what we do. They try to evaluate how well we do it and in the long run I think that's a good thing in terms of how we perform our job. That's information we use in making our policies and, therefore, it ought to be information which ultimately the public has access to in order to see why and what we did.

CHAIRMAN MILLER. I would feel more comfortable if I at least had some input from the Committee, and I am willing to go as far as you all would like. I'm willing to play it any way. I don't like to be trying to represent the Federal Reserve with a very crystallized view that makes me feel that I'm overstepping a little. I don't personally feel any concern about good times and bad times. I think the world has come to the point where if we are going to be responsible and responsive, we're going to have to be giving some indication of what we see ahead, whether they are personal views or whether they are consensus views. And some day we are going to have to be looking at bad times ahead and we are going to have to say so.

VICE CHAIRMAN VOLCKER. Yes, this is partly the difficulty you get into. Do we want to project publicly a high rate of inflation now? The Federal Reserve projecting an acceleration of inflation! Or at other times do you want to project a recession before--

CHAIRMAN MILLER. You see, if I'm asked before the [Congressional] Committee on April 25 what my personal views on inflation are, they are going to be higher than the Administration's and that's going to be in the newspaper. Now whether we want to say we all have a view that's leaning a bit that way--is that better? Or should it be me? I can play it either way. But I don't think we can avoid answering the question; I don't think we should. I don't think I

should avoid answering the question because the message that inflation is getting worse is a message to action and if we don't say it, I think we are not measuring up. I think there has been a tremendously favorable reaction to my strong statement on inflation already. It hasn't been negative. [The reaction] has been, "My God, if that's true, let us do something."

VICE CHAIRMAN VOLCKER. I think there is a subtle distinction between your expressing alarm, which is entirely appropriate and very helpful and encouraging, and the Federal Reserve at some time, in its august majesty, saying this is what [inflation] is going to be.

CHAIRMAN MILLER. Mark had his hand up first and then I think--

MR. WILLES. Just to respond to that point because I think that's one of the key points to the argument on the other side, which is that we ought to be making policy looking ahead as to what's going to happen six to nine months down the road. What happens now is that it all seems patently inconsistent to the public because we appear to be tightening when there's no reason and we appear to be easing when there's no reason. I think it would be a great advantage, in terms of our ability to do our work, to have those kinds of statements out in the public domain.

CHAIRMAN MILLER. Bob.

MR. BLACK. Mr. Chairman, I think one of the things members of Congress are apt to do is to try to get us publicly at odds with one another. There are a lot of differences of opinion as to who ought to do the testifying. My feeling is that to the extent possible you ought to do it on this kind of matter. If [these Congressional Committees] end up with a lot of different opinions, they are going to ask different ones among us to come and express those opinions and they are going to play us off against one another, which I think would be a catastrophe.

CHAIRMAN MILLER. That's correct. If we ever move beyond [my] personal views, it should be unidentified--[and stated in terms of] consensus and ranges.

MR. BLACK. That's very advisable.

CHAIRMAN MILLER. Henry.

MR. WALLICH. I'm really very concerned about the Federal Reserve predicting a rate of inflation because that works its way through immediately into interest rates, if anybody takes it seriously. I wonder whether there aren't ways of qualifying this. For instance, I found myself putting down three alternative scenarios here for these [inflation] numbers. After all, we don't control them; the outcome depends on what the Administration does and what Congress does.

CHAIRMAN MILLER. That's what the Congress wants--clarity.

MR. WALLICH. Likewise, I think probabilities can be mentioned [on] fears that inflation may rise significantly, but I would be very bothered by some numbers stated cold, whether [they represent] your view or the Committee's.

MR. PARTEE. That's really a very narrow range on inflation--[6.6] to 7 percent.

CHAIRMAN MILLER. Yes, it could be widened.

MR. PARTEE. I think we'd want a wider range than that.

CHAIRMAN MILLER. I took off the ends of it; it could be widened easily. Let's see. Bob Mayo wanted to speak.

MR. MAYO. You're right, Mr. Chairman, that the Congress wants clarity but many in the Congress confuse clarity with simplicity. They would like to have a digit for everything and once they get into this game they can trap us by remembering figures that we would just as soon forget. [Laughter] No, I mean that seriously.

CHAIRMAN MILLER. What you're saying is that you'd like the Chairman to be on the spot.

MR. MAYO. No, I want to keep the Chairman off the spot by not getting him to expose figures that we would rather all forget later on. It's not that we are irresponsible but we are human beings. I'd also suggest that one of the precedents set by setting up target ranges on the monetary aggregates in the first place was, I think, to dignify those as overly simplistic definitions of what we are doing in the public's eye. And [I like] the fact that we have been able to resist thus far the projection of interest rates in particular. I agree with Henry's point that the more figures we give them the more they like figures and the more they will slant them, and we could be getting ourselves into a trap.

