TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

December 19, 1978

Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcript was not fully edited for accuracy at the time it was produced because it was intended only as an aid to the Secretariat in preparing the record of the Committee's policy actions. The edited transcript has not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Staff Statements Appended to the Transcript

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

Meeting of Federal Open Market Committee

December 19, 1978

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, December 19, 1978, at 9:00 a.m.

PRESENT: Mr. Miller, Chairman
Mr. Volcker, Vice Chairman
Mr. Baughman
Mr. Coldwell
Mr. Eastburn
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. J. Davis, Keir, Kichline, Paulus, 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

Messrs. Coyne and Guenther , Assistants 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

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

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

Mr. Mullineaux, Research Officer, Federal Reserve Bank of Philadelphia

Mr. Levin, Manager, Securities Department, Federal Reserve Bank of New York

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

CHAIRMAN MILLER. Good morning, ladies and gentlemen. I appreciate everyone's willingness to meet so late in the morning, given your usual preferences for early sessions. I've taken the liberty of trying to develop a format for today's meeting that I hope will prove useful and beneficial. If not, we can certainly adjust it back. I would like to experiment with some way that would accomplish all of our purposes and perhaps make it easier for the Committee to get our work done in the allotted time. What I am going to suggest is that we go directly through items 1 through 5. Item 4 we'll be hearing from the staff on the economic review and 5 we'll be hearing from our Economist on his views.

Then what I would like to do is to get the round robin in, where every member of the Committee gives comments on his views of the economy--without necessitating numerical variances from staff--and indicates any important signals, regionally or nationally, seen that would cast light on our overall evaluation. But indicate at the same time what this implies from your point of view in terms of policy direction. Again, not numerically but in terms of does this imply tightening, easing, steady as we go, or substantial this or substantial that. And by the way, we can get how everyone sees it and after the coffee break perhaps we can then focus on the specifics of the directive and the guidelines and see if we can in that way streamline somewhat the process without in any way curtailing the search for inputs and comments. But by making comments on both the economy and the monetary outlook at the same time, I think it will shorten the process from going around twice. I'd like to try that today, if you are willing, and see how it works.

The first order of business is to approve the minutes of the actions taken at the last meeting; they have been circulated. Are there any comments or corrections? Hearing none, we'll record those as approved. And the next item is to deal with foreign currency operations, the report on the operations since the last meeting. Scott Pardee.

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

CHAIRMAN MILLER. Thank you, Scott. Any questions? Henry.

MR. WALLICH. It's reported that support for the dollar in Europe may flag because of the oil price increase and the desire to see that reduced in terms of their local currencies. In fact, the drop that you note in the dollar has already undone something like 1/3 of the oil price increase, as far as the countries with strong currencies are concerned. Have you heard anything on that?

MR. PARDEE. Yes, well, if I seem a little agitated, I've just gotten off the phone with the Bundesbank on that precise point. And all I got was a lecture. Obviously, this is not official policy on the part of the German government or any other government, but I was told it was about time that we did something on fundamentals and all that. So it's not the official policy but it's one of the things in the market that's poisoning the atmosphere and leading to further sales of the dollar. We ourselves found in our intervention yesterday that we got an unusual cluster of Middle East names.

SPEAKER(?). What does that mean?

MR. PARDEE. Well, the selling was coming out of the Middle East more. The New York market itself was quiet; it was quiet from noon on. It was a heavy cluster of names that came out of the Middle East.

CHAIRMAN MILLER. Phil, did you have a question?

MR. COLDWELL. Just to clarify that last comment, that's all.

CHAIRMAN MILLER. Yes, Dave?

MR. EASTBURN. I have a question about the Greenbook; it's on this subject and perhaps Ted could address it. The last paragraph of the Greenbook supplement talks about the prospects for the dollar in the next year and concludes that with an improvement in the trade surplus and the relative inflation performance the dollar should about hold where it is. I would have thought you'd say it might improve. Would you comment on that?

MR. TRUMAN. Well, I think it's fair to say there's a possibility it might improve, but the consensus of the staff here was that the dollar would be about where it was--and in fact the Greenbook was written in the early part of last week.

MR. EASTBURN. Before this.

MR. TRUMAN. Before this, so that suggests that there would be some improvement certainly from current levels. In fact, as far as the staff when we do this forecasting, it's sometimes helpful to use a number rather than words as we do in the Greenbook. So that tends to include a range of plus or minus 2 percent. Again, I think the consensus, for what it's worth, is that there would be some improvement--maybe even a 4 to 5 percent improvement from where we are today.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Just to follow up on that, though, Ted: If the price rise for oil means that our trade balances are less good by a few billion dollars by the end of the year, isn't it true that other countries would be proportionately even less well off as a result? That is, we import less oil than Germany, Japan, Switzerland, or France, at least, and so I should think they would have a greater deterioration relative to previous expectations than we would.

MR. TRUMAN. Well, you reminded me of something that I didn't say. The other thing we had not included was the OPEC price rise. For the year as a whole, that has very little effect compared to what we've been assuming before. We've estimated now maybe 3/4 of a billion dollars for the year as a whole. However, it adds to the current account deficit of the United States, we would think, about $2 billion at the end of 1979. That means that the pattern we'll have throughout the year is going to be that we may have some sort of initial improvement and then it's going to be flatter than we expected. And, in terms of what Scott was just mentioning, that does not suggest that you are going to have the kind of dramatic improvement that was embodied in the Greenbook forecast. Now, as far as the impact on the United States versus the rest of the world, the fact is that our oil bill per se is approximately twice as large as that of any other country.

MR. PARTEE. Relative to GNP or what?

MR. TRUMAN. No, not relative to the GNP, but in terms of the oil bill. So the figures--that $2 billion is the largest number that's around. While it is true that we have a lower dependence on imported oil than Japan or Germany, we have a large overall oil bill and, therefore, any increase will add to the psychologically important [dollar amounts.]

VICE CHAIRMAN VOLCKER. It is also larger relative to our balance of payments, which I think is the main--

MR. MAYO. Yes, I think that's more important.

MR. PARDEE. You also have had the kind of psychological imponderables and the one that Henry raised.

MR. PARTEE. You mean our oil bill is a larger proportion of our imports than would be the case in Germany?

MR. WALLICH. Because our imports are small; the oil proportionate to GNP--

VICE CHAIRMAN VOLCKER. [Unintelligible.]

MR. PARTEE. That's hard to work through. Then our exports must also be smaller relative to--

VICE CHAIRMAN VOLCKER. They are.

CHAIRMAN MILLER. Scott.

MR. PARDEE. You also have the psychological imponderables beyond just the forecasting tools the economists normally use in terms of the expectations towards policy. Governor Wallich raised one point--that the Europeans may allow their rates to rise. And there is the feeling that perhaps the United States may let the dollar drop as a way of financing this. So it's not just taking previous trends and projecting them forward. It's this policy context we have to consider.

CHAIRMAN MILLER. Thank you, Scott. We need an action to ratify the transactions since the previous meeting. I think the details have been circulated. Are there comments or objections? Hearing none, we will record that as approved and move on to domestic open market operations and the report from Mr. Sternlight.

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

CHAIRMAN MILLER. Thank you, Peter. Questions or comments?

MR. WINN. Can you elaborate on your last comment a little bit?

MR. STERNLIGHT. Well, as I mentioned, the dealers had a very poor year in 1977--the worst since we have kept records of this. As a group, the primary dealers had losses on the order of $100 million. This past year was not that bad, but it was a poor year. The figures we have together at this point suggest a magnitude of roughly $30 million lost through nine months of the year. This is a volatile industry; people are used to ups and downs, but I am concerned that there are some longer-term factors at work there. I think [given] the growth in the number of dealers, they tended to be very aggressive in their competition with each other, paring down margins. They have tried to take positions because they can't make money on the spreads as much anymore. They seem to guess wrong quite frequently and take losses on positions. Just a series of factors, mostly [involving] the aggressiveness of their competition, has impaired the profit opportunity. I think the electronic means of communication that they have now has tended to [unintelligible] up the competition as they scramble to make the best possible market to customers. And then many customers are operating almost like dealers in the rapidity of their buying and selling activity in the market.

MR. KIMBREL. Peter, have the losses been concentrated in a few dealers or are they pretty generally scattered throughout?

MR. STERNLIGHT. In '77 losses were very general. Only a few dealers made very slim profits and almost all of them made losses. There's been more of a scatter--more dispersion--this past year. A few have turned in a not too bad performance and some have been quite heavy losers.

CHAIRMAN MILLER. Bob Black.

MR. BLACK. What are the implications of that for monetary policy, Peter?

MR. STERNLIGHT. Well, I think the Treasury depends on a vital, healthy government securities industry for the underwriting of its debt. I think market participants depend on a healthy industry just because many seek to make liquidity adjustments in the government securities market. We are dependent on it in the execution of monetary policy--having a vital market out there where we can buy and sell securities as we need to adjust reserve positions.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Peter, were the losses you're talking about concentrated in a few firms or is there a wide dispersion between profit and loss?

MR. STERNLIGHT. Well, as I mentioned, there was wide dispersion in the '77 losses. In this past year, maybe about half of the firms have had losses. And some of the losses were quite substantial--enough to give, on balance, a loss for the industry as a whole.

MR. COLDWELL. But there is still interest in becoming a dealer bank?

MR. STERNLIGHT. Less than earlier, although there are still firms that seek to get in, not because they expect to come in and make a lot of money in the government securities but because they see it as necessary to round out their activity. A large corporate underwriting firm may see this as a desirable adjunct to its business in the corporate area.

MR. MAYO. Peter, many years ago there was some effort made to suggest that the Treasury should sell its securities on a commission basis and go like the stock market on the turnover in the secondary market. I haven't heard anything about this for years. Is that dead or does what you are describing here give any impetus to that discussion?

MR. STERNLIGHT. Well, every once in a while one or another dealer comes up with the suggestion. I wouldn't say the Treasury might have to give it renewed consideration.

MR. MAYO. Are any of the dealers that have a very broad base in other parts of the securities market using the government operation as a loss leader in any way?

MR. STERNLIGHT. I think one could say that to some extent, yes. I think that's part of this desire to enter an industry where the profit experience has been poor recently. They still want to get in just [for the] prestige factor because they see it as a desirable way to peddle their corporate securities.

CHAIRMAN MILLER. Thank you, Peter. We need an action to ratify the transactions since the previous meeting. [A report] has been circulated. Are there any comments? Are there any objections? Hearing none we'll record that as approved and move to item 4 on the agenda, which is the staff report on economic situation by Jim Kichline.

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

CHAIRMAN MILLER. Normally I would say thank you. In this case I'm not sure I can say that.

MR. COLDWELL. What part of Las Vegas did you come from?

CHAIRMAN MILLER. I think with these odds, Jim, we'll call you Jimmy the what. Well, anyway I'll thank you. Before we start our discussion of this, Steve, would you give us your comments on how you see these relationships?

MR. AXILROD. Thank you, Mr. Chairman. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN MILLER. Again, can one say thanks for that clear-cut definition of policy? Thank you for outlining the choices. Before we start the go-around, are there any particular points that need clarifying? If there are technical questions that could be handled elsewhere, that might be better. But if there are any things that should be clarified here-- Yes, John?

MR. BALLES. This is sort of a belated question back to Scott Pardee. You referred to the lecture that you got from the Bundesbank this morning, Scott.

CHAIRMAN MILLER. That was after he lectured them.

MR. BALLES. What do you think they mean by a credible anti-inflation policy?

MR. PARDEE. He said higher interest rates. He said it three times. And I said, "We've got higher interest rates." So we got into jawboning back and forth. Let me get back to fiscal policy, the whole range of things that we've been discussing over the month. The problem is simply that the numbers haven't come through to support all of the things that we said over the months about winding down inflation and turning the trade balance around. The trade balance is improving--that [will happen] in time. But it is more a question on the inflationary front. I wouldn't accept what the Bundesbank has to say about our policy. We have to have our own deliberations. They wouldn't accept what I had to say about their policy.

MR. PARTEE. You said Merry Christmas.

MR. HOLMES. That's later this week.

CHAIRMAN MILLER. Yes, Bones.

