TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

September 19, 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. Meek, Monetary Adviser
Mr. Axilrod, Economist

Meeting of Federal Open Market Committee

September 19, 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, September 19, 1978, at 9:30 a.m.

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

Messrs. Balles, Black, Kimbrel, Mayo, and Timlen, 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. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Mannion, Assistant General Counsel
Mr. Axilrod, Economist

Messrs. Burns, J. Davis, Ettin, Kaminow, Keir, Kichline, Paulus, and Truman, Associate Economists

Mr. Holmes, Manager, System Open Market Account

Mr. Pardee, Deputy Manager for Foreign Operations

Mr. Coyne, Assistant to the Board of Governors
Mr. Kalchbrenner, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Siegman, Associate Director, Division of International Finance, Board of Governors
Ms. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Balbach, T. Davis, Eisenmenger, Parthemos, and Scheld, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Kansas City, Boston, Richmond, and Chicago, respectively

Messrs. Brandt, Fousek, and Keran, Vice Presidents, Federal Reserve Banks of Atlanta, New York, and San Francisco, respectively

Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York

Ms. Clarkin, Securities Trading Officer, Federal Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting of
September 19, 1978

CHAIRMAN MILLER. We're missing a couple of people, but it is 9:30 so I think we will proceed. I think the most important order of business this morning is to welcome Nancy Teeters to the Board of Governors and to the FOMC. It's very nice to have your first full day at the Federal Open Market Committee meeting; my first day was testifying before the House Banking Committee. I think you're going to have a more pleasant day than I had, but I hope you've done as much homework as I had to do.

MS. TEETERS. I've done quite a bit of homework.

CHAIRMAN MILLER. Well, it gets worse. I would also like to say, Larry, how pleased we are to see you back [though] with your cane. It was probably the low point of humor last night--I won't give any attribution--when they said that was because you were a Keynesian. I thought I would not really be able to have [your] support. Nonetheless, [we are pleased with] your rapid recovery. The fact is that we missed you last month and are delighted to have you back. If you vote right for a couple of times, we'll see that you don't get injured further! Welcome to you both.

The agenda is before you, I believe, and the first order of business is approval of the minutes of the Committee meeting of August 15 and the telephonic meeting of September 8. That has been circulated for comments and corrections. Hearing [none,] those will stand approved. [Next is] a report on foreign currency operations since the August 15 meeting. Scott Pardee.

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

MR. WALLICH. Is it possible to so look toward future operations as to make it plausible that the Treasury and the Fed will get out of debt at about the same time--that we are more or less in step in terms of the 50-50 on new drawings and 60-40 on when we purchase D-marks?

MR. PARDEE. It will be closer than it was before now that we are drawing on the basis of 50-50 but we are repaying on the basis of 60-40. Rounding it off, we have about $700 million left.

MR. WALLICH. That's 7 to 3 and we're repaying 6 to 4; it’s closer than it was before. It would be hard to calibrate it so we'd both be out of debt at the same time. It's not unreasonable to say that that's a possibility.

MR. PARDEE. It's close, yes.

MR. JACKSON. We've gone through a number of actions and announcements, and so forth, and seen the consequences of them. Do you have a judgment as to whether or not future actions of a similar character or scope would have any impact on the marketplace? In other words, I'm really asking your judgment as to whether or not we're about to run out of so-called announcement effects and whether the only possibility we have is some more substantive long-term solutions. Or would actions similar to those we've taken in recent weeks still have some impact on the exchange market?

MR. PARDEE. This is a very difficult question because the market is now so pessimistic, so bearish, and so negative on everything that comes out. It's not everybody; many people out there feel as we do that the dollar is oversold, unrealistically low, undervalued--all of the terms that we bring out under these circumstances. But there are so many bearish people who have an economic stake in having a lower dollar. That is, they have short positions in dollars and they're prepared to throw big money [out there] to maintain those positions and make their profits. It's a very speculative atmosphere in the exchange market [and it's] not only the banks. You have the IMM in Chicago and you have some pretty big corporations in Europe; I don't necessarily see much from the U.S. [corporations]. And, of course, the last two days there have been rumors about Middle East money, following the Camp David [meetings].

So it's hard to know. There's this speculative atmosphere. How are we going to persuade those fellows that they can't make profits by selling dollars? I think the approach that's been taken this time of a sequence of things, which are clearly positive themselves but not necessarily sufficient, at least has kept the market off balance. The dollar is higher than it was in the middle of August. The atmosphere is not as horrible as it was at that time. So there is a feeling that the U.S. government does care, President Carter cares, and the Federal Reserve and the Treasury are taking steps and have taken steps. But now you come to the hard part of your question. Well, they haven't done enough. This is where we come back to the energy program and really [coming to] grips with inflation. Until we have some positive numbers, a combination both of trade and price figures, I think we're going to have a bad market. In July the market jumped on us when we had good trade figures and poor price figures; in August they jumped on us after getting good price figures and poor trade figures. What we need is a month in which both the trade and price figures are better.

CHAIRMAN MILLER. Larry.

MR. ROOS. Scott, assuming that this gas bill passes--and there's been a lot of difference of opinion as to whether or not the energy package is really important--what would be your thinking as to the effect on the dollar? And how long-lasting will that effect be if next week this package passes?

MR. PARDEE. I think it will help, and it may give [the dollar] a brief rise. But I'm disappointed in the reaction of the market to the Camp David [outcome]. They were all focusing on it, speculating up and down last week. And then when it went through positively, for all intents and purposes, the dollar is now lower than it was before. So it will help in the long run to get this whole controversial issue out of the way and in the short run perhaps will give a lift to the dollar but, until we get some good numbers, I think that will pass very quickly.

CHAIRMAN MILLER. Bob Mayo.

MR. MAYO. I had the same question.

CHAIRMAN MILLER. Thank you very much. Now we'll turn to action to ratify the transactions since the previous meeting. You've all had the packet on transactions. Are there any questions or comments? May I have a motion to approve?

SPEAKER(?). I move.

CHAIRMAN MILLER. Second?

SPEAKER(?). Second.

CHAIRMAN MILLER. Any discussion? All in favor say “aye.”

SEVERAL. Aye.

CHAIRMAN MILLER. Opposed? So voted. Now we’ll turn to consideration of the Manager's recommendation with respect to foreign currency operations. Alan Holmes.

MR. HOLMES. Well, Mr. Chairman, there is for once not much in the way of swap drawings maturing before the next meeting of the Committee. We have one swap drawing of $35 million equivalent of German marks maturing in early October. This will be the second renewal. We have two Swiss franc drawings totaling about $13 million equivalent maturing in early October also, both representing first renewals. I recommend that the Committee agree to roll over these three swap drawings at maturity should we not be able to acquire sufficient foreign exchange to pay them off. I think there's a good chance we will, but in these days I don't want to make any forecasts.

CHAIRMAN MILLER. Fine. You've heard the recommendation. Is there any discussion? Henry.

MR. WALLICH. Mr. Chairman, I continue to think that we ought to have a program of gradually but steadily buying [foreign] exchange as we go. We're working on how to devise this so it doesn't lead to adverse consequences but I'd like to urge the Desk again, whenever there is a reasonable chance to pick up some exchange in the market--if the market is rising and it wouldn't seem to the market that we were putting a lid on the advance--to take advantage of the opportunities.

MR. HOLMES. Governor Wallich, at the moment we have almost enough marks to pay off this swap drawing. But goodness knows what is going to happen tomorrow or the next day.

CHAIRMAN MILLER. We may have to use them.

MR. HOLMES. That's precisely the point.

CHAIRMAN MILLER. Is there a motion to approve the recommendation?

SPEAKER(?). So moved.

CHAIRMAN MILLER. Any further discussion? All in favor say "aye."

SEVERAL. Aye.

CHAIRMAN MILLER. Opposed? So voted. Thank you very much. We'll move from the international to the--

MR. HOLMES. Mr. Chairman, I have a couple of other recommendations.

CHAIRMAN MILLER. You have a couple of other things, excuse me.

MR. HOLMES. As of October 5th our swap line with the Bundesbank will have been in continuous use for twelve months although specific drawings under the swap lines have been repaid well before [they had been outstanding for] a 12-month period. While paragraph 1C of the Authorization for Foreign Currency Operations in my mind is not exactly crystal clear, it has been interpreted as requiring Committee approval if a swap line--I'm not talking about drawings but this is a line itself--is in continuous use for more than twelve months. I request that approval.

CHAIRMAN MILLER. Otherwise, we could be in default?

MR. HOLMES. Otherwise, we'd be in a little problem, except I believe that that [paragraph] can be interpreted somewhat differently.

CHAIRMAN MILLER. Any discussion?

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN MILLER. All in favor say "aye."

SEVERAL. Aye.

CHAIRMAN MILLER. Opposed? So voted. Alan, you also are going to discuss the possible terms of renewal?

MR. HOLMES. Mr. Chairman, I'd like to do that quite briefly. At the last meeting, Scott Pardee referred to the proposals that Dr. Gleske of the Bundesbank had made to alter the terms of our basic swap agreement. We will be presenting the Committee with a memorandum containing detailed suggestions within the next few days but at the risk of being a bit premature, I would like to preshadow the suggestions that will be made.

First, Dr. Gleske proposed that the 50-50 profit-loss sharing provisions be eliminated. I happen to share this view for three basic reasons. Except for our current drawing on the Bundesbank, this provision has meant a sharing of profits, not losses, from our point of view. The net dollar and cents value of the provision to the Federal Reserve and Treasury has really been quite small. Second, the fact that the 50-50 ratio applies to our drawings on foreign central banks but not to foreign central bank drawings on us has caused some resentment, I think you'll understand, on the part of our partners in other central banks. Third, when we undertake coordinated operations in the exchange markets, foreign central banks are taking full risk on their operations, which are usually much larger than ours, and half of the risk on our operations. Since most central banks in the swap network are already taking very large losses on their old dollar holdings apart from current acquisitions they are obviously not particularly happy with the 50-50 arrangement.

Now, it can be argued that there are political advantages to the 50-50 arrangement and I understand that in discussions Governor Wallich has had with Treasury, the latter is not prepared to agree to this change, at least at the present time. I believe we should continue discussions with the Treasury and, if the Committee should agree, move at an appropriate time. Finally, in negotiations in Basle, Governor Wallich was able to elicit agreement on the part of Dr. Gleske to withdraw his proposal to eliminate the 50-50 provision. The matter is, therefore, not a matter of controversy between the Bundesbank and us.

Linked to the elimination of the 50-50 provision was a proposal that the Bundesbank would receive interest on the dollar counterpart of our swap drawings at German interest rates rather than U.S. interest rates. At current interest rate differentials this would involve substantial savings to the Treasury, much more than offsetting the losses on our current swap drawings. It would also be symmetrical with our own commitment to provide funds under the swap arrangements at U.S. interest rates. I would therefore support Dr. Gleske's proposal in this respect also but I should point out that it will probably be withdrawn if we do not agree to the elimination of the 50-50 clause.