CHAIRMAN MILLER. I think perhaps we've spent enough time with this today. I would appreciate your thinking about it and perhaps coming in with some suggestions at the next meeting. Ernie Baughman has written a letter, which you've all received, suggesting that we also take a look at a longer-range view of monetary policy and the aggregates. My suggestion would be that this matter be taken up by the Subcommittee on the Directive. Chuck, that's your committee, I think. Perhaps at the next meeting you could give us some views on this. I think it's well worth examining.

MR. PARTEE. Certainly.

CHAIRMAN MILLER. Is that satisfactory?

MR. BAUGHMAN. That's quite satisfactory.

CHAIRMAN MILLER. Now, I think we turn to the directive itself, unless there is some order of business I'm not familiar with. You have a draft before you, which has general paragraphs. I might ask if there are any comments on the general paragraphs before we come to the operational paragraph. I have one on line 8, page 1. I think when unemployment went last time from 6.4 to 6.3 percent it edged down; but when it goes from 6.3 to 6.1 percent it might just decline. I think when it falls 0.2 of a percentage point it is doing more than edging.

MR. PARTEE. You're right. Absolutely.

SPEAKER(?). How about using "precipitous"? [Laughter]

CHAIRMAN MILLER. Yes, a precipitous drop in unemployment. I just think "decline" might be a better word. Are there any other comments on the general paragraphs? Then what is your pleasure on the operational paragraph? We have two choices, the formulation that is described as "monetary aggregates" and the one that is "money market." Anyone? Paul.

VICE CHAIRMAN VOLCKER. I don't know whether I want to address myself to that limited question at this time.

CHAIRMAN MILLER. Fine, address yourself to a broader view.

VICE CHAIRMAN VOLCKER. Let me just [address] myself to where I would like to see [the funds rate] go during this period. I feel very much the way I did last month in the sense that I think it would be wrong in the foreseeable [future] to give an easing signal, for a variety of reasons, maybe most importantly the concern we've expressed about inflation around the table. And I think the international consideration is also very evident. I think both of those reasons outweigh any doubts or uncertainties we may have about the economy [given] the fact that the figures are so distorted recently.

I would go beyond that and say I could conceive of circumstances in which some modest tightening move--and I would say modest certainly--might be useful during this period, although I certainly wouldn't make it now. I say that against a background that was described to us by Steve Axilrod about the outlook for the aggregates. I don't think we can attach much significance to what happens to the aggregates in the short run, particularly if they go down or remain rather sluggish during this period against the high figures we had for quite a period last year and against the outlook, uncertain as always, for the probable strength rather than weakness as we move ahead and get through the winter period and through the coal strike. What we do now isn't going to affect what happens to the aggregates in the next few weeks but it will have some significance later in the year. We ought to be thinking in terms of steady to possibly slightly up rather than any declines [in interest rates]. I think the easiest way to express this, in terms of the directive itself, would be to

limit the federal funds range by putting a floor on it at [the rate] we've in effect had--6-3/4 percent. I don't really want to see the rate going up much above 7 during this period without a careful relook, so that suggests, as I proposed last time, a 6-3/4 to 7 percent range. And I still think it makes some sense to move it up if the aggregates are running high, which would point to an aggregates kind of directive.

MR. PARTEE. But a very much constrained one.

VICE CHAIRMAN VOLCKER. Some question was raised about this last month. So I was forced to do some thinking about it this month, and I'm prepared to argue that the best way to use an aggregates directive is to constrain the federal funds rate in this particular period. That's because I wouldn't want to see an aggregates directive and have a wide federal funds range and either have it go way up or way down. Nevertheless, I don't mind moving the rate if the aggregates are high; but I don't want to move it forever. And I guess "forever" I define as really above 7 percent in these circumstances, which itself would get an interesting market reaction. I wouldn't want to risk a greater one by moving it above the 7 percent area.

Now if you don't like that idea, I think we ought to bias it differently and just move these aggregates ranges down, depending on whether it's [alternative] A or a B or C. I wouldn't use A at all. I would just move the aggregates ranges lower if you want a wider range [for the funds rate] and then bias it in that direction but I prefer the other. I might say in that connection that New York for some reason has a substantially lower estimate for M1 and M2 for this particular period than the Board this time. I don't attach great weight to either of them but it is true that that estimate is substantially lower this time.

CHAIRMAN MILLER. Gentlemen, I don't know what your procedures are but maybe I can make a couple comments on how I see the situation and maybe I can be helpful. It seems to me that any lowering of the funds rate bracket would be inconsistent with the views that I've been expressing and would, therefore, not be in the direction I would want to go. It also seems to me that going to higher targets for the federal funds rate right now might be premature in view of all the other considerations around. I am sympathetic to the idea of a steady course at 6-3/4 percent, but I think a range of 6-3/4 to 7 is a little unworkable. I would prefer to use 6-1/2 to 7 percent and administer it at 6-3/4 percent, with consultation before allowing it to go below that as we did recently when we maintained [the 6-3/4 percent rate] even though the aggregates were below the range. A second point of view is probably quite consistent with your last point, Paul. I do think that it would be healthy to have M1 at least, and maybe M2, more toward the alternative C ranges than the B ranges. So I tend to have, as I expressed it at a recent Board meeting, a B+ attitude. I would be a little more comfortable with [the ranges for the aggregates] if they were reduced some; I don't know how far. But I do like the idea of keeping the federal funds range at this point at 6-1/2 to 7 percent, but targeting the [rate at] 6-3/4 percent without some additional consultation. I don't know if that's helpful to you.

