TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

October 17, 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.

Statements Appended to the Transcript

Mr. Pardee, Deputy Manager for Foreign Operations
Mr. Holmes, Manager, System Open Market Account
Mr. Kichline, Associate Economist (2)
Mr. Zeisel, Associate Economist
Mr. Truman, Associate Economist
Mr. Sternlight, Deputy Manager for Domestic Operations
Mr. Roos, President, Federal Reserve Bank of St. Louis

Meeting of Federal Open Market Committee

October 17, 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, October 17, 1978, at 9:15 a.m.

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

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

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

Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Mannion, Assistant General Counsel
Mr. Axilrod, Economist

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

Mr. Holmes, Manager, System Open Market Account

Mr. Sternlight, Deputy Manager for Domestic Operations
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. Henry, 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

Mr. McIntosh, First Vice President, Federal Reserve Bank of Boston

Messrs. Balbach, Boehne, T. Davis, and Scheld, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Philadelphia, Kansas City, and Chicago, respectively

Messrs. Cox and Keran, Vice Presidents, Federal Reserve Banks of Atlanta and San Francisco, respectively

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

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October 17, 1978

CHAIRMAN MILLER. Good morning, ladies and gentlemen. We have a busy agenda today, so I will ask your indulgence to take care of those matters we can expeditiously in order to leave as much time as we can for the weightier subject. I'll remind everyone that we do have a luncheon planned after the FOMC meeting. As usual, we have a number of items to discuss of importance. But without taking more time this morning, let us proceed quickly with the routine part of the agenda. First is the approval of minutes of the meeting held on September 19. Those have been circulated. Are there any comments or corrections? Hearing none, those are approved. The second item is foreign currency operations, and first we have a report on the operations since the last meeting by Scott Pardee. Scott.

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

CHAIRMAN MILLER. Normally I would say thank you, but I'm not sure I will. I appreciated your report. Any questions? Henry.

MR. WALLICH. If the dollar has been the vehicle for going long on marks and Swiss francs, would that suggest that there's some unwinding of positions ahead--to buy back those dollars or to repay them?

MR. PARDEE. Yes, I think there is a very substantial oversold position against the dollar that could be unwound at some stage. But it's one of these problems that we have in economics where you have a curve and you can slide down the curve but you may not be able to slide back on the same curve. And my fear is that people are now deciding [that] the dollar is not going to recover over the next few months or the next few years and they're going to change their investment and money management habits more or less permanently. Certainly, right now I think there is a substantial technical position in favor of the dollar should we get a change in market sentiment. It may be on the order of tens of billions of dollars, but we won't see it until there is this turn in sentiment.

MR. COLDWELL. Scott, what is the market telling you that it thinks we ought to do about this?

MR. PARDEE. Well, as I say the main concern is inflation. People are now focusing on the anti-inflation program which has been indicated by President Carter and other advisers. Every time there's a new announcement that it's going to be delayed, that tends to lead to a new bout of selling pressure on the dollar. But there is a problem that every time this question comes up I give you something new that the market's looking for--[something] to be done in terms of raising of interest rates, an energy program, and all these other things. There's just a general lack of confidence the things will be done quickly enough. But as I say, fortunately, many of the fundamentals are moving in our favor now and I think it's just a matter of time before the underlying elements are recognized by the market as turning in our favor.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Scott, I have the impression, though it's sort of a vague one, that our interest rates relative to those abroad have a larger margin than the difference in the inflation rate. Why would that then be a concern? I would think that the prospects are for an increase in the inflation rate abroad and that everybody would recognize that.

MR. PARDEE. They do recognize the absolute differential but you're talking about day-to-day speculation in the market. If you can make 1 percent overnight, that's a differential of 360 percent per annum.

MR. PARTEE. Yes, but that's just a run in the market. I mean that has to reverse.

MR. PARDEE. Yes, it has to, but it hasn't; and we've been going several months with the same problem. As I say, the Dutch took the trick of raising interest rates very sharply on call money--that is a technique of forcing shorts to cover--and then bringing the rates down.

MR. PARTEE. But it's a satellite country of Germany, of course.

MR. PARDEE. That's right.

VICE CHAIRMAN VOLCKER. It isn't quite clear, I think, [whether] the interest rates are fully offset.

MR. PARDEE. Pretty much.

CHAIRMAN MILLER. Larry Roos.

MR. ROOS. Yes sir. I'd just like to pursue one aspect of what you said. Initially, as I heard your statement, you pointed to the lack of credibility toward our determination to deal with inflation effectively. And then a few [moments] ago you said that the fundamental factors were improving. It seems to me that we've had those fundamental factors that we earmark such as the gas tax and these other things like the energy program. Are you not saying, though, that probably the one thing that could do most for our problems is a really meaningful anti-inflation effort that we stuck by and that people could believe? Is that what you're saying?

MR. PARDEE. I'm saying that is what the market is saying right now.

MR. ROOS. Hasn't it been saying that for the last six months?

MR. PARDEE. It's been saying that, but the moment it comes through if at the same moment an OPEC seller is selling $100 million against marks, then everyone is going to shrug it off. This is the problem. The market forces have taken over and they're driving the dollar lower.

And market forces somehow have to be stopped, whether by a change in market sentiment or what I don't know. But it's a serious situation.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. Scott, how would the market view a recession?

MR. PARDEE. Oh, they don't want a recession. They're not dealing next year; they're dealing with today and tomorrow, the next week, and the next few weeks. And we have this cumulative process under way. No, I've argued with people. And I spend more of my time arguing these days than intervening and they're both equally frustrating. No one wants a recession, but they don't like what they see at this moment.

CHAIRMAN MILLER. Phil.

MR. JACKSON. Do you see any evidence of foreign official institutions changing their reserve holdings in enough quantities to be of concern?

MR. PARDEE. It's hard to see directly. We have seen some transactions. It's in what is called the second tier central banks outside of the OECD. The smaller central banks in OPEC, Latin American central banks, central banks in Asia, and so forth we know have been diversifying to some degree. The central bankers themselves--we've had many of them in recently or talked to them on the phone--claim that they are very cautious but many of them also admit that they are diversifying. It's not so much the central banks as other government institutions. Many of the OPEC countries have development banks and development funds and portfolio managers who are very big and very clumsy in their operations. Yesterday, for example, the word got around that one of the German banks that handles big accounts for OPEC was a large seller of dollars at eleven o'clock our time, and that knocked the stuffing out of the market for the day. So you get these kinds of reports almost every day now. At one point or another, some big holder of dollars has sold dollars in a clumsy way.

MR. JACKSON. Is our withholding tax problem exacerbating this situation?

MR. PARDEE. Not as far as the central banks are concerned.

MR. JACKSON. I was thinking about the other institutions.

MR. PARDEE. I don't think they're worrying so much about a technicality of that sort.

CHAIRMAN MILLER. Ladies and gentlemen, we need to ratify the transactions since the previous meeting; [a report] has been circulated. Is there any dissent or objection to ratification? Hearing none, that is approved and we move to consideration of the Manager's recommendation on foreign currency operations. Alan Holmes.

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

CHAIRMAN MILLER. You'd like approval on the renewals?

MR. HOLMES. Yes.

CHAIRMAN MILLER. Is there any objection? Hearing [none], that is approved. And, Alan, while you have the floor let us move on. I believe you and Scott have written us a memo regarding those discussions to amend the swaps, and I believe you'll report to us on the recommendations. Excuse me, Phil.

MR. COLDWELL. I wonder if the Manager has a recommendation concerning the volume of operations. It seems to me that the last time we raised the limit on operations. Do you want a continuation of that increase?

MR. HOLMES. Governor Coldwell, I think we'll wait until we get close to using up the intermeeting limit before we come to the Committee for that. Are you talking about the overall limit or--

CHAIRMAN MILLER. You’re talking about domestic, aren't you?

MR. COLDWELL. Yes, I'm talking domestic.

CHAIRMAN MILLER. I think we increased it from $4 billion to $5 billion on the domestic. You're thinking of the intermeeting limit on activity in foreign exchange.

MR. HOLMES. Yes, on the foreign. I'm sorry, I got confused.

MR. PARDEE. We are approaching the [limit in the] authorization on the net open position. But Alan and I have decided that we're going to try to hold as well we can within the current authorization over the next month. And if we have to, then we'll come to the Committee.

MR. PARTEE. How far away are you?

MR. PARDEE. But it would be in the context of this interim limit.

MR. COLDWELL. How much leeway do you have?

MR. HOLMES. About $400 million, which is above the amount that we normally have--larger [than our holdings] can increase in the interim.

CHAIRMAN MILLER. It's a $300 million limit between meetings.

MR. PARDEE. We've got room.

CHAIRMAN MILLER. Let’s see how it goes.

[MR. HOLMES]. On September 29, Mr. Chairman, we transmitted to the Committee a memorandum on Dr. Gleske's proposals for revision of our swap arrangement [with the Bundesbank] which, along with other swap agreements, will be up for renewal in December. I really have nothing to add to that memorandum unless there are some questions. Then I'd like to go on with the recommendations if there are no questions.

CHAIRMAN MILLER. Let's have your recommendations. Then we'll have questions and [discuss] the recommendations.

MR. HOLMES. All right. I would propose, Mr. Chairman, that we accept the proposal that the current exchange rate be applied to swap renewals and the proposal that certain clarifications in the language of the existing swap arrangement be worked out. Any language change would, of course, be cleared with the Foreign [Currency] Subcommittee. I would like to proceed with negotiations with the Bundesbank and other swap partners along these lines and I ask for Committee concurrence. There are the two--

CHAIRMAN MILLER. There were four proposals to the Committee.

MR. HOLMES. Right.

CHAIRMAN MILLER. You recommend that we go ahead--

MR. HOLMES. That we go ahead on these two.

CHAIRMAN MILLER. And defer the other two at this point because of the problems that they would raise in terms of current perceptions of our swap arrangements.

MR. HOLMES. Right. Well, Mr. Chairman, on the 50-50 profit sharing, which is another proposal, and on changing the interest rate to the German rate--

CHAIRMAN MILLER. We would defer that.

MR. HOLMES. But I would like to see if the Committee really goes along with that sort of approach because there may come a time, even before the end of this year, when the situation has changed enough so that the Treasury may have [no objection] and we might agree that we could go ahead with these, too.

CHAIRMAN MILLER. All right. The proposition for consideration is whether there is general concurrence on the two you recommend and whether there are instructions on the other two to work in that direction. I'd like to put it into context at this meeting that, whatever we decide, we authorize the Manager to negotiate these technical changes subject to the final approval of the

Foreign Currency Subcommittee. I don't think we want to approve the language since we all haven't seen it; but we can't put it before us at this point because you haven't negotiated it.

MR. HOLMES. Right.

CHAIRMAN MILLER. So that would be how we would proceed technically. Are there questions on those proposals?

MR. KIMBREL. Just simply a clarification. In the interest of getting a sentiment: Would this be a reciprocal arrangement? If they were initiating swap drawings, they would expect to pay the Treasury bill [rate]?

MR. HOLMES. That's what they would do under the current swap lines. It's asymmetrical in that sense. [The proposal is that] they would pay our rate and we would pay their rate.

CHAIRMAN MILLER. Both of these are asymmetrical. The 50-50 sharing happens only when we draw; when they draw, they take 100 percent and the interest rate based on our bill rate. [For us] it's just reverse from what they do when they draw. Any questions or comments? Any viewpoints?

MR. MORRIS. I think the German proposal is very reasonable, Mr. Chairman. The existing arrangements were a heritage of the Bretton Woods days, and we ought to recognize that things have changed a lot since then.

CHAIRMAN MILLER. Let's first see--since there doesn't seem to be a groundswell of comments--if we can have your concurrence on the first two recommendations. Is there any objection to those two recommendations that Alan has made? Hearing none, we'll instruct you [to proceed].

Now, how about the other two, which Alan says the Treasury isn't too excited about? And thanks to Henry's discussions, these can be put off at this point. My own inclination is to believe that at an appropriate time, we probably should work to change those [terms] to make them symmetrical. I really think that's the direction we should trend toward over time. I don't know when it should be done. Paul.

VICE CHAIRMAN VOLCKER. I agree with that, Mr. Chairman. I think that the analysis was put pretty well in the memorandum and that it makes sense in the long run. But I recognize the political problems involved, so I think we better defer to the Treasury in the short run.

CHAIRMAN MILLER. Phil.

MR. JACKSON. What would this do to the capacity of the Treasury to be our partner in these intervention efforts, given the limited resources that they have to do it with? If we went to a full loss here--

MR. HOLMES. Well, I don't think the loss is the major problem for the Treasury. I think the status of the [Exchange] Stabilization Fund is their main problem. The fact is that at one point, as you mentioned, Congress was tending to require that there be an appropriation for the ESF to cover any possible exchange losses, which the Treasury--I think quite rightly--wanted to avoid. And I think that's the stumbling point, as far as the Treasury is concerned. I do detect on the part of the Treasury a desire to move ahead and eliminate this once they think the situation has calmed down and their extended position under the swap with the Germans, for example, can begin to move the other way.

MR. TRUMAN. In fact, Alan, I think it's possible that the way it would be worked out technically is that the interest rate differential might end up accruing to the ESF. So that in fact would improve its position because of the technical way it would be arranged to be handled [unintelligible] forward.

CHAIRMAN MILLER. It would historically; we don't know the future. Henry.

MR. WALLICH. Well, logically there's something to be said for the proposed change. Certainly the way things are now, where we share 50-50 in losses but pay the high interest rate, is altogether bad for us. At a minimum [if] we share 50-50 in losses, the interest rates should also be merged or split. As for giving up the 50-50 loss sharing, one anticipates over time that intervention properly done, when it's merely to counter disorder, should yield a profit. That has been true in the past. It doesn't seem to be working out quite that way so far, so we've been fortunate to have had the loss sharing this time around. But I think for the long run, a simple analysis suggests that we'd be better off not sharing losses and that we'd be better off getting the benefit of the lower interest rate on borrowed currency. You might remember, of course, that that relationship of interest rates is a logical one--that the strong currency has the low interest rate, the weaker one the high rate. It doesn't always hold.

CHAIRMAN MILLER. Sometimes it's the other way, yes. But it's the most logical expectation. Chuck.

MR. PARTEE. Well, I don't know. I'm still dubious about the proposition. It seems to me, as far as the interest rate differential is concerned, that it might have not held because a lot of times the foreign country, our partner country, might not be doing what is appropriate for it to do in terms of international dealings. Indeed, I think we've had some difficulty over this phase--looking back over the last several years--in getting the Germans to put their rates down as far as they should have been given the economic circumstances of the country. And I can imagine situations in the future when a difference in points of view on economic objectives could in fact give you an inverse relationship. So I'm not nearly as confident as seems to be assumed here that the interest rate differential will work in our favor.

Secondly, I have the impression, rightly or wrongly, that often in the past we have intervened for our account in a foreign currency in a [situation] when we were under considerable

pressure from the foreign country to do so. Now, I'm not saying that it hasn't been in our self interest to intervene when we have, but I think the tendency has been that we're almost always being encouraged by the partner on the other side to intervene, to keep the market open in the afternoon, to show the Federal Reserve's hand. It seems to me, without being able to cite examples, Alan, that frequently it's considered sort of a matter of statesmanship for us to get into the market and to show that we are also not letting the dollar just go wherever it would but are exercising some discipline on it. I think what that reflects is the fact that there is usually a dual interest in our intervention, an interest at least as great on the part of a foreign country as there is on our part. It seems to me [unintelligible] all right, when we intervene in our own self interest as dictated by our own circumstances. And I think there's a change--

CHAIRMAN MILLER. Chuck, may I interrupt for a technical question? I may misunderstand, but as I understand it, under the charter of the IMF we're obligated to intervene to counter disorderly markets.

MR. PARTEE. Mr. Chairman, the question of what constitutes a disorderly market is--

CHAIRMAN MILLER. I understand that's a debate, but when that debate comes up it's often just as much our urging somebody else to do something as somebody else urging us to do something.