MR. KIMBREL. I just have a question to Jim. Did I follow, Jim, that you were suggesting that maybe because of the weather the housing growth has been borrowing from the future? You would [expect] some considerable weakening because of borrowing--

MR. KICHLINE. That's right. I might say there's no way to understand the fact that we have had a great deal of strength in that sector. We checked with a number of major builders and there has been a suggestion that the weather has been quite good and that, combined with their expectation of generally tighter mortgage market conditions, [has led them] to try to push their starts through. To whatever extent that argument is correct, one would expect somewhat greater weakness later on.

CHAIRMAN MILLER. Jim, what about the seasonal adjustment in November? Could a small increase in actual starts with good weather show up as a bigger number in the seasonal adjustment?

MR. KICHLINE. I don't believe the November seasonal is that big. The December and January ones are quite big. I might note that the only area that increased in November was the

North Central area. And in October that's where home sales just went through the roof; there was something like a 120 percent increase.

CHAIRMAN MILLER. In the Northeast?

MR. KICHLINE. In the North Central region. Every other area in the country was down on the starts figures this month.

MR. COLDWELL. Sounds like a good explanation until you start adding in the future figures of the home builders and other mortgage groups that are making commitments at a faster--

MR. KICHLINE. That's right. You can get caught with the lags in this process, as you know, and things could fall apart right quickly. I noted in reading the Redbook that sprinkled throughout each District Bank's report was essentially a tightening flavor in the mortgage market and a slackening of housing activity. But it's clearly not evident in the numbers that we have in hand.

CHAIRMAN MILLER. Nancy.

MS. TEETERS. You've moved up your price expectations. Is that the result of the rise in crude oil prices? Is that the major impetus behind that?

MR. KICHLINE. No, we have had an expectation of about an 8 percent [increase in crude] prices. We haven't changed that much for 1979. It's the energy side, where I think we just underestimated the impact of natural gas prices--for example, what had been happening to gasoline prices. That's really the key. We did not change our [crude] price projection at all. In addition, I might say, we have not been encouraged by the performance of unit labor costs. The third-quarter numbers, for example, showed [initially] an increase of around 5 percent in unit labor costs. Revised figures of a week or two ago showed a 7 percent increase. Productivity is estimated to have been lower and compensation a bit higher. So the underlying patterns seem to us to have deteriorated some more.

MS. TEETERS. But the gasoline prices started up before the OPEC price increase. You didn't think--

MR. KICHLINE. No, that's right.

MR. PARTEE. This doesn't include the OPEC thing.

MR. KICHLINE. No, it does not. We had 7-1/2 percent. We are at 7-1/2 percent.

CHAIRMAN MILLER. Which was from January 1, incidentally. So you have to realize that it is only less in the beginning and more at the end.

MR. KICHLINE. That's right; it's 7-1/2 versus 10. And we don't have the extra 2-1/2 percent on average, but the latter half of the year looks poor.

CHAIRMAN MILLER. Paul.

VICE CHAIRMAN VOLCKER. Well, after that conversation I would just offer an observation. It's hard for me to see how you get down to this 7 to 7-1/2 percent range in prices in the second half of next year unless you are putting an awful lot of weight on the President's program. But that's not my question. My question is budgetary. I think you have by the full employment measure of stimulus actually negative stimulus--if that's the right term--in the first quarter, which surprises me a little bit with the tax reduction, so any comment you would offer on that I would appreciate. But also I get the sense at least the money market analysts in New York for some reason are beginning to project a substantially larger budget deficit this year than the official estimate.

CHAIRMAN MILLER. Which year is that---the '79 fiscal year?

MS. TEETERS. You get a recession, Paul.

VICE CHAIRMAN VOLCKER. Well, it's not early enough to have-- They also have a very large one in the following year. That's maybe a recession, but I don't think a recession is the full explanation this year. All I asked for is comments from the staff about this possibility.

MR. MAYO. Isn't this true of the New York community generally--that they are always projecting a bigger budget deficit?

VICE CHAIRMAN VOLCKER. What surprises me about this is that some of them have been ahead of the government in projecting a lower deficit in recent years and lower expenditures, which has turned out to be the case. Now it seems to be reversed.

CHAIRMAN MILLER. Well, it's hard-- Jim, let's get it back in focus. Jim, tell us about all that new employment and personal income that's going to [generate] all that revenue.

MR. KICHLINE. Well, the question on the full employment surplus or deficit, from the fourth to the first quarter there is virtually no change, [even] with a tax cut. At the same time we have the social security tax increase, which is a partial offset; and on the expenditure side we have a fairly slow growth of expenditures related to the Commodity Credit Corporation expenditures, which have boosted this quarter a bit and we anticipate will not in the first quarter. So it's really that there are offsetting items going on within the accounts, so we don't have much change in fiscal thrust right now. With regard to the budget deficit numbers, I guess we feel fairly comfortable with what we have now.

VICE CHAIRMAN VOLCKER. Which is similar to the Administration's figure.

MR. KICHLINE. That's right, though we would like to think that we have done our own work. We do have differences in various categories. We have some outlays a bit lower. We think there will be a little bit in the way of shortfalls, not a great deal. But we have somewhat higher interest payments so they are offsets. But in total we are quite close. I was under the impression that most of those who have higher deficit numbers are operating with different economic assumptions. That was my general impression.

MS. TEETERS. Well, it is also vague in the accounting. That is, the social security tax increase--even though the major part of it is an increase in the ceiling and doesn't take effect until the latter part of the year--shows up totally in the first quarter.

VICE CHAIRMAN VOLCKER. I understand that. Still that's only half the tax reduction, or a little more than half.

CHAIRMAN MILLER. Ladies and gentlemen, I think we are perhaps ready to try to get your inputs individually. Through careful analysis of past meetings, it has been determined that the proper procedure today would be to start with Henry Wallich, who isn't here, and go clockwise. I suppose he is frightened about the possibility of being the lead-off!

MR. PARTEE. He had a very brief statement today, didn't he?

CHAIRMAN MILLER. I would ask for three components, or two particularly, on the economy as you see it, in terms of any variance from the staff forecast. It need not be numerical; it can be qualitative or quantitative. Also, I would particularly like each of you to comment on how you read the implications for monetary policy at the moment, particularly [regarding] the directive between now and the next meeting. So we will start with you, Phil, and when Henry comes in we will pick up.

MR. COLDWELL. Well, Mr. Chairman, it seems to me that we have not made enough headway toward slowing this economy down. I am very sorry to see the large increase in real GNP. That sounds cruel to say, but accompanied with that is a major increase in inflation and another further jump of 0.7 percent even on the average wages. I can't in good conscience look forward to that kind of package for 1979, where we are looking at a minimum of 8 percent. And if this has to be restructured in the latter part of the year, I suspect it would be even higher.

If the Committee decides to buy the idea of skipping the January meeting, then I think we need greater leeway and more flexibility to meet the shifts in January and I will address that problem later on. A basic problem to me is that inflation is not showing any slack in it whatsoever that I can see. The aggregates to me are totally unreliable. We haven't seen anything that would educate me that the staff or others who have been commenting even know which direction these things are going to move over the next few months. The ATS may have been a complicating factor; it may be something else. So I am giving my attention primarily to market conditions, loan demand, and the strength of the economy. Now on all three counts, it seems to me that we are burgeoning fast and I am very sorry we didn't catch some more of it before we hit this quarter. Consequently, in my view the staff estimate, while still credible in the sense of the GNP, I think is unsatisfactory totally in terms of the rate of inflation and I would apply considerably more restraint.

CHAIRMAN MILLER. Thank you, Phil. Henry, you were the lead-off man, but we skipped you. So we are going to come back to you. We are not going to omit you.

MR. WALLICH. You want me to [comment now]?

CHAIRMAN MILLER. Please.

MR. WALLICH. Well, it seems to me that the economy is now in a state of demand-pull inflation--aggregates or no. We are beginning to push against the capacity limits. The Redbook reports particular areas are filled with considerable pressure, although the general tone of the Redbook was not all that strong. We are getting inflationary rate pressures, I think, in part as a result of monetary developments that occurred quite a while back. We can't expect the present aggregates to have much influence, and I doubt that the present aggregates tell us much about the future course of the economy because there are so many reasons why they might be weak and might not be reflecting the economy.

I think loan demand at banks at the present time is a better indicator; the banks are selling off securities. Individuals and businesses are buying the securities because they want to get rid of their cash balances, and what remains is strong expansion through bank credit. Now, one has to ask oneself, as Jim Kichline did, how does the present bulge carry forward into the future? The consumer seems to be borrowing from the future and there one cannot foresee much strength. But strong consumer buying can trigger temporarily inventory accumulation; and likewise pressure on capacity can induce additional investment. I don't think anybody would be investing now in order to get capacity for the next few quarters. But he would be looking beyond possibly a small dip in the economy and would realize that at last the capacity limits have been reached and he has to do something to enlarge his plant.

All that suggests to me that there is some underlying strength here that we don't observe. Furthermore, I think we have been continually wrong in our evaluation of the inflationary risk. As I look at the forecast that we have made over time on inflation for this present time--namely, October or November of '78--we started out fifteen months ago with an estimate of 6.1 percent and we gradually upped it and it's coming to over 8 percent. On unemployment we have done the reverse. We thought unemployment would be 6.6 percent fifteen months or a year ago and we've gradually come to see it at 5.8.

MR. PARTEE. How about real growth?

MR. WALLICH. Real growth has been slower than expected also.

MR. PARTEE. Also working down throughout the projection?

MR. WALLICH. Yes. That reflects the poor productivity performance [which] is another inflation factor. So I think not only have we done much better on unemployment than we expected and much worse on inflation than we expected, but we also seem to have a built-in bias toward a low inflation forecast, whatever the cause of that. When I see we are going to get down to 7.3 percent in the second half of next year, I wonder, like Paul does, if we shouldn't add a point or two and allow for a worse outcome.

Well, all this pushes me in a direction of greater tightness. I think tightness is really a relative term here. With inflation expectations rising, nominal interest rates don't mean what they seem to; and to maintain real interest rates where they were, nominal interest rates have to go up. I would agree with Phil Coldwell that we should at this time look at interest rates and not look at the aggregates because they are so disturbed. So that points to a money market directive. I also agree with what Steve Axilrod said in the way of widening the funds rate range. In my case, I would want to widen it in an upward direction.

CHAIRMAN MILLER. Thank you, Henry. Frank.

MR. MORRIS. Mr. Chairman, I don't think we understand what is really going on in the economy.

CHAIRMAN MILLER. I'll go along with that.

MR. MORRIS. I think it's because we haven't had enough experience judging the reaction of both the consumer and the investor to an economy with a high rate of inflation.

CHAIRMAN MILLER. That's right; we haven't had any experience.

MR. MORRIS. Quite clearly, the numbers coming in over the past month are vastly stronger than I had expected and I think stronger than any of us had expected. And I think it's quite possible that the fourth quarter will be even stronger than the staff has projected and perhaps the first quarter as well. At the same time, we are getting these conflicting signals between what is going on in the real economy and the behavior of the aggregates. I think it's quite clear that we are not for long going to have a very exceptionally strong economy coupled with very weak growth in the aggregates. One of these two things has to come to an end, and I don't think we are sure which one is going to give at this moment.

This suggests to me that this is an extremely poor time for the Committee to be planning not to meet for seven weeks, unless we are prepared to give the Manager a lot of room on the fed funds rate to respond to changes in the aggregates. I think it would be very poor management on our part to leave for seven weeks anything like the kind of directive we gave the Manager last month. It seems to me most probable that we are going to face a bulge in the aggregates in the next three months, and I suspect it will be bigger than the bulge that Steve and his group has given us in their projections. I think both domestic and international considerations require us to move pretty promptly against the bulge in the aggregates. I think the exchange markets would certainly be carefully observing any resurgence in the rate of growth in the U.S. money supply. I realize that suggesting that we meet again in three weeks will place a big burden on the staff and I simply suggest that they respond by giving us not the full Greenbook-Bluebook treatment but some simple updating. But I think we are in a too unstable situation to consider not meeting again until February 6th.