The second proposal of Dr. Gleske is that the current rate of exchange be applied to swap renewals rather than the rate at which the debt was first incurred. This is in accordance with currently accepted market bookkeeping practices and I would suggest that we accept it.

The third proposal is to clarify language in the agreement with respect to obtaining foreign exchange needed to repay swaps in the market whenever possible. This happens to be our current understanding and I see no problem in clarifying the language a bit. It should, however, be linked to clarification of the obligation of the Bundesbank to [sell] us marks directly should there be mutual agreement that they can not be acquired in the market in a timely fashion.

I would hope that the Committee will be able to discuss the Gleske proposals at its next meeting after it has had time to study the forthcoming memorandum, which will be in your hands within a few days. That's all I have, Mr. Chairman.

CHAIRMAN MILLER. Thank you. Paul, you have a particular comment on--

VICE CHAIRMAN VOLCKER. Well, I happen to agree with the logic of what Alan said on the 50-50 business. I think it's always been something of an anomaly. I have the feeling that it was a lot easier to sell, particularly to the U.S. Congress, that way and that's a pretty persuasive reason. But if that reason has relaxed in any way, I would support the notion of making the agreement conform to the logic of the situation. In principle I think we intervene when we think there's an expectation of a profit anyway and it should work out for our financial advantage over a period of time. I recognize that if it's too difficult politically, that has to remain the persuasive element for the moment, but over time I would like to see this made more symmetrical.

CHAIRMAN MILLER. Henry, do you have any comments?

MR. WALLICH. I think, Paul, this is reasonable. There's a relationship of the interest rate and the expected change in the exchange rate, which in equilibrium offset each other. That is, the German interest rate is 3 percentage points lower than ours, there's an expectation in the market that the D-mark will appreciate by 3 percent over a year, and so if we pay the German rate, we can afford to take the full loss. We take 50-50 on any loss of the exchange rate; we ought to have a 50-50 rate on the interest rate also. That's what I've been criticizing at times--that we were paying the U.S. high interest rate and yet we're getting the 50-50. The full risk should have been on the Bundesbank if we paid the full U.S. interest rate. So I think backing away from the 50-50 is perfectly feasible. It gives me a little pause to hear that foreign central banks are unhappy with it. If they're unhappy with it, it makes you suspect that maybe there's something good in it for us.

The concern of the Treasury I think is genuine; it has to do with making a change in the terms of their swap at a time when the dollar is weak and they are subject to criticism. I think we have to head this [way], but next year when the dollar is strong we could have another go at this.

May I say one more thing, Mr. Chairman, at the risk of running [too long on] this. The EC government wants to homogenize all our swaps. That means bringing up things like the 50-50 and other minor differences, although we homogenized them pretty much last year. Lester said he would try to talk them out of it and seemed confident that changes proposed by the EC government may therefore not come up. Thank you.

CHAIRMAN MILLER. Thank you, Henry. You all will receive a copy of the memorandum and at the next meeting we'll have an opportunity to consider this. I hope, because the next meeting is the meeting for setting ranges, that we will use the interim time [to look carefully at] the memo so that we'll be prepared to respond to this. I think the proposals are reasonable. It doesn't make sense [currently]. The United States should be grown up. If it's going to intervene, it should intervene for its account like other countries and not expect somebody else to share [the risk].

MR. PARTEE. I think it depends partly, Mr. Chairman, on what you think the intervention is for.

CHAIRMAN MILLER. To counter disorderly markets.

MR. PARTEE. Yes, and I think there's an advantage to the counterpart currency as much as there is to the dollar. I think that's the basis of the principle for the sharing. I see no reason to back away from it.

CHAIRMAN MILLER. No, I don't think so, Chuck, because you're just saying split it in two. [When] they intervene in the market and we don't share with their intervention, we don't take half of their risk. It isn't that this is the only intervention. If this were the only intervention, your argument would be sound. The Japanese intervened with how many billions of dollars?

MR. PARDEE. It was in March alone.

CHAIRMAN MILLER. We don't share that. We intervene for $3 billion and we go around and ask like beggars that somebody share with us and it's not the sole intervention.

MR. PARTEE. Yes, but I think that there's quite a different attitude regarding the effect of the exchange rate from the standpoint of the foreign partners as against the United States. And I think the basis for the 50-50 split is perfectly reasonable. Now, I rather agree in principle with the second point that Alan made. It seems to me that when we renew the contract, we might renew it at the current price. But I don't agree with doing away with the 50-50. Now, perhaps the memo will convince me.

CHAIRMAN MILLER. That is our report on the international situation. Now we'll move to the staff's comments on the economic and financial situation and outlook. Jim Kichline.

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

CHAIRMAN MILLER. I would like to suggest [a change in our] procedures this morning. Nancy, in the past we've not only had an opportunity to question and comment on the staff's report, but we've then had a round robin and asked each participant to give his own estimate of real GNP growth over the next four quarters, what price [developments] will be over the four quarters, and what the unemployment rate will be in the fourth quarter out.

I think that it might be desirable today to omit that particular round robin since we've done it fairly frequently on the second quarter. There isn't that much change and perhaps we'll do that quarterly instead of every time. Instead, I would suggest after a chance to comment or question the staff that we just go briefly around and see if anyone has any particular variations or additional points they would like to make from their region or from their own analysis of the overall situation. So are there any questions or comments? Dave.

MR. EASTBURN. Jim, I have a question--or really two questions. One has to do with the Greenbook forecast compared with what I understand to be most of the other forecasts around. As near as I can determine, the Greenbook is more optimistic than any other projection, and I wonder if you would speak to that a little bit. Second, it's my understanding that implicit in your relationships between money growth and velocity and GNP is an assumed fairly substantial shift in the demand for money. And I wonder what basis there is for that assumption.

MR. KICHLINE. On the second one, I feel comfortable in talking about it but Steve has developed some material on that and perhaps he might wish to comment on your second question. With regard to the first question--that is, the Greenbook forecast relative to various outside forecasts--of the ones I've seen I think it's quite correct to say that the Greenbook is more optimistic. One of the questions to be asked is to what extent do the assumptions differ in monetary or fiscal policy or other things and that's not always entirely clear, but I suspect that doesn't account for the major difference. As far as I remember for 1979, for example, both Wharton and DRI are fairly close in terms of the Board's staff judgmental projection for the year in total, but the pattern is dramatically different. Both of those forecasts, I believe, show a sharp decline or very sluggish performance in the first half of the year and then [growth] picking up later on. The Board staff forecast doesn't show that slowdown but shows real growth fading throughout the year.

So, on average, you come out about the same place, but it's really a very different forecast. We, for one thing, are counting upon an impact of the tax cut; I think perhaps we have a little bit bigger fiscal impact there and that certainly accounts for our first half relative strength compared to others. Secondly, we have made judgmental adjustments for what we believe to be a change in consumer spending attitudes. I think a major difference in these forecasts relates to consumer spending patterns. The evidence over the last couple of years certainly isn't conclusive, and things may change, but it does appear to us that consumers have preferred to acquire goods rather than financial assets in this period of inflation. And that characteristic of trying to acquire goods would carry through into the housing market where I think, adjusted for the interest rates we have assumed in the forecast, we have a fairly optimistic housing forecast. So I think those are the major differences. But it's quite clear to us when looking at the other forecasts that we do rank on the optimistic side. Steve, did you want to comment?

MR. AXILROD. Well, Dave, I think I wouldn't describe it as substantial because I've assumed all along that the Committee is aiming at the top of the 4 to 6-1/2 percent range, following the discussion the Committee had when it set the target. If the Committee were aiming at the middle of the range, I believe that you'd have to say there is a more substantial downward shift involved. The downward shift, if you judge it from our quarterly econometric model--which is not the only model that exists in the world--is of modest proportions. It's something like 1-1/2 percentage points, which compares with the shifts in terms of that model on the order of 5-1/2 and 4 percentage points in the early part of this recovery. Of course in the last two years there has been, in terms of that model, almost no shift. It has been predicting pretty well and if that turned out to be the case, at current interest rates--or even at the interest rates we've projected, which are slightly higher--you'd have an M1 growth maybe a percentage point or so above the top of the Committee's range. Our basis for assuming that you'd get that percentage point less [is that as] the interest rates get even a little higher there's encouragement for innovations, apart from the automatic transfers, that will again generate activity on the part of corporate treasurers and also rich individuals to economize on their cash holdings. Now, we assume that activity will be considerably less than earlier in this period. We've assumed some such activity, but it's of quite modest dimensions, really.

CHAIRMAN MILLER. Other questions of the staff? Roger.

MR. GUFFEY. Yes, a question, Jim. We're still puzzled as to how you get the kind of kick in the first quarter of 1979 from the tax cut that is proposed. I assume it's from personal expenditures as a result of lesser withholding, but the figures don't seem to add up.

MR. KICHLINE. We didn't do the arithmetic right?

MR. GUFFEY. No, I guess I'm really asking a question. Isn't it true that the tax cut will be spread more throughout the course of the year rather than getting the kick-up in the first quarter as suggested here?

MR. KICHLINE. There are really three elements I'd like to mention there. One is that our assumption is you do get the equivalent in our case of a $19 billion tax cut at an annual rate becoming effective right in the first quarter. Now, there are offsets. And I think the question really arises with the offsets. With regard to one of those offsets--namely, fiscal drag or the effect of a progressive tax system--that amounts to something like $8 billion or so over the year. But that occurs gradually; it's about $2 billion a quarter. So that doesn't all take effect in the first quarter. The other is social security, and the social security payments are worth, in terms of net tax, something like $9-1/2 billion or so. And the accounting mechanism does indeed make those all effective in the first quarter [rather than] just spread smoothly. In practice, however, and as far as consumers are concerned, that wouldn't occur, because much of the increase relates to an increase in the base from $17,000 to $22,000. And that really would only begin to take effect later in the year. So we've made an adjustment in our own thinking, believing that consumers will see a sizable increase in their disposable income and some of that will filter into spending. We've used our model also, and the model results are roughly consistent with what we have. But I think it's an open question. And it’s clearly one which some of the other forecasters have as much weaker.

CHAIRMAN MILLER. Willis.

MR. WINN. Mr. Chairman, a question and comment. The question, Jim, involves the problems of the seasonality of the adjustments on the new orders of durable goods. The fiscal year shift, you take unadjusted figures and you get a different picture. Yet that's one of the puzzling developments here on the current scene.

My comment, Mr. Chairman, has to do with my role as one of Governor Jackson’s stable boys. I think it's proper to call the attention of the group to the explosion that's taking place in credit in the securities markets and the rapid expansion in the numbers of customers--if you can depend upon the statistical reporting series, which I think is questionable. But there is quite an explosion of activity there and the independent action of the exchanges to raise the margins on certain kinds of securities.

MR. KICHLINE. On seasonal [adjustments], I'm not familiar with any particular problems that have come up. We do look at the not seasonally adjusted data, but quite candidly I don't feel comfortable discussing it in detail now. We can certainly provide a brief memo that would look at those figures more carefully.

MR. WINN. I just wondered if there is something in that that accounts for some of this behavior.