MR. PARTEE. Well, my impression over the years has been that we have been under pressure to intervene.

MR. HOLMES. Mr. Chairman, if I may respond to that as well. That may well have been true in the past but I do think, as the Chairman noted, that the situation has changed now. We are more big boys on our own feet in this business. We do have certain obligations that we have to live up to. So I would think that would be less of a problem now even though there always will be a mutual interest in intervention. And for us to insist on 50-50 loss sharing on our intervention--well, certainly we would not accept that from a foreign central bank who is intervening many, many times more than we are in our own interest as well as theirs.

MR. PARDEE. The bigger interventions are normally in the other market.

MR. HOLMES. By a foreign central bank.

MR. PARTEE. I realize that.

MR. PARDEE. Also, Chuck, you never hear from us about all the urgings we get from central banks where we do not intervene. We are constantly bombarded, particularly in times like this, [with requests] for us to intervene in other currencies like Belgian francs, Dutch guilders, Austrian schillings, and Scandinavian currencies. But we don't bother to report that to you.

MR. PARTEE. That's precisely my point. My point is that there is a very strong interest on the part of other countries in our intervention. And when we do it, I think it's reasonable to say we do it on a 50-50 basis.

MR. PARDEE. Well, we do it in our own interest.

MR. PARTEE. Yes, in some sort of large sense, I guess we do.

CHAIRMAN MILLER. I fear the converse. If we're urging other countries to intervene, I don't want to see us taking 50-50 risks with them. That's the problem. And I think we've urged just as much intervention. In fact, the amazing thing is that the obligation is for the weak currency to intervene to counter disorderly markets and actually the intervention for the dollar mainly has been by other central banks. We have really pushed the burden on to others who have intervened directly, taking 100 percent of the risk. I think it's very hard to argue, therefore, that we should [take only 50 percent of the risk]. It seems to me that [the argument] breaks down a little.

MR. PARTEE. You may be quite right from the standpoint of [fairness]. Perhaps we've got an unfair advantage. My point simply is that I believe we're giving up an advantage.

CHAIRMAN MILLER. An unfair one.

Let me ask this because I think we've spent the time we can spend on this issue today, since it's not up for action immediately. Chuck's comments are consistent with the comments I've heard from him since I've been here--so he at least has a consistency though I will not characterize it--but I've heard other sentiments. Considering Chuck’s comments, would the general consensus be to continue to look toward this with sympathy--at a proper time to go on a symmetrical basis on these matters? I see a lot of heads moving this way. Besides Chuck, are there many reservations?

MR. JACKSON. I just want to be sure the Treasury is still with us.

CHAIRMAN MILLER. Oh yes.

MR. WALLICH. I think Chuck has a good point. After all, the dollar is a world currency. We're supporting something which is of great interest to others. When Paraguay supports the guarani, that's of no interest to anybody except Paraguay.

CHAIRMAN MILLER. Well, we will continue to give you that guidance, Alan and Scott. Thank you very much. And, Phil, if it's still all right, we could put off your question until we come to Peter's report. Is that all right? Fine. Then we'll move on to [agenda] item 3, which is the economic and financial situation and outlook. Jim, you can lead off here.

MESSRS. KICHLINE, ZEISEL, and TRUMAN. [Statements--see Appendix.]

CHAIRMAN MILLER. Thank you very much, Jim, Jerry, and Ted. We are open for general questions for the first part of our follow-up. After a period of questions, I would appreciate another go-around where I would ask each of you to comment on any variation [in your views] from the staff projections.

MR. PARTEE. Just as a matter of clarification, Jim, in the next to last table in your presentation, the 1972 unemployment [and other] rates are averages for the year?

MR. KICHLINE. Yes, they are.

MR. PARTEE. And, of course, real GNP was growing rapidly during 1972, so the peak rate of GNP in '72 would have been quite a bit above the '72 average. The capacity utilization, however, is what--a quarterly peak?

MR. KICHLINE. No, it is the peak rate in a month in 1973; and they were generally in late summer or early fall.

MR. PARTEE. The peak month. How do you account for the rather pronounced difference now compared with then in the materials industries as against overall manufacturing? I hadn't had the impression that capacity had expanded that much in paper, pulp, steel, aluminum, and other basic materials industries.

MR. KICHLINE. There has been a considerable amount. Between 1975 and 1976 we estimate about 3-1/4 percent expansion in materials capacity and around 3 percent in 1977. And in the first three quarters of this [year] we have an estimate of about 3-1/4 percent. So there has been a fair gain in materials capacity since that time. There are still some key areas that pose problems. As you know, cement is one which is reportedly in question. But in general I think there has been an expansion in materials capacity since the ’73 experience.

MS. TEETERS. Doesn't the lack of a worldwide boom also come into this?

MR. KICHLINE. Oh yes, that's quite important in our assessment of the reading of these numbers. We are not in a period currently of substantial demand abroad; internationally traded commodities are not in short supply. So, I think in reading the degree of ease or tightness here, the international situation is a real plus.

CHAIRMAN MILLER. John Balles.

MR. PARTEE. I just have one other point of clarification. I just want to be sure.

CHAIRMAN MILLER. Excuse me, Chuck, I didn't mean to cut you off.

MR. PARTEE. Do I understand that the base projection for 3.3 percent real growth over the next five quarters assumes a bill rate of 8-1/4 percent?

MR. KICHLINE. Yes, it's the low end of the federal funds rate range in the Bluebook under alternative B. We key off our interest rates from that, which is an 8-1/4 percent bill rate--not very far from where we are today.

MR. PARTEE. It was 8.21 yesterday.

MR. KICHLINE. Yes. So implicit in this forecast is very little change in interest rates from current levels.

CHAIRMAN MILLER. John Balles.

MR. BALLES. Thank you, Mr. Chairman, I'd like to ask Ted Truman about the outlook that he presented for the United States and other leading countries. One encouraging factor that I see in your charts, Ted, is that in effect you're saying that in 1979 you expect some convergence in the growth rates of real GNP in the United States and its major trading partners. But what I didn't hear you say, unless I missed something, is what you expect to see on the inflation front. [I ask] because, going back to Scott Pardee's rather pessimistic report on the state of the dollar, it seems to me that we won't really come to grips with the weak position of the dollar internationally until we get a reversal of trends that have been under way for some years now--with real GNP growth considerably faster in the United States [relative to] our major trading partners but also a considerably higher inflation rate [here]. Now, if we could see some daylight at the end of the tunnel--not only a convergence of real growth rates but also a narrowing of the spread between inflation rates--that would be helpful. But I don't think you covered that. Could you give us your view on that?

MR. TRUMAN. Well, I did, but it may have been so parenthetical that it wasn't entirely clear. I keyed off from the third quarter to try to keep it in that framework. Our best guess is that you've had through the third quarter of this year about 3-3/4 percent--or 3-1/2 to 4 if you want to use the range--real growth abroad. We expect that to continue; we don't expect an acceleration, on average, abroad but we expect a continuation from the very low levels that we had going into this year on the growth side. Meanwhile, our growth has come down somewhat so you get the convergence--in fact a crossing in that dimension. I would say, though, that you don't get enough of a convergence; it's not going back to the historical relationship where the growth abroad averaged maybe 2 percentage points higher than the growth in the United States.

On the price side, which I covered in the first chart, the dotted lines there [show] the relative CPIs. The fact is that this year--or again the year ending in the third quarter--there's been quite a difference. On average we estimate that ending in the third quarter you've had about a 5-3/4 percent annual rate of price increase abroad in these ten major countries, as contrasted with 7-3/4 percent in the same period for the United States. It's a difference of approximately 2 percentage points. Next year you see that the red line continues down but at a lower slope. That reflects the fact that although our inflation performance is about the same, at least on average--slightly lower on this third quarter-to-third quarter basis--the inflation rate abroad is expected to come up

somewhat, to something in the 6-1/2 percent range. That's because of the U.K. and Japan, primarily. What I've tried to suggest by way of convergence is that there is a gradual convergence. The growth rates seem to be crossing and [the spread between] inflation rates seems to be narrowing. If the markets in fact are looking for a restoration of slower inflation here than abroad, then the tunnel is longer--if I can put it that way--than [by] 1979.

MR. BALLES. All right, I guess my next question then is: Are consumer prices really the most relevant price gauge for measuring with respect to currency given the fact that there's a lot of stuff in the CPI that doesn't get traded abroad?

MR. TRUMAN. Well, there's a long and technical debate about that and we have in the October Bulletin an article coming out on that subject. As far as the United States is concerned, the various measures show approximately the same thing. One of the problems [relates to] unit labor costs and export unit values. For unit labor costs, we only have data through the first quarter of this year; for export prices we only have data through the second quarter of the year. So it gets a little difficult to compare. But, on average, the story that is told by the various price indexes for the United States is the same. So wholesale prices of manufacturers, for example, show instead of approximately a 15 percent real change in the exchange rate something like a 14 percent real change in the exchange rate. For the United States it doesn't essentially make much difference. An aside--the monetarists, if I may put it that way, would argue the CPI is exactly what should be used, not traded good prices.

CHAIRMAN MILLER. Bones Kimbrel.

MR. KIMBREL. Mr. Kichline, [regarding] liquidity measures, at an investment seminar in Atlanta this last week a vice president of Prudential was quoted as suggesting that Prudential was committed through 1979 with no additional opportunity. That came as something of a surprise. Is that reasonable or are we hearing any of these types of suggestions in other spots?

MR. KICHLINE. I think that company may be, from the limited reports we have, tighter than most insurance companies. But we are getting to the point of the year where they like to be reasonably committed for next year. The insurance industry with regard to a liquidity measure is actually running with a fairly high volume of cash and short-term liquid assets according to our flow of funds accounts.

CHAIRMAN MILLER. Bones, was he talking overall or as to some particular segment of their business?

MR. KIMBREL. I don't know. He may have been talking about their decision to commit X amount in private placements or something. I really was not there and did not hear [what was said]. It was just a quote that came up that suggested that they were--

CHAIRMAN MILLER. It sounds out of touch doesn't it, Jim?

MR. KICHLINE. It sounds too tight.

MR. KIMBREL. It does. Yes, that is my point.

MR. PARTEE. They might be tighter than other companies.

CHAIRMAN MILLER. It could be one company. Mark Willes.

MR. WILLES. Thank you. Jim, [my question relates to] the last table where you run the simulations that we get from time to time. The work that we've done with models like the one you use--we haven't done it with yours and I don't think we can--suggests that if you build in some mechanism for rational expectations, you get quite different patterns than this, including a much more rapid impact on prices and perhaps substantially less impact on real output and unemployment. Do you have anybody who is going to try and fiddle with that with your models to see if the same thing happens with yours?

MR. KICHLINE. Yes. We have work going on now to try to incorporate in the various parts of the model a better expression of expectations than is now captured in the model. It's clearly a weak point of the model now. I guess my own judgment would be that perhaps we wouldn't get as strong a response as the results of your work in this area just looking at some of the early things we've done. But I think it's a quite valid comment that our model does not have in it as much of an "expectations" phenomenon throughout as [your model] apparently. You're quite correct; I have no problem in saying that we have not progressed very far in putting that in the model.

MR. WILLES. It can change substantially the perceived impacts of policy alternatives.

MR. KICHLINE. It can.

MR. PARTEE. But this is based on historical experience isn't it, Jim? It's not based on some new theory but on historical experience.

MR. KICHLINE. That's right.

MR. WILLES. No, but the point is that even--

MR. MORRIS. Based on experience that didn't have the kinds of inflation rates that we are now failing to enjoy.

MR. WILLES. My point is a different one than that. If you take the same models and construct them just a little bit differently and then apply them to the same data, you get a substantially different perception of policy impacts than if you do it the way the model is currently constructed. You can fit it--

MR. PARTEE. But I still think, Mark, the test of the pudding is in the replication of the past. Again, no matter what your theory is, it has to be a model that--

CHAIRMAN MILLER. It's got to be proved throughout the cycle.

MR. PARTEE. To show it works, and this one is based on the past.

MR. WILLES. The only point I'm making is that you can have a model which fits historical data just as well and yet generates dramatically different future time paths. That's the only point. It is not a question of whether it fits history well, because it fits history just as well.

CHAIRMAN MILLER. Bob Mayo.

MR. MAYO. Mr. Chairman, I found the international charts more than usually exciting this time. I think the staff did an excellent job on them. One of the phenomenon in here that I think is sort of fascinating, but was only partially brought out in the presentation, relates to the comparative inflation rates here and abroad. A good share of the good showing by Germany and Japan, who are great importers of oil, is directly derived from the fact that they're paying for oil in U.S. dollars, which means that it becomes cheaper and cheaper as the dollar goes down in value. I know that this is just an analysis of a segment but it gives me some hope that, indeed, if the U.S. dollar is oversold at this point the turnaround will come eventually. I'm convinced of it, and that in itself is going to improve the international price competitiveness even if nothing else happens.

MR. TRUMAN. It's a little bit sad to count [on]. I think you're right [about] the oil, and there are other dollar-denominated international commodities. The fact that the dollar has gone down has made them cheaper in foreign currencies, especially in Japan but in the U.K. and a number of other countries as well, and has helped their performance this past year. And our forecast of some pickup in inflation abroad is in part dependent upon the fact that we also are assuming or projecting--choose your own word--that the dollar will stabilize. That means they will lose that positive benefit.

MR. MAYO. You have made no attempt have you, Ted, to do an analysis of what these indexes would look like if the price of oil were abstracted from them? It becomes pretty much of an academic exercise, I suppose, because of secondary effects.

MR. TRUMAN. Yes. On this round we have not done that. We have in the past on some similar things--essentially the impact of oil price increases on foreign prices [or] inflation rates and they are, of course, significant.

CHAIRMAN MILLER. Well, ladies and gentlemen, according to my reading of the Greenbook the staff has projected for the third quarter of ’78 to the third quarter of ’79 a real GNP growth of 3-1/2 percent, a gross business product fixed-weighted price index of 7-1/2 percent, and an average rate of unemployment in the third quarter of 1979 of 5.9 percent. I don't think it will be necessary for us to ask you to give precise figures on those three; if you could give us any

significant changes, qualitative or quantitative, that would help us sense whether we're [unintelligible]. In keeping track of where I started last time--and it's my determination that we do better when we start with Presidents--I want to start with Larry and come down this way this time. We started with Roger last time around.

MR. ROOS. Of course, we predicate our projections on specific rates of money growth; and based on a 6 percent money growth projection, our real GNP estimates are somewhat below the staff's. We would estimate about a 2.1 percent rate of real GNP growth during the year at 6 percent M1 growth and inflation at about 6.5 percent, which is below the staff projection.

CHAIRMAN MILLER. Unemployment?

MR. ROOS. Unemployment is almost 6.1, which is almost the [same].

CHAIRMAN MILLER. Thank you very much. Bones.

MR. KIMBREL. Mr. Chairman, we too are a little more pessimistic than the staff, with real GNP at about 2-1/2, unemployment at about 6-1/2, and our price index at about 8-1/2.

CHAIRMAN MILLER. You're different in both directions from Larry. Thank you. Dave.

MR. EASTBURN. Quantitatively, I have no major difference with the Greenbook forecast. Qualitatively, I have two comments--picking up on Jim's comments about where the risks lie--that the risks are on the downside for the real economy and on the upside for inflation. I'd certainly like to stress on the real economy that qualitatively and intuitively I have the feeling that we are building a good possibility of a recession into our forecast. One reason I feel this is that, looking back into history, I find no instances where we've had the combination of slow, gradual rates of decline that the standard forecast has together with the very high inflation rates that we're also forecasting. That in my experience is a unique combination, and I would have a real question as to whether that's a sustainable combination. On the price side, I think it's quite clear that the risks are on the upside.

[Let me mention] just one item of information. We've tried to make some assessment of what businesses think about the President's forthcoming announcement, whenever it's going to be. In particular, we’ve tried to find out if there's been any anticipation of this in terms of pay increases and price increases. The main impression we get is a sea of vast indifference. [It seems] that they don't particularly care and they're cynical, to use Scott's term, about what's likely to come of it. And if substantial teeth are attempted to be built into it, they'll resist it. So I think it's a very pessimistic kind of outlook.