CHAIRMAN MILLER. Thank you, Frank. Ernie.

MR. BAUGHMAN. Mr. Chairman, I, too, am impressed with this conflicting evidence. As a result of that, I am more ambivalent than usual today in terms of policy. [Let me mention] a couple of facts that may be of interest. As you know, we have a large builder on our board who builds pretty much around the country and also a bit abroad. He reported that he recently bid an identical building in Houston to one he bid a year ago and now has it about completed. And the current bid was exactly 25 percent higher than the one a year ago. He was citing this as an indication of the rate of increase of construction costs in that area. He indicated a similar estimate for the Chicago area of 20 percent. He noted also that the ability to lease promptly is easing off as a result of these higher costs and the necessary higher leases. He expects that that will bring on a slowing in the rate of construction for that type of property.

Conversations I have had recently with businessmen in a wide variety of activities suggest to me that we are probably going to see more investment, particularly in new equipment and possibly in the total of business fixed investment, than is being reported in the surveys and than is currently being projected. In fact, I would expect that the projection may be low in that particular component. Our banks are experiencing--and expect to continue to experience at least for some time--very strong loan demands. In connection with that, they are expecting to make some further upward adjustment in the prime rate. Small banks report that they are having more difficulty upstreaming loans, and large banks report that they are having more difficulty downstreaming them. I think an indication of a little tightening up in the market is that they are all getting a little closer to that situation which they will call “loaned up.”

It is interesting that drilling activity is off significantly in the Southwest in the last month or two. The explanation given is that there is a temporary localized glut in [natural] gas. And in those circumstances, where they can, they like to schedule their output to the local market as compared to moving into the international market. I simply report that; I don’t know whether that is a valid explanation. That drilling activity is down, I think is a fact, but I’m not sure about the explanation.

We see a few indications of the effects of higher interest rates and tighter credit on activity. Cattle feeders, for example, find that they use up their credit line with about half as many cattle in the lot now as they did when cattle were much lower in price. And in one instance a builder and operator of warehouses has reported that he has had to cut back his plant substantially because he couldn’t get the volume of financing that he would like to have. But his volume is up very sharply; his business is so terribly good that he is turning away customers, with no credit to meet their needs.

Well, from all of this, I come out in the total pretty close to where the staff comes out. As I have indicated, I would up the investment figures a bit, I would reduce the personal expenditures figures a bit, I'd up prices a bit, and I'd up nominal GNP somewhat. But those are not major differences. As to credit policy, I could go today either with standing where we are and observing a bit longer in view of what's happening on the aggregates--I would not be prepared to abandon them as Phil apparently would be--or I could be comfortable moving to a little higher fed funds rate. On balance, I think primarily because of foreign [exchange markets] and inflation--not because of domestic economic activity projections--I would be inclined toward a little additional restraint as reflected in the fed funds rate.

CHAIRMAN MILLER. Thank you. John.

MR. BALLES. Without repeating some of the comments that have been made by the four preceding figures that I am in agreement with, I would stress that in my judgment--and I have been arguing it for some months--we are and have been at practical full employment, both with respect to labor and plant capacity. And I think that if inflation continues as it has been for some time now, it will be a key problem in terms of a threat to a stable growth path. There's not much we can do about overshoots that have occurred in the past couple of years. They have occurred and there are long lags, in my opinion, in the impact of policy and we are beginning to see [the effects] now. Just as in football, when in doubt, punt. So having said all of that, I think we are at the stage of a cycle where if in doubt because of this inflation danger we should lean on the side of more restraint. Now that the Board staff has reduced its economic forecast somewhat for the year ahead, there is very little difference remaining between our staff and the Board staff and it's not worth going into what the fairly small differences are.

The slowdown that we expect comes not only because of the distortions that have been produced by inflation but also because we can't continue a growth rate such as we have had over the past year or two in the face of having reached a practical full employment point. I do suspect--and it's no more than that--that this strength we see in the fourth quarter, which is greater than anticipated, and certainly greater than I had anticipated, is borrowing from business in the future. I'm just getting too many signals that there is a mood out there in the country of "buy before prices go up even further." And to a limited degree that explains the surge of consumer spending, especially on the big ticket items, but that I think is going to run out of gas sooner or later and maybe sooner. And that further reinforces the expectation that we had that going from the fourth quarter of this year to the fourth quarter of 1979 real GNP will be probably under 2 percent; 1.8 percent is what we show specifically, which is a bit less optimistic than the Board staff.

Of all the imponderables we are trying to wrestle with today, I suspect the biggest one is the confidence factor and how it is going to impact both consumer and business spending in the future. [Doing what] we can do to reinforce through our posture--as it's perceived by the public, banks, businesses and consumers, and especially by foreigners--that we are going to be resolute in following a policy that will wind down inflation is about the only way we are going to get back to a more stable economy. So in view of the uncertainties in the projections, both of real magnitudes and the aggregates, and because inflation continues to be an unresolved problem that there is no visible evidence as yet of it slowing down, I'd lean on the side of a bit more restraint.

CHAIRMAN MILLER. Thank you, John. Mark.

MR. WILLES. Thank you, Mr. Chairman. With regard to inflation, I still see about 8 percent. It's not surprising that we continue to see high numbers. It just takes a long time to [see the effects of policy tightening]. We are going to see high numbers from now until sometime fairly far into the next year and, unfortunately, we have to be just a little patient on that.

With regard to real growth, [I'd say] somewhere between 2 and 3 percent. The only real difference we have with the staff on the outlook is that we still remain substantially more optimistic about business spending than the staff does. A typical comment from businessmen that I've talked to is that of a worldwide manufacturer in our District who says, "We have gone essentially four years without major business spending and we are essentially at full capacity. We don't care what interest rates are, we've got to build the plants." We just have a feeling that there is something there.

With regard to the international situation, I think Chuck is right. The economics of that price increase should have redounded to our benefit. And because that didn't happen, I think Scott's response is also right that what people are looking at is some assumption as to the policy response rather than the economics that are involved. I guess that is the most worrisome thing. They still don't believe us when we say we are going to stick with it. They think at the least sign of trouble we are going to back off, and I think that's too bad.

With regard to policy, I did the same thing that Henry did only on a slightly different issue--looking at policy moves rather than history on our forecasts of prices and unemployment. I don't know whether it's Christmas or what, but I feel as I listen to the Committee that I am rapidly turning from a hawk into a dove because I am starting to get nervous about repeating what has been a fairly typical mistake for the Committee. And that is that once it gets religion it goes too far. As anxious as I am to get [the aggregates] down, I want to get them down slowly precisely so we don't precipitate the recession that I think we can avoid if we are careful. Now having said that, intellectually--

CHAIRMAN MILLER. You have turned soft. You are only recommending 11 percent!

MR. WILLES. I am not willing to jettison the aggregates. They're imperfect but they are one of the few things that we have some strong analytical and theoretical base for. I think they are just fraught with problems. Steve mentioned the possibility of a shift in demand. If that's going on at the same time we have ATS going on, we could badly fool ourselves in looking at low numbers and think we are doing something when in fact we haven't done anything. So I think that's a very real risk. And how we hedge that against my previous concern, [which] is just to keep from going too far and causing a recession, I'm not sure I know. In the short run it seems to me that the problem is not quite as difficult because we have had such a long period of strong growth. So if we err a little bit on the side of weaker growth for a month or so, I don't think that's going to have any lasting impact. And if the international situation tells us that somehow we need to have a little further response, I wouldn't object to that. But I must say that I personally am getting very close to feeling that we need to be really careful so that we don't go too far too fast and cause a major problem.

CHAIRMAN MILLER. Bob.

MR. MAYO. Well, Mr. Chairman, we just witnessed a new form of “Mark” intervention! To capitalize on what John was saying a minute or so ago on the strength of the fourth quarter, I would add to consumer restlessness that prices may go up, producer restlessness--and maybe consumers, too--with regard to potential strikes and still a potential for mandatory controls, even if those mandatory controls take the form of court-enforced voluntary controls, if I may put it that way. We are going through an interesting phase of suits in this day where everybody sues everybody, testing what the executive power really is with regard to voluntary controls. I wish the President well on this. And yet I see success as being closer to the mandatory controls which we all abhor.

When I add all this up, Mr. Chairman, I find that an 8 percent inflation factor for next year is unfortunately too low. I hate to be that much of a pessimist, but I feel that it may be closer to 10. I hope feverishly that I’m wrong. But I see again food doing worse than the 8 percent--worse being higher. And even though the oil figures in the cold light of day are not that much different from what had been put down in most of our assumptions, there’s the psychology again. As Scott has said about the Bundesbank, I think we are getting into an emotional state on the inflationary impact here, too. It is a frustrated state rather than a constructive state, and this bothers me as much as anything.

Having said that--and maybe this sounds inconsistent--although I have no real quarrel with a 1-1/2 to 2 percent increase in real GNP next year, I think the first quarter may be somewhat stronger than the staff predicts. And it may well be that we will get into a negative growth period by the end of the year. So we may have the worst of both worlds in 1979, in that inflation will not have cooled down under the impact of greater unemployment by year-end and some mild recession by year-end. But we’ll have both the inflation and the soft economy looking ahead to twelve months from today.

I, therefore, find it even more difficult than usual, as I guess Ernie mentioned as well, to try to interpret this for policy. Yet I think we have no alternative on the psychological side but to maintain our resolve in keeping restraint in place even at the chance that we’re going to be accused of causing any recession anyway at this point. I don’t say that in a defeatist attitude, but I think we still have to edge [rates] up just a little tighter partly because it’s expected of us in the whole aura here of worrying about what to do about inflation. We are the last bastion in the eyes of a great many people and I think it would be a mistake just to hold still right now. There are risks but I think we have to tighten a little further--not dramatically like we did November 1, but a little further.

CHAIRMAN MILLER. Thank you, Bob. Roger.

MR. GUFFEY. Mr. Chairman, with respect to our view, it’s not greatly different from the staff’s projections. We would be a bit less optimistic about growth in 1979 and then again about the distribution throughout the year. We think there’s enough strength going into the first quarter [to be] fairly strong in '79. If we're somewhat less than the staff, this implies in the latter part of '79 that there would be more weakness than the staff implies. As far as the inflation [projection], we are a bit higher--something around 8-1/2 percent as opposed to something less than 8. And on unemployment we're about the same. It is not, I think, surprising that we are getting some fairly strong growth in the fourth quarter. As Ernie Baughman and others noted particularly in the Southwest--and it's true in the Tenth District as well--we are at full capacity, not only in terms of plant and equipment, but also human resources. There's almost no unemployment at all, at least in our part of the country. A very strong fourth quarter and a very strong first quarter of '79 seem to be in train.

Having said that, and now turning to policy, I would join those who have some real concern as to how far we have moved already and how much further we should move--bearing in mind that we've moved rather dramatically in the last 60 days as far as tightening interest rates. We do have some weak showing in the aggregates, although as some others have said [it's not clear] what all that means. It's heartening so long as it doesn't last too long. I have a feeling that we're going to see some growth in the early part of 1979--perhaps much greater than the staff is projecting--and I'd like to be in a position to act against any really substantial growth in the aggregates early in '79. That implies, of course, higher rates. But for the time being, unless there's a reason dictated by the international situation that we need to go up, I would prefer that we stay essentially where we are with maybe a modest increase to 10 percent. But I'd be very hesitant to move [the funds rate] above 10 percent unless there's some dramatic event internationally that requires us to move further.

CHAIRMAN MILLER. Thank you, Roger. Well, we'll leap across the table to our colleague.

MR. ROOS. Mr. Chairman, the trend of the economy in our District roughly parallels the staff observations. Loan demand continues to be strong and we don't see any serious indications of excessive inventory accumulation. As for Christmas retail sales, any information we can get seems to indicate they will be fairly strong.

However, we base our projections of the future, as you know, on an analysis of various rates of money growth. And as surprising as it may be for any of you to hear it coming out of my mouth, I would [echo] what I believe Mark said, and that is we should keep a wary eye on the possibility of continued and perhaps excessive moderation of growth in the aggregates. The softening of aggregates growth has not prevailed long enough for me to shift gears and suggest that we abandon restraint, which certainly is a necessary element in dealing with inflation. On the other hand, if the aggregates continue to grow at a moderate or less than moderate rate through future meetings and we tolerate that, we could have serious consequences.