MR. KICHLINE. I'm just not aware of anything. One of the major things you may be aware of deals with transportation equipment. Commercial aircraft orders, for example, have been bouncing all over and have been a major factor in the volatility of that particular series.

CHAIRMAN MILLER. Well, ladies and gentlemen, the staff projections would indicate that from second quarter of 1978 to second quarter of 1979, looking at four quarters, real GNP will grow at 3-1/2 percent and prices on the gross business product fixed-weighted price index will be up 7.1 percent. For the unemployment rate--I believe I'm correct--the average in the second quarter of 1979 would be 5.8 percent. Is that right, Jim?

MR. KICHLINE. Right.

CHAIRMAN MILLER. So those are the kinds of figures the staff is looking at. [For] the fourth quarter of ’77 to the fourth quarter of ’78, they're looking at 3-1/2 percent real growth, 8 percent prices, and unemployment at 5.9 percent. So, those are for the calendar year 1978 and for the four quarters--second quarter to second quarter.

Why don't we mix up the order of batting this time and start down here with Roger and come around this way? I would suggest that so that we can be through [on time]. We found out, Nancy, that the first three speakers take up all the time. We have to start at different places every time or some people would never get a chance to talk! When you start with Governors, it takes particularly long. I try not to start with Governors; they've been schooled in 45 minute lectures or something. Roger.

MR. GUFFEY. I'll break your track record and only say that we did not disagree with the staff's projection other than in the area of price inflation. We think it will be somewhat larger, at or near 8 percent for the year ahead.

CHAIRMAN MILLER. You're talking about to the second quarter of 1979.

MR. GUFFEY. That's correct.

CHAIRMAN MILLER. Thank you. Bob.

MR. MAYO. I would join Dave's comments that the staff projection is a little on the optimistic side. I look for a little more inflation than the staff does and a little less GNP production.

CHAIRMAN MILLER. Thank you. Mark.

MR. WILLES. I'd just say ditto to what Roger said.

CHAIRMAN MILLER. Okay, thanks Mark. John.

MR. BALLES. Well, as has been the case for some months, we expect less real growth and also less inflation than the staff does. We don't expect a stimulative effect on consumption from the tax cut because of the social security offset, the effect of inflation pushing people into higher income brackets, and that sort of thing. That's where our differences really lie.

CHAIRMAN MILLER. You expect less inflation?

MR. BALLES. Yes, because we expect less real growth.

CHAIRMAN MILLER. Thank you. Ernie.

MR. BAUGHMAN. I think the staff projection is quite a reasonable one. Having said that, I think the odds are about 50-50 that they will come out low as high. I think that's where we should try to be. As to potential problems, the main thing that I've encountered is skepticism as to whether we will avoid increasing numbers of bottlenecks--in other words, whether there will be as much elbow room in plant capacity. The staff analysis suggests no real problems in that area; there is concern around that there will be.

CHAIRMAN MILLER. Thank you. Frank.

MR. MORRIS. Well, Mr. Chairman we're still much more pessimistic than the staff and we think that [is supported by] some of the numbers that have come in over the past month. [I'd note] the surprising weakness in new orders for durable goods, which was broadly diffused across all types of orders--it was not a phenomenon of transportation equipment in particular--and the very disappointing performance in the capital goods sector, including the weakness in new orders plus the sharp decline in capital appropriations, which have a long lead time. So we're still very much on the pessimistic side, looking for 1-1/2 to 2 percent real growth and, for that reason, a little less inflation than the Board staff has projected.

CHAIRMAN MILLER. Frank, the ticker tape this morning says chief executive officers of U.S. companies turned more pessimistic about the economy according to the Conference Board's latest survey. Its measure of business confidence fell to 49 percent in this year's third quarter, down from 58 percent in quarter two. Phil.

MR. COLDWELL. Mr. Chairman, I don't have any problems with the staff forecast in the aggregate. I don't happen to agree with the pattern they're showing. I think they're overly optimistic on the degree of impact of the tax cut in the first quarter. I think we're likely to have more inflation than the staff shows and probably a little less GNP in terms of real growth. But my differences are in terms of a half percent--not terribly off from the basic pattern in terms of the total.

I am a little curious, Jim, about your description of the employment as slowing. July and August I always thought were slow months anyway and I don't really see anything there.

MR. KICHLINE. Seasonally adjusted.

MR. COLDWELL. Also, I'm a little curious about your description of industrial production slowing when we're still getting more than 1/2 percent a month, having come off [unintelligible]. I thought it was doing very well. The consumer goods weakening I thought was something that needed to come along, and if we're going to maintain 1/2 percent growth with that kind of weakening then [something] else has to be strengthening. So I'm a little curious about your description but your net result is pretty close to mine.

MR. KICHLINE. May I comment briefly?

CHAIRMAN MILLER. Yes.

MR. KICHLINE. I would agree with you on industrial production. My point there was slowing from what we had seen earlier in the year. But I think I did use the phrase "but still quite good." So I would concur with you that it was a matter of describing movements within the year.

VICE CHAIRMAN VOLCKER. May I just interject a supplementary question for Mr. Kichline to comment on? I had a vague feeling that the industrial production figure is looking good relative to other figures and that they don't seem quite consistent. Is that vague impression accurate or not?

MR. KICHLINE. Well, I think, yes. There is a good deal of activity going on in the construction business equipment area in terms of production. And we do expect an increase, for example, in shipments, in the area of capital goods. If not, we're going to get an inventory backup there. But there's a good deal of activity in this heavy equipment area that's showing up in the IP. Consumer goods are quite weak. Overall, I think the data coming in, if you adjust for the goods portion of GNP, are roughly consistent. We don't perceive a big problem but I think that is one of the stronger features of the recent data. It is one of the stronger parts.

CHAIRMAN MILLER. Henry.

MR. WALLICH. Well, I think the odds favor continued expansion, though one can not discount the possibility of a downturn. I think what we have going in our favor is the absence of major imbalances of the usual cyclical kind. We have some new ones. We have the very high rate of inflation, and I think that is our main threat to a stable expansion now. We have a large budget deficit that more than offsets the net negative exports. We have the weak dollar. These are the principal imbalances plus the inflation. The staff's estimate of inflation looks low to me. Maybe for the next quarter, the third quarter, we can count on something better than we previously thought, but I think for next year the chances of getting high wage settlements and high wage increases are very serious.

CHAIRMAN MILLER. Thank you, Henry. Steve.

MR. GARDNER. Well, I can agree with the staff's forecast. I've felt in the last month or so that we've had lots of points of strength and an implicit desire to be pessimistic. I just can't do that when we've had as much strength as we've had. I'll go along with the staff's forecast.

CHAIRMAN MILLER. Thank you, Steve. Paul.

VICE CHAIRMAN VOLCKER. Well, the staff forecast seems reasonable to me. It's probably a trifle higher than I would come up with on real growth and a trifle lower for inflation but it doesn't seem at all unreasonable to me. As time passes here our recovery is looking a little more tired, as I suppose in some sense it should. It's getting older. It's getting a little less liquid than it was but I don't see any very quick or strong pressures coming from that end, although it could build in the course of the next year. I feel a little better that it may work out reasonably well in connection with some signs of revival in foreign growth, which would help the balance of payments, help the dollar, help everybody feel better, and also add perhaps to the direct strength in the business scene through the export side. I don't think that change is big but we seem to be entering a situation here that's not totally satisfactory--to understate it. Some slowdown seems to be reasonable, even a little more than the staff projected. I think it's a tolerable kind of situation here, given the inflationary problems.

CHAIRMAN MILLER. Thank you, Paul. Phil.

MR. JACKSON. I don't have any basic disagreements [with the staff forecast], although I'm inclined to think that the real growth is probably a little on the optimistic side. I'm inclined to think that personal consumption expenditures may not grow as expected because of the flattening of real incomes. I'm also concerned that while the economic effect of strikes has always been generally considered to be zero--because you make up what you lost--I don't think we're going to see that in 1979. I wouldn't be surprised if strikes were a significant deterrent to economic activity in the first half and have a real impact on the year as a whole. So, on balance, I'm inclined to think it may be 10 to 15 percent less than the staff projection.

CHAIRMAN MILLER. Phil, do you have any particular reaction to the housing outlook in the forecast?

MR. JACKSON. No, that's right on stream, in my judgment. Again, it depends on what the rest of the people around this table do to a certain extent. At this time I think in this neighborhood is about where it belongs; 1.8 or 1.9 million wouldn't be bad news at all.

CHAIRMAN MILLER. Thank you. Chuck.

MR. PARTEE. I think Frank Morris put his finger on something we have to look at very carefully in the next several months. I'm troubled by the sharp drop in durable goods new orders for business equipment, although it's just one month and I think we need to see the pattern over two or three months. But I certainly find the amount of steam in plant and equipment spending less than I anticipated it would be as the year went on. And I think it is conceivable that it's going to fall well short of present staff expectations, looking ahead into 1979.

That survey that you mentioned I think I heard about a couple of weeks ago, at least on the basis of preliminary figures. It's not only that you're getting more pessimism expressed by businessmen in the survey. Whereas before the typical pessimistic view was that the economy is not going to do well but my company's prospects look very good, now a significantly higher proportion of executives feel that their own company's prospects are not very good. So we could have, instead of a generalized pessimism, a specific pessimism; and it could have a considerable impact on capital spending plans and even on inventory strategy for the period to come.

As before, I tend to be a little on the low side of the staff projections for real growth over this period--3 to 3-1/2 rather than the 3-1/2 percent average. That means in practical terms that the unemployment rate will be drifting up, rather than with good fortune staying constant if the staff projection is right. Of course, I would point out to everyone once again that the staff projection is only for 3-1/2 percent real growth, which is rather minimal real growth. For this late point of the recovery it’s not so bad, but rather minimal because anything much below that will mean an updrift in the unemployment rate.

CHAIRMAN MILLER. Chuck, that comment you mentioned is in here--that they're not only pessimistic for the general economy but are now becoming more so for their own [businesses].

MR. PARTEE. That's the first time. This is a rather new survey and it's the first time they've ever found that.

CHAIRMAN MILLER. Thank you. Nancy.

MS. TEETERS. Well, the staff forecast is remarkably similar to the one I've been using all summer.

CHAIRMAN MILLER. Aha! So there's been a leak.

MS. TEETERS. One way or another there's been a leak. I would call attention to the swing in the full employment surplus, which is shown on page I-7. Fiscal policy is taking a rather large swing toward restriction at the present time. Looking at those numbers, I think I would be coming down off of my forecast that I had made to the [House Budget] Committee in the past two months. I would also like to point out that the impact of the tax cut will depend very heavily on its composition. If it's heavily capital gains with it starting in January, as it came out of the House, much of the impact will go over into 1980. If we have a capital gains change effective on November 1st, we're going to get an impact in the latter half of this year, so you may have to watch, as I'm sure you do, how we finally settle that particular issue. Other than that, I have no more comments on the forecast.

CHAIRMAN MILLER. Thank you, Nancy. Bob.