VICE CHAIRMAN VOLCKER. If I may just add one further bit of clarification. You say don't put the rate below the 6-3/4 percent without consultation; that is certainly a point I would agree with. Suppose the aggregates come in high? Do you also feel we shouldn't move it above 6-3/4?

CHAIRMAN MILLER. Oh, no. I think I would allow it to go above. I just wouldn't allow it to go below because of the worry that I feel about the inflation situation.

VICE CHAIRMAN VOLCKER. In practice you're precisely where I am.

CHAIRMAN MILLER. That's what I think. I think that if we could administer it that [way] we would have a better program.

MR. PARTEE. And you're recommending the alternative C ranges for the aggregates?

CHAIRMAN MILLER. Well, I'd like to hear a little discussion. I think the M1 in alternative C would be better. Whether it makes any difference in M2, I don't know. I probably would take alternative C on both M1 and M2 and alternative B on the federal funds rate. That's my viewpoint. Now, in the order people have indicated [a desire to comment], I call on Phil Coldwell.

MR. COLDWELL. Mr. Chairman, I'm not too far away from you and Vice Chairman Volcker on this, with perhaps a slightly different twist to it. I would take Paul's 6-3/4 percent lower limit on the federal funds rate and put the top end up to 7-1/4 percent. I would take your alternative C as a guide to M1 and M2, mainly because I think we need to take advantage of any kind of window we can get toward lower aggregates growth. I think we're going to be faced with higher aggregates growth; and there's no point in getting socked in with more of these spikes if they come along after the seasonal adjustment. I don't know, Steve, whether you've ruled them out or not. But I would prefer that we take this kind of a measure now. In effect, it's a slight tightening of the posture of the Committee, [which I favor] because I see inflation as being our biggest problem over the months ahead and I'd like to get a leg up on it.

CHAIRMAN MILLER. Phil Jackson.

MR. JACKSON. I differ in the judgments that have been expressed. It is my view that if we were to get the third month in a row of relatively slow growth in the aggregates this, first, would be a signal to the international exchange market about the consequences of Federal Reserve actions, which would produce a lessening pressure on the value of our dollar. Second, I would say that if we got the third month of slow growth which is anticipated in April--that's what we're really talking about--this would tend to bring in to more valid question how strong underlying economic circumstances are. Further, I think that a change of 1/4 of 1 percentage point is not a major policy change when it's sustained by aggregate facts which would be known to the public, and for that reason I would favor an aggregates directive. However, when it comes to the ranges, I would favor

the alternative B lower [limit] of 4-1/2 [for M1]. It strikes me that the top figure ought to be 8 not 9. We have just seen that the staff has proposed a major shift in the seasonal adjustment for April. What was it, 5.6 percent, I think?

MR. AXILROD. Around there.

MR. JACKSON. In that light, if we kept the 9 and if the 4.6 projection for March stays constant, this would mean that April could go to 13.4 percent before we'd see any change in the Desk's attitude. It strikes me that that's too high, particularly in light of the seasonal adjustment that we've already got. And while I realize bringing 9-1/2 down to 8 is still going to allow a substantial growth in April, it strikes me that that's the better course of action for that reason. I'd say 4-1/2 to 8 percent [for M1]; the 6 to 10 percent I think is probably a reasonable projection [for M2]; and I'd go with the 6-1/2 to 7 percent for the federal funds rate.

CHAIRMAN MILLER. Henry Wallich.

MR. WALLICH. I feel that the good days of stable interest rates are approaching an end. We have a strong month, as far as prospects for M1 are concerned, ahead of us. Of course, this may turn out to be wrong, but I share Phil Jackson's thought that the seasonal adjustment which has already been applied in order to pull [April's growth rate] down ought to make us aware that this may be a very strong month without showing itself. And I look at the interest rates that are projected over the rest of the year in Appendix 2. Now, this calls for alternative B if things turn out that way--a 1-1/4 percentage point rise over the rest of the year. And we don't get there by sticking at a 6-3/4 percent fed funds rate indefinitely. I would wait, certainly, until the evidence is in on a strong April; but with that in mind I'd lower the M1 range to 4-1/2 to 8, which I find desirable. Anyway, I prefer narrower ranges. I'd set the funds rate range at 6-3/4 to 7-1/4, with instructions to the Manager not to go to the midpoint of that until two more weeks of data are in so that we don't make a false move by chance. But if the data develop as expected, then an upward move will be triggered after a while, and I think we have to--painful as it is--make a start on getting the funds rate up. I haven't said anything about M2; I would move that to 6 to 9 instead of 6 to 10. And I'd go with an aggregates directive, always bearing in mind that the instruction is not to move for the first couple of weeks.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. You and Governor Jackson have expressed my opinion. I think the federal funds range should be 6-1/2 to 7, with the arrangements you have explained on consultation. And I've felt for some time that our ranges are too large. We moved to 6 percentage points and we're now down to 5, and I think we could take another cut. I would endorse the view that we should cut the range for M1 to 4-1/2 to 8 percent.