CHAIRMAN MILLER. Willis.

MR. WINN. I would say perhaps a little lower on the real GNP--real output of 2-1/2 to 3 percent--and a little higher on prices, at 7-3/4 to 8-1/4 or something of that kind. What disturbs me

in all of these forecasts are the price developments. I just don't think you can talk to people without coming away with a different sense that this is simply not sustainable, in terms of the bitterness that is building up in a very, very broad area. I get public reactions that are different than we put into our forecast.

CHAIRMAN MILLER. Bitterness?

MR. WINN. On the price developments.

CHAIRMAN MILLER. Translated into what?

MR. WINN. Well, their reactions are either going to be explosive on one side or complete withdrawal on the other. At the moment I'm not sure how that will fall out but it's a very widespread feeling and the first time I've encountered it. It's such that you can't talk to any group without that being the dominant factor in the picture.

CHAIRMAN MILLER. Bob.

MR. BLACK. Mr. Chairman, my view on the long-run economic outlook, like the staff's, has really not changed a great deal since last time. It's somewhat tempting when you see the strength that we've got in residential construction and business fixed investment, and also the pickup in retail sales, to think that things may be a little bit better. But then when the producer price index comes in at a double-digit rate, I get quite discouraged. I think the main factor in the long-term outlook is going to be expected and actual rates of inflation.

As I indicated last month, if the Administration comes up with something that is perceived to be rather effective--including dealing with a reduction in the deficit--and if we're effective in getting the aggregates under control, then I think we might get growth of 2 to 3 percent in real GNP by the third quarter of next year. I would hope that we could also keep the rate of the business fixed-weight price index below 8 percent. And I think the unemployment rate might be around 6-1/4. If we are not successful in dealing with inflation, because we don't handle our monetary policy as well as we might or the Administration doesn't do as much as it might on the fiscal, then I think we could have inflation coming in at a higher rate and in that case I would expect a lower rate of real GNP and a higher unemployment rate.

CHAIRMAN MILLER. Nancy.

MS. TEETERS. Well, I think the risk on the downside has increased considerably since about a month ago. This is little changed from the projection of last month, and my own perception of the economy is of one reaching a peak in terms of expansion. I would like to associate myself with the worries that we've never accomplished what we say we're going to do. We've either slipped into a recession or have resumed recovery. A policy of growing right at the potential rate of real growth and a constant unemployment rate is a very difficult thing to bring off. I think the possibilities are that the downside risks are [much] greater now than they were over the summer. If

anything, I would have a lower rate of GNP and a slightly higher unemployment rate than being forecast by the staff.

CHAIRMAN MILLER. Thank you. Chuck.

MR. PARTEE. Well, I feel a little better about the economic situation than I did a month ago. I think we've [now] got more evidence that production has moderated and that final sales have picked up and it's one of the most important balancing items there is in the equation. So if we're getting another adjustment--a modest, midcourse adjustment--in production and if sales will hold up, I'd be inclined this time to take the staff's projection, whereas a month ago I would have been on the low side of it.

I also feel a little better about inflation. I don't think it's going to be as wild as some people have been noting, partly because I think the President's program will have a marginal impact and partly because the food supply situation is really quite good. It has been an awfully good year in growing and I think that has a fundamental influence on price behavior. I guess I feel that the unemployment rate is a little low here. Although the staff has assumed that people will stop joining the labor force because jobs won't be there, I'm not so sure that that's so. So I would have a little more labor force growth and, therefore, a somewhat higher unemployment rate.

Finally, I would point out that fundamental to my acceptance of the projection the staff has here is the policy assumption of a bill rate of 8-1/4 percent. Just as Larry has in his an assumption of the 6 percent money supply growth, my emphasis is on interest rates. And I think that this interest rate level is about an equilibrium level relative to the growth patterns that are projected here.

CHAIRMAN MILLER. Thank you, Chuck. Phil.

MR. JACKSON. I think things are looking a little better although, unlike Chuck, I would say that on balance inflation probably looks a little worse. That's because, despite the good crop situation, I think our income outlook is for higher wages all the way across the board. I'm not optimistic about the improvement in productivity that the staff is projecting. I'm more pessimistic that we'll continue to see a very low rate of productivity. So on balance I'd be inclined to think that while the GNP projection is about right, the inflation measures, if anything, might be on the slightly low side. Unemployment probably will stay about the same.

CHAIRMAN MILLER. Thank you.

VICE CHAIRMAN VOLCKER. I'm in the happy or unhappy position of feeling just about the same way I felt last month, which is--

CHAIRMAN MILLER. We all remember what that was.

VICE CHAIRMAN VOLCKER. I agree with all the comments that the risk is for slower growth on the growth side and more inflation on the inflation side. In fact, I project a slightly slower real growth rate and a slightly higher inflation rate. I don't know what the implications are of these comments, which I suppose I agree with, that it's difficult to have this nice, gradual slowing down. I don't think the easy answer is to speed it up under these circumstances. I think we're just left in a difficult situation.

I do feel a little more pessimistic about some of these [things]--well, optimistic in one respect and pessimistic in another respect--on the external side. Anyway, I've been presented with a forecast--I don't think any of these are very reliable--that would show more rapid improvement in the current account as we get on into the next year than the forecast that Mr. Truman had; they're in the same direction. I'm not so optimistic about any convergence in the inflation rates; I guess you didn't have a convergence, [Ted], but I would think there might be more divergence than was suggested here, partly because of the dynamics of the exchange rate itself. I don't think it will work through at all with the kind of exchange rate changes we've gotten recently. That will continue to depress price performance and economic activity abroad and give us inflationary problems for some time here--even if it stopped right now, which I'm not so sure it's going to do. But even if it did, I think this would take a period of three to six months to work through anyway. And that tends to work against any convergence of inflation rates internationally. I think that's unfortunate but true.

CHAIRMAN MILLER. Thank you. Henry.

MR. WALLICH. For the short run and for one month, I think the picture is better. Housing is well maintained and business investment looks stronger, so the expansion has gained another few months of probable life. No expansion is immortal. If the peak is next year, [this expansion] will be four years old and that will be well above the average. And I think one could say that it had been a successful performance, not a great failure [if] something happens that has happened cyclically for two hundred years with considerable regularity. We can, I think, push this [expansion] into the future by restraining inflation; that is the thing that is likely to kill it. I see inflation going further than the staff's forecast. I see, unless the President's program is surprisingly successful, very high wage settlements and I see anticipatory price increases. And I think for a good part of 1979 we'll find ourselves with double-digit inflation. That means then declining GNP, perhaps a positive downturn. The position of the dollar contributes to this inflationary scenario and to the risk of recession. I think the main thing we can do is to restrain inflation now.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Mr. Chairman, I think I'd agree with a lot of what I have heard around this table--much of what Henry, Philip, Chuck, and Nancy said. I do have the same relative position: that we have seen some improvement in the economy this past month. In a kind of fundamental sense, it is getting a bit better. I don't find any evidence in what I read of an improved inflation rate, and the inflationary forecast of the staff is just unacceptable to me. I just can't agree

with the idea of a future that holds a 7 to 9 percent--and maybe even Henry's 10 percent--inflation rate.

So I guess I get mixed up between what should be the forecast and what I think we ought to do to alter that forecast. I don't accept the idea of the staff's fundamental assumption that interest rates will remain at the low end of the ranges of alternative B. If that's the way we are going to play the game, we end up with an inflation rate that's unacceptable. Given this assumption of the staff, I'm not far off [from their projection]. I just don't think it's going to yield an acceptable policy for the future economic growth of this country.

CHAIRMAN MILLER. Frank.

MR. MORRIS. Mr. Chairman, the numbers have come in a little stronger in the past month than I'd expected. At the same time, we're shifting our policy period from the second quarter to the third quarter and this sort of offsets things. But we still come out much more pessimistic than the staff, with something like 1-1/2 to 2 percent real growth. In other words, I think that the chances of avoiding at least a mild recession in '79 are not too good. But we are also looking for some deceleration in inflation to about 6-1/2 percent and an unemployment rate of about 6-1/2 percent.

CHAIRMAN MILLER. Ernie.

MR. BAUGHMAN. Mr. Chairman, I have no particular difference with the staff's projection with respect to production. With respect to inflation, I share the view that we are likely to see stronger price movements than projected here. And along with that, it seems to me that there's a good possibility we will see somewhat more unemployment than is projected. In fact, to me the real issue as we attempt to decide policy--I'm using "we" in a very broad sense now, broader than the Federal Reserve--is this: Unless we can bring forth some means of reaching more directly into the wage negotiations that are coming up and getting an outcome from those that is different than has been projected in the charts here, our prospects become dimmer rather than brighter.

Even though I suggest that with stronger inflation there is a probability of greater unemployment in total, I have to add that in my part of the country at the present time we have predominately very tight labor markets. Business firms are engaging in extensive recruitment efforts, ranging far outside the area, and are having difficulty bringing people in at the rate that they would like to employ them.

It seems to me that there is another important question in the picture. While we're projecting a continuation of the present rate of saving--and I guess that may tie in somewhat to the projection of essentially the present rate of inflation--it seems to me there's a significant probability that our saving rate may change. As people see a continuation of inflation at a fairly strong rate, we may see a continuation of the trend we have seen this past year in efforts to take protective actions. That, of course, will feed back on price developments and also, unfortunately, on production developments, as attention shifts to protective [measures in] various production efforts.

CHAIRMAN MILLER. John.

MR. BALLES. Well, we see somewhat less real growth than the Board's staff, which has been the case now for some months. But I would like to emphasize one factor that I have not heard discussed, although I can agree with many of these views about the risk of less real growth than the staff has projected. And that is that, based on a number of studies we have made, we see the economy essentially at practically full employment, both in terms of availability of skilled labor and even some unskilled labor, which has been touched on by a number of people including Ernie. In terms of cost effective unused capacity, we don't see as much slack as the staff figures here suggest. Therefore, we don't see the possibility of real growth over the next twelve months rising beyond what our model tells us--2 to 2-1/2 percent--by pushing on the accelerator of aggregate demand. At the same time, I'm much more--

MR. PARTEE. You think these unemployment figures are wrong, John?

MR. BALLES. Well, I think they need to be interpreted with great caution, given the sense one gets just by talking to firms trying to hire people in today's labor market. I get this from my directors all of the time; Boeing is having tremendous difficulties.

MR. PARTEE. That's a West Coast observation.

MR. BALLES. They want to add 25,000 people to the payroll. [They are] hiring away people at higher salaries from all sorts of local firms, including the [Seattle] branch of our Bank, I'm distressed to say. The labor supply just doesn't seem to be there for firms actively in the market, and that's going to be a constraining factor. And I think [it’s going to be] a factor leading in turn to higher inflation just on the wage settlement side--on the unit cost of production side. So I'm not any less optimistic than the Board's staff on the inflation figures; in fact it could be somewhat worse. But I also see real growth being constrained by these limitations on supply. That's about where we come out.

CHAIRMAN MILLER. Mark.

MR. WILLES. Mr. Chairman, what Henry and Phil said is pretty much what I was going to say on the forecast. The only other comment I was going to make was about Dave's comment on the President's program. I think enough of that program has been [leaked] that people have figured out what they think it's going to be. To the extent that in some sense it's more effective in doing something to prices than people currently expect, it seems to me that that also raises the possibility that it could precipitate substantially slower growth than we're expecting. If people's income and profit potential turn out to be less than they now expect them to be, that's precisely the kind of shock that can lead to a retrenchment in economic activity. So while it may have some impact on prices, it may also have an unexpected impact on output and unemployment.

CHAIRMAN MILLER. Bob.

MR. MAYO. Mark's last point is an interesting one. I've sensed a little of this, too, Mr. Chairman, in a feeling that businessmen in several areas in the Midwest are more anxious this time around to protect their profit margins than they were in the 1973-74 experience. They still feel a little bit wounded from that. And the net effect of the President's anti-inflation program as it is now interpreted in the market may be some tendency toward greater unemployment. This goes in the face of some of the other things that have been said here. I [would note] also that just about every restaurant in suburban Chicago has a "help wanted" sign up. They just can't get people, even at the lower skill levels; people just don't want to work in that sort of activity.

So we have a mixed bag here. Although there have been some things on the good news front since the last meeting, I feel a little more pessimistic than I did a month ago. Again, [as for] taking solace in figures, I'm somewhat of a cynic in that area. But I am a little concerned. The way I read the consensus forecast outside of the Fed, our staff forecast for the next year is one of the highest, and I think we are too high. I come out with 2 to 2-1/2 percent real growth. I don't think there is more than one chance in ten that we can hold the inflation rate next year under 8 percent. There are too many things that are already built in. And following up on my own [unintelligible] on unemployment here, I think our chances of holding the unemployment rate under 6-1/2 percent next year are rather slim.

CHAIRMAN MILLER. Roger.

MR. GUFFEY. Thank you, Mr. Chairman. I guess you could characterize our feeling as one of a bit less optimism than the staff has projected. Particularly with respect to GNP, we would look for a performance of around 3 percent, which we don't view as pessimistic, frankly. It is about as high as we would hope for.

Secondly, on the price side, we are a good deal more pessimistic in the sense that there do not seem to be those factors working that will give us any assurance that prices will come down. Rather, [it appears that] they will accelerate even further and we are looking for something in the range of 8 percent--perhaps even 8 percent plus. There has been some comment [about] some contribution from the food sector because of good supply in the growing season of 1978. But I would remind you that prices of food are more greatly affected by the middle man than they are by the producer. Secondly, the producer price that will hit the middle man for processing is now being determined to a greater and greater extent by some floor of government subsidy. So you just don't have the elasticity in that price that you once would have expected.

Lastly, with respect to unemployment, I would share [the view of] those who have mentioned--I guess I would start with Ernie--[unintelligible]. Unemployment in our area is virtually zero, particularly for skilled people but it does indeed run on down to those people who wait tables. We do not see very much unemployment, so the figure of 6 percent that is commonly [cited] nationwide is certainly not [the case] in our area, as far as we can tell. But as this year unfolds we would expect the unemployment rate, because of the price impact, to move upward. In the year that we are looking at, we think perhaps unemployment will go to the 6-1/2 level from the current 6 level.

CHAIRMAN MILLER. Bones, do you have any comments you want to make?

MR. KIMBREL. Well, Mr. Chairman, maybe [my question should be] directed to you. With the several references to the Administration's anti-inflation program, I wonder if there are any significant items of intelligence that you would feel free to share with us.

CHAIRMAN MILLER. I'm not in the loop, so I can't share them. I think they have gone underground with their program after considerable discussion early in the year about the framework of what might be done. I'd just comment on a couple of things. I think we are now in an era when labor--skilled labor--is less mobile. Therefore, when you have a buildup in the aircraft industry, you'll have shortages of skilled labor in Connecticut building engines and in Seattle building airframes. In the past you were able to move people much more quickly; now they don't want to sell their homes and families don't want to move, for all kinds of [reasons]. Also, since I remember going into business in 1956, [based on] every meeting I have been to there is nobody who wants to work at dishwashing. So Chicago is up-to-date; that hasn't changed in 22 years.

My own view of the situation is that I would be within the range of the staff's projection. I have generally through the year felt that the staff was on the high side--I thought we were coming down from the forecast earlier and we have been doing so--because I thought we would restrain the economy deliberately. I still think [that]; they're closer to my view now, although I would put it at 3 to 3-1/2 on GNP, 7-1/2 to 8 on prices, and probably 6 to 6-1/4 on unemployment. The real issue is up to us.

Incidentally, Mark, you were talking about how businessmen behave. Was it behavioral or rational expectations or what do you call it? When I was in business, I never gave up business and had my overhead sitting on me unabsorbed because I had somebody tell me that I voluntarily shouldn't increase prices so much. I don't think businessmen behave that way because their profits are far more destroyed by leaving part of the present plant and capacity idle rather than sell their product. I just don't believe that's the way they behave.