MR. BLACK. Given the recent behavior of the aggregates, the social security and minimum wage increases scheduled for the first of the year, the likelihood of strikes that Phil Jackson mentioned, the bottlenecks that Ernie mentioned, and wage/price pressures, I think the staff may be a little low on inflation. I think 8 percent would be a little closer. I think the rate of real growth is apt to be more like 2 to 3 percent, and I would not rule out the possibility of a mild recession beginning sometime next year. And if so, then unemployment might be in the neighborhood of 6.5 percent.

CHAIRMAN MILLER. Thank you, Bob. Willis.

MR. WINN. I'd remind the group that for the last couple of years we've been making funeral arrangements for the economy after the strong starts at the first of the year and then worries [later]. My own feeling is that it still may be a bit premature for this event. The durable goods [figure is a] question--what prompted my question earlier--but I have a feeling that we may have more strength than is apparent. But what worries me is further down the road for two reasons, or three reasons maybe. First, commercial construction and apartment house construction are really running full out. And there is no apparent barrier in terms of financing and [related] factors. So, what worries me is that if these are brought on stream, then we may suddenly get a glut in this area with a very sharp turnoff.

Second, we're seeing some interesting things in consumer spending; jewelry, furs, and other premium items are really going great guns. The nondurables are having problems. And what worries me on this score is that with consumer credit [readily available]--with the credit cards and a number of other things--we may have introduced a much higher degree of cyclical behavior in the consumer area than we've experienced previously. And if this occurs simultaneously with construction and a few other things coming to a head further down the road, there may be a problem. But at the moment I suspect we're going to get more support in the consumer area as a result of the still pushing of the credit card and credit and other factors we've projected. So, on balance, I come out with the feeling that for the few months ahead the staff forecast is probably more on the low side--not much, but we may see unexpected strength.

CHAIRMAN MILLER. Thank you, Willis. Dave.

MR. EASTBURN. Well, as my question indicated, I'm a little less optimistic this month than I was a month ago. And I'm a little less optimistic than the Greenbook forecast, probably tracing down to the consumer sector where I think there is going to be more weakness than [in the staff projection]. Housing I suspect may hold up fairly well, basically because it is the only inflation hedge that the average person has and I think that will hold the demand up pretty well. As Henry indicated, a very basic factor is the inflation rates that we're having. I think it's quite remarkable, with that kind of inflation rate, that we have even the moderate growth that's forecast. I think we're doing quite well, given that inflation rate.

CHAIRMAN MILLER. Thank you, Dave. Bones.

MR. KIMBREL. Mr. Chairman, we think that there's considerable [momentum] for another 15 to 18 months. Against that, though, we are somewhat concerned that the growth may be slower than the staff has projected and yet the inflation rate may be faster. We, too, may have a biased look at the moment, prejudiced by housing because of the exciting developments in our own area. Calling around to a number of housing and mortgage people in the last couple of weeks indicates that [they are] just excited and think that the outlook is extraordinarily fine. Nevertheless, in reading the Redbook I notice that is not shared around the country so I think we have to temper that a little bit. Generally, we're not far from the feeling of the Greenbook.

CHAIRMAN MILLER. Thank you, Bones. Our clean-up hitter, Larry.

MR. ROOS. Mr. Chairman, I still have not lost my belief that what happens in the near future in terms of output growth and what happens in the long pull in terms of price level movements depends to some extent on what our monetary policy is. We agree with the projections of the staff, although for different reasons, that we should have about 7-1/2 percent price growth next year edging up to 8 percent in 1980. But we believe this is because we've had two years of 8 percent money growth. We don't question the facts [but] we have arrived at the conclusion through a different route.

We do feel that real GNP can vary from around the 3 percent mark next year to 4 percent, depending on the decisions we make as to money growth. We feel that if M1 is kept at a 6 percent growth during the forthcoming quarters, we will have a real GNP figure of about 3 percent but it would be about 4 percent if we continue at an 8 percent rate of money growth.

Finally, with regard to the Conference Board consensus, we had a luncheon last week with fifteen treasurers of our large corporations, most of whom are treasurers of Fortune 500 companies. There was unanimity--and this literally was unanimous—-in their optimistic and positive point of view. Not one of these fellows indicated less than confidence about their company’s future. Their outlook was basically positive for the 12 or 24 months ahead, so I guess there's room for a difference of opinion. Our feeling is positive and we feel strongly that what happens will depend on what we do.

CHAIRMAN MILLER. The [responses to the] Conference Board's survey are confidential, so it has no effect on the stock market. When the executive speaks publicly he must say his company is going to do well.

Thank you, Larry. I must say that I appreciate everyone's cooperation. This has been the most cogent set of comments in the briefest time that we've had. So we must be setting a new record. I commend you all; you may get the Congressional Medal of Honor if you keep this up! May I summarize? Didn't I hear a consensus that seemed to show very few significant variations from the staff [forecast]? And I would say the consensus of the balance would be a little slower growth and a little more inflation--with some a little more in either direction. That's a very helpful rundown. Does anybody have any additional remarks?

MR. MAYO. I have another question that I should have brought up earlier. We keep hearing rumors but no facts yet that the housing boom may be nipped because the savings and loans are getting cold feet now on the 6-month T-bill certificate. I was wondering if staff had any input on this question--whether they consider this to be an ominous possibility or whether it's just talk.

MR. KICHLINE. I think in large part it is talk. It depends on the institution. We've heard some of those comments but I think the bulk of the qualitative comments that we have come across have been quite positive. And the major reason for that is the spread, which is very favorable for picking up mortgages: You pay 8 to 8-1/8 to 8-1/4 percent and put out a 9-1/2 percent mortgage. So the spread is very positive and the larger institutions are quite willing to undertake them.

CHAIRMAN MILLER. And the portfolio is rolling over from other sources of funds.

MR. KICHLINE. That's right. So I think it's a mixed picture. I might say that we did not choose to put all of the additional funds that we have in the projection, given the performance of that certificate, into mortgages. That’s because later on we do have a concern about the liquidity of those institutions and just the balance sheet structure. So I think over time more of these institutions will be concerned and they will begin to be less willing to add mortgages even though the spread is very favorable.

MR. AXILROD. President Mayo, I might add just a fact. We've been erroneously predicting that the rate of growth of inflows to S&Ls would slow because there is some sort of stock adjustment at work. We now have the data for the first ten days of September and we're projecting a 17-1/2 percent rate of growth at the S&Ls in September. Undoubtedly this will slow, but as Jim said, this isn't in the statistics at the moment.

CHAIRMAN MILLER. We may have to knock off those certificates. Larry, you had a question?

MR. ROOS. I have a question, Mr. Chairman, and it's not asked in a cantankerous vein. But I'm concerned. As we went around the table, we all seemed to recognize that we do face a 7-1/2 to 8 percent rate of inflation now. Do we as a group feel that this is preordained because of circumstances that we can't control? I'm concerned that we seem to feel well, it may be 8 percent, and if it's 8 percent we've done our job well. I'm really not trying to be critical, but is our monetary policy responsibility such that we should maybe discuss whether we're satisfied to see the economy drift into an 8 percent inflation rate? And if not, are there things that we can do to affect this? I really ask that in a genuine, innocent, and physically recovering vein. Are we in any way the masters of what happens, or are we merely observers on the sidelines? I'm lost.

CHAIRMAN MILLER. I take the fifth.

MR. PARTEE. I don't want to comment.

MR. BAUGHMAN. Yes, there is a relevant observation that may be made, which is that the Administration has said that they are going to bring forth a new anti-inflation proposal. If that should appear to be a program of substance with some possibility of having a significant impact, it could provide a basis for a wave of optimism through both the business and consumer sectors of the economy. That would be quite positive. If, on the other hand, it appears to be quite transparently meaningless--mostly talk and nothing that is likely to have a substantial impact on the wage-price push--then I think there is a strong possibility that the effect will be quite the opposite.

CHAIRMAN MILLER. Let me make a couple of brief comments, but I really think this belongs in our monetary discussion because we could spend the whole meeting on this. But let me just observe a couple of things. One, when I came here six months ago the outlook for the growth of the economy in real terms for the current calendar year was 4.7 percent. The staff projection is now 3.5. I would say that one of the main forces in that reduction has been monetary policy. So, have we had any positive contributions to the slowing of the forces of inflation? I would say there has been a conscious effort, Larry. I would say, in the argument that the Federal Reserve should not be left to do it alone, that the fiscal plan for stimulus in the next fiscal year has been changed by $20 billion less stimulus. I would have to say that’s substantive. Maybe some of you would argue for more or less but I would have to say that these are substantive consequences of the exercise of monetary policy in pointing out the dangers of monetary policy and getting, therefore, a response from the Administration and from the Congress to spread the burden.

So I think in isolation we are suffering from the inflation buildup over twelve years and in my opinion some misguided steps over twelve years. If we think we have been able to turn it as much as I have just described in six months, in terms of the outlook and the mix of things, I wouldn't exactly be critical. And I would be very cautious to restrain the system more in the face of the pessimistic comments we already have and [precipitate] a recession just to make us all feel that we have done something more. I don't think that would contribute enough to solving the problem. You know, we are already down to growing at or below the trend line. Really, is there more that we can do short term? And don't we have to live through the cycle? I don't know. We'll come back to this in the monetary policy [discussion]. John, did you have a final comment?

MR. BALLES. One final comment but I'm afraid it's not a very optimistic one. I'm not sure quite what to read into George Meany's blast yesterday of wage-price guidelines, but it doesn't sound very promising--

CHAIRMAN MILLER. Vintage mania, I would say.

MR. BALLES. It doesn't sound very promising in terms of getting the cooperation of labor.

MR. PARTEE. It was a little milder than I had anticipated.

CHAIRMAN MILLER. Actually, this was reported as being milder than expected.

MR. PARTEE. I thought it was.

MR. BALLES. What I heard on TV didn't sound mild.

CHAIRMAN MILLER. Let's [cover that] perhaps in the general discussion. And before the break, let's cover the domestic open market operations. We have a report on operations, I see, from Paul Meek.

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

CHAIRMAN MILLER. [Secretary's note: This question was asked during the statement.] You said 14 to what?

MR. MEEK. I said 14 to 17 billion. There are even some that are lower than that, but that's the consensus at the moment. [Statement continued.]

CHAIRMAN MILLER. Thank you, Paul. Let me first get the routine business out of the way and then move on to the secondary. Routine is just to ratify the transactions of the Desk since the last meeting. Paul made a voluminous report, I believe, available to you. Are there any questions or comments or may we have a motion for approval?

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN MILLER. It has been moved and seconded. Discussion? All in favor, say "aye." Opposed? So voted.

The second point you made, Paul, was the temporary increase in the authorization--to raise [the limit] on the change in the open position over the period stated.

MR. MEEK. To $4 billion.

CHAIRMAN MILLER. You said temporary. I understand temporary to mean what in terms of time?

MR. MEEK. In the period between now and the next meeting of the Committee.

CHAIRMAN MILLER. [Until] the next meeting. All right. Steve, do you have any comment on that particular question?

MR. AXILROD. No, Mr. Chairman. For technical reasons, there appears to be a sizable need to provide reserves and I believe that increase would be justified for this [upcoming intermeeting] period.