CHAIRMAN MILLER. 4-1/2 to 8?

MR. EASTBURN. I meant 4-1/2 to 9 percent and 6 to 9-1/2 percent. I'd cut 1/2 point off now and maybe take another cut later on.

CHAIRMAN MILLER. Thank you. Willis.

MR. WINN. Well, I think I'd be a little stronger in my cutback on the [ranges for the] Ms in view of the adjustment factor we put in [which] makes comparison very difficult over time. I would go to 2 to 7 on the M1 range and 5 to 9 on the M2 range. We certainly don't move against forecasts, but I'd surely move if the evidence came in because as I look down the road, like Henry I think we've got to face the unpleasant task [of moving the funds rate up] and I'd rather move earlier than later [given] the magnitude of the problem. But I'd go to 2 to 7 and 5 to 9 in view of the seasonal adjustment we've put in there because the comparisons really are going to be quite extreme.

CHAIRMAN MILLER. Bones.

MR. KIMBREL. I, too, am very much concerned about the inflation and inflationary expectations that we've encountered, and I think we ought to take advantage of this opportunity to move--maybe not aggressively, but certainly there's the opportunity for some modest move. Playing with the numbers I guess I, too, would like to close the range some so M1 I'd maybe put at 4 to 8 percent; I have no objection to 5 to 9 on M2. For the federal funds rate, I would very much dislike seeing the rate sink below 6-3/4 percent but again, hopefully, it would not move above 7 unless we had some additional numbers [and the need to move it up] became apparent. So, I would like to see a 6-3/4 to 7-1/4 percent range, with some modest leaning upward.

CHAIRMAN MILLER. Larry.

MR. ROOS. Mr. Chairman, I would recommend an M1 range of 4-1/2 to 8 percent, an M2 range up to 8-1/2, a federal funds range of 6-1/2 to 7-1/4, and an aggregates directive. I might just say that this is the sweetest music I've heard as far as the aggregates are concerned in some time, Mr. Chairman. I think that it's vital that we are willing to be flexible in letting interest rates rise if need be in order to accomplish what we all seem to be aiming for in the aggregates. We happened to review the Bluebook of March 1977, which was just a year ago. At that time we set quite delightful aggregates targets. The Bluebook projected a growth of 5-1/2 percent in M1 for the year and, as you know, the figure has come in instead of 5-1/2 percent at 7.8 percent--and I think it's essentially because of our emphasis on keeping the lid on interest rates. What I'm pleading for, sir, is that after we set these targets for the aggregates on a sensible basis we really do what is necessary to achieve those targets in the months and years ahead.

CHAIRMAN MILLER. Thank you. Ernie.

MR. BAUGHMAN. Mr. Chairman, my preference is for the aggregates specified in alternative C and for a federal funds range of 6-3/4 to 7-1/4 percent and an aggregates directive. I could be persuaded, however, along the line of Paul's comments, to go 6-3/4 to 7 on the federal funds range if it looks like going as far as 7-1/4 would disrupt the market.

CHAIRMAN MILLER. Frank

MR. MORRIS. Mr. Chairman, I like your specifications--I think they're very suitable for the situation--with a money market directive. I say that because I am uncertain as to just how strong the economy is. Therefore, I think we ought to essentially have a stand pat philosophy until we can get a better fix on it. On the other hand, if we do get a very strong rate of growth in the aggregates in April, I think this would be prima facie evidence that our projections of a strong rebound are probably right and, therefore, I wouldn't object to going up to 7 percent under those conditions. And I wouldn't mind cutting back the upper limit [of the range for M1 and M2] somewhat as long as it didn't mean that we would be moving up on a fairly small or moderate rate of growth in the money supply in April.

CHAIRMAN MILLER. Bob Black.

MR. BLACK. Mr. Chairman, my statement is distinguished only in that I've got slightly different figures.

CHAIRMAN MILLER. That's the purpose of having big spread sheets.

MR. BLACK. I can find all the figures I have in mind, but not in exactly this combination. I would lean toward an aggregates directive and I would prefer a funds range of 6-1/2 to 7-1/4. And if we do that, then I think M1 might appropriately be set at a range of 4 to 8 and M2 at a range of 5 to 9. If we settle on a money market directive, I would want to [lower] those ranges since the trigger point is somewhat different under the money market directive--that is, we don't react until we are approaching or moving beyond the upper limits. So I would want the M1 range there to be [4] points, 3 to 7 percent and 4 to 8 [on M2] with 6-1/2 to 7 on the federal funds range.

CHAIRMAN MILLER. John.