For example, if there is an 8 percent growth of money over the next year, we think that the output growth would be upwards of 3 percent. If money--this is M1 in the old context--grows at 6 percent, we would anticipate that real GNP would grow at about 2 percent. But if we were willing to tolerate a reduction in money growth to, let's say, 4 percent, we think that we'd have almost no growth in real GNP. And we think money growth at that rate over a prolonged period--one quarter or two or three quarters--could really precipitate a serious recession.

My prescription for monetary policy at this meeting would be essentially what alternative A or even alternative B provides with perhaps a widening of the fed funds range. However, I do think that we should keep a close eye on whether or not aggregate growth does continue to moderate, because I think we could be in as much trouble as a result of an excessive prolonged reduction in the rate of growth of money as we are today in terms of the inflation that has resulted from three or four years of excessive growth of the aggregates.

CHAIRMAN MILLER. Thank you, Larry. Bones.

MR. KIMBREL. Mr. Chairman, it's our judgment that we would prefer to see some slight additional firming. Loan demand continues strong, but we are not observing any real likelihood of a crunch. It seems to me that funds would be available at a price. And indeed, we aren't very comfortable in feeling that the money growth moderation we have experienced recently will prove very lasting. Productive capacity and help wanted ads lead us to believe very strongly in our area that we're very close to full employment.

While we would not want to suggest that we feel a recession is inevitable or not inevitable, we are alert to the fact that the consumer pull-back could be real and a continuing discussion of this as an inevitable event will be [a self-fulfilling prophecy]. We are more impressed at the moment by the fact that the nervous reaction and the lack of confidence in our foreign exchange markets need some continued attention on our part. Likewise, the domestic financial markets I think are more and more beginning to question our willingness to face the fundamentals of continuing mounting inflation. So, with what would appear to be little assurance that prices and inflation expectations are going to improve in the near term, I think we would like to see some additional firming but of a very modest amount.

CHAIRMAN MILLER. Thank you, Bones. Dave.

MR. EASTBURN. Well, I would hold steady for this meeting, and I'll try to give the explanation for that position. It seems to me that until recently there have been two general scenarios about the business outlook. One is the one that's in the Greenbook, which is a gradual steady downward movement without recession. The second is that that will continue on down through the zero point and we will have a recession. A third one, which I think is gaining more currency and which I find more intriguing, is what might be called the "last gasp" scenario. [In that scenario] the economy is now showing strength because it's in the last phase of expansion. And it will be seeing a fair degree of strength through the rest of this quarter and the first quarter, which will lead to higher interest rates than most people are now forecasting--more along the [lines of the] Salomon Brothers forecast than the Board's flow of funds forecast--and then lead to a recession in the second half of the year. I think that is becoming a more and more likely possibility.

In view of that, we have been re-examining "Poole's rule," which you may remember. Bill Poole formulated the [rule] that when you have prolonged and substantial deviations of money growth from the trend rate of growth, you will have a recession. We find that we are not in danger of that at this point, but we have a concern that we might be in danger of that [soon]. And we feel that we need to be careful about further restraint and unexpected weakness in the money supply.

So my position on that account would be that we ought to hold steady now and watch and see for more evidence with the aggregates. I would prefer a money market directive in that kind of situation and I would widen the funds range. As far as meeting dates are concerned, I think we can either have a shorter [intermeeting] period or have telephone conferences. I think telephone conferences probably could take care of it if necessary.

CHAIRMAN MILLER. Thank you, Dave. Willis.

MR. WINN. Things are rather bizarre in Cleveland. I hope you won't think that I am following the Cleveland tradition in my comment. I'd like to take a little different path. I think we are frozen in a pattern of operation that should be reexamined when you think about our focus on rates. If we examine other underlying conditions, we assume that it's going to take up to 14 to 15 percent on the [short-term] interest rate to get the braking effect that we want in terms of our present tack. I suspect we could do the same thing with maybe a 1/2 or 3/4 percentage point increase on the long-term end of the rate range. And I think maybe we ought to think that through a bit.

Usually we put our brakes on at the end of a cycle and then end up with over-capacity in a number of areas. Then when we try to stimulate things, we feel equally frustrated on the other side. We are faced with looking at problems of commercial and industrial building where we probably have a 1-1/2 to 2 year run without going into over-capacity. Yet that's very interest-rate sensitive to the long-term rate, but 14 to 15 percent on short-term rates is not going to slow that a bit. And if we could effect some slowing down and braking at that end of activity, we might be able to rush that very quickly with a change in the rate level because rates are the chief cost factor in a great deal of that kind of construction activity. I wonder if we shouldn't think a little more clearly on our focus of what we are trying to achieve in terms of strength and whether a slight increase of that might avoid a very big rise in short-term rates, [which is] what I'm afraid it is going to take to accomplish our purpose. I'm thinking about not only the braking effect, but the stimulating effect that may be far more effective at that end than the [short] end where we are focusing most of our attention.

The second comment I'd like to make is that the wage factor, at least in our state, is certainly starting to get out of control. [That's true of] everything from the state legislature on down, [including] the Teamsters and others. So the wage factor is a very big problem in terms of people's thinking and what they're [doing].

The third comment I'd make is that I consider the retailers the soft underbelly of the future. I'm not quite certain as to how that [sector] is going to behave. We have had sales stimulus from the pre-Christmas season but very little price cutting, as I recall. And whether we will get an after-Christmas price cutting and change attitudes or not, I don't know. But it seems to me that that's very sensitive to where we go in the future.

[Let me make] two other incidental comments. Cleveland doesn't confine itself to Cleveland in terms of its investment interest. I get all kinds of danger flags pointed to the Southern California condominium real estate markets, à la the Florida markets a couple of years ago. More people have been beating my ear on the dangers happening there, which always are pointed at the other fellow, I guess.

CHAIRMAN MILLER. Any chance of it coming to Washington?

MR. WINN. It would be welcome, I'm sure. The natural gas [situation] that Ernie mentioned is not restricted to Texas. It's also prevalent in Ohio; excesses are being reported and they have no storage space. It's partly that the winter weather has been mild in contrast to previous winters. So we do have excess showing in that area.

I'm concerned that we may be closer to changes in trends than we have been previously, and I think this needs to be watched very carefully. And I share the feeling that maybe seven weeks is too long between meetings, with the international and the domestic situations. My personal feeling is that because of the psychological factors and the focus on us and the strength that I agree is prevalent throughout [the economy, it] requires further attention on our part. So I would feel that perhaps a little more modest braking would be appropriate but I'd like for us to consider the long-term end rather than the short-term end.

CHAIRMAN MILLER. Thank you, Willis. Bob.

MR. BLACK. Mr. Chairman, we were a bit surprised by the strength in the fourth quarter. I don't think it has really altered our overall picture of next year except to push a little further in the future the weakness we thought might occur somewhere around the second or third quarter. As far as the year as a whole is concerned, we still hold our early forecast of the rate of growth in real GNP of 1-1/2 to 2-1/2 percent. We are still less optimistic than the staff regarding inflation and we put that somewhere in the neighborhood of 8 to 9 percent. We would also come out ahead in our own [forecast] on the unemployment rate at the end of the year, putting it at about 6.5 and maybe a little bit higher than that.

Now, for the approach to the policy decision, we follow this procedure that we have been using for some time that I described in that memo we distributed to you. In using this, we recognize that there has been a lot of weakness or slowdown in the growth of the aggregates recently, which is very encouraging. But I think we have to bear in mind that these are low partly because of the effects of ATS. They also may be low for the reason Steve stated--that there may be a downward shift in the demand for money relative to GNP. And we also have to bear in mind that they are built upon this very rapid rate of growth in M1 early in the year.

So with these points in mind, we continue to think that our main objective should be to try to bring down the long-term rate of growth in M1 somewhat gradually. We described the strategy that we've been following in that memorandum of mine. This calls for a rate of growth in the year ending the third quarter of last year of 8 percent and in the fourth quarter of this year of 7.5 percent, which incidentally looks like exactly what we'll get. The implied deceleration reflected the relatively slower [unintelligible]. Let me move on to the first quarter. We had suggested that it come out at 7 percent and we think looking back to the first quarter of last year maybe that's too much deceleration, so we raised that to 7-1/4 percent.

MR. PARTEE. But year-over-year, Bob?

MR. BLACK. Yes, year-over-year.

MR. PARTEE. The first quarter of '78 to the first quarter of '79.

MR. BLACK. That's right. To take care of it, we raised this from the 7 percent we had to 7-1/4 percent. But even with this adjustment, we have a path of the implied growth rate in December-January of 4-1/2 percent. Against this background, the rates of growth that are the trigger points in the Bluebook are too high for us. Alternative A calls for 7-1/2 under a money market directive and alternative B calls for 7 percent. And if you put back in the effect of ATS, that means that we're willing to accept double-digit rates of growth on an old basis before we actually act. So translating that into measurements that we would use, we would favor an aggregates directive and we would put the range for growth of M1 at 1-1/2 to 5-1/2 percent. We would really rather not specify at this juncture a rate of growth in M1+ and M2 because at this stage of the cycle typically we have a slowing in these, and I think it could lull us into a sense of safety and prevent our reacting in case we do get an excessive rate of growth in M1. Turning to the fed funds rate, we would [prefer] 9-7/8 to 10-1/2 with a highly asymmetrical midpoint of 9-7/8. It is a little further on the midpoint than anyone else has suggested.

MR. PARTEE. I think that's as asymmetrical as you can get.

MR. BLACK. It's quite asymmetrical. But seriously, we don't foresee any circumstances that would suggest we ought to lower the rate below that, particularly in view of [the current] situation and the recent OPEC price action. But we do want leeway to move that rate up in case the M1 does go beyond 4-1/2 percent. Now, we really don't expect this. Our guess is that we could sit right where we are and the aggregates will come in at this lower rate. So we would anticipate remaining about where we are, but we'd like to move in case we are wrong in that.

CHAIRMAN MILLER. Thank you, Bob. Nancy.

MS. TEETERS. My view of the economy is that it's remarkably well balanced, considering the stage of the cycle that we are in. And, as you well know, I still feel very strongly that we should sit still and see what we are doing. There are very conflicting numbers--a lot of inconsistencies in the data that we have. I would strongly recommend that we stay where we are. I think we've gone far enough. We've moved dramatically in the past 60 days and we have very conflicting information coming out of the market. And I see no reason to tighten further. I find myself saying that I'm really quite gratified that the monetarists are being consistent at this point. If they really looked at the money supply--

CHAIRMAN MILLER. Did you ever doubt? They're all on this side of the table.

MS. TEETERS. So my strong recommendation is that we stay where we are. We might widen the range on the fed funds. However, if you observe the actual numbers on the fed funds rate, they've been right at the top every time. You know, if you give them the range, then the rate goes to the top of the range rather than the midpoint. We didn't give much of a range this time but the rate has still been at the top of it. The weekly average has been around 9.8 percent.

MR. HOLMES. The midpoint is 9-7/8, which is 9.875.

MS. TEETERS. And I would go for a market directive.

CHAIRMAN MILLER. All right, thanks, Nancy. Chuck.

MS. TEETERS. Wait, I'm not finished. I agree with Chuck that Switzerland, Germany, and Japan should have taken an action [unintelligible] in the value. There's another inconsistency out there, and that is this downward pressure on the short-term value of the dollar. However, the foreigners are coming in here and buying everything they can put their hands on, which means that their long-range evaluation of our economy has to be very different from the short-term evaluation of the economy. It seems to me there is something also inconsistent in the international situation, just as there is an inconsistency in the domestic situation. I'm done.

CHAIRMAN MILLER. Now, Chuck.