CHAIRMAN MILLER. On that particular question, does any member have a question or comment or concern?

MR. COLDWELL. Well, only that I hope it does not encourage the Desk to do more in the way of increased activity in the market.

MR. PARTEE. I don't know that they've ever been constrained.

MR. COLDWELL. I don't think they have.

CHAIRMAN MILLER. Well, we need a motion to approve that increase, which will run to the next meeting.

MR. PARTEE. I so move.

SPEAKER(?). Second.

CHAIRMAN MILLER. Any further discussion? All in favor, "aye." Opposed? So voted. Now, are there any questions or comments on the report that Paul has given? Yes, John.

MR. BALLES. I'd like to read a more optimistic interpretation, Paul, into that decline of long-term bond yields. The wish may be the father of the thought here. But I'm convinced, as are a lot of people, that inflationary expectations in fact have a great deal to do with the level of long-term bond yields. My interpretation, perhaps wishful thinking, is that the market has perceived the Fed as tightening up recently and, therefore, diminishing the chance of escalating inflation and perhaps even raising the chances that it will peak out before the end of the year. And markets, being very forward-looking, I think are taking this into account. Now, you can always come back with other technical explanations--light calendars, this and that, and so forth. But I would place the major weight on the explanation I've given.

MR. MEEK. Well, I think that is certainly one factor on the part of some investors. The technical explanation that you alluded to is that in fact money management has attempted in the wake of the '73-'74 experience to be more sophisticated and to pile up more money in the short end, awaiting the peak in interest rates. Everyone has been betting on that. Over the course of the summer, there has been a change of view that one didn't want to miss that peak, and we have had a sustained investment of long-term funds. I think the next few weeks will tell whether it has run its course or--

CHAIRMAN MILLER. There's still quite a bit of liquidity waiting for that time, isn't there? So it may take a considerable time--

MR. BALLES. In the forecasts of interest rates that market people make, the peak ranges from Lee Prussia from the Bank of America, who is expecting a fairly considerable decline in short-term rates by the second quarter of next year, to some others who don't see that happening even in 1979. I think the market prognosticators are about as widely divided at this juncture on the outlook for rates and when the peak will occur--if there is to be a peak--as I can remember.

However you have arranged this, please keep doing it will you? [With] long-term rates down, I say all good things can happen to the economy.

CHAIRMAN MILLER. Henry.

MR. WALLICH. For both domestic and international reasons, I think it would be desirable to get even more of a downward sloping yield curve. The Treasury bill rate is still well below other short-term rates. The coupon area could come down a little. I'm wondering whether the Desk is doing all it can to move rates in that direction. I noticed you have been buying coupons, but you also have been buying some Treasury bills directly from foreign accounts. I would hope we could get the intermediate- and long-term area to continue going down and in the short-term area a straightening out of the yield curve.

MR. MEEK. Well, the reserve need that we are now confronting, which is a rise of $5 billion in the Treasury balance from the current statement week to the next statement week, will be such as to require us to be buying in all sectors of the market. So we'll certainly be in the coupon market once or possibly twice over the next two weeks, I would say.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. I, too, had thought that there was a possibility for perhaps a little help in the international area on operation twist. But I must say, as I look at this yield curve, that it is about as twisted as it can get, in my view. That is, as Paul indicated, the peak is before two years and it declines progressively as one goes out. And that's a pretty extreme situation. I must say I don't think there's a lot of chance of an appreciable further decline in long rates if short rates remain where they are or a little higher. I just don't see how it can occur because I think the arbitrage would become too big of a consideration in the placement of funds.

CHAIRMAN MILLER. Well, thank you for your report. We will now take a break for coffee and rest and come back and finish off the meeting.

[Coffee break]

CHAIRMAN MILLER. All right now, Larry, I expect you to make prudent monetary policy since you raised the subject. Let's hear from Steve Axilrod.

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

CHAIRMAN MILLER. Thank you very much. Let me call your attention to a couple of figures on pages 6 and 7 in the Bluebook. On page 7 you see the September estimate for M1 is in the 10-1/2 range--10.8 or 10.4 depending on the alternative. And it's in the 6 percent range in October, according to the Board staff's estimate. That means about an 8-1/2 percent growth in M1 because of the strong growth in September, which is already pretty much a reality. And the projection is that there would be a considerable reduction of growth rates in October. Now, the New York Bank, as I understand it--Alan, you can correct me--is estimating slightly different figures. They are looking at 8-1/2 or so in September--a lower rate in September--and are looking at 7 percent--a slightly higher rate--in October, for an average of about 8 percent. So the averages between the two views of New York and the Board would be 8 percent in New York and 8-1/2 percent at the Board.

That's the situation we are looking at because of the strong growth in the aggregates in September. For that reason, it would take a phenomenally low growth in October to bring the 2-month average rate very low because if you start off with either 8-1/2 or 10 you are already up there pretty high. It seems to me, therefore, that we have somewhat of a dilemma because we need to set ranges for growth and we are somewhat constrained by the existing strong figures in September. My general view is that a federal funds rate range of 8-1/4 to 8-3/4 would probably be appropriate as the next step in our efforts to meet the targets. I think the 8 percent bottom of the range is too low, considering the unlikelihood of any need for or desirability of easing. And I think it is premature to go to 9 on the upside until we see more of what's happening.

As to the ranges for M1 and M2, given the figures that I have just indicated to you, if you place New York at 8 percent as your guide and bracket that somewhat you see where we're heading. If you take the Board's 8-1/2 and bracket it you see the kind of problem. Just how we should deal with that is a bit of a difficulty. It probably means we need a range of 6 to 10 or 6 to 9 percent or something like that on M1.

Well, with those introductory comments--and I will come back to perhaps some summary comments when we've heard from all of you--I would like to run through the Committee. First, I'll ask for Vice Chairman Paul Volcker's comments and then go alphabetically through the Committee's voting members and then the other Presidents.

VICE CHAIRMAN VOLCKER. Well, I approach it from exactly the opposite order you approached it, Mr. Chairman--from the aggregates to the federal funds rate rather than the reverse. I must confess to some bias toward keeping the short-term targets in some relationship with the longer-term targets. Obviously in the past year or more we have been missing the target on the upside. After our last big increase in the base, for a couple of months we ran within the new target, but we are now moving outside it again. And it rather reinforces my feeling that we should not accept something on M1 as high as 6 to 10, which seems to me to be a confession [that] we are going to accept what September hath wrought. If indeed it "wrought-eth." I won't repeat that.

CHAIRMAN MILLER. Please, we need to clean up our language.

VICE CHAIRMAN VOLCKER. On M2, I think we have a little better argument for going above the long-term range because we are getting--for reasons we know--the reaction to the 6-month certificates. So I could see raising [the range we had] last month and going higher than the long-term range there. I think I'd be happier with something like 6 to 11 or 6-1/2 to 11 than what is there under alternative B. I would really be happier on M1 if we stick to 4 to 8. But then I think I would constrain the federal funds rate just the way you did, Mr. Chairman. I don't know as I couldn't live with 9 at the upper end, but I can see where that might appear to be a fairly rapid movement, certainly justifying a new look. And maybe you don't want to do it even if you had the look--even if the aggregates [forced you] into the look. So I am perfectly willing to second the motion on an 8-1/4 to 8-3/4 percent range. I just want to get the aggregates down from the level specified in alternative B.

CHAIRMAN MILLER. Thank you, Paul. Ernie Baughman.

MR. BAUGHMAN. Mr. Chairman, it seems to me that the objective of the policy posture should be that of trying to keep enough constraint on the economy so that any capacity that it has to moderate inflation it will undertake to do that. And I find myself, in trying to develop some monetary specifics, leaping back to that. I'm coming out very close to where Paul came out. I don't really see much value in going below 4 on M1, although I don't object to that. But I do subscribe to 8, which is the current projection, as the maximum for the target range. And I'd do the same thing on M2, 9-1/2 being the current projection; I'd pick that up as the top of the target range. My inclination would be to put the bottom two points below the top in both instances, which is the projected bottom of the alternative B range. On fed funds, again my inclination would be the alternative B suggestion, which is 8-1/4 to 9. And if we were to wind up with higher tops on the ranges, I would think we definitely should retain the suggestion of 9 for the top of the fed funds range. If we can lower the top of the ranges on M1 and M2 to the current staff estimates of what the actual may be, then a top on the fed funds of 8-3/4 would be acceptable.

CHAIRMAN MILLER. Thank you, Ernie. Phil Coldwell.

MR. COLDWELL. Mr. Chairman, I approached this on the basis that we have not yet obtained the credit restraint necessary to slow inflation. The inflation [expected] even by the most optimistic of those I have heard around the table is by my standard excessive. I don't believe we can permit the aggregates to continue to grow at this pace we have seen, and I still think policy has a contribution to make to slow them down and to slow the expectations of higher inflation. The international value of the dollar to me is a symptom. But I would point out, as the rest of the Board knows, that I've been traveling in Latin America in the last month or so, and I am disturbed about what I have heard in terms of the compositional changes in their reserve assets--shifting out of dollars. Some of this, of course, is expected as this [situation] moves ahead.

As far as the specification of policy, I too am unwilling to go as high as alternative B on the top side; the bottom side doesn't bother me a whole lot. I would like to have a couple of months of weak aggregates figures. So if we are looking just at the M1 and M2 specifications, my preference would be ranges of 5 to 9 and 6 to 10 or 10-1/2. On the federal funds rate, I would like to see us move 1/2 percentage point, to 8-1/2, promptly and I'd bracket that. I don't care whether we put [the top] at 8-3/4 or 9. I would like some running room if this is going to be restrained. The way I put it down for M1 and M2, maybe we ought to have a re-consultation as we did this past month. Frankly, I'm not terribly enamored with all these M1 and M2 figures. I'd much rather look at what we can achieve and I think the interest rates are not yet slowing the demand [to the extent] necessary to constrain the inflation.

CHAIRMAN MILLER. Thank you, Phil. Dave Eastburn.

MR. EASTBURN. I am influenced by two countervailing forces, as I guess many other people are. On the one hand are rates of growth of money that I think are excessive. Take the September increase plus the revisions; it gets us up to rates that are higher than we really would like to see. That consideration would lead me to something like a 3 to 7 percent range on M1. But then the other consideration, which I expressed earlier, comes into view and that is the increased pessimism about the real economy. So I would moderate my first view on the ranges, reaching some kind of a midpoint there. I think I would come out to a 5 to 9 percent range on M1 with a 6 to 10 percent range on M2. And I'd go along with your range on the federal funds rate of 8-1/4 to 8-3/4.

CHAIRMAN MILLER. Thank you, Dave. Steve Gardner.

MR. GARDNER. I have difficulty in hearing my colleagues, which means I've missed great wisdom. I'm sorry.

CHAIRMAN MILLER. Well, the acoustics aren't that good and I am having difficulty too. So if all of you get up and speak into your mike we'd all hear you. So now reciprocate.