MR. BALLES. Well, I share the view that all the specifications of the aggregates are too high. In fact, by coincidence, I had put down the same numbers as Willis Winn. I'll join him in suggesting M1 in a 2 to 7 percent range and M2 in a 5 to 9 percent range. And for reasons that have been set forth in detail, and that I agree with in view of accelerating inflation, I would make the federal funds range 6-3/4 to 7-1/4.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Well, I don't take great exception to the figures that are being cited, but I certainly do to some of the language that's being used. I don't think this is a good time to take advantage and move. What have we learned? We've learned that this morning the fourth-quarter GNP has been revised downward for the second time and that the first-quarter GNP will be at best 3-1/2 percent and could well be below that. We don't know whether the coal strike is settled or not at this point. What we see, as Frank pointed out earlier, is weakness in numbers that we have on the economy at this point. And I just don't think the public would understand at all our talking about seeing this as an advantageous time to move up interest rates. Now, if we're forced to move up interest rates because the aggregates are strong, that's a different matter. But I think that's the only basis that we have right now for contemplating any kind of tightening move.

I don't much like to look back and say: Well, what would growth have been with the old seasonal? If we do that, you know, we're playing a game all the time. What is the real number? Will it please stand up? If you look back at the old seasonals, you would say that February was very weak because, after all, we added 3 points to February with the revision in the seasonal factor. I do think it's possible to say that, having made corrections to the seasonal factors, we now should regard a strong month as a more serious proposition than a strong month was previously. And in that sense, a substantial burst in the money numbers in April--which is strictly a projection on the part of the staff because they don't have any data whatsoever but only the instinct that the numbers are likely to move up--would be a damaging development and one that would give us a basis for tightening a bit. And I think that's what we have to ride on.

I also don't like the idea of cutting these ranges as much as has been suggested pretty generally because I don't know that we have a more stable series than we previously had. If you look at the seasonal factor adjustments for last year for M1--the seasonal factor adjustments alone without regard to sign--you'll find that the average error was over 2 points. That isn't the kind of situation in which we should significantly narrow the ranges that we're asking the Manager to look at because, as Chairman Burns used to say, 4 is really 8 in this series. And there is a lot to be said for that--4 may be 8 and 8 may be 4. I think we've just had a very fine demonstration in those seasonal factor adjustments, if in fact, they are correct. However, I would be prepared on this occasion, because we are dealing with the possibility of a large April, to reduce the range to 4 points. Since we have a relatively moderate indication for March, we have to guard against the possibility of a quite large April. It's not a question of a small number as against a large number, but of a moderate number presently projected for March and then a possibly large number for April. Also, I think perhaps a little bit of bias in the specification of the aggregates might be prudent at this time since we are so concerned about inflation and the possibility of a new upsurge in the aggregates.

The ranges I put down are 4 to 8 for M1, which is the same as yours, Mr. Chairman, except that I cut a point off the top. And I think I would want the M2 range to be narrower than the M1 range. I would put that at 6 to 9, which is a reasonable rate of increase. I think our experience [suggests] that we ought to have a somewhat smaller range on M2 as a matter of convention than

on M1. And 6-1/2 to 7 is okay by me on the funds rate. Even with that narrow funds range, I would recommend an aggregates directive because I think our posture--if it is true that we're into a period where we're likely to be coping with large aggregates and upward pressure on interest rates--is better with an aggregates directive than it is with a money market directive.

CHAIRMAN MILLER. Thank you, Chuck. Mark.

MR. WILLES. Thank you, Mr. Chairman. I came to this meeting prepared to be an outlier, and I find that I am very comfortably in tune with a large number of my colleagues.

CHAIRMAN MILLER. Oh, this is a good group.

MR. WILLES. I would make just one comment. I agree with everything that has been said. I think Governor Wallich gave my speech much better than I was prepared to give it. And I find great comfort in the fact that Chuck just gave almost the same speech. And that's a rather unusual occurrence.

CHAIRMAN MILLER. We have a lot of discipline around here.

MR. WILLES. I think 8 is the top number that I'd like to see on M1. I'm really not too concerned what we make the bottom; 4 is fine with me. Frankly, I really don't care much about M2 because I'm not sure in the current environment that it means very much--or at least I don't understand what it means. I would have a preference for 6-3/4 to 7-1/4 on the funds rate with the same provision that Governor Wallich mentioned.

The only additional comment I would make is that we have all expressed the hope that by taking this kind of action we can deal with the inflation problem--which we all seem to understand as the number one problem--and somehow simultaneously not aggravate the unemployment problem. My guess is that by taking this action today we may well be, if we persist, increasing the risk that unemployment will be as Chuck has suggested. I for one am willing to take that risk, but I think we should do that knowing that that's the course that we're embarked upon.

CHAIRMAN MILLER. We haven't heard from Bob Mayo. Would you like to comment?