MR. PARTEE. They could be two different entities doing these two different things. Well, I was going to emphasize just briefly without a long-run go-around the very strong nature of the conflicting signals we are getting on the economy. We have an assumption, if you believe the figures, that not just durable goods but nondurables too are very strong. Attitudes are weakening quickly and we have the P&E surveys [indicating] a future weakening. But durable goods orders and indications of capital spending--and the kind of thing Ernie mentioned on the cost and volume of nonresidential building and that the Chicago economist reported--suggest great strengthening in the capital goods area. And we have employment and the nominal GNP going up like mad. And the money numbers are very weak; it's not just M1 but M2 also. In the last couple of months they have been weak, and M2 shouldn't have been affected adversely by ATS. Indeed, if anything, it should have been positive because of possible shifts from thrifts into the banking sector.

So the pattern that I see is that the real numbers we have are strong and numbers that might indicate the future are weak. And I don't know what to do with it. It could be a last gasp, as Dave suggests. On the other hand, it could be a new boom, as Henry seems to suggest. Certainly, Henry's view of the process--that is, that heavy final sales could bring inventory demand, which could bring output, which could bring capital spending--is the way that the economy operates. That could easily be the case, and we might be at the beginning of a totally undesired boom in the economy. I just don't know which it is. I'm more inclined--

CHAIRMAN MILLER. But you're going to have to vote.

MR. PARTEE. I have a position I'm going to take which allows me not to do that. I would say this: The trouble is that we are up against capacity constraints and this has been very bad news to have this last burst because it means we have no room on the up side. We can't make an error on the up side. If we do, we will greatly aggravate what I believe is now becoming a horrible inflation outlook. I don't think anything could have been worse than the announcement effects of the OPEC price increase. On the radio and the television around town in the last couple of days they've been pointing out that that increase is double the wage guideline that the President specified. Now, what does that lead [people] to believe? [I'd say they'd feel] that they can't settle for that wage guideline. And I think that kind of effect is going to rapidly spread. It's not just the real effects of the price increases; the announcement effect of the price increase is just terrible.

I have no idea where inflation might go in the period to come. I do think that if we are going to have continued strength in the economy along the lines I've seen recently--and if we are going to have rapid price escalation, which is possible--then it's got to show up in the monetary numbers. On the other hand, if we are going to have weakness in the economy developing, it's going to have to continue to show as weak monetary numbers.

Therefore, I'm strongly, strongly, directed toward looking at monetary aggregates, [weak though] they may be, because I think it's the only decent kind of steering mechanism we have in this kind of environment. I would say that we ought to be guided by the monetary aggregates. If they do explode--and they could well explode in January and February, Bob, because I think every past experience we have had would suggest that, unless this is the turn, we are going to get another mark-up in those monetary aggregates--we'll see it and react against it by raising interest rates. And if they don't explode--if they weaken further--we will see that and we can react by reducing interest rates. So, I think now is the time for the Committee to show some flexibility in interest rates on the basis of what it sees developing in the aggregates, and that would be what I would recommend.

CHAIRMAN MILLER. Thank you, Chuck. Paul.

VICE CHAIRMAN VOLCKER. Well, like everybody else, I see a little more momentum in the economy than we anticipated. And I would anticipate that that would continue a while into the new year. [So I see] not much short-term danger, though I do continue to think that there's a substantial risk of an actual downturn in the latter half of 1979, let's say. But the question is where that risk comes from. How we can best minimize it? I think the risk of aggravating that chance by tight money is very small. The decline in the money supply that I see looks very temporary to me [based on] all historical experience--a temporary aberration when the economy is expanding as fast as it is. I suspect it will show up in large part as a bad seasonal adjustment factor when we get all finished with it.

So, I'd want a lot more evidence before that figure frightens me into any easing of interest rates against the background of a persistently high rate of growth in the money supply. I think a much greater risk for the economy is a perpetuation of what we saw before November 1--the falling away of confidence reflected in the feeling that there was no grip on inflation or on the exchange rate. I think that is the kind of event that could not only maximize the chance of a recession but maximize the severity of a recession if and when it appears. And we have the very evident fact, which many people have commented on, that inflation is getting worse and not better.

When one looks at those risks, I don't think we have any choice. I don't think we can afford to sit here passively at this time. I think we are maximizing the risks of both inflation and recession--and severe recession--if we aren't alert to moving in a somewhat more restrictive direction. I think, as other people have suggested, that we ought to be ready to move quickly if the aggregates begin moving up again, but I think we also have to move if the exchange markets suggest that necessity. I do not think we can hold this exchange market by intervention alone. I think that's purely a fatuous view of our abilities in these circumstances.

When I look at this, I don't know whether we absolutely have to move immediately. But given the impact of the oil price and the effect that has on confidence, I would think a little prophylactic move might be wise, in terms of moving before the exchange market gets any worse than it has gotten in a very mild way. I'd be guided from there on with an eye both on the aggregates getting too high or the exchange markets coming under pressure. And under no circumstances would I give any sense of easing or backing away from what we have already accomplished. I think that's the worst possible action we could take at this point, regardless of what happens to the aggregates in the course of the next month.

CHAIRMAN MILLER. Well, ladies and gentlemen, thank you for two hours of attention. This go-around has indicated about as much unanimity as I've ever seen--namely, confusion. But one interesting point I noticed is that I don't believe anyone actually suggested easing. The discussions were around standing pat or firming or being prepared to let the results of the aggregates direct us in the coming weeks. I suggest that we take our break now and perhaps we can pick this up again with some suggestions when we come back. Let's break until ten past [the hour].

[Coffee break]

CHAIRMAN MILLER. Well, ladies and gentlemen, we can reconvene. I did not indicate my own position. I might say, as I said to some during the break, that the meeting this morning has a certain Biblical quality in that it seems to me the first shall be last and the last shall be first. As I read the discussion--which proves that we [must] have logic here--it seems to me that in the nine months I've been here, as you look over the difficulties from month to month [and] look overall at the objectives, there has been a definite and I think unanimous policy objective of slowing the economy and doing so while maintaining balance and doing so on a smooth basis without undue shocks. We've now seen the aggregates begin to move down. That's encouraging but the economy itself has surprised all of us, I think, with its strength in the fourth quarter; it should have continued the slowing process that had been evident in the third quarter.

To be consistent with our policies, it seems to me that what is indicated is a slight degree of additional restraint with, I hope, some greater flexibility to act in the interim based on the facts--what happens in the economy and what happens to the aggregates in particular. And [we ought] to be prepared to continue the process we've been at until we find that point where there is a smooth and gradual turndown in the economy without major disruptions.

It also seems to me from the sentiment expressed here that we might plan an interim consultation; I might suggest that we plan an interim consultation on January 16 by telephone, recognizing that seven weeks is too long and that a full-blown meeting a few weeks from now will probably [not be warranted]. We won't have any new data of any significance because of the nature of this time period, [but I suggest] that we make an agreement to consult again--not wait to see events but plan it so that we'll be in touch with everyone and make sure that there are no indications of new directions.

Now with that in mind, I'll ask Steve to outline a proposal for your consideration--again, a little different procedure this time. If we could put before you a proposal and then ask the voting members of the Committee to indicate as we go down the list whether this is acceptable to them or whether any parts are not acceptable--and if so what they are--I think we could focus on a consensus more rapidly. Steve, will you please give your inputs?

MR. AXILROD. Thank you, Mr. Chairman. As a brief introduction, I would say that the data we are getting on automatic transfer seem to be giving us a reasonable handle on evaluating it and we are going to be continuing with that data [collection] through January. Therefore, I think it's possible to move back toward giving M1 more equal weight than has been given to it in recent months, particularly in light of its weakness. I would suggest returning to the period when M1 and M2 were given just about equal weight. I would suggest a range, Mr. Chairman, for M1 of 2 to 6 percent--that is taking 1 percentage point off of the top of the alternative B range. And for M2 I'd suggest a range of 5 to 9 percent, which takes 1/2 point off of the top and bottom, or a range of 5-1/2 to 9 percent. One is not far superior to the other.

On the interpretation of M1, if it does happen that our ATS data are showing instead of the 2-1/2 to 3 percentage point shift that we have built into this--if the shift happens to be 5 or 6 percentage points or vice versa, of course, [if it is less than we assumed]--we would bring that promptly to your attention to indicate that the range was out of kilter. I would suggest for the Committee's consideration the fed funds rate range of alternative B but it might be desirable to interpret that as moving rather immediately to 10 percent and letting the rest of the adjustments within that range depend on developments with regard to the aggregates.

With regard to those developments, I would suggest the possibility of interpreting the aggregate ranges somewhat asymmetrically--that is, that the Manager be more sensitive to movement of the aggregates toward the tops of their ranges. That is, be more willing to tighten the funds rate as the aggregates move toward the tops of the ranges and less willing, or less inclination to move promptly in easing as the aggregates move toward the bottoms of the ranges. This would be just a suggested interpretation. All of that could be accomplished with either a monetary aggregates or a money [market] directive, but I think more consistent with past Committee practice would be a monetary aggregates [directive].

MR. ROOS. If you have an M1 range of 2 to 6 percent during this next period, what do you factor in as being the M1+ addition that you put in?

MR. AXILROD. Well, I would suggest that that would be probably at the bottom of where it is--maybe 0 to 4 or 1/2 to 4.

MR. ROOS. I mean the growth rate of M1+ in, let's say, the next 4 to 5 weeks. What does it look as though that's going to be?

MR. AXILROD. Well, we have under alternative B a growth rate of a little over 2 percent for the December-January period. I think consistent with the suggested M1 and M2 ranges would be a growth rate just a shade under that. So I would say 1/2 to 4 percent or 0 to 4 percent.

MR. MAYO. Is there a reason, Steve, that you'd stick to a range for M1 and M2 rather than just putting a cap on each of them?

MR. AXILROD. For M1 I think the weakness of the last couple of months makes it desirable to begin to give some credence to continued weakness. Thus I think it's probably important to not only have a cap on the upper limit but to have a lower point where you may want some response--although I suggest that the response would be not prompt but delayed. You'd have to get right down to [the lower limit] to respond. That's the reason for having a range instead of simply a cap. I also think now we are beginning to get a handle on experience with ATS and can interpret it better for you.

CHAIRMAN MILLER. Does everyone understand the proposal?

VICE CHAIRMAN VOLCKER. He didn't give a funds rate range.

CHAIRMAN MILLER. Yes he did, 9-3/4 to 10-1/2.

MR. AXILROD. With a move to 10.

CHAIRMAN MILLER. An immediate move to 10 is a suggestion. Does everybody understand this?

MR. EASTBURN. Could I ask a question about that funds rate range? Steve, would you contemplate a reduction to 9-3/4 percent? Does the bottom of that range really mean anything?

MR. AXILROD. Well, I was suggesting that possibility if M1 and M2 came in at the bottom of their ranges, literally, down to 2 percent [for M1] or 5 percent in the case of M2, giving some weight to both. That is, if it was down on M1 but up on M2, no.

CHAIRMAN MILLER. You have a money market [directive] on the down side and an aggregates on the up side.

MR. AXILROD. That's right. That's what I was, in effect, suggesting.

CHAIRMAN MILLER. You have to get to the bottom limits to reduce [the funds rate] but on the tightening you can do it on the way up. It's a new Federal Reserve invention.

MR. AXILROD. That's why I didn't know whether it was an aggregate or a money market--

CHAIRMAN MILLER. It's a hybrid directive. Yes, Mark?

MR. WILLES. Can I just make sure I understand the arithmetic?

CHAIRMAN MILLER. Yes, please. I want everybody to understand it before we comment on it. That's one of the rules--that we understand before we play.

MR. WILLES. The forecast for December is 2 percent and if you had 3 percent ATS that would be 5 percent for December. If you had your proposed 6 percent cap on M1 for the two months, that would allow 10 percent growth in January--or if you add another 3 percent for ATS, 13 percent in January.

MR. AXILROD. It would say that at that rate of growth the Manager would be at the top of the funds rate range. Since I don't know that you could affect that [M1 growth] in that month, to "allow" is a funny word.

MR. WILLES. You would move [the funds rate] before you get to the top, with an aggregates type directive.

MR. AXILROD. I would assume that with this directive and those specs the Manager would be at the top of the funds rate range at that point.

MR. PARTEE. And, Mark, might I point out that December's not in the bag. I think the biggest weeks are still to come. Historically, you know, major movements occur right before Christmas and right after Christmas--the window-dressing. We have less than the normal amount of confidence in our forecast for December than for other months at this time of the month.