MR. WILLES. I don't disagree with you at all.

CHAIRMAN MILLER. So, you may find other reasons why they ignore the President's program and break it, or you may find reasons that they can sanction it and keep them in it. In my company we did business with the government and if they could sanction us and hold us, we would have gone out and worked like the dickens to get more unit sales and absorb our overhead and improve our margin and maintain our profitability. I think just the reverse psychology would have existed. We could not give up our long-term market position in major products--sophisticated products--because of a 1-year situation. We would never have stopped our capital spending or research or anything over such a phenomenon. I don't believe businessmen behave that way.

We sit here and talk about these things technically, but I've just come from the business council and, while they don't like these things, there's no pessimism around. These are the big

businesses. They look for a continuation of relatively modest growth, but they look at it a little differently than we do around this table. My view is that the real future of this time period is up to us. You know Pogo said "I have met the enemy and he is us." And the gist of the question is: Will we, in our exuberance to prove our theories, trigger a recession? Because once you trip the psychology of the buyers or scare them, you drive them underground, as happened in '74. You go within months [from] boom and worries about inflation to a deep, deep recession where you have strung out inflation to 6 percent and you have it back in two years to 8 percent because you haven't accomplished [anything] fundamental. What we need is a steadiness of purpose. Inflation built up over twelve years; we are going to have to wring it out over five to seven years. If we think we can do it in a quarter or two quarters, we are fooling ourselves. My worry is that once again we will use high amplitude action to deal with what really requires a dampening of the process. The high amplitude action we got in the early '70s was not perceived as solving the problem.

MR. ROOS. Mr. Chairman, in connection with what you have just said and this exercise we went through, one of the things that is confusing to me is that we speak in terms of pessimism and optimism, and we seem never to have really defined what we think would be the [desirable] rate of growth or what we are pessimistic about. For example, suppose we are concerned, as you just expressed concern, about precipitating a recession. Mr. Chairman, if we are speaking of a recession in the classical sense of the term, which as I understand it is two quarters of a negative rate of growth, there's absolutely no intention on the part of those of us who are the most restrictive in our attitudes toward monetary policy that we should bring [growth] down quickly enough to precipitate that type of situation.

I don't know whether this is the time or not to express one's opinion on this matter of a recession but I think this is the hang-up that so many of us expressed: If we don't have an expansive monetary policy, we will have a recession. And when you look at the record, sir, there isn't a single demand-induced recession that has occurred since the World War that I can learn of, that was not preceded by a significant drop in money growth for a sustained period of time. For at least two quarters the rate of money growth dropped below the 20-quarter trend by at least 2 percent. And I don't think that even the mavericks like Larry Roos have ever suggested that we should plunge the rate of growth down precipitously to below the trend growth of money. But if we just reduce it to 6 percent--and I guess this comes in the next segment of this meeting--and hold it there and make clear to the world that we are going to hold it there, and over a period of years gradually reduce it, we can get this job done, in my opinion, without precipitating a recession.

CHAIRMAN MILLER. Larry, I was not present at any FOMC meeting in 1973 or 1974, but I assume the Federal Reserve didn't deliberately intend to [precipitate] a recession. I sat in Boston in '73 and '74. And yet we had the most severe one we have had. So I just have to say that my own experience is that the leader of economic policy will tell you all these wonderful things and that in three months it will turn around. And in three months people have gotten scared so they stop buying. And inventories that today look very balanced are suddenly excessive. If there is a drop of buying we suddenly have to have rebates to get the automobiles off the floor. They are being built now on the basis of selling 10 million a year. If consumers start buying at a rate of 7 million a year, you have a crisis. And that can happen.

SPEAKER(?). Mr. Chairman.

CHAIRMAN MILLER. I don't think this is the time to debate. I would say only one thing. We have pulled off a minor miracle and I think we should take a little more confidence ourselves in pulling off that minor miracle of contributing to a slowdown in the economy on a balanced condition. The decision to authorize the money market certificate was a decision that cost us in these theories because we have maintained funds in the money supply that would have flowed out of the money supply and made us look better--if you want to measure by aggregate growth--if we had not done that. So by trying to maintain housing, we have worked against ourselves--in my view properly--because we now have a balanced economy in which nothing is dragging us down into a recession unless we find the place to crack it.

The miracle is to have the Wallich soft landing. And I would merely say to you that to find that soft landing, I don't know how much more we have to do. But I know that since we have seven years to do it, we'd do better to gently come at the problem rather than whack it too hard on the head and be sorry. Because once you trigger the point where the public gets scared and stops buying, you can't reverse it; [economic activity] will go [down].

MR. ROOS. But even the most ardent monetarists, Mr. Chairman, have spoken up consistently for a very gradual reduction. But I think we are interpreted by people who disagree with us as suggesting some precipitous reduction in the aggregates growth--

CHAIRMAN MILLER. I understand you don't. I only look at the nominal interest rates and I know that we are getting very near the point where we will have results in the economy from interest rates. That's the way people behave. We can have a theory all we want. We can do it as gradually as we want but if we have to get 12 percent interest rates to do it, look at the chart over there. When we get that, that's when the recession comes because people get scared; rightly or wrongly, they do. And they did very quickly in that time period. That spike, that Mount Everest, stands out there as a warning to us. It has nothing to do with how gradually you try to [reduce the growth of the] money supply. It's how much you affect these other things.

I'm just expressing my personal opinion. I think if we try to continue to accomplish this slowing in the rate of growth in money supply by driving up interest rates, we are going to trigger a reduction of consumption and buying and spending that will send us into a recession. And I think we will be back with $100 million federal deficits. And we won't have accomplished very much following that exercise before we have the highest federal deficits we have ever had, taking away all the monetary restraint that possibly could have been put into the system.

MR. ROOS. Aren't these long-term interest rates, though, somewhat of a reflection of inflationary expectations? In other words, if the aggregates continue to grow aren't those--

MR. PARTEE. Is the money supply increase also a reflection of the inflation?

CHAIRMAN MILLER. We need to take a break and come back after coffee to pursue this.

[Coffee break]

CHAIRMAN MILLER. Ladies and gentlemen, we have a busy hour ahead, with a couple of small matters to take care of. We're supposed to at this time look at the long-run ranges for the monetary aggregates. And we have, of course, complications because of the automatic transfer service being available effective November 1, a short period from now, unless there's a court injunction or stay. I don't know if our Counsel is here or not. Tom, any report on the court action?

MR. O'CONNELL. No, I've checked it recently, Mr. Chairman. You've stated it correctly that the matter of stay is still within the discretion of the court.

CHAIRMAN MILLER. You might all turn to page 5 of your Bluebook. Steve, if you would lead off with your comments, I would appreciate it.

MR. AXILROD. Thank you, Mr. Chairman, I hope my comments will be less complicated than the Bluebook but it's a very complicated situation. So I apologize in advance for both.

I would, as statistical background, like to make two or three points to the Committee first. For the year just ended, that is the year ending in the third quarter of 1978, the Committee was generally within its monetary ranges that it had set for the Q3 1977-to-Q3 1978 period. It was within two of the three. M1 grew at an 8 percent annual rate in that period, above the 4 to 6-1/2 percent range; however, M2 grew at an 8.2 percent rate within the 6-1/2 to 9 percent range and M3 at a 9.3 percent rate, also well within its 8 to 10-1/2 percent range. And in the quarter past, there has been evidence of a faster growth in M2 and M3, mainly because of the success of the money market certificates. We wouldn't expect the rates of growth of these certificates to be sustained at the rapid rates seen when they were first introduced. Thus, I think the extremely rapid rate of growth in thrift accounts in the third quarter is a transitory phenomenon, though growth will be faster over the next year than would otherwise have been the case.

Let me make a final statistical point, Mr. Chairman--and I will be coming to this somewhat later in more detail in view of the prospective distortions in M1 because of the automatic transfer service and I might add also because of the last minute introduction of interest bearing NOW accounts in New York State which ought to begin also to have a significant effect on M1. The Committee might bear in mind that the alternative measure that the staff is suggesting at least as a collateral or supplementary measure, M1+, grew at a 6 percent rate in the year ending in the third quarter of 1978--somewhat below the rate of growth for M1.

With regard to economic considerations for setting longer-run ranges--and abstracting for the moment from ATS--I'd like to bring the following points before the Committee. Evidence continues that the demand for M1 is higher than the FOMC target implies, given built-in inflationary pressures and a reasonable growth objective for the economy, say, in a 3 to [3-1/2] percent range for real growth. For six quarters now there has been no downward drift in M1

demand, judging by the M1 demand equation of our large econometric model. That model doesn't predict everything perfectly by any manner of means but I think some attention has to be given to a period of six straight quarters where it has been predicting very well. I think this argues for raising the M1 range in the interest of realism; and I think I made this point to the Committee somewhat in vain three months ago.

CHAIRMAN MILLER. Completely in vain, as I recall.

MR. AXILROD. On the other hand, raising the M1 range may have an adverse effect on inflationary psychology. Moreover, recent overshoots in M1 growth would seem to argue at least arithmetically for lowering its range if the Committee wishes to achieve a 6 to 6-1/2 percent M1 growth over the longer run--if the Committee takes that as its objective. And I think we pointed out in the Bluebook that it would take about a 5 to 5-1/2 percent rate of growth in M1 to get you 6 to 6-1/2 percent over a period beginning with the fourth quarter of ’77 on into ’79. Perhaps the most important consideration in a sense now would be the relation of the range setting done by the Committee today to whatever the Administration's anti-inflationary program is.

We're obviously somewhat handicapped in discussing this by a total lack of knowledge of the program, but I think I wouldn't be amiss to make three general points. If the ranges were raised and the Chairman's testimony is November 16--so that would be after the program is announced--I think this would rather [clearly] be perceived by the market as not being supportive of the program and would probably worsen inflationary psychology and prospects for the success of the program. A lowering of the ranges would seem to suggest that the Fed was moving toward monetary conditions that would, if anything, reinforce the program and in that sense might be said to increase its prospects of success--that is, if the ranges were realistic to begin with and then lowered. The third point is that maintaining the ranges I believe would be construed as more or less a neutral stance consistent with lower interest rates than might otherwise prevail if the program were to work.

Let me turn now briefly to the implications of the automatic transfer service for the longer-run ranges. Of all the aggregates, it obviously adds the greatest uncertainty to M1 and suggests the need both to lower and widen the M1 range if such a range is presented at all. The range needs to be lowered because the shifts are only going to be one way, we believe--from demand deposits to savings deposits. So the direction seems to be very clear. What's less clear is the amount of shift. Because of the uncertainty involved in that, I believe it would be very desirable to widen the range and I'll make a suggestion at the summary point. The other aggregates are affected by these shifts but to a relatively minor extent. Both the suggested M1+ and M2 would be affected by the transfer service because of transfers from thrifts. We estimate an effect of only 0.4 and 0.2 of a percentage point from such transfers. M3 would hardly be affected at all unless people transferred funds out of market instruments to put them in these kinds of accounts.

The issues before the Committee are particularly complex this time and, as I noted, so is the Bluebook. Therefore, I'd like to make an effort to summarize the various advantages and disadvantages in terms of a set of proposals on the aggregates. If I had real courage, I think I

would suggest abandoning M1 entirely and that may be the best course. But the court hasn't met and made a decision yet. We aren't really certain about how rapidly the transfers are going to occur, so it may still be best to present an M1 range, though widened. But I would strongly recommend adding a range for [M1+] to provide collateral information with regard to the behavior of the transactions demand for money in a transition period. I would not rely only on M2 and M3 in such a period. Our research suggests that a narrow money measure, whether M1 and possibly M1 in the new environment, conveys better information about current and prospective short-run income changes than does a broader measure. In other words, it's a better monetary indicator of how to change the money markets than a broader measure. Broader aggregates are more sensitive to asset shifts and involve, of course, such non-money elements as 6-year certificates, 8-year certificates, and 4-year certificates.

With regard to M1, I would suggest a range of 2 to 6 percent for the period from Q3 '78 to Q3 '79. Such a range has the following advantages: It's wide enough to reflect the uncertainties that prevail and that were discussed in the Bluebook. At one extreme it would allow for a shift out of demand deposits because of ATS by as much as 4-1/2 percentage points from the top of the FOMC's current M1 range, which I believe is the minimum realistic rate of growth in M1 and is the rate of growth used in Mr. Kichline's projections. And it would allow for a shift as low as 1/2 percentage point. I believe 4-1/2 percentage points is a highly likely amount of shift, given the analysis we have made. This range, by representing an adjustment because of ATS to the top of the FOMC's current M1 range, would establish probably a more realistic M1 range over the next year. It would also appear to the market that the Committee does not intend, in effect, to accommodate the more rapid expansion in narrowly defined money by not adjusting its target sufficiently to prospective institutional changes. And it would thus, I believe, be supportive of any anti-inflationary program.

With regard to M1+, I would certainly include it as an additional aggregate and would recommend the alternative B range of 5 to 7-1/2 percent. There is much to be said for a wider range because of various uncertainties; and if the Committee wished to lean to the restrictive side, a wider range would be 4-1/2 to 7-1/2 percent. That would be 3 points, the same as the M3 range, or it could be 5 to 8 if the Committee wished to lean to the less restrictive side. I could not make up my mind which way I'd want to lean and I think the 5 to 7-1/2 percent is probably a desirable range.

With regard to M2 and M3, I would see no need to change the current ranges, which are 6-1/2 to 9 and 7-1/2 to 10 percent, respectively. Relative to recent trends and prospective credit needs to finance economic expansion, these ranges appear quite taut. That's all I have, Mr. Chairman.

CHAIRMAN MILLER. Thank you, Steve. There are a couple of points I would make on the long-run ranges. I could be persuaded to drop M1 but, on balance, I suspect that it might be better if we retain it in some form. I might point out that over the weekend Congress did pass the modified Humphrey-Hawkins bill, and I expect the President to sign it. That bill includes an amendment of the Federal Reserve Act to deal with our reporting to Congress on monetary policy.

We had worked out the language with the Senate Banking Committee and it survived, as I understand it. It involves a process, fortunately, that keeps our cognizance with the Banking Committees and doesn't begin to confuse it with the Banking and Joint Economic Committee and other committees, which would make our life even a little more difficult because we'd constantly be in cross battles of the committees. But instead it provides for us to report twice a year instead of four times a year. Instead of asking us to [provide] independent estimates of what the economic plan should be, it merely asks us to comment on elements of the economic outlook from the Administration's plan submitted to Congress and to indicate in the first report what the FOMC's intent is as to monetary policy over the calendar year. That first report would be February 20th and that would cover our response to the President's proposed plan and give our indicated monetary policy for the calendar year of 1979.

On July 20 we would testify again, giving our update of the monetary policy intended for 1979 and a first look at our policy intended for 1980. In all cases the language says that nothing in those reports would bind us to stick to that policy if circumstances changed and we felt that we should change it. It doesn't lock us into the policy; it's language that we've seen before, but I think it does get us into a fairly comfortable format, compared to earlier proposals which would have required us to [give] independent recommendations as to economic policy and to report to various and sundry committees. So that's the situation.