MR. GARDNER. I have no problems with alternative B and the intermeeting range for the federal funds rate with 8-3/4 as the midpoint on whatever range we set. We do have to slow the aggregates; we often immediately reach for the red telephone when the aggregates show higher numbers than they should or than we want. But that doesn't seem to work very well, both in the longer ranges and the shorter ranges. I think we ought to keep playing the same game and put the range for M1 and M2 in October [unintelligible]. Nobody mentioned the fact that M1 is going to change all around [soon]. When is it, the 1st of November, Steve?

MR. AXILROD. Yes.

MR. GARDNER. That's going to create some havoc with our systematic collection of figures.

CHAIRMAN MILLER. If we have a massive outflow into savings, we will be right for the wrong reasons for the first time.

MR. GARDNER. Right. In any event, that's the way I would feel, Mr. Chairman.

CHAIRMAN MILLER. Thank you, Steve. Phil Jackson.

MR. JACKSON. Mr. Chairman, I don't share the judgment of those who have felt that money was exploding all over the place and that we are irresponsible and so forth. I think the study that the staff did on the so-called M1+, or M1 prime or whatever the label is, shown on table B-9 is very interesting. In fact, if you look at that table for a minute you'll see that within the past year, through the first half of '78, it looks like that rate of growth was about 6.3 percent. I'll say 6-1/4 or something like that. And then if you look at the projection on velocity of about 3.6, you get results in the neighborhood of 9-3/4 to 9.9 versus a projection of nominal GNP of 11 percent. It [seems] like we've been about on target and the trend has definitely been down in that concept of measurement of money. So I don't think that we ought to be too self critical.

Getting to the real point of the discussion here, though, I would favor an 8-1/4 to 8-3/4 federal funds range, going to 8-1/2 immediately. And on M1, I'd take 6 to 9 because I don't think we can afford to have two months in the 10 percent range without adverse public reaction. But I would take 8 to 12 for the M2 range and a monetary aggregates directive.

CHAIRMAN MILLER. Thank you, Phil. Now Chuck.

MR. PARTEE. Well, my problem is that I don't consider the 2-month average M1 growth that's being projected extraordinarily high relative to the economy. It may be a trifle high, but not very. If we have what we were talking about--roughly an 11 percent increase in nominal GNP--I would expect an increase in narrow M1 of 7-1/2 to 8 percent. If we want to have M1 growth far below 7-1/2 to 8 percent, that means we want to have a nominal GNP growth well below 11 percent. And I am afraid that we are close to the stalling point in the economy and the effect will not be so much to restrain inflation but to restrain economic growth and give us a recession--at least a growth recession and maybe more.

I do agree that the Committee faces a practical problem in that a 6 to 10 or 6-1/2 to 10-1/2 percent range, on the order of the specs here, seems quite inconsistent with the long-term range that the Committee has adopted, and perhaps that can't be faced. Therefore, it might be that the range needs to be reduced, recognizing that that means the probability is that you'll go to the top of the range and you'll touch off the top of the interest rate specification that you've given to the Manager. You could take 5 to 9 [for M1] and 7 to 11 for M2, which I have put down, and assume that that will be the result. But then the real question is: How far do you want interest rates to go up in this immediate period? You have preordained, almost, that they will go up as far as you specified in your instructions to the Manager.

My feeling is that we have had a large increase in interest rates. I guess that's no secret. But I was just looking at the chart on the federal funds rate in the back of the book and I find that during 1977 we raised the federal funds rate 200 basis points and so far this year we have raised it another 175 basis points. That’s a total of almost 400 basis points in less than a 2-year period. And I don't think the economy looks as if it is getting away from us in the sense of explosive growth in demand or prospects for expansion in activity.

So I think it’s time to pause in the rise in interest rates and see in fact whether Frank's concerns about plant and equipment may be borne out. And other concerns people have expressed about consumer spending may be borne out. [Let’s see] whether in fact, as most Committee members have suggested, the growth rate is likely to be less than 3-1/2 percent rather than more than the 3-1/2 percent in the staff projections. So what I would do is to take those aggregates ranges that I have mentioned--5 to 9 and 7 to 11. Then I would constrain the funds rate to 8-1/4 to 8-1/2, stay at 8-3/8, and have the money market directive in effect to hold it constant during the coming period unless the aggregates are notably stronger than the 9 or 11 tops of these ranges.

CHAIRMAN MILLER. Thank you, Chuck. Nancy.

MS. TEETERS. I would counsel to stay put at the present time. There have been a lot of moves going on in the market, a lot of activity. The economy is slowing down; that third quarter projection is for a 2.9 percent rate of real growth and one of the things that bothers me the most about the economic forecast--although I agree with it--is that we have never done it before. We've never taken our trend line growth to 3-1/2 percent without [the economy] either tipping over or suddenly taking off on us. It would be nice if we could accomplish that. But I doubt that's the way it’s going to look 6 to 8 months from now. And if I have doubts on the projections, it would be on the down side [because] the economy has slowed down considerably and there has been a big increase in interest rates. I would stay another month in the position that we are in currently. So that would put me at 8-1/4 to 8-1/2 [on the funds rate], and I don't really know what that implies yet for growth in the monetary aggregates. I am going to have to work on those relationships.

CHAIRMAN MILLER. Thank you, Nancy. That's what I call a very tactful cop out, Nancy. You are not going to get off the hook. You are going to have to give your aggregates.

MR. WALLICH. Well, I go with Phil Jackson in looking at the M1+ numbers but I draw somewhat different conclusions from them. I think this is a very interesting study. It shows that we once more underestimated the rate of money growth both because of the benchmark adjustment and because of the cash items bias. Now I have two or three more items that cause us to underestimate M1 growth: the Euromarkets--and we continue to debate that--corporate RPs, and NOW accounts. When I throw all of these together I get the impression, very impressionistically, that we may have underestimated the rate of growth of M1 by 2 to 3 percentage points. When you factor in a normal growth trend of M1 velocity of 2, we've got an effective rate of growth of M1 of something like 4 to 5 percentage points more than what we think we have. In other words, with our 7 to 8 percent real increase in M1 as recorded we quite amply finance the 11 percent rise in GNP [given] rising interest rates and their effect on velocity. Then we have the fact, as Steve Axilrod pointed out, that interest rates don't bite as much as they used to; they don't bite so hard on housing. We have the fact that long-term rates fortunately are coming down, which is where I think it counts for long-term investment. But the funds rate seems to be getting a little more detached from other interest rates, leading the pack less tightly than it used to. So in short, I would like to see us move quite firmly: M1, 4 to 8; M2, 5-1/2 to 9-1/2; and a funds rate range of 8-1/2 to 9-1/4 but go to 8-3/4 for the time being and hold it there. And I guess that compels me to make it a money market conditions directive.

CHAIRMAN MILLER. Okay, Henry. Mark Willes.

MR. WILLES. Since I have been accused of being a maverick, may I quote a statement that you made, Mr. Chairman, with which I'd like to agree to show that I am in the mainstream.

CHAIRMAN MILLER. I probably have made two or three you could agree with!

MR. WILLES. At least. But this one was particularly interesting to me. This was in a letter that you sent to Congressman Reuss and it says “theoretical and empirical work by economists indicates that the trends in monetary expansion over the longer run have little impact on the behavior of real output and employment, the primary impact being on prices. Thus, if the monetary authority makes clear its commitment to the achievement of money stock growth rates that will ultimately be consistent with price stability, it will have provided a reliable basis for planning. This has been the direction in which the Federal Reserve has attempted to move during the past three years and in which we plan to continue to move in the years ahead.” I think that's a very positive, correct statement--one with which I agree 100 percent. I must say that if we adopt the ranges that I see put down here by some members of the Committee at least, we will not be consistent with that statement. And in my judgment we will have the consequences that are implied by that: We will not have the environment in which appropriate business and other planning can take place.

I'd like to make just two brief comments before I give what are going to appear, I'm sure, to be outrageous recommendations. The first is that it’s a common assumption--I think in the System as well as outside the System--that it is not possible to reduce the rate of growth of money without precipitating a recession. And I think there is substantial reason to believe that there is a way in which that could be done. That is to say, you could reduce the rate of growth of the aggregates and you could reduce the rate of increase in prices and not precipitate a recession. Obviously, I don't have the time here to explain that, but it seems clear to us with the work that we have done with regard to how expectations are formed and how that influences people's decisions that it’s possible to do so. In that light I'd suggest that perhaps one reason why businessmen seem increasingly pessimistic may well have to do with inflation--that inflation is a cause of that pessimism rather than the fear that we are about to enter into a recession. We do not see the risk of a recession in the foreseeable future, in the absence of some major shock--a serious strike, or the dollar goes wild, or some sharp adjustment in policy, or something like that. Therefore, it seems to me that inflation is still clearly the number one economic problem that we have. And I just don't see how we will ever deal with that in a way that makes people believe that we are going to deal with it unless we do something to get the rate of growth of money down.

Our errors, in the recent past at least, have been in being surprised on the up side in terms of the growth of the aggregates. We keep looking for that to fall off and we are always disappointed in hindsight because it doesn't. It seems to me, therefore, that we really ought to have for M1 a top rate of growth of 7 percent. That is not likely to be achieved over the course of the next month, but it will do exactly as Chuck suggested. It will force us to move the interest rates up, which I think we should do. And I would like to repeat something I've been saying now, probably ad nauseam, and that is that interest rates are not high. Real interest rates are still negative; they are not biting. Credit is flowing like crazy. So I think we can do that without any substantial risk to real spending decisions. So I think we ought to have an M1 range of 3 to 7 percent. I have trouble with M2, just as I would with the M1+, because of Regulation Q ceilings but 6 to 10 would be fine for me on M2. I must say that I think both for domestic reasons and international reasons the thought of a federal funds rate of 9 percent isn't at all disturbing to me, so I'd like to see us use that full range. And I would suggest a federal funds range of 8-1/4 to 9 percent.

CHAIRMAN MILLER. And what midpoint, Mark? What would you do immediately?

MR. WILLES. I'd go immediately to 8-1/2.

CHAIRMAN MILLER. All right, thank you. Willis.

MR. WINN. Mr. Chairman, I guess I've come full circle. It's a circle we have been around here in our discussion. I associate myself with the Volcker position in the sense that I think we do have to continue signaling our concern about the aggregates growth, whatever those aggregates are, with the periodic adjustments we make to them. And we also need to retain a sort of "watch and look" posture in the sense of the 4 to 8 and 6 to 10 on the aggregates with an 8-1/4 to 8-3/4 funds rate range. That doesn't seem like a draconian kind of development and it gives us a chance to assess later on the changing economic scene as well as the developments in these aggregates and move then to 8-1/2, with an aggregates directive.

CHAIRMAN MILLER. All right. John Balles.