MR. WILLES. I'm not trying to delay the issue; I'm trying to understand.

MR. AXILROD. With those facts, if it worked out that way, I would assume that the Manager would be at the top of the funds range.

MR. WILLES. So that, theoretically, you could get about 8-1/2 percent for the two months if you add ATS back in. But that would be with the funds rate moving up potentially as high as 10-1/2.

MR. AXILROD. That would be my understanding.

CHAIRMAN MILLER. Any other questions about the substance of the proposal? Then let me just ask how the members react to that. Paul.

VICE CHAIRMAN VOLCKER. Well, these are my feelings. I'm nervous about any decline here, as I said. But with the asymmetrical aspect, I guess I could live with it. I would prefer having the lower parts of the ranges even lower. But I can live with it.

CHAIRMAN MILLER. Okay. Ernie.

MR. BAUGHMAN. I can live with it.

MR. COLDWELL. Mr. Chairman, I would prefer [on M1] a 1 to 6 range and the 4 to 8 range on M2. I'm willing to buy the fed funds rate but I'd like to throw in for Committee consideration a slight amendment to it. I'd agree to the 9-3/4 to 10-1/2 range and the move to 10 but I'd like to see a little device we have [used]--not recently but a year or so ago--called a zone of indifference to permit the Desk to play it in the 10 to 10-1/8 range without kicking back much. This I think provides a little more flexibility for the Manager and at the same time it does give a picture of slightly greater restraint in the initial move. The 10 to 10-1/8 would be a kind of zone of indifference in which the Manager could play.

MR. PARTEE. What he does is he hits 10 and then errs on the side of tightness.

MR. COLDWELL. Right, and he hits 10-1/8 and he errs on the side of ease. It allows a little more flexibility than this business of naming a single rate. I think we have been caught on that too much. It also provides a little bit of lack of knowledge to the market; maybe they won't nail it quite so tight. I guess with those changes, I'd be willing to [go] with it.

CHAIRMAN MILLER. Sounds like you don't buy it.

MR. COLDWELL. All right, I don't buy it if that's the way you want to interpret this. I was trying to see areas in which I could move and still--

CHAIRMAN MILLER. Yes, but you have substantial differences on the ranges of the aggregates, as I understood you.

MR. COLDWELL. Well, 1 percentage point on one end of M1, and 1 point on each end of M2.

CHAIRMAN MILLER. Thank you. Dave.

MR. EASTBURN. As I indicated earlier, my preference would be for alternative A straight through, but I think that the proposal is acceptable. I do have a concern, as I indicated to Steve in my question, about a reduction in the funds rate given the international situation. And I'd like to suggest that if that appears to be imminent we have a consultation on that.

CHAIRMAN MILLER. Okay. Chuck.

MR. PARTEE. Well, I find your proposal acceptable. I would say that I'm becoming increasingly concerned that we do not find ourselves in a lock as we begin to move into a period of weakness. I think this tends to do that because we don't really allow for any downward movement in the funds rate. That's all right with me because of the international situation but I would like it understood that if these aggregates are really weak--or if other things develop in the economy that look very unsettling--we can reconsider. I say that because I think we are going to have to start to consider the possibility of actually reducing interest rates in the economy.

CHAIRMAN MILLER. Okay. Nancy.

MS. TEETERS. I find it unacceptable. I think it's absolutely the wrong time to take another increase in the tightening of credit. What it will bring about is an increase in the prime rate. I'm sure you are going to go to 10-1/2 percent within ten days on this thing. And that's going to get all the hawks sending the prime rates to 13 and 14 percent. It's just sort of verifying their action. I would recommend staying with the scenario of "A."

CHAIRMAN MILLER. Okay. Henry.

MR. WALLICH. I think we have to focus more on the funds rate than on the aggregates. I think it's a delusion that we are steering the aggregates by means of the funds rate. The funds rate now has a special function, namely to regulate the dollar situation. So I don't think we should have any decline in the funds rate. I think we should consult if the aggregates point downwards, as has been suggested. That's a wise precaution. I would give the funds rate a wide range in terms of the aggregates: M1, 0 to 6, and M2, 4-1/2 to 8-1/2. On the funds rate itself, I'd say 10 to 10-1/2 and go to 10-1/4.

CHAIRMAN MILLER. Okay. Mark is next.

MR. WILLES. I would like first to make a commercial, Mr. Chairman, and disavow that I am a monetarist. We hold a balanced portfolio in Minneapolis.

MR. PARTEE. He's like an Episcopalian not being a Catholic.

MR. WILLES. Someday when we have more time we will explain the substantive differences between the monetarist and what's even worse, I might say, and that's a rational expectations-ist. But that's another story.

I can live with the specifications that Steve gave, on the assumption that we really don't envision any circumstances where we'll let the fed funds rate drop this time and we've built in a mechanism where if the aggregates do become strong we'll move the rate up.

CHAIRMAN MILLER. Thank you, Mark. Willis.

MR. WINN. I can accept the suggestion made by Steve. I think I would prefer dropping the ranges to 0 to 6 on M1, 4 to 8 on the M2, and 9-3/4 to 10-1/2 [on the funds rate].

CHAIRMAN MILLER. But you would accept the specifications? Well, I would certainly agree that we could go with this proposal at this time. I would think that the idea of erring on the up side of 10 with a little flexibility makes a little sense. I think the Desk could see the advantage of not letting it drop below 10 again and, therefore, err a little on the positive side. It seems that there are 2, 4, 6, 7 members who would be agreeable as specified. I don't know if the others would feel, despite slightly different preferences, that they also could go with this with the one modification. Why don't we run down a vote and see?

MR. BAUGHMAN. I understood a semi-commitment to the suggestion--I believe it was Dave's suggestion or someone's--that we not let the funds rate drop. And I thought the inference there was below 9-7/8. Your comment I construe as indicating the inclination to not let it drop [below] 10. Could we get some clarification on that?

CHAIRMAN MILLER. No, no. Unless a change in the aggregates indicated a shift, if we're moving to 10 now, that 10 would be operated erring above 10. But changes would move from that point in either direction.

MR. PARTEE. But I think the answer is yes, that we've got to have pretty weak aggregates to drop below the 10.

CHAIRMAN MILLER. We would consult. We are going to consult on the 16th of January in any case, but we would consult in the meantime.

MS. TEETERS. Mr. Chairman, what does this move do to the economic forecast?

MR. KICHLINE. Well, in terms of 10 percent, that's really only 12-1/2 basis points, and I think the answer is really nothing. If we begin talking about going to 10-1/2, that's really quite different; we'd be talking about a weaker economy, particularly in the second half of 1979.

MS. TEETERS. How much weaker?

MR. KICHLINE. Jack, do you remember? I think you're talking, I don't know, about 1/4 or 1/2 percentage point. We are already taking a couple of tenths off because of the OPEC effect in the second half. So you're talking about an economy that in our view would be less than 1 percent real growth.

MS. TEETERS. And what do you think the probability of two quarters of negative growth would be if we went to 10-1/2?

CHAIRMAN MILLER. One [in] three.

MR. AXILROD. Governor Teeters, I think one factor you'd want to consider in this is how permanent that 10-1/2 is. It's a question of whether or not Jim is talking on the assumption that it goes to 10-1/2 and stays there. It would be a somewhat different outlook, I'm sure, if it went to 10-1/2 and came back down in a few weeks.

MS. TEETERS. Well, I haven't seen anything come back down since I've been here.

MR. AXILROD. I'm just adding that as a point.

CHAIRMAN MILLER. Look at the roller coaster, what I call Mount Everest. It came back down.

VICE CHAIRMAN VOLCKER. Even the economy hasn't gone down.

CHAIRMAN MILLER. One of the problems is that growth was supposed to be about 3-1/2 percent in the fourth quarter and it's over 4 percent. That's one of the problems, unfortunately. Well, let's run down your check list. I will vote for that proposal.

MR. ALTMANN.

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

The vote is 8 to 2.

CHAIRMAN MILLER. Thank you very much. We completed that action at 11:40; we are doing very well. I don't know if you liked that procedure or not but I think that we got all the comments. Perhaps you can give me privately your evaluation of whether that's going to be a better way to do it or not.

We now need to move to a few other important matters. Item 8 is the consideration of the Manager's recommendation with respect to foreign currency operations. Alan Holmes.

MR. HOLMES. Mr. Chairman, my recommendations will fall in three categories: routine swap rollovers, the System open position, and the System's warehousing facility for the Treasury. The System has seven D-mark drawings totaling $451 million equivalent and six Swiss franc drawings totaling $114 million maturing between December 30 and January 26. All are first renewals and I recommend that they be rolled over at maturity should we not be able to pay them off. Now, if the January meeting is cancelled, then we would need approval at this time, I think, of the rollover of an additional $2.04 billion D-mark swaps, $350-odd million Swiss franc swaps, and $85 million Japanese yen swaps, which mature by mid-February. Those approvals would normally be done at the regular January meeting.

MR. PARTEE. We'd have a February meeting before February 15, wouldn't we?

CHAIRMAN MILLER. Yes, we have one on the 6th.

MR. HOLMES. Typically, we have asked for renewals covering a period after the next Committee meeting. It gives us a little opportunity to work out repayments ahead of time.

CHAIRMAN MILLER. But Chuck was pointing out that some of those come due after our next meeting.

MR. HOLMES. That's right, but typically we ask for renewals of [any swaps maturing] a week to 10 days after the next Committee meeting.

MR. PARTEE. There's very little [likelihood] that we are going to pay off--what was it--over $2 billion?

MR. HOLMES. Two billion, 40 million.

CHAIRMAN MILLER. The answer is that we have to roll them over. The authorization would be to roll them over in the absence of acquiring the currencies with which to repay.

MR. HOLMES. That's right.

CHAIRMAN MILLER. May we have your approval for that proposal? Hearing no dissent, it is so ordered. You have other proposals?

MR. HOLMES. Yes, Mr. Chairman. Our heavy intervention in the exchange market brought our open position to within less than $200 million of the $5 billion authorized by the Committee last Thursday. An intermeeting rise in that limit would have required publication this Friday, and given the speculation both in the market and in the press about U.S. use of its foreign exchange availability, it seemed desirable to avoid the possible announcement effect. In these circumstances, the Treasury agreed with the Chairman's suggestion that they provide from their own account any marks needed for intervention Friday until this Committee meeting, until the Committee had a chance to consider the question.

CHAIRMAN MILLER. So this was a period of 100 percent funding by the Treasury which, as you know, is unusual and it should be noted.

MR. HOLMES. For two days.

CHAIRMAN MILLER. For two days.

MR. HOLMES. Mr. Chairman, I think a good case can be made for suspending the overall open limit authorization. Such action would underscore the System's commitment to the November 1 program and particularly avoid the need for an intermeeting change in the authorization that might [cause] a market misreading because early release of that information would be required. I'd prefer this course of action. But I think the same objectives can be achieved by a sufficiently large increase in the open limit. An $8 billion open limit would permit the full use of our D-mark swap line--we only have $2 billion left in that line--and also allow for an additional $1 billion for intervention in Swiss francs and in yen. That seems to me to be reasonably acceptable, although I'd prefer a suspension [of the limit].

CHAIRMAN MILLER. Well, this is a point on which we don't have strong feelings. I might say that we've been somewhat concerned about a series of [announced] actions that would allow foreign currency traders to track what our intervention has been. Therefore, one of the reasons for a larger open position than we normally would like for control purposes has been to give us flexibility to maintain confidentiality on the degree and the extent of our intervention. So for the same reason, we could go one of the two ways. Recognizing that the limits of the swap agreements themselves provide the outside limit, we could just have no specified limit. We recognize that the Desk is in very close consultation with the Subcommittee, which is really tracking this carefully. Or we could do as Alan suggests and put in some limit that gives us leeway of about $3 billion until the next meeting. Now, we really have no strong feelings. If there's any preference on the Committee, we could go either direction. Henry.