MR. MAYO. Yes, Mr. Chairman, thank you. I thought up until this meeting that I was perhaps the greatest cynic around the table on seasonal adjustment. I think Chuck has challenged my self-established description. But I do feel that on the monetary aggregates we have a lot to learn yet on how we make seasonal adjustments when year after year, even with the adjustments that have been made recently, we still have undulation with regard to the first month of each quarter. Therefore, I feel like Governor Jackson that it would be much better to have an 8 percent top on the M1 range; whether the bottom is 3 or 4 is immaterial to me. I think we proved last month that we probably would have been better off with a zero than the 1 that we came out with,

but that's neither here nor there. As far as M2 is concerned, again 5-1/2 to 9-1/2 or even 5 to 9 is all right with me.

I seem to be about the only one around the table who feels that a money market directive would be the more appropriate stance at this point, although I don't feel that strongly. I think we are aiming for a continuation of 6-3/4 percent [on the funds rate] unless something really gets out of line. So, why not say it? I feel very strongly, Mr. Chairman, that your description of the 6-1/2 to 7 on the federal funds range is correct. I would not want to change that, not only for the reasons that have already been mentioned, but I have somewhat of a PR reason that may not be significant. You would be the only one probably to pass final judgment on that, but 6-1/2 to 7 is where we are. I think there is enough uncertainty as we look at the outlook today--I share some of Frank's views on this--that I would not want it changed because there may be weaknesses we're not sure of yet. You would be in better shape, in my book, going up to testify right after the minutes of this meeting are made public, if you were testifying in an environment where we had made a decision today to stick with a 6-1/2 to 7 percent federal funds range.

CHAIRMAN MILLER. Thank you. Roger, would you like to add any comments?

MR. GUFFEY. Just briefly, Mr. Chairman. Thank you. I would prefer to have the alternative C aggregates--that's the 4 to 9 [for M1]--particularly if we have an aggregates directive. If I understand how that is viewed by the Desk, that would trigger an upward or a downward movement someplace within a percentage point of the outside of those ranges. So it doesn't seem to me to make much difference whether we're talking about a 4 to 8 or a 5 to 9 percent range, if in one case with a money market directive we use 4 to 8 and if with an aggregates directive we use the 4 to 9. In other words, [action by] the Desk is going to be triggered at the same point. As a result, I would prefer to stick with the C aggregates, with an aggregates directive--maintaining, however, a federal funds range of 6-1/2 to 7 percent. I share the view of Paul Volcker and many others that we should not go below the 6-3/4 present level unless there are very unusual circumstances. The thing that bothers me a little bit, remembering back to both '76 and '77 again, is that we got very strong growth in the aggregates in April of each of those years. To my knowledge there's never been a very good explanation of those. Soon thereafter the growth rates returned to much lesser levels. I guess I am concerned that with an 8 percent top, for example, and with an aggregates directive, we may be taking action that is really not appropriate. That is, the aggregates may not be telling us what we think they are because we've not been able to explain what has happened in past years. So in summary, I would go with the C aggregates, with 6-1/2 to 7 and remaining at 6-3/4 percent [on fed funds].

CHAIRMAN MILLER. Thank you. Alan would you like to make any comments?

MR. HOLMES. No, I don't think so, Mr. Chairman.

CHAIRMAN MILLER. Steve?

MR. AXILROD. No, I have no comment, Mr. Chairman.

CHAIRMAN MILLER. Do you have something else?

MR. BLACK. You have no comment or none you would like to make?

MR. AXILROD. I didn't know whether you were asking for an opinion on the policy.

CHAIRMAN MILLER. I'll take an opinion.

MR. AXILROD. Well, Mr. Chairman, my view would be that it would be desirable to lower the top end of the M1 range just to guard against excessive growth beginning without any response on the part of the Committee. I would not in any way really want to lower the bottom of the range because I would be somewhat fearful that if we had three straight months of low growth, as I believe Governor Jackson mentioned, that would indicate either that the economy was not as strong as we expected or that Federal Reserve policy was going to restrain growth below what is desirable.

MR. HOLMES. Mr. Chairman, may I make one comment? It's not quite clear to me what funds range the Committee is going to pick but I gather with 6-1/2 to 7 that we don't go below 6-3/4 percent without consultation. I'm not quite so sure with 6-3/4 to 7-1/4 whether we don't go above 7 without consultation. I ask because some members have expressed some reluctance to move very much on the upside unless the aggregates were extremely strong.

MR. PARTEE. What is the midpoint of that higher range, Alan? What do you interpret to be the midpoint of that higher range--7 percent?

MR. HOLMES. No, I'd say we'd [view it as] 6-3/4 percent unless the aggregates tell us to move up. That's for the Committee to decide but that's the way I would interpret what I've heard today.

CHAIRMAN MILLER. May I just [review] the bidding? Did I hear any FOMC voting member ask for a money market directive? There were several who didn't speak [to that]. Phil, did you have any preference?

MR. COLDWELL. No, I think I would stay with the monetary aggregates directive this time, Mr. Chairman.

CHAIRMAN MILLER. Dave could you--

MR. EASTBURN. I would agree with that.

CHAIRMAN MILLER. Mark?

MR. WILLES. I agree with you.

CHAIRMAN MILLER. Willis?

MR. WINN. I agree.