MR. BALLES. This Committee continues to search for how to reach a soft landing because I think that is our continued problem. We obviously have a real dilemma. A good many of us have seen a slowdown in the rate of economic growth following several years of extraordinary growth. But also many of us are concerned about the implications of what will happen to both business and consumer psychology [and] the international market unless we get on top of the inflation problem and show some signs of deceleration. [For] a couple of years from time to time I've been proposing to this Committee that we ought to have some systematic way of getting from here to there in terms of the short run to the long run. The way you get overshoots, big overshoots, time after time, of course, is a month-to-month decision [not to take] draconian [steps. What] I had proposed in the past, which probably is too rough now, is that whenever you're at or over the target ranges the upper limit of the band should be the upper range of the long-run target. That would mean a 6-1/2 percent top for M1 now and a 9 percent top for M2. I'm not prepared to go that far this month and thus I would compromise with something like 4 to 8 on M1 and 6 to 10 percent on M2 and go immediately to 8-1/2 on the federal funds rate with a range of 8-1/4 to 8-3/4 percent.

CHAIRMAN MILLER. Thank you, John. Bob Black.

MR. BLACK. Mr. Chairman, I find the recent behavior of the aggregates very disturbing. It seems to me that we are repeating experiences we had back in ’76 and ’77 when, despite our vowed intention of bringing about a gradual deceleration in the aggregates, we acquiesced--inadvertently to be sure--in letting the aggregates accelerate. I think some of those past mistakes have come back to haunt us now in the form of a lot of inflation, which we're experiencing this year. The problem all three years, as I see it, lies in our inability to predict the level of money demand on the basis of the given federal funds rate. The proper solution, I think, has to be to move relatively more toward some kind of reserve target rather than a federal funds rate. I realize we can't debate that here and now but I believe we're going to have continuing problems hitting the aggregates unless we move in that general direction.

Now, despite these long [held] doubts of mine about the operating procedures, I've been hopeful that we were making some progress toward a gradual deceleration but these revisions of the aggregates shattered those hopes. Even the pleasure that I got out of the downward revision in the M2 series was more than offset by the acceleration in August and the projected acceleration in September.

So in short, I feel that we ought to make some further move to slow the aggregates. I would favor the “B” specifications on the federal funds range; I would cut the limits on M1 [to] 4 to 8, recognizing as Mark and Chuck did, that this would trigger upward movement in the rates. [I’d set] M2 at 5 to 9. I would favor an aggregates directive and I would move promptly to 8-1/2.

CHAIRMAN MILLER. Thank you, Bob. Roger.

MR. GUFFEY. Thank you, Mr. Chairman. Just an observation first of all: What has happened over the past month seems rather incredible to me--that is, that the markets have absorbed with very little pain or very little anguish the 1/2 percentage point increase that we have fostered. And it seems to me that the markets are now in a position to accept a further increase. With that background and my concern, which is beginning to become stronger, that the aggregates are growing far in excess of the long-term ranges--[I would move rates up further]. Although we make efforts to move the aggregates back toward the tops of their ranges, each month we find we're further away from them--thus, Mark Willes's comments with regard to the meaning of interest rates and the fact that they’re not biting in this environment as we might have expected them to. That suggests to me that we have to take further steps and be rather bold about it--though maybe not quite as bold as Mark. That's why I would like to see this Committee today with ranges on M1 of 5 to 9 and on M2 of 6 to 10, adopting the federal funds range that you originally proposed, Mr. Chairman, of 8-1/4 to 8-3/4 percent. I’d go with an aggregates directive, which would suggest that, if we get into the upper portion of those ranges--which I would fully anticipate very early in this period--we will be at the 8-3/4 percent level within a short period of time. And I think that would be appropriate.

CHAIRMAN MILLER. Thank you, Roger. Bones.

MR. KIMBREL. Mr. Chairman, I associate myself with those who have suggested that monetary policy may indeed have some influence at this juncture. And I liked Steve Axilrod's comment that we could minimize any risk of undue increases in the aggregates. So for both domestic and international reasons, I'd like to see us move the M1 range to 4 to 8 and M2 to 6 to 10, with a federal funds range of 8-1/4 to 8-3/4--the same numbers you used--and an aggregates directive.

CHAIRMAN MILLER. Thank you. Bob Mayo.

MR. MAYO. Mr. Chairman, I think I'm probably as concerned about inflation in this country as anybody around this table. I also feel very strongly that monetary policy has an important role to play. I recognize that the lags in the effect of monetary policy are substantial--and substantive in amount, not just in time. And I must admit that I have some concern about pushing too hard here. I would buy the 8-1/4 to 8-3/4 [on the funds rate range]. I have no particular problem with that. I would not move; I would consider the present 8-3/8 percent as the asymmetrical midpoint and wouldn't move from it, however, until we see our next spate of news--bad or good, whatever it may be--on the monetary aggregates.

I guess I'm a maverick though, Mr. Chairman, on our seeming over-attention to the embarrassment--and it is an embarrassment--about the 6 to 10 percent M1 range that's in alternative B. I refuse to get embarrassed about it because I don't think the 2-month averages mean a damn, if I may use the phrase. I have suggested, and I think several of my associates have also, within the past two years that we ought to find a way of going to a quarterly range. That at least is a little better than the two months. So I refuse to get excited about the 6 and 10, even though it is a thermometer by which we get measured. I think we can dispose of it, not as irrelevant but perhaps as inconsequential, in view of the broader perspective.

I must say that there are all sorts of ways of doing figures and the linkages of course, as we all know, are very imperfect. But if I take our present ranges, Mr. Chairman, of 4 to 6-1/2 percent on M1 and 6-1/2 to 9 percent on M2 and I pay attention to our short-term directive, which always says we give approximately equal weight to M1 and M2, I find that this comes out [using the two midpoints] as 5-1/4 percent to 7-3/4 percent for a long-term range. It's rather interesting to me that if you take the moving average of M1 and M2 over the past year, August to August, you come out with a 7.7 percent increase. That, of course, is rather close to the top of 7-3/4 percent but it's within the range. I illustrate this not to say that I am smitten by the accuracy of such figures but just to point out that you can do all sorts of things with figures. Also I would point out, more seriously perhaps, that that moving average figure a year ago at this time was 8.9, so we've made an improvement of 1.2. So I would like to join with your statement, Mr. Chairman, that indeed the Fed has made a contribution to a fairly efficiently working economy at this point, even though obviously we haven't gone as far as we would like to.

So I'll stick with the 6 to 10 [on M1] and perhaps join you in the embarrassment of explaining it, but I think it could be explained away. I would join the staff on alternative B on M2. And as I say, 8-1/4 to 8-3/4 is my preference [for the funds rate range], too, but I wouldn't move yet. I'd wait for some more figures. My feeling is a little different from Roger's with regard to the calmness with which the markets have accepted the last 1/2 percentage point increase in interest rates. I think we have an international cover that has protected us on that. I don't want to overplay our cards in assuming that that will continue.

CHAIRMAN MILLER. Thank you, Bob. Frank Morris.

MR. MORRIS. Mr. Chairman, at least on the surface it would appear that our decision this month is more difficult than last month because on the one hand we have more evidence that the economy is moving into a period of slower growth but this evidence is accompanied by another bulge in the growth rates of the monetary aggregates. A month ago I thought we were in a decelerating phase of monetary growth and it now appears that we're in an accelerating phase. With August and September we'll be publishing under the new numbers close to 10 percent for those two months [for M1] and a little over 11 percent for M2. The question is: Which of these targets do we move toward? It seems to me that the evidence suggests that at this juncture we ought to be moving toward dealing with the bulge in the aggregates--toward assuring ourselves that we don't extend this bulge through October. I'm reassured only very slightly by the 6 percent M1 projection for October since the reliability of those projections is so extremely low. I'd hate seeing another 9, 10, or 11 percent added to what we have.

I take this position because I've been looking at the issue of how severely monetary policy is impacting the expansion at this point in time. And my conclusion is that the impact is not a very severe one. We have, at a time when the economy is close to full employment, the remarkable phenomenon of inflows into thrift institutions at double digit rates, which I think is unique in the monetary history of recent years. We have a commercial banking system that I don't think is under any substantial pressure. If you look at the change in portfolios at commercial banks, you again find something strange for a period when the economy is close to full employment. And that is that the commercial banking system has been increasing security holdings over the past three months, including holdings of municipal bonds, which again is not characteristic of the behavior of a banking system that's under any kind of pressure. Furthermore, we're seeing another interesting phenomenon in that over the past couple of months as we have pushed short-term rates up, long-term rates have come down.

All this suggests to me that we have more room to act on the aggregates without having traumatic effects on the real economy. So I would propose a range of 8-1/4 to 9 on the funds rate, moving the target immediately to 8-5/8 and with ranges for M1 of 4-1/2 to 8-1/2 and M2 of 6 to 10. Also, Mr. Chairman, I would not be too worried about a massive impact of automatic transfers on M1 during the next year. I don't think it's going to happen. The New England experience with the NOW account shows that people don't change their deposit habits very readily even when they're offered a remarkably good deal, as they were offered in New England with a no-service-charge NOW account. The banks apparently are planning to price this new service of automatic transfers fairly expensively. If they stick to this, I think automatic transfers are going to kick off with something like the gait of a large turtle.

CHAIRMAN MILLER. Thanks, Frank. Larry, you not only drew the clean-up position on the circle this morning, but alphabetically you do too. It would not be inappropriate, nonetheless, to stay within the time limit.

MR. ROOS. Mr. Chairman, there is an advantage to being at the end of the batting order because you can sense a certain consensus of the points of view that emerge from the opinions that were stated. First of all, as far as this short-term scenario is concerned, I think the die is pretty well cast. I would be for alternative B or better--by better I mean lower aggregates growth [ranges]. But I would like to make a suggestion and try it on for size, if I may, Mr. Chairman. It seems to me that there is at least a majority consensus within this group that inflation is a problem and that it would be desirable, if possible, to attempt to slow growth in the aggregates without causing a recession. I think even the most maverick of us would be resistant to anything that would lead to recession. I might point out that on page 7 of the staff's projections for M1 growth, either alternative A or B would indicate nearly a 2 percentage point drop between the fourth quarter of ’78 and the first quarter of ’79 in aggregates growth, which I submit would lead to recession. I certainly would oppose that.

However, I think our next big decision point is at our meeting next month when we set the yearly targets. Assuming that most of us think that it is important to try to slow aggregates growth without recession, I wonder what would be accomplished or not accomplished, Mr. Chairman, if you were to ask each of us to address ourselves in writing--and not more than two pages of writing--to how we feel aggregates growth might be slowed without causing a recession. Certainly, some of us might say it can't be done. Then at least we would state in writing that we don't think growth in the aggregates can be reduced without causing these other severe consequences. There are some of us who think that there is a simple and feasible way to do it. So I just wonder if we couldn't spend a few minutes strategizing rather than getting right into the numbers game at our next meeting. I think this might be accomplished by attempting, with our research people, to put down in two pages or less [our thoughts on this issue]. This would at least cause us to address ourselves to what I think are the fundamental concerns of all of us. I think we tend to miss that target when we get into discussing 8-1/2 versus 9, or 3-1/2 versus 4. I'd like to see next month, unless this is a totally irresponsible suggestion, each of us come forth in summary fashion with how we might address the long-term future--at least the aspect of whether we can reduce aggregates growth without causing recession.