That being so, we are going to have somewhat of a different outlook in our presentation and preparation for next February 20. In the meantime, I think we might be wise to maintain a form of M1 for this go-around until we [know] more. And I tend to agree with Steve that we ought to have a range that's wide enough, given the uncertainties involved with both the ATS and the President's program, so we could with reasonable expectations make it realistic. I don't know whether I completely agree with the 2 to 6 range; it seems awfully wide. I could live with something a little narrower, but it's reasonable. I tend to agree that we [should retain the ranges for] M2 and M3. There might be an increase in M2 because of shifts from thrifts into banks with automatic transfers but we don't know how much or what. So I would tend to leave those until we see how that works. I think we have a wide enough range that if the President's program is effective, we'll still be within it in terms of it dampening inflation. And I just believe all in all that it's fairly reasonable. Now, 5 to 7-1/2 is anybody's guess on M1+, but I think it's a reasonable place to begin this experimentation. Chuck, I believe you had--

MR. PARTEE. I just want to say that the Subcommittee on the Directive met yesterday and we've been struggling with this question of relating the short-run ranges or targets with the long-run targets. We reviewed the Humphrey-Hawkins legislation and, of course, it does change in some rather fundamental respects the setting of targets because there will be no sliding base. Therefore, we agree with you that it does change things enough so that it is a new ball game beginning next year. And we will have a report for the Committee by the January meeting on a recommended course of action, relating to the new system, however, rather than the old. I would point out, Mr. Chairman, that the amendment takes effect on January 1, 1979 so I agree with you in that I think we are really obligated, though it may mean nothing, to have one more year ahead in our projection of the aggregates. I think it would be misunderstood if we didn't have an M1 range but it ought to

be wide enough to accommodate possibly a considerable shift into savings deposits from M1 forms [of deposits].

CHAIRMAN MILLER. Thank you. May I add, Chuck, one other thing? And that is that I think we shouldn't mix this up with what we may want to do on the short range.

MR. PARTEE. No, I agree with you.

CHAIRMAN MILLER. We may or may not want to use M1, so I think this is a different issue. I don't want to get involved in that now, but it seems to me for this purpose of testifying--on November 16, is it Steve?

MR. AXILROD. Yes.

CHAIRMAN MILLER. Now, I would caution one thing. We have quite a bit of time between now and the time of that event. If we should have a court decision adverse to us--a stay or something else--I think we have to come back to the FOMC and not go to the Senate Committee with something that's out of date. So I think we have to adopt something today subject to change if anything drastic happens that would make us want to fit different ranges to the outlook.

MR. PARTEE. Even if there is a stay, I would point out that New York has NOW accounts and that's a big state, and we would have to take that into account.

CHAIRMAN MILLER. Yes, we have a lot of problems.

MR. MORRIS. Chuck, would you elaborate on what you meant by the sliding base?

MR. PARTEE. Well, we now do [set ranges] for the upcoming year. So for example, this time we're considering third quarter to third quarter and last time it was second quarter to second quarter. Now the lock is on the calendar year and the re-estimate in July is on the same calendar year and the next one; so there won't be the kind of slide that there was before.

CHAIRMAN MILLER. There won't be the quarterly updates. Maybe there will be a new one every year. It could be a mid-course correction. Before we start the round questions, Paul, you may have something you would like to comment on this.

VICE CHAIRMAN VOLCKER. I just had a question of Steve. If I understood him correctly, he's saying continue the present ranges of 6-1/2 to 9 and 7-1/2 to 10 for M2 and M3, but go to 5 to 7-1/2 for M1+. I'm just asking for the technical consistency. If you look at the Bluebook, it would say that the 5 to 7-1/2 would be consistent with higher M2 and M3 figures or vice versa.

MR. AXILROD. Yes, we centered those M2 and M3 [ranges] around the midpoints of the current [ones for] M2 and M3, which would encompass our best estimate. In alternative B, for M2

our best estimate is 8-1/4; [for M3 it’s] the midpoint between 8-1/2 and 11, which is 9-3/4. That would be encompassed by the present M2 and M3 ranges. I think for policy purposes it's highly desirable not to raise the M2 and M3 ranges and to leave the current ranges, which give enough scope--even if the staff projections are right--to be within them. And they provide added scope, in case the President's program is effective, to have a lower rate of growth.

MR. PARTEE. It seems to me not unreasonable, Paul, to do that, although I do think there is the possibility that we'd run over the top of M2 because of the diversion of funds from thrifts to the banks. My own preference would have been for 5 to 8 on [M1+] for the same reason. I think it's very hard to estimate. And remember, M1+ will include all of the ATS accounts whether they're truly transactions accounts or idle balances. It will include any conversion from thrifts to the banks that are put in there in order to raise the minimum size of the account to the point where there are no service charges. But that is a minor problem.

CHAIRMAN MILLER. Mark Willes.

MR. WILLES. I found Steve's presentation very helpful. I'd like to follow his presentation to make a couple of statements as much by way of making sure I understand what he said as well as arguing what I think is right. If you look first at M1, for example, without adjusting for automatic transfers, there is a question as to whether or not the 6-1/2 is the right ceiling or not. If we didn't face the November 1 problem, then that's what we'd be debating, among other things. And I think we ought to treat that question separately from the question of adjustment for automatic transfers first, because some of us think 6-1/2 is still a right number and we ought to debate whether it should be 6-1/2 or 8. But second, Steve made a very interesting comment when he said that he thought a 4-1/2 percent shift was highly likely. Let’s suppose that we had a 4-1/2 percent shift and we maintain an M1 range of 2 to 6 percent. Then that means that you could have, given our current environment, rather than a 6 percent growth in M1 a 1-1/2 percent growth in M1 before you've violated your ranges. So what we would in effect be doing, if you attach much probability to that kind of a shift, is that not only do we not take 6-1/2 as right, but we're willing to live with 10-1/2. And I for one would find that prospect absolutely unbearable.

So in making whatever adjustment we make, it seems to me that as a technical matter it might help in terms of policy if we discuss pre-ATS [figures] to see where we come out on that and then discuss the adjustment after that. The only way we can make the adjustment is to figure out what we think the most likely adjustment is. And if you gave equal weight to 1-1/2 [and] to 4-1/2, then the most likely is 3 or whatever. [So I’d] make the adjustment on that basis and then proceed. Otherwise, it seems to me that we run a very serious risk of biasing the results and ending up with a substantial change in policy based simply on a relatively narrow technical matter.

CHAIRMAN MILLER. I'm confused. If you take the other side, and you have 1-1/2 as another probability, you're talking about an 8 percent M1.

MR. AXILROD. May I comment on that?

MR. WILLES. If you have 1-1/2 and you hold it at 6, then clearly you've biased it the other way. That's precisely my point. The only way that I can see to deal with that is to try and figure out what you think the most likely outcome is and then go accordingly.

MR. AXILROD. Well, there are two comments I would like to make. One is statistical and the other is economic. On the statistical point, it's almost impossible to deal with--pardon the jargon--two independent [variables] and to encompass all the tails of the ranges. You maybe ought to have a 10 or 12 percentage point range, and that's obviously impractical. So I think the Committee's job is to put down the range which is both reasonably likely and also will convey the correct policy. On the economic point, President Willes, I think if it was happening as you suggest, as is possible--that is, that you are getting in effect a 10-1/2 percent M1, then interest rates would have to be a lot lower for that [to occur]. The Committee would have to sanction a lot lower interest rates. And if it were developing as you suggest what I think would happen is that for, say, a 9-1/2 to 10 percent funds rate, which is our projection--and if the shift were 4-1/2 percentage points, which is our projection--[for] 6-1/2 percent the Committee would have to be running at a 2 percent M1 growth. If it weren't running at a 2 percent M1 growth but at the 6 percent M1 growth--in effect the 10-1/2 percent without transfers--then you wouldn't have the funds rate at 9-1/2; you'd have something like 7-1/2 or 6 percent. In the practical world, I don't think your outcome is very likely. Secondly, in the [real] world we would be getting data to try to monitor the extent of shifts so we will be able to report to the Committee these kinds of developments. I think the economics are very different from the arithmetic.

CHAIRMAN MILLER. Bob Mayo.

MR. MAYO. Mr. Chairman, I think we're trying too hard again. I would like to see us keep to the M1 range of 4 to 6-1/2 percent on the grounds that we really don't have much idea as to what's going to go on, not only on automatic transfers and how long it's going to take but we also don't know on New York NOW accounts. Let's keep our straight definition. We're going to change the ground rules in another few months anyway. [Let's] keep it at the 4 to 6-1/2 subject to interpretation as we learn--as we take our temperatures. I don't see any percentage for us, Mr. Chairman, in making an estimate now as to the effect of this. It could be very slow in coming. There is an awful lot of inertia. And despite advertising campaigns, I think it can be even slower than the NOW accounts in New England. So I don't see why we need to stick our necks out; I would prefer to stick to the [current] M1 definition. I'm [not] enamored of M1 but I would resist changing it now. I'd wait until we are at a better position to do that, maybe with the new system under Humphrey-Hawkins.

CHAIRMAN MILLER. Phil Jackson.

MR. JACKSON. I would argue that the thing to do would be to drop M1. Several reasons lead me to that. First, we do have a new system of projecting the aggregates and, therefore, anything we do today is only going to [be in] effect, for all intents and purposes, over the next two or three months as a long-range policy guide. And in January the Committee will have to reestablish a policy guide for the future.

Second, I have for a long time felt that our concepts of money on which we base policy aren't properly reflective of the underlying purposes for which they were originally designed because technical aspects of privileges of certain types of intermediaries have changed and, therefore, our underlying purposes for measuring money this way have been distorted. And it is my hope that the Committee will modify its definitions, not only of M1 but M2 and M3 all across the line. It would be my hope that we'd go forth and modify those definitions beginning with the new Humphrey- Hawkins concept of reporting--and have a good clean slate to start off.

Third, as some of you may recall, it is my judgment that we have unfortunately gotten this Committee into a public relations problem. Having chosen targets that are not indicative of the relationship between nominal GNP and M1, we have been unwilling to adjust them--which a reasoned judgment would lead us to do--because of the public relations consequences. And I think dropping M1 is--pardon my language--the easiest way to go. [I'd go] out the back door instead of the front on this subject and not just change it, drop it. Therefore, the public doesn't know whether we did it or didn't do it and you don't have all these public relations [issues]. So I would argue, when you add all those up together, that [we should look at] the M1 that comes closest to defining the transactional concepts of money that M1 was originally designed to measure. With the number of variables that have already been mentioned around the table--and every time somebody speaks they mention another one I hadn't thought of--it strikes me that M1+ is the only reasonable one. I think that's the fairest to the public, to the extent that the public has asked us to address this subject in the intervening months between now and Humphrey-Hawkins, and this would provide a good transition to a new concept.

CHAIRMAN MILLER. Phil Coldwell.

MR. COLDWELL. Well, I like some of the things that Philip is trying to aim toward but I question whether this is the time to do it. I really don't know that ATS is going to do all that much violence to us over the next two or three months. I think there's a lethargy to this but I don't know. Consequently, it would be my suggestion to the Committee that we set our M1, M2, and M3 ranges as if there were no ATS and put a couple of memo items at the bottom of the page saying here's an M1+ and here's an M1 with ATS which could be referenced if things really changed in a major way. It would seem to me we're getting into a question of policy versus procedure. And I'd rather keep the policy separate.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Well, I agree quite a lot with Phil Jackson, but I think what we have to recognize as more important than anything else is that M1 can no longer be a control variable. There will be no way of having any precision in the estimate of the proportion of ATS that belongs in M1. What we'll get in ATS is a combination of heretofore passbook account balances and heretofore checking account balances. We could ask the banks, and we plan to ask banks, what they think the split is but, you know, that's going to be within 10 or 20 percent of an accurate number and it has no longevity. We can't ask them a month down the road and then two months

and three months because they won't know. So, there is no way that we can keep M1 as a control variable for policy, assuming that ATS goes into effect.

I would do what the Chairman suggested. That is, I would specify some kind of an M1 range just for the cosmetics of it, but I think what we have to say is that we don't know how to judge that range because we don't now how quickly or to what extent the ATS service will take hold. Therefore, it seems to me that we do have to have a memo item on the M1+ just in order to satisfy people that we're doing a respectable procedural job.

And Mark, on your point, I think what we have to say about our M1 range is that how we will feel about where we are in that range will depend on how fast we believe that ATS is taking effect. If it's very slow, we'd expect to be toward the top of the M1 range. If it's quite fast, we might be well down in the range; we might even be below the bottom because we can't say. I have a very difficult time choosing between 1-1/2 percent and 4-1/2 percent as being the effect over the first year. Frankly, I think it will be quite low. The staff thinks it will be quite high. I just don't know. I think it would be very dangerous to try--given our total lack of knowledge about this--to estimate a center point and say that we have allowed for this amount.

CHAIRMAN MILLER. Especially since we're not giving up the other measure, so we are not losing--

MR. PARTEE. We have to modify what we say about the other measure. What we will accept within this range will depend on the extent [of the ATS effect].

CHAIRMAN MILLER. We'll keep M2 and M3 also.

MR. BAUGHMAN. Could I ask Chuck a question about his comment that M1 after ATS cannot be used as a target variable? Would that comment also apply to the other aggregates?

MR. PARTEE. No, I think you could still use M2, as we have before, because that shouldn't be affected. It's just the distribution [between M1 and M2].

CHAIRMAN MILLER. You could pull in some funds from the thrifts but probably the magnitude is not that enormous.

MR. PARTEE. We'll have to make an estimate, Ernie, as time goes on to see if we feel that money is moving from the thrifts. But you could use [M2] because savings accounts have existed heretofore in that, so you'll be getting both the savings account proportion and the transactions balances; [there's just a] shift of the proportions in there.

MR. BAUGHMAN. I had understood you to say that M1+ likewise could not be used.

MR. PARTEE. No, I think it is the only control variable for a narrow money definition.

CHAIRMAN MILLER. At this stage. John Balles.

MR. BALLES. Well, first of all, Mr. Chairman, I happen to come out with the kind of recommendation that Steve started off with and that you spoke to. Keeping M2 and M3 unchanged is my fairly strong preference. I think what the debate will probably hinge on is whether to keep M1 and, if so, at what range and whether to add M1+ and, if so, at what range.

I'd like to revert to Steve's analysis. At the risk of appearing ungrateful, Steve, after you threaded your way through various mine fields here, the one thing that you didn't express a view on, at least in your remarks or in the Bluebook, [relates to the weighting]. If we were to [have] both M1 and M1+, with respect to day-to-day operations within the 2-month horizon there will have to be some decision on relevant weights. And while I realize it's not a direct element in taking up the 12-month ranges, I think we should keep in front of us the fact that if we do add M1+ and keep M1, we are going to have to cross that bridge at some point. And I, for one, would be interested in what options you would offer or what your views were on the relevant weights to use.

MR. AXILROD. Mr. Chairman, would you prefer for me to respond to that now or at the point where you're discussing the [short-term ranges]?

CHAIRMAN MILLER. I'd like to see us get the long-term ranges set and we'll come to the short-term. On whether we use M1 at all, I think we can have a different decision there, John. We're dealing with this requirement to report to Congress and give these ranges and there are quite a few people who want to speak on this. I hope there's going to be a [chance] for us to focus on this. I'd like to get a straw vote as to whether people want to continue to put out some number on M1 or not and then maybe we can at least know what we're talking about. If there's an overwhelming consensus, we can cut this [discussion] a little short and we can get at that. How many of you would like to continue to use M1, [given] the factors we've heard at this stage? Seems like a pretty strong preponderance. So that means [we need make a decision on] what number. And how many of you would like to publish as a collateral item M1+?

VICE CHAIRMAN VOLCKER. What does a collateral item mean?

CHAIRMAN MILLER. A memo item.

MR. MAYO. Footnote.

MR. ROOS. Mr. Chairman, could you qualify it by saying as a footnote? And just as a [unintelligible] Congress will go crazy.

CHAIRMAN MILLER. Yes. We put these things in and the associated [developments] in M1+ would be in the footnote, yes. I gather there was a pretty strong [consensus] for that.

VICE CHAIRMAN VOLCKER. As the footnote.

MR. AXILROD. Do you mean [have language] in the directive like “the associated range for M1+ and bank credit” or in a footnote to the directive?

CHAIRMAN MILLER. It makes no difference to me. I don't know. We normally go through the M1, M2, and M3 and then say the [associated range for] bank credit.

VICE CHAIRMAN VOLCKER. The question is how much weight it has in the operation.

MR. AXILROD. Well, that's a separate question from putting it in the longer-run ranges.

MR. COLDWELL. I don't think we ought to put it as “the associated range.” The way that's written is that the following are our targets and these would be compatible with those targets. We don't know whether M1+ is compatible.

CHAIRMAN MILLER. You realize, John, there is no weight associated with these.