MR. WALLICH. Well, either way is possible. I think naming a number like $8 billion tips off the market in an undesirable way. However, suspending the limit entirely, even though we certainly would maintain very close consultation, I think is not ideal in principle. So I'd look for an alternative way. We could suspend the [limits on] intermeeting changes, which now are $100 million on the overall open position in any one day and $300 million for the intermeeting period. We could suspend that in particular for the intermeeting period, bearing in mind that every dollar number here is multiplied by two because we're now going 50-50 with the Treasury. And we would not, as I understand it--subject to being better informed--have to publish any of what we do in this area because it comes under the procedural instructions, which we don't publish, [whereas] any [change] in the authorization does have to be made public. Furthermore, even if it were to be published, the intermeeting limit wouldn't tip off the market; it wouldn't tell the market [anything about] the accumulated magnitude of past or future operations.

CHAIRMAN MILLER. But we would still have to suspend the aggregate limit.

MR. COLDWELL. No, you can't do that.

CHAIRMAN MILLER. No, they are different things.

MR. WALLICH. You'd have to give [the Desk] room on the aggregates.

CHAIRMAN MILLER. We either have to give a specific number or a suspension.

VICE CHAIRMAN VOLCKER. Are you suggesting that you can take the aggregate limit and put it under the procedural instructions?

MR. WALLICH. The aggregate limit would disappear under this proposal. You would not be without some control.

MR. COLDWELL. Mr. Chairman, I think it's not [a good idea] to eliminate the [limit on the] aggregate open position. (A) I don't think it's desirable from a public relations standpoint; and (B) I don't think it's desirable from the Committee's standpoint.

VICE CHAIRMAN VOLCKER. I happen to have a preference along with Governor Coldwell on this. This is the basic limit and I think the Committee probably ought to have one. I would swallow the public relations disadvantage and make sure it's big enough, but I could go either way in the end.

CHAIRMAN MILLER. As I say, there's no strong feeling. If there's any sentiment for setting an $8 billion limit--the previous one was $5 billion--we'll move it to $8 billion. That would be perfectly fine. It will be disclosed; whether that will create any concern or not, I don't know. It shouldn't. It would indicate to people we've gone over $5 billion. Any sentiment?

MR. COLDWELL. I favor the $8 billion.

MR. PARTEE. I think I have some preference for a limit, but I think we [unintelligible] and if it turns out--

CHAIRMAN MILLER. Why don't we then consider the proposal to move the limit to $8 billion? Are there any comments or dissents? Hearing none, we will approve that. Oh, incidentally, I should say because Henry said it, but I'm not sure it was disclosed properly and perhaps you are [not aware], our relations with Treasury from here on are going to be on a 50-50 basis. We have arranged that with them. Now they have resources. Alan, you have further recommendations?

MR. HOLMES. Mr. Chairman, I'd also like to recommend that the authorization to warehouse foreign exchange for the Treasury be raised from $1-3/4 billion, which the Committee approved last week, to $3-1/2 billion. That increase in the authorization last week accommodated the successful sale of $1.6 billion Treasury D-mark bonds last week. The Treasury plans to proceed with the Swiss franc offering in January and is considering a second D-mark offering and a Japanese yen offering early next year. It would seem prudent, at least for the time being, for the Treasury to retain maximum flexibility by keeping the foreign exchange proceeds of these bond sales available for us for intervention if it's needed. Warehousing accommodates that need for flexibility without involving the Federal Reserve in any exchange risk. Warehousing does have an impact on reserves in the banking system, but since that impact is known in advance, it can be offset by domestic open market operations whenever necessary. It's just another reserve factor.

CHAIRMAN MILLER. It reverses out when we use the D-mark for intervention.

MR. HOLMES. Yes.

VICE CHAIRMAN VOLCKER. So moved.

CHAIRMAN MILLER. Any other discussion?

MS. TEETERS. Is $3-1/2 billion enough?

MR. HOLMES. I think so for this stage. We have to do some rethinking with the Treasury over the next few months.

CHAIRMAN MILLER. We'd probably have to raise it if they go to the market again in February.

MR. HOLMES. This will take them through several months.

MS. TEETERS. Well, we have $1.6 billion already and what's the Swiss franc sale--$1.2 billion?

MR. HOLMES. It's not finally decided, but about that level. We probably would need another increase. We could go to $5 billion now. That would be one way of handling the second D-mark [offering]. We could do that now if the Committee so desires.

CHAIRMAN MILLER. Either way.

MR. PARTEE. This has the effect of transferring income from us to the Treasury, doesn't it? But it's income that we would be transferring anyway.

MR. HOLMES. It all comes out of the same pot before we get through.

MR. PARTEE. If it were $5 billion, you're talking about maybe 4 percent or so, so that's $200 million in income.

MR. HOLMES. We would lose because we would hold lower-yielding--

CHAIRMAN MILLER. Which we don't have and we transfer to them so they take it directly. It's the same difference.

MR. PARTEE. The magnitude would be approximately--

SPEAKER(?). Debt management.

CHAIRMAN MILLER. Very much so. Henry.

MR. WALLICH. I hope this doesn't sound too esoteric. We are making a very fundamental decision here. We're getting to be like every other country that has foreign exchange reserves. In the past, we only had gold and SDR. Here we have foreign exchange reserves and we are now making a decision on how to finance these reserves. For all countries this is a very important decision. It tends to affect their money supply--their domestic monetary management. So we should be well aware of what it is we are doing. The reserves belong to the Treasury. This is one very important decision, which I guess is set by law in our country, although not necessarily. The Treasury owns the gold and the SDR, but we could own the exchange reserves; it makes a great deal of difference in a country who does [own them] because the balance of power between the central bank and Treasury is influenced thereby. We seem to be in the present framework the financier of the balance. We supply the money, we face the money market consequences, which seem easy so long as all we have to do is offset a few billion by open market sales that we give to the Treasury, and we compensate that by selling our own securities to the market. But some day it could be different. It could be large relative to our portfolio. So I think we ought to first think about what it is we are doing on a structural basis.

Second, until we've arrived at a better understanding, I would argue for a small increase in the warehousing limit. It gives us time to think; it gives us time to talk to the Treasury again about this. If there should ever be a problem, the limit would tend to give us a chance to review the situation.

CHAIRMAN MILLER. I have been going on the assumption that at this stage of discussion this Committee did not want to buy that foreign currency position and own it for its own account and for its own risk. I may have misread that; some day that might be a decision we'd like to take. At the moment I think if we did that, we'd be accused of moving the potential foreign currency exchange risk outside of the budgetary process, where it now resides with the Treasury. See, we are taking up foreign exchange; if there is a loss here, it will be a Treasury loss in their accounting under the appropriations procedure. So I've assumed that. I'm not saying it wouldn't be good policy for this nation for us to own those reserves. But I think we want to do a lot of homework and a lot of preparation before we make that decision because it has some political repercussions.

MR. PARTEE. You're not speaking about owning foreign exchange, I think, Henry, but rather of developing a position where one of our assets is an exchange rate guaranteed, non-U.S. security. That [involves] proportionately fewer U.S. securities in our portfolio and that might sometime become large. I agree with the principle you are expressing, but we more or less participated and agreed and urged Treasury financing--say, a $10 billion figure. And it seems to me that having been so prominent in the discussion of that, it's up to us to be prepared to finance up to $10 billion in that. It won't get that large because we'll probably use up some. So, although I agree with your principle, I don't see any problem with the $5 billion figure that's been suggested because we'll reach it soon and I can't imagine that we would say to the Treasury, "don't go to Japan; we were wrong back in the fall."

CHAIRMAN MILLER. Especially since we urged it so hard.

MR. PARTEE. Yes, so I don't see--

MR. WALLICH. Well, at some point we might want to raise the point of who is to own these reserves. This is very important.

CHAIRMAN MILLER. That's a question that's coming--to consider downstream. Dave Eastburn has been trying to get his word in edge-wise.

MR. EASTBURN. I think this is a very good point. I had worried about it when that wire came through about the warehousing procedure. I just wonder whether one way to tackle this would be to have a staff paper on this, Mr. Chairman, which lays out the alternatives and the implications for the moment of the various ways to go.

CHAIRMAN MILLER. Yes, we certainly can.

MR. HOLMES. Mr. Chairman, may I just point out that at this particular moment the United States is not faced with the problem of having net holdings of foreign exchange. We're still relatively short at the moment, and so all the foreign exchange assets we have could be used to repay debt.

CHAIRMAN MILLER. To repay debt. It seems appropriate to me--in fact, [if we do not], I think it would be somewhat of a breach of faith since we're the proponents of this process, which is essential if we're going to finance our current account deficit in a way the deficit nation should do--to make this policy shift. And for the central bank to make it more difficult or more inconvenient for the Treasury I don't think is an appropriate way to go. On the other hand, I think it's a big issue. I think it would take a lot of study and a lot of staff papers to decide that we would want to become the holder of foreign currency reserves ourselves. So I'm not saying we shouldn't look at that. Anybody else?

MR. COLDWELL. I would subscribe to Henry's view in a way; I think we ought to have a look down the road. I agree with you, however, that there's no way we can't support this in this initial phase. But I think we ought to look at the longer-range implications of this and who is going to hold the funds and what financing is done. So I'd like to go ahead and raise our warehousing limit. If it takes $5 billion, that's all right with me. But I do think the study needs to be made.

MR. HOLMES. That's all.

CHAIRMAN MILLER. All right. Now we move to a kind of pro forma subject, item 9, the discussion of the report of the Subcommittee on the Directive. Chuck. Excuse me?

MR. AXILROD. There was an additional thing that the Committee may or may not want to take up with regard to this warehousing. Unless action is taken, half of it will have to be renewed in six months and then the other half in one year. Under the current circumstances, the simplest thing might just be to have it renewed in one year, rather than going through a 6-month and then a 1-year procedure.

CHAIRMAN MILLER. Oh, I think that makes sense because it will be used in the meantime. Certainly some of it will be used.

MR. COLDWELL. It does have the advantage of bringing it back to our attention in six months.

MR. AXILROD. Well, we have to simply divide it up in half. As this builds up whatever half is going to be in six months the Committee will simply have to take an action to roll it over for another six months. It's purely a housekeeping procedure, and it's a question of whether the Committee wants to go through that housekeeping business in six months or one year.

MR. COLDWELL. Well, it's housekeeping only if we don't make a decision to change the direction in terms of ownership.

CHAIRMAN MILLER. It seems inconceivable to me that we wouldn't hold their currency.

MR. COLDWELL. No, I'm not saying that. If we decided as a result of a long-range study that we are going to hold these ourselves, not Treasury, it will matter. We'd have the flexibility in six months.

CHAIRMAN MILLER. I don't think we'll have any problem in buying them.

MR. AXILROD. That leaves it then that half of this comes due in some sense in six months and half of it comes due in one year.

CHAIRMAN MILLER. Well, my preference is to go for the year, so we don't have this [twice]. We are going to study some things in the meantime. I think if we go to the Treasury with a proposal or plan, they would be perfectly amenable to a plan. But my preference at least is not to have these housekeeping issues keep rolling in here. What is the preference?

MR. PARTEE. You'd rather have a year.

CHAIRMAN MILLER. Yes, I would rather have a year.

MR. PARTEE. I think that's right. There's no possibility in six months unless there's a--

CHAIRMAN MILLER. No, I think we have to do so much homework with the Congress before we'd want to hold these because of the implications to us. We might be bringing ourselves under the appropriations process by starting this.

MR. COLDWELL. Well, we have swaps.

MR. MORRIS. Would the loss be the Treasury's?

CHAIRMAN MILLER. Yes, we'd take this from the Treasury, you see.

MR. MORRIS. Would it be chargeable to the budget or would it be chargeable to the Exchange Stabilization Fund?

CHAIRMAN MILLER. It's chargeable to the current account. That was one of the big legal and accounting decisions that had to be taken to get them to agree to do this. If they had to charge it to the Exchange Stabilization Fund, they were out of resources. If there is any currency exchange loss, it will be booked as you go as an additional interest cost, in effect--an additional cost of holding a resource.

SPEAKER(?). It will be a realized loss?