CHAIRMAN MILLER. That looks like one thing we've decided; there's a very large groundswell for the aggregates language. The next thing one might observe, looking this over, is that everybody uses [different] numbers and words and they all seem to come out to 6-3/4 percent on the federal funds rate. On the other hand, there seems to be pretty good sentiment that we should clip down some of the range on M1 and I gather on M2. Steve, I didn't quite understand your point. You said you wouldn't like to see the lower end reduced. Are you talking 4-1/2 or 4?

MR. AXILROD. I had in mind 4-1/2 but the difference is very small, so it's not a matter of much importance.

CHAIRMAN MILLER. All right, let me see. On M1, it seems to me that if one were talking 4 to 8, one would catch almost everybody's view on this. It almost looks like the 5-1/2 to 9-1/2 or 5-1/2 to 9 would catch most people on M2. But some would like to start it at 6 and there was only one person who would go up to 10. Almost everybody had 9 or 9-1/2 on the upside and 5-1/2 or 6 on the bottom side. There was one 5. Would it be appropriate to consider 4 to 8 on M1 and 5-1/2 to 9 on M2? And I really think we could live with the 6-1/2 to 7 percent [on the funds rate] with the consultation below the 6-3/4 better than we could the other [proposed ranges]. So it would be 6-3/4 and consult before taking it below that and have complete discretion to go to 7. Now, could we get a consensus on that kind of resolution? I gather that it's unanimous almost. You've got my vote [too] that we should go to the monetary aggregates, so I won't say anything [on that]. I always like to be on the winning side!

MR. COLDWELL. Mr. Chairman, if we follow the formulation you've laid down at 6-1/2 to 7, 6-3/4 is the midpoint and you would stay at the midpoint unless--

CHAIRMAN MILLER. We would not go below the midpoint unless there was prior consultation because of conditions.

MR. COLDWELL. In other words, we would not be taking the flexibility down below to 6-1/2 percent.

CHAIRMAN MILLER. No.

MR. COLDWELL. How about the upside for the 7?

CHAIRMAN MILLER. The 7 the Desk would have [available] at its discretion.

MR. PARTEE. If the aggregates came in on the upside.

CHAIRMAN MILLER. Sure, and with the regular directive.

MR. JACKSON. I'd buy that, Mr. Chairman, because we are in an environment in which we may have a similar posture to what we had a few weeks ago, where our aggregates may tell us one thing but circumstances beyond the aggregates may dictate a different response. I would say that this is a very responsible way to handle it.

CHAIRMAN MILLER. So we put in 4 to 8 for M1 and 5-1/2 to 9 for M2.

MR. WALLICH. Mr. Chairman, we're now constraining the funds rate more than we've ever done, I think, by giving it essentially a 1/4 percentage point range to move in. We've come a long way from saying that the funds rate ought to be reasonably flexible. Reasonably flexible shouldn't be too much in the means of determining market rates and we should look to the aggregates. But here we're moving very far in the direction of a pure interest rate target, just moderately constrained by the aggregates. And it seems to make some sense in the present case; we anticipate an upshoot in the aggregates and we want to have the rate triggered in the upward direction. But in that case I think we ought to have 7-1/4 rather than 6-1/2 to 7.

CHAIRMAN MILLER. You mean 6-1/2 to 7-1/4?

MR. WALLICH. Well, really 6-3/4 but I could live with 6-1/2, subject to not going there without consulting.

MR. PARTEE. I wouldn't be prepared to do that without talking in order to take it above 7 percent. I think we really ought to consult before we go above 7. We may need to do so. [We] biased our specs on these aggregates so that we have a greater chance of being quite high on them, and it gives us an opportunity--

CHAIRMAN MILLER. I think there was a preponderance of members who wanted to keep a 7 percent lid on the funds rate. We still have the range; it only takes a phone call to decide that we've got to have the rates higher. I hope we could agree to do that. May we vote on that basis? Mr. Secretary.

MR. BROIDA.

Chairman Miller	I vote for my proposal.
Vice Chairman Volcker	I vote for that proposal, too.

Mr. Baughman	Yes
Mr. Coldwell	Yes
Mr. Eastburn	Yes
Mr. Jackson	Yes
Mr. Partee	Yes
Mr. Wallich	Yes
Mr. Willes	Yes
Mr. Winn	Yes

It's unanimous.

CHAIRMAN MILLER. There are a few other items of business in this meeting and we may even soon [get] to lunch. I hope you all will join us. Item 9 is the review of the authority for lending securities and there has been a memorandum on the subject both from the System Account Manager and from the General Counsel. Peter is prepared to comment, but I rather think that unless there are particular questions we could get your views by voting. [Someone] moved approval. Is there a second?

MR. PARTEE. Second.

CHAIRMAN MILLER. [Hearing no objection,] we will record that as approved. [Next is a] review of the Authorization for Domestic Open Market Operations. There is a copy [in the memo you received and] no changes have been proposed. However, I think Steve had a comment he wanted to call to our attention.