MR. MAYO. Couldn't this be handled in the text [of your testimony], Mr. Chairman, without--

CHAIRMAN MILLER. Yes, it could be handled in a way that does not [characterize] it as a substitute target or tolerance range. Maybe we ought to try some language on you. I think we'll have time to circulate this before I testify, which is quite a ways off.

VICE CHAIRMAN VOLCKER. Are you saying the same thing then for M1? Is that also treated in this way?

CHAIRMAN MILLER. M1, I assume, would be given as a normal tolerance range. We’d have ranges for M1, M2, and M3; we’d treat bank credit as we normally do; and then we'd have some comment on M1+ by way of a [memo item].

MR. JACKSON. Would we assume ATS in M1 in testimony or would we--

CHAIRMAN MILLER. We're going to have to revise our targets if the ATS is [not put into effect]. We'll have to have a telephonic meeting and change our targets if ATS is blocked. That's what we'll have to do.

SPEAKER(?). But we would not have M1+ in the directive?

CHAIRMAN MILLER. No, M1+ wouldn't be one of the [ranges stated there]; that's what I sensed everybody wanted.

VICE CHAIRMAN VOLCKER. But you're having M1 now in full parity with M2 and M3 in these long-term targets?

MR. WALLICH. M1, I think, should be downgraded.

CHAIRMAN MILLER. I think so. Let’s do it again. An M1 range is to be stated but in a downgraded mode. Is that what everybody's agreeable to?

MR. ROOS. M1 downgraded?

CHAIRMAN MILLER. M1 downgraded--not eliminated but downgraded.

MR. BALLES. In explanatory text?

MR. PARTEE. Well, what I think you do is put in a qualifying phrase.

CHAIRMAN MILLER. A textual comment to qualify it [along the lines of]: This has uncertainties associated with it because we haven't been able to assess the effects of ATS. There’s no weight on this one; this is the long-run range. This is just each individual one. So I think all you do with M1 is say that this range is set with the recognition that we have uncertainty because we don't know for sure the effect of ATS. Yes, Mark.

MR. WILLES. Mr. Chairman, we have similar kinds of uncertainty when time deposits start bumping against ceilings and so on. We never qualify those. It's not at all clear to me why we are going to summarily downgrade M1 just because we have increased uncertainty of a kind that's similar to what we have often with M2 or M3.

CHAIRMAN MILLER. Well, I'm delighted to do it any way you want because I don't think it’s going to shake the world one way on the other whether we just leave it cold or comment about it.

VICE CHAIRMAN VOLCKER. We are just talking about one quarter, too.

CHAIRMAN MILLER. I have no strong feeling. I'll do what the Committee wants. But let’s resolve it one way or the other. There's no problem in M2 and M3. There is no problem, apparently, in putting in M1+ as some sort of range with a comment. First, how many of you want a qualifying statement about M1 that would be of the nature of indicating that the range has been set with some degree of uncertainty about the effect of ATS? How many of you just want to state it with no comment? So it looks like we'll put in a qualifying statement.

MR. GUFFEY. Mr. Chairman.

CHAIRMAN MILLER. Yes sir, Roger.

MR. GUFFEY. There was one point. Apparently around this table there is an assumption that it is wise to publish an M1+ and I would just like to raise a question about it. The work that we have done suggests that M1+ is indeed a measure or modifier to M1 as we go through this period of

adjustment and uncertainty. But with respect to M1+ as any type of guide--as a replacement for M1 in terms of a measure of a narrow aggregate--it has a great deal of volatility to it because it includes all savings accounts at banks and those are interest-sensitive. As a result, it seems to me--

CHAIRMAN MILLER. Disintermediation could affect it.

MR. GUFFEY. Yes. It seems to me that if we now surface that and tell the public that we have another measure called M1+ and we give the definition of it, we may have a very hard time getting away from it as we move into the Humphrey-Hawkins testimony. As a result, I would prefer that we publish M1 with some recognition and qualifying statement--that the range is broadened, for example, because of uncertainty but not [introduce] a new aggregate measure called M1+. I think it's going to get us in trouble down the road. My point is that if we are going to use a narrow definition, I'm not sure it's the best definition.

CHAIRMAN MILLER. I'll go back to our list; Larry.

MR. ROOS. Well, Mr. Chairman, just a procedural suggestion. You recall some months ago I proposed to this Committee that we make more use of our economists throughout the System. It seems to me that several issues are surfacing, [such as] the Humphrey-Hawkins issue and this issue, that require or justify a certain amount of serious discussion--more time than we can give to it here. And I would ask--I don't know where that paper is--that consideration be given to having a convocation of any Reserve Bank economic staffs that want to participate, as well as any of us, within the next month or two to talk about some of these fundamental things that are occurring. We do it on membership, on automation, and on a lot of other things, and I think it would be helpful.

CHAIRMAN MILLER. Well, Larry, I think we can't wait until January when we're making the decision; we will have to make the decision at the February meeting. I don't know how our schedule fits with the 20th but that being [the date of the Humphrey-Hawkins testimony], I do think we do need some pre-discussion. We can't come up to the wire without this being resolved. Chuck, do you think the Subcommittee on the Directive could provide the Committee with some inputs so we get a chance to kick this around?

MR. PARTEE. Well, as I said, we defined our obligation, Larry, as being one where we have an investigation of these questions and report to the Committee by the January meeting or before--maybe by the December meeting.

CHAIRMAN MILLER. Can we have something in December? Then there will be time.

MR. PARTEE. Now, in writing our report we are going to be using staff input and there could well be some staff contribution from staffs other than those represented by the members of our subcommittee. If there is something that can be done, Steve Axilrod is the staff director of the subcommittee and he's the one to work through. But I agree with you that there are a lot of important issues here, and I think we will have to look at them carefully. I realize there's an

affection for M1, but there's no way to estimate it and have it be worth anything anymore. And the point about interest rates being frozen, Roger, the same thing is true of demand deposits. The interest rate is zero on demand deposits. And the interest rate is frozen on savings accounts at 5 percent--same condition.

MR. AXILROD. [I'd like to] follow up, Mr. Chairman, by saying that the staff has been under instructions to prepare alternative definitions of money. [Not only] in view of the discussion but even before the discussion, we were planning to circulate those before year-end throughout the System.

CHAIRMAN MILLER. I think we need some lead time. I think Larry is absolutely right. None of us can digest this in one meeting or one session. We want to go back to our staffs and discuss it. Paul.

VICE CHAIRMAN VOLCKER. I don't know where we are procedurally, Mr. Chairman. I'm ready to talk about substance if you're finished with this.

CHAIRMAN MILLER. Well, let's see if Frank Morris has any more on that.

MR. MORRIS. I agree with Phil. I wish Steve did have the courage to come out [with a recommendation] to eliminate M1. The idea that it's a better economic indicator I just don't think stands up, at least in the statistical analysis. That analysis shows that since 1966, M2 correlates better to GNP than M1. So it's not clear to me in what sense M1 is a better indicator. Also I think that a proliferation of indicators is not a healthy development for this Committee. I look back over the past couple of years and we comforted ourselves in '77 that while M2 was strong, M1 was well within our guideline. And we comforted ourselves this year that while M1 was strong, M2 has been within the guideline. If you look at both years combined, they are both way outside the guideline. I question whether a proliferation of indicators is leading us in the right direction.

CHAIRMAN MILLER. What we need is to return to the halcyon days when the Central Bank operated in secrecy.

MR. MORRIS. I think we need some market input to this new concept of M1+. One possibility is that there are other things that might be included--for example, overnight RPs. I would hate to see us put M1+ in a directive until we've had some feedback from the market and from the academic world as to whether it is a reasonable alternative. Are we ready to give it any kind of official sanction?

MR. PARTEE. I think what we ought to do is cut down that definition. I noticed they had credit union share drafts in there. Maybe we ought to just say M1+ is M1 plus savings accounts at the commercial banks for now. That picks up the NOW accounts at banks and it picks up the automatic transfers.

MR. JACKSON. What does that do to Mr. Axilrod's projections of the rates of growth, though?

MR. PARTEE. Very little.

MR. AXILROD. Well, the credit union share drafts--

MR. PARTEE. Just define M1+ as being M1 plus savings accounts at commercial banks.

MR. AXILROD. The others are pretty minor, except for the NOW accounts in New York. I'm not sure what will happen there.

MR. PARTEE. I meant for just now, Steve. And then for the first of the year we can talk about redefinitions.

CHAIRMAN MILLER. Roger, have you covered your point?

MR. GUFFEY. Yes sir.

CHAIRMAN MILLER. Okay, Dave Eastburn.

MR. EASTBURN. I've voted my preferences. I'd just like to join those who would express a good deal of caution about M1+. Instead, I'd concentrate my efforts between now and February on devising a new basis for doing this and saving the consideration of M1+ until then.

CHAIRMAN MILLER. Well, we have heard a number of comments. Let me read you [my summary]. I think we have settled that we will publish [a range for] M1. I think that was pretty well recommended. We've had a rather large plurality in favor of footnoting or indicating something on M1+, but now we have heard some contrary arguments. Shall we reexamine that question? And we will first assume [we're talking about] M1+ as now defined, Chuck, so we don't get too many confusing things here. Do you still want to use M1+? I don't think we get bound by it. I think we can come up in January with whatever we want. I wouldn't feel personally bound by the precedent. But do you want to do it as some sort of textual indication at this point or not? Once again, let's have a show of hands on yes. We had a large number a moment ago.

MR. ROOS. With downplaying, sir?

CHAIRMAN MILLER. Yes. [I count] 10. That's a pretty large percentage. We weren't counting. How many don't? Let's see, that's six. Now let's have the voting members. How many would like to use it? [It's] seven; we have a plurality. Okay.

VICE CHAIRMAN VOLCKER. I don't think it's a major issue if [M1] is downgraded.

CHAIRMAN MILLER. Yes, okay. Now we'll come back to substance, Paul, and get our ranges set in three minutes.

VICE CHAIRMAN VOLCKER. You had a little discussion [before] the break that got into the substance of policy, and I just want to say that I want to be prudent and cautious too. I don't think we could be accused of not having been prudent and cautious and gradual. I do have some question as to whether we pitched it at the right level in the last year. I suppose I answer this question with a feeling, having looked back, that we've been a little too easy--not drastically so but we've tended to be on that side. And meanwhile inflation has gotten worse, and that's the principal problem that we face; it's the major risk to the stability of the economy. If it does accelerate, I think that's the thing that is going to produce the worst recession, not necessarily in the short run but in the long run--by which I mean two years instead of one year. I'm not looking way out in the future.

CHAIRMAN MILLER. I don't think inflation has accelerated since I have been at the Board, to put it bluntly. It has gone down since I've been at the Board. It was 10 percent; now it's 8 percent. So I'm not sure that I can share those sentiments. Since I've been here I've been presiding over a decline [in inflation] of 2 percentage points.

VICE CHAIRMAN VOLCKER. I was thinking of a period of probably 15 to 18 months.

CHAIRMAN MILLER. Well, you fellows fouled it up before! Nancy and I didn't.

VICE CHAIRMAN VOLCKER. There is something to what you say. But I also think inflationary expectations have hardened a bit during this period even while the actual rate is going down from 11 to 8 or whatever it is now. And that is a problem. I do think this is a critical period, partly because the President's program gives us a little chance here maybe to change psychology. I think everybody is going to look at that cynically. But it does offer the only opportunity we have--I don't know of another--to change expectations a little bit. I think the principal reason people can be cynical about it--there are many reasons and many fears--is legitimate. I think that it will squeeze profits and that it will lead to controls and all the rest. But my first [concern] is that people will see this as a substitute for monetary or fiscal restraint. And I don't think we want to feed that expectation. We will legitimately maximize the effectiveness of the President's program, I think, if we show that it's not a substitute. Hopefully he will say that it is not a substitute.

I know we don't know what [the President's program] will be, which gives us a little technical problem. All I know is what I read in the newspaper. If what I read in the newspaper is right, I think you can mechanically argue that our present targets, taking the midpoints of the ranges, are probably a little too high. If he's really talking about guidelines of the sort that you see--a price guideline of under 6 percent and a wage guideline of 7 percent--and we get the kind of productivity that was being implied this morning, those are not inconsistent. Now, we can be skeptical about whether he will be successful, but we are in a little peculiar position, I think, in having an easier monetary policy in some sense in terms of the aggregates than the President's program would call for. I don't know what it is, but this does leave me with the feeling that you can

justify the current ranges--I'm now talking M2 and M3--though they're probably a little high. But they give us enough leeway to go down, and we don't know what the President's program is going to be. I would prefer to see those slightly lower but I can live with the present ranges.

CHAIRMAN MILLER. Let's try something, Paul. We do have a time constraint and everyone has this in mind. Suppose we take Steve's suggestions first. He had 2 to 6 for M1 and maintaining 6-1/2 to 9 for M2 and 7-1/2 to 10 for M3. So that M2 and M3 are the present ranges and M1 would be 2 to 6. I don't want to cut off the options, but let's just see. Let's just ask right now for the voting members to show their hands if they would be amenable to that kind of position at this point. Five.

VICE CHAIRMAN VOLCKER. The only problem I have with it is that I don't see why the M1 is so high. It's a degraded item, but--

MR. PARTEE. Well, because we don't know. There might not be any automatic transfer shift at all.

VICE CHAIRMAN VOLCKER. You don't know in either direction.

CHAIRMAN MILLER. Yes, that's the trouble. How many did you count?

MR. ALTMANN. I think seven, but I--

CHAIRMAN MILLER. Try it again. On the voting members how many would accept the proposal Steve has made? Six. Okay, how many could not? It couldn't be more than five. Three. Phil, you didn't vote, did you?

MR. COLDWELL. No. I kind of like it both ways, M1 and M2 with [and without] ATS.

CHAIRMAN MILLER. Pardon?

MR. COLDWELL. I'd like an M1 with no ATS in there, too.

CHAIRMAN MILLER. Well, we are going to come back if there's no ATS.

MR. COLDWELL. Well, I'm asking: Can we live with the 2 to 6 percent? I have no problem with it. Then the question is: Do you also have M1 if there's no ATS?

CHAIRMAN MILLER. If there's no ATS, we are going to have to have a conference call and decide what we do with the ranges.

MR. COLDWELL. What [if there are] no shifts of any substance over the next quarter?

CHAIRMAN MILLER. We would have had the range too [low]. We would be outside our range. We wouldn't get it down to 6 percent. That's the risk of the 2 to 6 percent.

MR. JACKSON. Mr. Chairman, let me emphasize that these are 1-year ranges; these aren't for one quarter. Therefore, we have a lot of time to explain that we made a projection and we missed.

CHAIRMAN MILLER. All right, let's call the roll on that. I think we have enough, so let's call the roll. We are doing M1 at 2 to 6, but with the understanding that we will have a new meeting to decide this by telephone in case we have a block on ATS.

VICE CHAIRMAN VOLCKER. With the understanding also that M1 is substantially downgraded in the language?

CHAIRMAN MILLER. Yes, it’s qualified. We agreed to that before. All right I'll vote for it.

MR. ALTMANN.

Vice Chairman Volcker	Yes
President Baughman	Yes
Governor Coldwell	Yes
President Eastburn	Yes
Governor Jackson	Yes
Governor Partee	Yes
Governor Teeters	Yes
Governor Wallich	No
President Willes	No
President Winn	No

CHAIRMAN MILLER. Okay we have the ranges established. Thank you very much. Let's go to the next item--domestic open market operations and a report by Mr. Sternlight. You have been waiting patiently, Peter.

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

CHAIRMAN MILLER. Thank you very much. I believe our legislation passed over the weekend and included the collateral matter. Did you know that?

MR. STERNLIGHT. No, I was not aware of that.

CHAIRMAN MILLER. So we thought we'd give you that good news.

MR. STERNLIGHT. I'm glad to hear that.

CHAIRMAN MILLER. Ken will report to us on these legislative matters at lunch. I think that will help us a bit. All right, we need the ratification of the transactions since the previous meeting; [a report on them] has been circulated. Unless I hear an objection, we will consider those ratified. Hearing none, we so order.