CHAIRMAN MILLER. Larry, before I respond to that, I'm not sure we understood your federal funds rate range. Did you intend--

MR. ROOS. Alternative B is fine. I'd like to see aggregates growth tightened even more and the fed funds rate as stated in alternative B.

CHAIRMAN MILLER. Let me say that I certainly welcome inputs at the next meeting, from those who care to do so, on how you see the strategy for reducing aggregates growth without bringing on a recession. I wonder if we really want the rigidity of written papers. I can see that that might become a situation where when we're in a collegial atmosphere and we're trying to consult with each other, and I'm not sure that the papers are so necessary. The input could be made verbally, I would think, and we'd probably be more comfortable that way.

We do have the problem, however we strategize, that the way the Federal Reserve operates at this point is to give directives to the Desk, and the Desk needs something to guide it. That's why we get into numbers, unfortunately. If we give the Desk vague comments on this, we're in trouble.

I think our struggle with numbers is not because we like a numbers game but because we need to give the staff at the Desk some way to govern their actions that is responsive to a directive from this Committee.

MR. ROOS. I didn't mean, Mr. Chairman, to eliminate the numbers but to build up--

CHAIRMAN MILLER. I understand. I regret that we have to deal with this great matrix. Now I have to make sense of this complicated matrix and see if we can strike a consensus. But at the next meeting we're going to be setting long-term ranges and I certainly would welcome inputs on how we can restrain the growth of the aggregates without triggering recession. Because there are nineteen of us, we have to realize that 19 times X minutes means that could take all day, so I think we have to be able to verbalize that with some conciseness. So I caution you to come prepared with your two pages but condense it to one paragraph when you recite it. In fact, prepare thirty pages for your private use.

Let me see if I can go through this. In the first place, I'm not sure whether Ernie Baughman had a move to the midpoint on his preference. Your range was 8-1/4 to 8-3/4, but did you intend an 8-1/2 percent midpoint?

MR. BAUGHMAN. I would move to 8-1/2.

CHAIRMAN MILLER. And Dave Eastburn?

MR. EASTBURN. I would, too.

CHAIRMAN MILLER. And Steve, the same for you? I don't think you expressed--

MR. GARDNER. Yes.

CHAIRMAN MILLER. In that case, let me see if I can recite [a summary]. On M1 I'll take the bottom number first. Will you keep score? One bottom number is 3; three bottom numbers are 4; three bottom numbers are 5; and four bottom numbers are 6. Does that add up to the [number of] voting members?

MR. ALTMANN. Nancy didn't give us one so that would be twelve. On the other side we have one 7; four 8s; five 9s; and one 10. Does that add to eleven?

CHAIRMAN MILLER. So the brackets go in that range. If you stuck with the largest number, you would have 6 to 9. Is that correct? Yes, the 6 to 9 would be the most prevalent one. On M2, I see one 5-1/2; five 6s; one 7; two 7-1/2s; and an 8. And I didn't give one; I just didn't get around to it. Let's see. On the up side we have two 9-1/2s; four 10s; two 11s; one 11-1/2; and one 12. Again, there you get a 6 to 10 percent range as the mode. It looks like we have much more agreement on fed funds. I'm talking now of the voting members, as you know. There’s a similar pattern--it isn't far off--on the nonvoting members. It looks like a very strong consensus; eight out of the twelve members are at 8-1/4 to 8-3/4. And the 8-1/2 appears in eight also. There are two midpoints lower than 8-1/2--at 8-3/8--and one at 8-3/4. I should add them up. It’s eleven because, Paul, you didn't give us a midpoint.

VICE CHAIRMAN VOLCKER. 8-1/2.

CHAIRMAN MILLER. Okay. Well, that makes nine at 8-1/2. So, one could say that this looks like an M1 range of 5 or 6 on the low side and more like 9 on the up side. And it looks like M2 is kind of at 6 to 10. And we have 8-1/4 to 8-3/4, with a move to 8-1/2 as a fairly broad consensus. What is your pleasure? Let me first see if we can have not a vote but an indication. Suppose it were 6 to 9, 6 to 10, 8-1/4 to 8-3/4 and an 8-1/2 midpoint. And I gather there was a consensus for an aggregates directive, assuming that was the case. How many voting members could support that? Five. How many can not support it? Four. Would someone like to change it? I think some of the votes are going to go one way and some the other.

VICE CHAIRMAN VOLCKER. I'd want to go somewhat lower on M1.

MR. COLDWELL. On the top side or the bottom side?

VICE CHAIRMAN VOLCKER. Well, I'd like to go lower on both, but particularly I don't like the 6 percent bottom.

MR. COLDWELL. 5 to 9.

VICE CHAIRMAN VOLCKER. 5 to 9.

MR. PARTEE. Ten is awfully tight on the top of M2.

VICE CHAIRMAN VOLCKER. I agree with that, too.

MR. PARTEE. I think 7 to 11 would be better.

VICE CHAIRMAN VOLCKER. If you'll go lower on M1, I'll go with that.

MR. JACKSON. It would be very helpful if the Manager would be explicit about how he would operate as a consequence of unfolding events. For example, if the Committee were to adopt 6 to 9 for M1, it would appear to me that the midpoint that the Manager would look at would be 7-1/2. Therefore, if the results were higher than 7-1/2 on average, insofar as that half of the two aggregates were concerned, he might be inclined toward raising, say, the 8-1/2 percent funds rate within its range. If you look at the present projection, it would mean that October would have to fall in the 5 percent range or less in order to keep M1 from dictating a move. And that might not be the Manager's perception. Frankly, that's one of the concerns I have about our lower ends of these aggregates ranges versus the higher ends, because we get mechanistic instructions to the Manager as a consequence of picking these. Somebody commented that he'd be happy to have a lower range. I might be happy to see a lower result, but that doesn't mean that I'd be happy with a lower range because it would force the Manager to do something completely different from what I want him to do.

CHAIRMAN MILLER. What do you do if you go to 5 to 9? You increase the probability that there will be an 8-3/4 percent funds rate.

MR. JACKSON. Let's ask the Manager to give us some perception in his own mind of how he might operate under a 6 to 9 percent [M1] component.

MR. HOLMES. 6 to 9?

CHAIRMAN MILLER. A 7-1/2 midpoint.

MR. HOLMES. Well, I think it's quite clear that the instruction as tentatively arranged here is an immediate move to 8-1/2. By immediate, I mean over a few days. We'll see more aggregates on Friday, again a week from Wednesday, and then again a week from Friday. As you know, I don't believe in precipitous movement to the upper end of the range right away because the weekly numbers are very volatile and they can be revised very easily, as we all know. So if we were just barely above the midpoint of the range--let's say at 8 percent with a midpoint of 7-1/2--I don't think I would be inclined to do much of anything but wait to see what the next group of numbers showed. And as we got closer to the upper end of the range, sure, [I'd move up] a shade but not to 8-3/4 right away until we hit the upper end. But I'd make sure that we were above 8-1/2, certainly--at 8-5/8 or something like that--as best we can do it. And as you know, we're not perfect.

MR. BAUGHMAN. Mr. Chairman, would it be appropriate to take a consensus on what I think is essentially Paul Volcker's suggestion of 4 to 8 on the M1 range and the others as you [suggested]?

CHAIRMAN MILLER. 4 to 8? I thought Paul said 5 to 9.

VICE CHAIRMAN VOLCKER. No, 4 to 8 is what I originally said.

MR. PARTEE. And [your Bank] has an 8 percent projection and staff here has 8-1/2. So you'd move immediately to the upper end of the range.

VICE CHAIRMAN VOLCKER. I would move immediately to the midpoint and [then] move to the upper end and remain that way.

CHAIRMAN MILLER. Well, I'll take any series of straw votes you want. You want to strike M1 at 4 to 8? How many want to support that?

VICE CHAIRMAN VOLCKER. I would support it.

CHAIRMAN MILLER. You have to hold your hands higher.

MR. PARTEE. What was the number?

VICE CHAIRMAN VOLCKER. 4 to 8.

CHAIRMAN MILLER. Four.

MR. COLDWELL. Try 5 to 9.

VICE CHAIRMAN VOLCKER. I was wondering about 4 to 9--approach it by steps. Say 4 to 9 and 6-1/2 to 10-1/2.

CHAIRMAN MILLER. Let me run the meeting, if you don't mind. How many would be willing to accept 5 to 9? I count one, two, three, four, five, six. Is that right? And apparently there is a very large consensus on the funds rate, as I gather. I may be kidding myself. It's funny. We add up the numbers, and people go for numbers that are different from what they indicate; it's hard to make this matrix work. Let’s go one step further. If you had 5 to 9 and 7 to 11 and the same interest rates, how many are able to support that? Five. This doesn't make any--

MR. COLDWELL. Why not split the difference here and make it 5 to 9 on M1 and 6-1/2 to 10-1/2 on M2?

CHAIRMAN MILLER. All right, let’s try 5 to 9 and 6-1/2 to 10-1/2. How many are able to support that? I need hands held high. One, two, three, four, five, six, seven. All right. Let's run a vote then on a directive that would have an M1 range of 5 to 9, an M2 range of 6-1/2 to 10-1/2, and a fed funds range of 8-1/4 to 8-3/4 with a move in the near term to 8-1/2, and an aggregates directive. Mr. Axilrod, do you have any comment--besides agony?

MR. AXILROD. Mr. Chairman, I have an opinion in regard to policy, if you are asking me that. But I started [with] a somewhat different premise than many members of the Committee because I believe the longer-run range of 4 to 6-1/2 for M1 is unrealistically low and, therefore, I would not push as hard on the funds rate. Although I don't have any particular disagreement with an upper limit of 8-3/4, I'd be very reluctant to go higher without examining very carefully what's happening on the incoming economic news in view of the fact that our projection depends essentially on that particular funds rate.

CHAIRMAN MILLER. Anybody else? Alan?

MR. HOLMES. I have no comments. I think the market will take an 8-1/2 percent funds rate without much difficulty; I think if we got to 8-3/4 very quickly, we'd get a bit of a reaction.

CHAIRMAN MILLER. Let’s read the proposal. Does everyone understand it? The proposal is 5 to 9 for M1; 6-1/2 to 10-1/2 for M2; a fed funds range of 8-1/4 to 8-3/4 with a midpoint of 8-1/2, and an aggregates directive. Let us call the roll.

MR. ALTMANN.

Chairman Miller	Yes
Vice Chairman Volcker	Yes
President Baughman	Yes
Governor Coldwell	Yes

President Eastburn	Yes
Governor Gardner	Yes
Governor Jackson	Yes
Governor Partee	Yes
Governor Teeters	Yes
Governor Wallich	No
President Willes	No
President Winn	Yes

CHAIRMAN MILLER. It's a vote of 10 to 2. Our next meeting, ladies and gentlemen, is on October 17. Through arrangements of the management it will be here. There are two important events that are about to take place. One is luncheon, during which we hope to discuss a number of things, particularly the members with so-called equity and the fair competition in banking proposal. And, of course, there is a very important event at 2:30--a reception for Governor Teeters--which I hope many of the staff will be attending. Unless there are further comments or discussion, we will adjourn.

END OF MEETING