MR. AXILROD. Yes, at the last meeting there was a discussion of operations in Federal agency issues, particularly with regard to their relationship to their required coverage behind currency and the possibility of developing a two-way market including sales of agency issues. Mr. Sternlight and I are planning to have a joint memo to the Committee by the next meeting, God willing. If we fail that, certainly by May [it will be done] but we're trying for the next meeting.

CHAIRMAN MILLER. Is a vote required on this subject?

SPEAKER(?). No.

MR. BROIDA. Well, yes, on the reaffirmation of the authorization.

CHAIRMAN MILLER. It is required. There is a motion, second. Is there any discussion? Any dissents? We will approve that. Next is the review of the agreement to warehouse currencies for the Exchange Stabilization Fund. We have a memo and Ted Truman is prepared to comment. I'm please to say that after consultation, I find that we do not take any

exchange risk on this warehousing. Therefore, I feel comfortable about doing it to accommodate the Treasury.

MR. COLDWELL. I do not.

MR. PARTEE. We've never done it, though.

MR. COLDWELL. We haven't done it and I don't like the idea in our exact current environment, where we're questioning whether the Treasury is going to fulfill its responsibilities in this action, that we have a warehousing arrangement which they can push off on us.

CHAIRMAN MILLER. Even if you have a legal opinion that they're liable for the risk?

MR. COLDWELL. Yes, even if I have a legal opinion. [We're] not only asking for a future payback to us but also going to warehouse their foreign currencies.

MR. TRUMAN. The Treasury doesn't hold any foreign currency; it would be hard to warehouse any.

MR. COLDWELL. No, but if they bought something, warehousing puts them over here and they'd be made whole, wouldn't they?

VICE CHAIRMAN VOLCKER. Not under risk.

CHAIRMAN MILLER. Not under risk, no.

MR. COLDWELL. But we would be holding their foreign currencies.

MR. WALLICH. Let me say, Mr. Chairman, this is quite the opposite operation from what we're talking about. This is one where the Treasury is a lender, not a borrower. Second, I really don't see any reason to believe that the Treasury will renege on an arrangement that it has made with you, even though verbally, and that we're now going to confirm in writing. And third, I don't know why we should quite needlessly--abstractly, it seems to me--irritate them by informing them that we're terminating this thing. If they've lent to Mexico, say, and we think it is a bad thing for them [to lend to] Mexico--we have not been in on the deal--and they come to us after a year and Mexico has [now repaid] they might say please warehouse [these funds]. That is the situation foreseen. We can still talk to them about it. We're not, I think, ironclad bound to make that transaction.

MR. PARTEE. Is this [like] the British deal, Henry? Was this done for the British?

MR. HOLMES. Mexico.

MR. WALLICH. Could be on [unintelligible] it was also on the British.

MR. TRUMAN. It was reinstituted the same time we were discussing this German balance agreement. There has been a warehousing provision in the foreign currency authorization since 1963. When we cleaned up the authorization, although the power to warehouse remains in the authorization, the explicit numbers associated with the warehousing were removed. And therefore, at that time, in light of the sterling balances, an agreement was negotiated. Twelve months ago, there was this exchange of letters, but it was not intended to be anything more than a confirmation of what had been practiced now for 15 years.

VICE CHAIRMAN VOLCKER. I would think the typical contingency--there could be all sorts of [cases] where you might want to use this--is where we wanted the Treasury to join with us in some lending. And they say we can't do it because we haven't got the money. And we would want the facility to say we can provide the money; you take the risk, we'll provide the money. It would make possible an action we want them to take rather than that they're foisting off something on us that we didn't like.

MR. JACKSON. Mr. Chairman, I feel very strongly about wanting the Treasury to share the burdens of operations on our part abroad. And I have been outspoken in that view. However, I don't see this proposal as being destructive of that objective. On the contrary, it strikes me that in the event the Treasury were to make a loan itself to some other country this proposal--by being able to replenish their funds with a warehousing arrangement with us--would enable them perhaps to stay in as our partners in support of our position instead of having to refuse to [join] because [the Exchange Stabilization Fund] doesn't have any money. For that reason I would support this. I don't think this is contrary to the attitude of keeping their feet to the fire over on the other side.

CHAIRMAN MILLER. Is there a motion to approve? Is there a second? Would all those in favor raise their hands please? Opposed? One vote opposed?

MR. BROIDA. Yes. Governor Coldwell.

CHAIRMAN MILLER. Item 12 is the review of the Authorization for Foreign Currency Operations, the Foreign Currency Directive, and the [Procedural Instructions]. No changes are proposed. Is this a required vote? This is moved. Is there a second? Any discussion?

MR. COLDWELL. There was a change made in the Procedural [Instructions].

MR. BROIDA. These are the others.

MR. WALLICH. How about the authorization that we have raised from--

MR. BROIDA. Oh, I see.

CHAIRMAN MILLER. So, is there any dissent from approval? Then we'll record it as approved. Next is confirmation of [the date of] the next meeting, which is April 18. Unless there is other business, I would suggest that we adjourn for lunch. Thank you for your patience.

END OF MEETING