The next item is comments by our Economist on prospective financial relationships. Steve, can you pull this one off?

MR. AXILROD. Well, I think I batted 50-50 on the first round. Mr. Chairman, I have only two brief comments, one of which is not quite appropriate because I'm not sure what the Committee did or didn't do with M1+. With regard to the directive, the Committee might wish to give particular consideration at this meeting to a money market directive in view of the absolutely huge uncertainties that are going to surround measurement and analysis of the monetary aggregates and also in view of the fact that the staff is forecasting growth in M1 abstracted from automatic transfers and M2 not too far from their longer-run ranges. So, as long as growth is around those ranges, it may be very desirable just to consider a narrow or restrictive money market directive without speaking out about the level of the federal funds rate that's the center of that particular directive--not have any particular movement in the funds rate from the decided level unless the aggregates are very clearly running above or below reasonable expectations. And I think alternative 1 and alternative 2 in the Bluebook on page 12 are [reasonable] relative to the long-run ranges.

If automatic transfers [go into effect] on November 1, Mr. Chairman, and if people move ahead and go into those, I think M1 is absolutely worthless as an operating range. We're not going to be able to get good estimates of transfers from demand deposits. And I think it's very dangerous in operating to rely on only a single range like M2 or M1, given the uncertainties in the world. Thus, in this period, I really believe that M1+ would give you a much better basis for operations than M1, assuming there are automatic transfers. And in the short run, M2 is not subject to [much] uncertainty, as President Guffey pointed out, because we're not about to get interest rates below the ceiling rate on savings deposits in this period. So my recommendation would be to drop the 50-50 weighting of M1 and M2 as we had suggested and let the Manager take account of the behavior of M1, M1+, and M2 within ranges decided by the Committee, using his good common sense in judging how these are coming out relative to how the Committee has thought in the past and how it might express itself today. And if the Committee adopted a money market directive, I think there would have to be very clear evidence that this collection of aggregates was running well above or well below its ranges. And if automatic transfers go into effect, I would tend to reduce the weight on M1 considerably and put much more weight on M1+.

CHAIRMAN MILLER. Steve, thank you. I happened to come to the same conclusion in the sense that I think we're dealing with considerable uncertainties and I would prefer to have a money market directive under these conditions. However, I don't find any one of these [Bluebook alternatives] too attractive. My feeling would be that we should have a fed funds rate of 8-3/4 to 9 percent. I wouldn't like to see it go below 8-3/4 in present conditions and I'm not prepared, [given]

what we've been doing in the past month with substantial increases in rates, to see it go beyond 9 percent.

As to the ranges, if it's too dangerous to use just M2, then I think we really are going to have to leave the Desk a bit more latitude in looking at these various movements. I don't know what to pick for M1, just to pick something. But for M2, because there might be some shifts of funds from thrifts into bank savings accounts to get the ATS, I would tend to use the 6 to 10 percent range. M1+ I don't feel that strongly about. Again, I'm just guessing. I'd like to hear from other members, but my inclination would be to start with 8-3/4 to 9 percent and a money market directive and M2 at 6 to 10. I don't know how the others [unintelligible]. Let's run down the list and see. Paul, would you like to express your view?

VICE CHAIRMAN VOLCKER. My inclination, more or less consistently with what I said earlier, would be to move the federal funds rate to 9 now, and maybe provide a range of 8-3/4 to 9-1/2. The M2 range for alternative [unintelligible] looks to me consistent with what we just decided for the long run. I don't know what you can say about M1 in particular. I think you can say one thing--that if it was high, it would be significant. I don't know quite what that number is, but I think we have to put the weight on M2, with the caveat that if M1 came in high--I suppose I would consider 6 or 7 percent high--against the projections and the automatic transfers, that ought to [carry] some additional weight. That's the kind of thing that would push us above the initial 9 percent that I would talk about. The projections say it wouldn't happen but if it did happen, I'd want to react.

CHAIRMAN MILLER. Ernie.

MR. BAUGHMAN. Mr. Chairman, I find alternative 2 acceptable, but I would be prepared to put the bottom of the funds rate at 8-3/4. I guess I would construe Paul's comment as pretty much embracing that. I think there's no need to elaborate further.

CHAIRMAN MILLER. Okay. Phil.

MR. COLDWELL. Mr. Chairman, I would get rid of M1 in this particular item and move to the money market directive. I think M2, contrary to what Steve says, ought to be our principal focus right now. It does have a heavy share of M1 in it anyway. And I agree with Paul that we ought to be watching with a great deal of care and maybe giving the Manager a bit more latitude. I would not want to see us today move to a 9-1/2 percent funds rate without some considerable discussion. My preference would be a range of 8-3/4 to 9-1/4 percent, centering on 9 and moving to 9 promptly.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. I would go the money market directive. I would retain M1 but give much less weight to it and have an 8-3/4 to 9-1/4 funds range, and I too would move to 9 percent. I

think it would be easy to get there and the market impact has already been accomplished with a discount rate increase.

CHAIRMAN MILLER. 8-3/4 to 9-1/4?

MR. EASTBURN. Yes.

MR. COLDWELL. I didn't say, Mr. Chairman; I would prefer M2 at 5 to 9.

CHAIRMAN MILLER. 5 to 9. Murray, did you get Dave's?

MR. EASTBURN. I'd take alternative 2.

CHAIRMAN MILLER. Alternative 2. Thank you. Phil Jackson.

MR. JACKSON. I would drop M1 entirely from the operational specifications today. I would give M1+ a 3 to 7 range and M2 a 6 to 10 range. And I'd have a money market directive with an 8-3/4 to 9 percent range, going to 8-7/8 immediately. I recognize, gentlemen and lady, that that's really picking at straws and I've argued against that for a long time. I'm rising above principle.

MR. PARTEE. Well, I think the money market directive is most important. And I regard a range for the funds rate of 8-3/4 to 9 as staying right where we are. We are at 8-7/8 percent, I think, and that just gives us a little latitude on both sides. I would argue that we ought to stay there for the time being for several reasons. First, we do have the Administration's program coming up sometime here in the next few weeks--the next few days, perhaps--and we don't know what the program has in it. And it's presumptive for us to be moving interest rates in anticipation of something [as important as] the President's program that we don't know about.

Second, Paul says we've moved very gradually this year, but we have moved 200 basis points since April, and April was only four months ago. And we haven't had time for the lag structures to work on anything. So we don't know where we stand; it's time to hold up a little to see where we are and to see what may occur. It may be that we'll need to go higher, but I think we need to get a look at it. And for the time being I think we've taken rates high enough.

And third, I find that the staff projection is about the only acceptable projection we can have. It has minimal growth in the real GNP for my taste. It has too much inflation, surely, but I don't see that we can knock down that inflation greatly by our actions in this period to come. And it does assume an interest rate level not very far from where we are right now. Therefore, I think we should hold up for the time being until we can see what the shape of the future is, consistent with the staff advice we're getting in the form of a projection.

As far as these aggregates are concerned, I really don't know. I guess I favor alternative 1, incidentally, not alternative 2. And I do believe we ought to have some room on M2 because we

don't [know] whether there are going to be shifts into it or not in this period to come. So I'd be very much opposed to Phil Coldwell's 5 to 9 [range for M2]; I think it ought to be 6 to 10. On M1, maybe what we could do is put an upper limit on it--so long as the narrowly defined money supply does not exceed 7 percent, for example--and forget the bottom end. Maybe use it just as a one-sided [target]. I agree with Paul that it would certainly tell you something if M1 went up with ATS, and perhaps that's a way of utilizing it.

I happen to agree totally with Steve that the only weekly figure we will be getting that can be a guide to the Desk--that would bear on this and isn't sullied by the ATS thing--will be for M1+. That is, we can pick up member bank savings deposits on a daily average basis as we've been doing, so we can add that to M1. And therefore, it will provide a control vehicle--the only control vehicle that makes any sense at this time below the M2 level. So I would put in an [M1+] range. I don't care [about the precise range we choose]. I think maybe I'd put in 4 to 8 but I guess 3 to 7 is all right. Who's to say in this period?

CHAIRMAN MILLER. Nancy.

MS. TEETERS. Well, I would favor a money market emphasis in the directive. I would also favor a federal funds range of 8-3/4 to 9 percent. I feel very strongly that we have moved very rapidly over the past four months and it's time to sit back and see what we've done. We certainly haven't done that to date. As to the aggregates, given the uncertainties, I would favor a wide range on M2 of 6 to 10 at this point. And I think I like your idea of an upper limit on M1--if it gets above a certain point--but I'm not quite sure what that is, Chuck. Is it 9 percent or 10 percent that we begin to--

MR. PARTEE. Well, no, I said 7.

MS. TEETERS. It seems to me that's a better way than giving a range.

CHAIRMAN MILLER. Okay, thank you. Henry.

MR. WALLICH. Well, I would go with the money market directive. I would keep M1 but put a low weight on it--say, 1/4--and put 3/4 weight on M2, much as I am skeptical of M2 as a general proposition. But in this situation, I don't see any other alternative. I would like to have M1+ as an additional guide. For the amounts, which are very speculative in this case, I'd go with alternative 2. On the funds rate I see the attraction of waiting and seeing what we've [achieved] when we've raised rates. [But] the aggregates aren't going to wait and see and they've been running high. If they weren't, I'd be happy to slow down on the funds rate. But as it is, I would go for the 8-3/4 to 9-1/2 percent range, go to 9, and stay asymmetrical at 9.

CHAIRMAN MILLER. Mark.

MR. WILLES. I would just like to point out [something], Mr. Chairman, again making the distinction that nobody seems to find acceptable. Pre-ATS, assuming no adjustment were going to

take place, if we had a 7 percent growth in M1 for the 2-month period, given the current expectation for October of around 3-1/2 percent, it would mean that November could come in at 10-1/2 percent before we do anything. If you then add ATS on top of that and have post-ATS an M1 target of 6-1/2 or 7 percent, you're talking about growth in M1 for November of anywhere from 10 percent on up, however much shift there is. And I just can't imagine, given the report that we had on the international situation [and] our concern about inflation and all the rest of it, that we would find that acceptable. I like Chuck's notion of having a limit on M1, but I wouldn't choose 7; I'd choose something like 5.

And it's not clear to me, even though there is this uncertainty, that the thing to do is to just jettison M1. We know something about M1; we can get a feel for how things happen. We're going to have at least one full month without ATS and it seems to me that maybe we're a little too quick to give [M1] up. On M2, it seems to me that for reasons Phil Coldwell stated we ought to have a 5 to 9 percent range. I don't like money market [directives]. If the Committee goes with one, which it seems clear that it will, I think we ought to have a range that goes at least to 9-1/2 and move immediately to 9. And I would say in the absence of some weakness that we don't see, we ought to move over the course of the month to 9-1/4.

CHAIRMAN MILLER. What's your bottom on that Mark?

MR. WILLES. 8-3/4.

CHAIRMAN MILLER. Okay. Willis.

MR. WINN. Steve, have the TT&L changes been factored into your November estimates?

MR. AXILROD. We would not expect that to have any impact on the money supply. We would expect it to go into effect somewhere in the first week of November. But we expect it to have an impact on the distribution of Treasury balances between the Fed and the banks and some effect, therefore, on Alan's operations in the market in the transition. But no effect on money supply.

MR. WINN. I think my preference would be a money market [directive] with an 8-3/4 to 9-1/4 [fed funds] range and alternative 2, I suppose, [given] our lack of knowledge of what's happening.

CHAIRMAN MILLER. Alternative 2?

MR. WINN. Yes.

CHAIRMAN MILLER. Okay, thank you. Next, John Balles.

MR. BALLES. I like very much what Henry Wallich had to say and earlier than that, Frank Morris. I think in view of the uncertainty that we face in the near term on M1, M1+, etc., there's

still an argument to be made--and I won't bother repeating it--for just placing more weight on M2. And I think that 3/4 weight would be a good thing to do at this point. As far as the federal funds rate is concerned, I'd come out with an 8-3/4 to 9-1/4 percent range, moving to 9 very quickly. And otherwise I'd take the alternate 2 recommendations.

Particularly at this time, Mr. Chairman--alluding to a very important point that you made--I think that we don't want to grind the economy down by very slow monetary growth and perhaps precipitate a recession such as happened in '74. I think we're faced with an opposite kind of situation now; inflation was worse then. We did in fact in retrospect, in my view, have much too slow a pace of monetary growth when the brakes were finally landed on. But I think the objective now ought to be to prevent a monetary explosion such as the type we've had in the last couple of months--in August and September. I for one wouldn't lean toward the kind of monetary policy that in fact triggered a recession the last time around and I don't think the majority of members are talking about that kind of thing.

CHAIRMAN MILLER. Thank you, John. Bob Black.

MR. BLACK. Mr. Chairman, I share the temptation of most people to use a money market directive. But I don't really like money market directives, even though there's a lot of uncertainty now, because I believe there would be a lot of uncertainty next time and if we do it this time, we may do it again. Despite that, I would go ahead and change--

CHAIRMAN MILLER. You'd rise above principle also.

MR. BLACK. Rise above principle? No, I'm not really going to do that. I'm going to stick with principle and say that I'd really rather go with an aggregates directive, although I don't object to anybody else feeling the other way. The problem I have is that the short-run ranges to me don't really tie in very well with our long-run targets. I've distributed a couple of times before a table that shows the rates of growth in M1 and M2 for successive yearly periods. For example, for the third quarter of '77 to the third quarter of '78, as Steve pointed out, the money supply narrowly defined grew by 8 percent. If in fact we have the amount of growth in M1 projected by the staff, for the period between the fourth quarter of '77 and the fourth quarter of '78--if you take the November figures as a good proxy for the fourth quarter--the rate of growth would be 9.2 versus the 8 percent. And I think we need to work down gradually from the 8 percent.

And when you go to M2, the last figure we have would be for the third quarter of '77 to the third quarter of '78, and that comes out at 8.2. If you let the November projection be a proxy for the fourth quarter--the fourth quarter of '77 to the fourth quarter of '78 would be 8.5. So what I'm really saying is that I think the short-term objectives, or targets, or whatever you want to call them, are too high if we're to make any progress currently in moving down to a slower rate of growth over time. And I would hope that in a couple of years or so they could be down. So I would want to set those a good deal lower than that. I was hopeful that we might be able to get down as low as 7-1/2 for this yearly period, and this would call for practically no growth in M1 if we have the automatic transfers.

So, using the aggregates directive, I would say -2 to +2 [for M1]. M1+ comes out to 2 to 6 and M2 to 3 to 7. I would use the federal funds range in alternative 2, 8-3/4 to 9-1/2 percent, and I'd edge it on up to 9 now.

CHAIRMAN MILLER. Thank you, Bob. Roger Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I think we would adopt the ranges for M1 and M2 that are set forth in alternative 1. With respect to M1+, in view of the comments earlier, I have no objection to setting ranges for that for internal operating procedures. And if I was misunderstood before, I'd like to correct that. I have no objection to the range in alternative 1 for M1+, which is 3 to 7. It is important, in my judgment, to go with a money market directive. I think there would be some advantage to moving to the 9 percent level, with a money market directive, immediately following this meeting. And as a result, I would select a federal funds range of 8-3/4 to 9-1/4, with the understanding that any movement from 9 percent during the intermeeting period would require some consultation.

CHAIRMAN MILLER. Thank you, Roger. Bones.

MR. KIMBREL. Mr. Chairman, without repeating many of the other fine points made, I think we would opt for alternative 2, a money market directive, the range for the federal funds rate, though, of 8-3/4 to 9-1/4, and moving promptly to 9.

CHAIRMAN MILLER. Thank you, Bones. Bob Mayo.

MR. MAYO. Well, my arguments have all been given. I would come out at 8-3/4 to 9 [for the funds rate], with 3-1/2 to 6-1/2--the 3-1/2 being irrelevant--for M1. A 6 to 10 percent range is okay for M2, and I'd leave it at that. I would interpret the present rate as being 8-7/8 and if we want to go above 9, I think we ought to have another meeting.

CHAIRMAN MILLER. Frank.

MR. MORRIS. I would opt for a federal funds range of 8-3/4 to 9-1/4 and move immediately to 9. I think we've got to keep probing until we find the level of rates that is going to stabilize the money supply. I also feel, given the degree of monetary restraint that now requires, that it would be associated with higher levels of interest rates than we've seen in prior cycles. I think that it would be safe, despite Steve's advice, to use a single M2 guideline of 4-1/2 to 8-1/2 percent.

CHAIRMAN MILLER. Thank you, Frank. Lawrence, are you clean-up hitter again?

MR. ROOS. I'd say don't throw my M1 out. If we have M1, without ATS [I'd suggest a range of] 3 to 5 and for M2, 5 to 9. And I think most important of all is widening the federal funds

range. If we try to stick to anything below 9-1/4 or 9-1/2, we can't possibly control the aggregates as we're trying to do. So I'd suggest 8-3/4 to 9-1/2 for the fed funds range.

CHAIRMAN MILLER. I missed your M1. What was it?

MR. ROOS. 3 to 5.

CHAIRMAN MILLER. Well, thank you all. Let's see what we have. A mess. Well, looking at the voting members, the consensus on the federal funds range is 8-3/4 to 9-1/4, I would say. There are a few 9-1/2s and there are a few 9s, but we don't have a majority of 9s without getting some 9-1/4s. On M2, it's about split between 6 and 10 and 5-1/2 to 9-1/2. Let's forget M1 for the moment and come back to that later. I can't really tell, there were so few people who really had an opinion. It sounds like the Partee dictum of a 7 percent cap might be as good [as any in terms of the] consensus that occurred, although there were some who were slightly tighter. What?

VICE CHAIRMAN VOLCKER. That seems a little high to me. I was just mumbling to myself.

CHAIRMAN MILLER. Well, you may be right because not many people really put a number down. So there were several drops and several passing. What is your pleasure?

MR. PARTEE. The money market directive did win.

CHAIRMAN MILLER. Oh yes, I think the money market directive is clearly the consensus. And I would say using M1 in some way was a consensus, too. M2, if you want to split it, it's 5-3/4 to 9-3/4, obviously. Have you ever done that? And on the fed funds rate nobody is below 8-3/4 and [most have the top at either] 9 or 9-1/4. You [suggested] having the cap put on it, and there were two or three 9-1/2s.

MR. EASTBURN(?). Mr. Chairman, did you have a consensus on moving to 9 percent? How does that come out, do you know?

CHAIRMAN MILLER. Well, of those who expressed [a view on] that, five expressed going to 9. That's a little less than half of the eleven [voting members]. The others didn't [say]. One of them was 8-7/8 and that was Phil Jackson. Nobody else expressed much--

MR. PARTEE(?). I agree with Phil.

CHAIRMAN MILLER. What was yours, Ernie?

MR. BAUGHMAN. I did not say [anything about] going to 9 immediately but I would prefer that.

MS. TEETERS. And I would stay at 8-7/8.

CHAIRMAN MILLER. We're going to have to try some go-arounds and see what we can come up with. One thing we're going to probably [agree on], if you look at the consensus, [is] the money market directive. So let's forget that; everybody or a very large preponderance seems to [prefer that]. I don't know of anyone who [favored] a monetary aggregates directive among the voting members. Let's take the M1 at a cap of 7 percent. Let's take M2 at 5-1/2 to 9-1/2. And let's take federal funds range at 8-3/4 to 9-1/4, going to 9 [promptly]. Let's get a show of hands on that directive.

SPEAKER(?). Just the voting members?

CHAIRMAN MILLER. Just the voting members.

MS. TEETERS. Would you repeat that?

CHAIRMAN MILLER. M1, not to exceed 7; M2, 5-1/2 to 9-1/2; federal funds, 8-3/4 to 9-1/4, and going to 9. How many of the voting members would vote for that? Six. That's a majority isn't it?

VICE CHAIRMAN VOLCKER. That 7 is a little high.

CHAIRMAN MILLER. You didn't vote in favor of this?

VICE CHAIRMAN VOLCKER. No, just because the 7 is too high.

MR. PARTEE. It's only because of that 7 that I agreed to the lower range on M2.

CHAIRMAN MILLER. We need some compromise to get a broader consensus here. I assume that the weight on M1 is not equal the way it usually is on this. I assume everybody kind of agreed with that.

MR. PARTEE. And that it would be a cap sort of thing?

CHAIRMAN MILLER. I don't want to take an official vote because I'd like to have more than a very thin majority. Paul, can't you see your way clear to this? It's a very reasonable proposition.

MR. WILLES. Hang in there, Paul.

VICE CHAIRMAN VOLCKER. Let me just argue the other side. The 7 is awfully high when we're getting this automatic transfer.

CHAIRMAN MILLER. Would you prefer a 6 to 10 on M2, and 6-1/2 on M1?

VICE CHAIRMAN VOLCKER. No. I don't prefer that 6 to 10 either.

MR. PARTEE. You just said we're getting the automatic transfer; that makes it uncertain what M2 will be. The M2 will be higher than it would otherwise be.

VICE CHAIRMAN VOLCKER. But M2 looks plenty high to me.

CHAIRMAN MILLER. We have a majority for this proposition but I think it's too thin and I'd like to see if we can gain some other support. Let's see. Paul didn't vote for it; Willis didn't vote for it, Nancy didn't vote for it, and Mark didn't vote for it. Well, let's try another one just for a second: [For M1] a cap of 7; for M2 a range of 6 to 10; for federal funds, 8-3/4 to 9, with [a move to] 8-7/8. How many would vote for that? Three. Phil Jackson, did you vote for the other proposition?

MR. JACKSON. Yes.

MR. EASTBURN(?). Mr. Chairman, would you like to try what you had first with a cap of 6?

MR. PARTEE. Then 6 to 10 on M2?

MR. EASTBURN. No, I'd leave it 5-1/2 to 9-1/2.

MR. PARTEE. I think you'll lose my vote.

CHAIRMAN MILLER. Let's just do it. If we had a cap of 6, and the others 5-1/2 to 9-1/2, and 8-3/4 to 9-1/4 going to 9, how many would vote for that? Seven. That got more votes than the other one did. Here's my final proposition. I'll give you a deal you can't turn down: M1, a cap of 6-1/2; M2, 5-1/2 to 9-1/2; and fed funds, 8-3/4 to 9-1/4, going to 9. How many would vote for that?

MS. TEETERS. Mr. Chairman, if you went to 9, could we then have the suggestion that there would be consultation before moving beyond 9?

CHAIRMAN MILLER. We could have that.

MR. PARTEE. We wouldn't ordinarily do it anyhow, unless we're at the top of those ranges.

MS. TEETERS. We went to the top of the range very quickly this last time.

MR. COLDWELL. We were already there.

CHAIRMAN MILLER. We were already there last month. This month we're starting off with a much lower base.

MR. PARTEE. It was a very biased vote--biased toward the aggregates.

CHAIRMAN MILLER. We'll start out with 6-1/2 to see if we can get more than 7 votes.

MR. PARTEE. Oh all right. Don't you fellows who were for the 6 give up now. Come on vote. Seven. We lost somebody. Who'd we lose? Yes, we lost Willis.

CHAIRMAN MILLER. Come on, Willis, goodness gracious. All right let's call the roll on my last and final offer: 6-1/2, 5-1/2 to 9-1/2, 8-3/4 to 9-1/4 moving to 9, money market directive, and pray.

MR. AXILROD. Mr. Chairman, is there to be a supplemental M1+? I just want to be sure.

CHAIRMAN MILLER. I think it would have [unintelligible]. I don't think you can watch it and be guided.

VICE CHAIRMAN VOLCKER. Just to be clear, M1 is kind of meaningless unless it's up toward the top of this limit. There's no weight really on anything below that?

CHAIRMAN MILLER. No one can [unintelligible]. If it gets up above 6-1/2 for M1, then--

VICE CHAIRMAN VOLCKER. No, we worry about it. [But] no matter how low it goes--

CHAIRMAN MILLER. So I will vote for that.

MR. ALTMANN.

Vice Chairman Volcker	Yes
President Baughman	Yes
Governor Coldwell	Yes
President Eastburn	Yes
Governor Jackson	Yes
Governor Partee	Yes
Governor Teeters	No
Governor Wallich	Yes
President Willes	No
President Winn	A reluctant yes.

Nine.

CHAIRMAN MILLER. We'll have canceling dissents. Well, thank you very much. Next is confirmation of the date of our next meeting, which is Tuesday November 21. Luncheon is next. I have one other announcement. Yes.

MR. BAUGHMAN. I think this Committee should decide tentatively today to reassemble the day after the President announces his anti-inflation program and address ourselves to that program and how it relates to our responsibility. [We ought to discuss] what we could do in the way of [unintelligible] a public announcement, which would undertake to underscore at least the objectives of the President's program. [We should] consider, of course, everything in our area of responsibility that could be cited as lending support to his program.

I would view several possible positive things as coming out of this. One, and most important, that we are doing everything we can with everything that's available from all sources on an anti-inflation front. Two, an opportunity to try to minimize the possible boxing-in effects from the announcement with respect to freedom of action in the monetary policy area. And I would think there would be an opportunity for something to be said which may not be said in the announcement--I have no idea what the announcement will be--with respect to the importance of finding policies that will reach more effectively into this wage-price push part of the economic picture than anything that's been put forth thus far. And finally, it seems to me that such an announcement or statement or the holding of a meeting of this Committee at that point in time would probably carry some meaningful message to the international sector that this country at long last is meaningfully and unitedly attacking the inflation problem.

MR. ROOS. What if this Committee at long last meaningfully [unintelligible] the President's program?

MR. BAUGHMAN. I'm assuming that the statement will be something that either will have or can be reasonably construed to have a substantial body of economic content.

MR. PARTEE. I think this is a Board matter, not an FOMC matter.

MR. BAUGHMAN. I think if it were done by the FOMC it would have the potential of carrying substantially more weight to the public, both domestically and internationally.

CHAIRMAN MILLER. May I just ask a couple of questions? If we were divided on the effectiveness of this program, I'm thinking this could backfire on us--the fact that we're meeting and it would become known.

MR. BAUGHMAN. If we were not united, I wouldn't put out a statement.

CHAIRMAN MILLER. Then I would wonder, if we came out endorsing the program and commenting on parts of it favorably and other parts of it unfavorably, whether we politicize the FOMC. If we indicate that we really intend to take other kinds of actions that we haven't consulted with the President about, it [might] be read as counter to his program and superseding his program.

Would that get us into hot water? I don't know. These are the kinds of things that I would be a little concerned about.

SPEAKER(?). I think we all will.

MR. BAUGHMAN. On that one aspect of it, it seems to me that holding such a meeting quickly after the announcement would permit us to construe anything that we were proposing to do as being supportive of this program and thereby blunt the charge that we were not being supportive or that we were going contrary to his [program].

MR. ROOS. Mr. Chairman I think it's fraught with danger because, first of all, I think this will be a controversial program regardless of what the White House puts out. The first charge would be that our Chairman was sort of falling into line the next day. I think we'd lose our independence. If we want to speak out as individuals, I think we're entitled to. I know their first dog and pony show was to be in St. Louis and there has been a tremendous difference of opinion within the business community, which was asked to sponsor it, as to whether they even wanted to give credence to it. So I think it's going to be controversial and I'd hate to see us put on the spot of having to take an official stand.

MR. JACKSON. It's true that the FOMC is not in the habit of issuing press releases on other people's business.

MR. COLDWELL. I think this matter has considerable danger to us, Mr. Chairman. Anyway, we don't have to decide [today]. We'd better take a look at what that program is and if it's going to be desirable for us to speak out, then we ought to do it.

MR. WALLICH. We'll probably be asked about it at the next--

CHAIRMAN MILLER. Yes, but there's two things, the FOMC and the Board of Governors. And if we're asked, do we opt to respond as a Board position or should it be ducked? Or are they to be individual comments or what? Those things I think have to be handled with great care. Paul.

VICE CHAIRMAN VOLCKER. The idea of a meeting has problems, I think, which have been alluded to here. I think Ernie has hit on a very good point as to the importance of this program and its [implication] for monetary policy. But maybe the burden is the other way, I would just suggest, in the sense of any announcement. [I say that] as one Committee member, anyway, who hopes that in shaping this program they do not try to box us in our monetary policy precisely. But anything they would want to say about the need for a consistent monetary policy--in terms of the growth of the monetary aggregates being consistent with a reduction in inflation--I think we ought to applaud.

CHAIRMAN MILLER. I think the probability is just the reverse; I think the probability is that he's going to have a statement which says this is going to be so effective that monetary policy can ease up.

VICE CHAIRMAN VOLCKER. That's precisely what I'm worried about.

CHAIRMAN MILLER. And a statement is likely to be touchy for us.

MR. BAUGHMAN. It's important that we respond to that immediately, it seems to me.

MR. PARTEE. Well, you can't--

MR. MORRIS. We respond by actions and that's--

CHAIRMAN MILLER. Frankly, I think that we'd all be so wise if we'd learn after these FOMC meetings not to take calls from the press. You have no obligation to answer calls from the press. You get drawn into these individual comments that lead them to pick through and surmise what we're doing. And I don't think the FOMC ought to come back in and get into a public debate with anybody in Washington over whether somebody else's policy will [lead] us to do A, B, C. [That's my view] on that issue now. Now, the other issue is a broader one. If they say this will make it possible for monetary policy to be easier, I sure wouldn't want to see us go into the street the next day and say, "Oh no, we're going to tighten up."

VICE CHAIRMAN VOLCKER. I sure wouldn't like to see them say that in the first place.

CHAIRMAN MILLER. No, I'd say that we would like to see neither.

MR. PARTEE. More likely [it will be expressed as] a hope that interest rates would be able to come down. That's more likely the kind of sense--

MR. MORRIS. There's no question if the President gets the wage rate down to 7 percent, then that makes it a hell of a lot easier for us.

VICE CHAIRMAN VOLCKER. That's right.

CHAIRMAN MILLER. What I was about to say before I forget is that Larry Roos had circulated a statement, which I got just before I came in here and didn't have a chance to read, and he has asked that we put it into the record. So I wish you all would read it and it would be officially in the record.

MR. ROOS. Thank you, sir. [Statement--see Appendix.]

MR. WINN. On another matter, Mr. Chairman, I've been unhappy this year with our experience with the Ms, and the meeting today convinces me that we're certainly not sure about

how to measure them or what they are. I wonder if this isn't the time to reopen the question of our guidelines. Even though we've explored it and buried it a number of times, [I'd like us] to reopen the issue of some sort of reserve base aggregate to be used to guide our actions. I think it's time.

CHAIRMAN MILLER. What is going on, Steve, in terms of looking at the definitions of money and the aggregates?

MR. AXILROD. Well, on definitions of money, we plan, as I mentioned before, to have within two months new definitions taking account of the fact that the world has changed. With regard to the reserve base as an alternative guide, we've had various definitions of the reserve base which from time to time have had varying degrees of prominence in the Committee's instructions. And that's a matter that I think might be taken up by the Subcommittee on the Directive when they consider the relationship of monetary targeting to the Humphrey-Hawkins bill.

CHAIRMAN MILLER. I don't want to duck the issue. I think it's a subject that needs exploration and I assume the Committee has done it before. It came up when I was first [appointed] to the Board of Governors. And the decision was--and I didn't have the background--that no changes be made at that time. Now we're coming up with a lot of new changes and I think we ought to restudy it.

MR. AXILROD. I would propose to bring it up by that route if Governor Partee agrees to it.

CHAIRMAN MILLER. Let's not come up to our January and February meetings where we're trying to decide on our new policies without some pre-thought because all of us need to digest these things. They're too complicated and too difficult.

Well, we have a 2:30 meeting with your Committee, John [Balles], and we might be a little late.

END OF MEETING