CHAIRMAN MILLER. I think they'll follow the process of realized and unrealized so that they'll put it into the quarters as they go by. They'll follow FASB, and count it on a realized or unrealized basis, which makes sense, because otherwise you build up a big blob and it may come all at once. This way it goes in [currently]. And it can go either way. You can have an interest reduction or an interest increase. The cost of these initial ones was quite satisfactory, I thought: 5.95 percent for 3-year notes and 6.2 percent for the 4-year. So you already have roughly a 3 percent cushion on the exchange risk that would bring you out even.

Well, what is the preference? I don't have a strong preference. Would you prefer six months or twelve months? Incidentally, the deal before was half and half. How many would prefer to go all the way to one year for the whole thing and let's work it out? That would be my preference, I think. How many would prefer six months? Looks like the twelve months have it. Is that all, Steve and Alan? I didn't mean to cut that off--

MR. ALTMANN. Any dissents?

MR. PARTEE. Oh, this is a vote?

CHAIRMAN MILLER. Do you want to be recorded as dissenting or would you join the [majority]?

MR. COLDWELL. Oh, I'll join.

CHAIRMAN MILLER. Now we turn, Chuck, to your directive.

MR. ROOS. Mr. Chairman, may I just ask a question before Chuck gets into this about how you intend to proceed in considering this issue? It is certainly of enormous importance; it's something your predecessor had planned to place before this Committee for consideration. I am talking about how we conduct policy. It affects the way we go about either cooperating or not with the Humphrey-Hawkins proposal.

The proposal and the memorandum reached us on Friday morning and I don't think it reached any of the other Reserve Banks [earlier]. I don't know of anybody who got it before Friday, which meant that there was, in effect, only one workday in which to consider it if we were traveling Monday. My question is: Is this going to be taken up for action today or is there a way that after it's presented and discussed more time could be made available to really consider this with our research people and others and react to it? I think it's vitally important.

MR. PARTEE. It depends on the issue. For example, if the Committee agrees to the proposed meeting schedule, then there won't be any January meeting. And then I think we will have to do in February--in terms of a report--what is suggested here because there won't be any meeting prior to February to change the thing. Some other issues could be delayed.

MR. ROOS. If anyone shares my feeling on the importance of this, that might be an argument to have a January meeting devoted in the main to an in-depth consideration of this. I think it's terribly important and nothing that should be decided without a lot of thought being given to it.

CHAIRMAN MILLER. Let me answer your question very simply: It's the will of the Committee. If the Committee is comfortable making a decision today, I think that will be the process. If it isn't, we'll have to schedule sessions as necessary or alternative means to get us to where we need to be. We do need by February 6 to have at least a conclusion on how we will handle it for our February 20 report. It would be a precedent and could be hard to unlock it. So we ought to make a very conscientious decision. But I think it's the will of the Committee. If there's a general feeling that this needs another meeting for further discussion, we'll have to find a way to arrange that.

VICE CHAIRMAN VOLCKER. Many of these proposals follow directly [the requirements] of the Humphrey-Hawkins Act; we haven't got much choice. They're presented as a decision of the Subcommittee on the Directive but they're really just translating the Act into what we have to do.

MR. ROOS. Well, Paul, we at least worked on it over the weekend and I think there are some--

VICE CHAIRMAN VOLCKER. That's not true of every one but it's true of many.

CHAIRMAN MILLER. Well, let's give the subcommittee a chance to present it and we'll see how it goes. We'll see how good they've done their homework. There are, however, five members of this subcommittee and we only have two dissents within the group, so probably that means--

MR. PARTEE. Well, Mr. Chairman, I might say that we did, of course, consider this with some time pressure because it's something that has to be instituted very shortly into the new year. But it seemed to me, and I think to the other members of the committee, that many of these decisions were procedural in nature. They had to be taken but they were procedural. Where we had quite fundamental issues--for example, running on nonborrowed reserves as an operating variable--we did not take them up because there just was not sufficient time. That certainly could be discussed at a later date. Although it has been discussed time and time again for the last decade, it could be discussed once again. We do have a couple of dissents, as everybody can see because we've put them very prominently in the beginning of the material. And we also presented the material in a way so that we could go through these eight recommendations one by one. They start on page 2 of the memo. And I think that's the best way to do this, to go recommendation by recommendation.

CHAIRMAN MILLER. Wouldn't it be wise to see if there is unanimous approval of any recommendation? Let's get that one out of the way.

MR. PARTEE. Well, recommendation 1 is simply expressing as the Committee's intent what the law requires us to do. It says that we have to specify [long-term growth ranges for the] money and credit aggregates for the calendar year. And recommendation 1 is simply an expression of the Committee's intention to do that. So I don't think there could be much dispute about that recommendation.

MR. COLDWELL. Is there a different interpretation? I'm asking for sheer knowledge, because I've not had a chance, as you know, to even look at this with any care.

MR. PARTEE. For some reason, Phil didn't get it.

MR. COLDWELL. I didn't get a copy until Monday, Larry, so--

CHAIRMAN MILLER. That's because he was nearby.

MR. COLDWELL. That's because I was too close. You have in effect said, I think, that the law says we must do it for the calendar year. My question is: Does that mean a different interpretation [is possible]? Say you do this in February; does that mean that calendar year or does the law say that the July meeting has to look at the next calendar year?

CHAIRMAN MILLER. Both.

MR. COLDWELL. It does require both in the law.

MR. PARTEE. The law replaces old Concurrent Resolution 133, so it's the--

CHAIRMAN MILLER. We tried to sell a revision midyear just in the current year; they wouldn't buy it. And instead of much worse things, the compromise was for the revision of the current year plus a preliminary look at the next year.

MR. COLDWELL. What were you talking about? Who were you trying to sell? I haven't gotten caught up with this.

MR. PARTEE. I would say, Phil, the expression is very general; it's monetary and credit aggregates. You could conceivably drop M1, drop M2, have nothing but credit, or have different credit aggregates. There's good flexibility but specification of an aggregate for the current calendar year and in a tentative way for the forthcoming calendar year in the July meeting seems to me to be required by the law.

CHAIRMAN MILLER. Well, this one is procedure. Does anyone have any problem with this?

MR. WALLICH. Excuse me. There is one decision, isn't there--whether it is to be year-over-year?

MR. PARTEE. That's recommendation 2. That's later on.

CHAIRMAN MILLER. Yes, Willis.

MR. WINN. Isn't this just a reporting requirement, not an operating requirement? In other words, we have to report twice a year on this basis but there is nothing to prevent you from looking or acting in the interim period when conditions change.

CHAIRMAN MILLER. That's correct, that's specifically in the law; it says that our--

MR. WINN. It's a reporting requirement, not an operating requirement.

CHAIRMAN MILLER. That's correct.

MS. TEETERS. But you've got to tell why in July you didn't come out the way you started.

MR. WINN. That's still a reporting requirement, not an operating requirement.

MR. PARTEE. That's correct. We can change it at any time and we could go broader than that, I think. Well, we could report this to the Congress and be operating on something entirely different, but--

CHAIRMAN MILLER. That would be a little deceitful.

MR. PARTEE. I really think that that is getting too complicated.

CHAIRMAN MILLER. We'd have to keep too many books. One second, Larry needs the floor.

MR. ROOS. I would suggest, though, that Congress isn't going to be lying in a docile posture--letting us switch our processes and our signals to meet our own needs. I would agree with Nancy that we've got to think of the Congressional relations aspect. If they think we're trying to dodge the intent or the spirit of the Humphrey-Hawkins bill, I think all whatnot will break loose and we'll really be forced to do things that we don't want to.

CHAIRMAN MILLER. I think we have to report our intentions and we should report them honestly; there's no question about that. But if we are reporting intentions, and if there is a big strike in the interim or if there is an oil boycott, we would change our program. And we would say that's why we had done it. That's what you're talking about.

MR. WINN. Otherwise we are locked in the ages-long controversy between automation and judgment as a policy.

MR. ROOS. If there's a big overshoot, you have to show it.

MR. COLDWELL. One final question on the first point, Chuck. You have used the word "targets." Is this advisedly [or] required in the law?

MR. PARTEE. The word "targets"?

MR. COLDWELL. Yes, rather than "guidelines" or "ranges."

CHAIRMAN MILLER. "Ranges" is the word in the law.

MR. COLDWELL. The word "targets" is used in your next to last line on the first page.

CHAIRMAN MILLER. The first [sentence] is right, though.

MR. COLDWELL. I was just hoping we'd stay away from that word.

MR. PARTEE. Well, it says the objectives and plans with respect to the ranges of growth.

MR. COLDWELL. In the past, we've tried to stay away from the word target, if possible. [I'd start that sentence with] "These ranges or guides should…" It's semantics, I know.

CHAIRMAN MILLER. These ranges or guides. Sure, why not? And the next [sentence] says "ranges." Okay. Do you want to move to proposal 2, Chuck?

MR. PARTEE. Well, proposal 2 does get to the question of how we define the calendar year. There seem to be three possibilities. One could say that it's December to December. Well, I suppose one could say it's the last day of December to the last day of December, but in practical terms it's the month of December to the month of December. We rejected that on the grounds that the base is too unstable, especially since December is such a volatile month.

One could say it's the quarterly average--the fourth quarter to the fourth quarter; that's consistent with the way we look at GNP and quite a few other numbers in the economy and it gives you the effect of the passage in time. That's our committee's proposal.

One could also say a calendar year average to a calendar year average. For example, the Germans use that, I noticed. The difficulty we see with that is that, in effect, the averaging procedure is so much more elongated since you really pick up the whole profile of the previous calendar year in determining the base. And after that it becomes very difficult to affect very much the figure you specify for a calendar year; once you're into it [there's] hardly any time at all. For some purposes we might want to use the average year over average year in terms of references. But we think what is consistent with the way people report and analyze and use our data and the GNP data is to make it fourth quarter-to-fourth quarter. That's all the second recommendation is.

MR. COLDWELL. May I speak to that? I'm not speaking with any great knowledge because, again, I haven't thought this out. But I'm wondering, Chuck, in terms of the midyear report where you've gone through half of the year and know what that average has been, at least in preliminary terms, and you have the remainder of that year to forecast. You're coming back, in your terms, to a quarterly average of the fourth quarter of the prior year and the fourth quarter of the year you are in. I wonder if, in the July reporting period, it doesn't give a little better picture of the year in which you're doing this to have an average over the whole year.

MS. TEETERS. Or, alternatively, to have both of them.

MR. PARTEE. I just don't know. I must say, as an economist who has been forecasting for a long time, that I can't even remember a year average on anything. I just never use it in analytic terms myself; maybe some people do. I think it's a very interesting device to create confusion because the year-over-year average is always different than the developments of the year as it goes on. I think where it might be used, Phil, is let's say in July you have an [overshoot] and you don't think you can get it down or that it is inappropriate to get it down within the year to the range you had set earlier. Then I think you use the next year, which you are permitted to do in July. That is, you could say we are running over for various reasons and you cite them.

CHAIRMAN MILLER. You would adjust the current year upward.

MR. PARTEE. You would adjust the current year upward and you could very well say we'll have a more gradual adjustment period that would run into the following year. That's the way I would use it rather than to take the yearly average.

MR. COLDWELL. I was trying to think of your comment in relation to the GNP number. If you use the GNP number, [after] the first [half] of the year, you know what your first half GNP has been. I guess forecaster minds work differently, but it seems to me that after I get past the first half I have some idea what that first half has accomplished already and then I look at the second half and add to it. And it's a cumulative figure moving ahead.

MR. PARTEE. You mean so you get an average. I just never do that myself.

VICE CHAIRMAN VOLCKER. Chuck, you say you never do it. Almost all of the GNP figures that are discussed at this time of the year are yearly figures.

MR. PARTEE. I never discuss the yearly figures; I think they're highly misleading.

VICE CHAIRMAN VOLCKER. You can't read the newspaper without reading that number.

MR. PARTEE. I think it's become much more common to talk fourth quarter-to-fourth quarter. That's the way the Council [of Economic Advisers] presents their estimates of the GNP.

MS. TEETERS. As a matter of fact, they're presented both ways. They still are. The budget document has year-over-year and the Council report has fourth quarter-to-fourth quarter. And they are a consistent set of numbers. I think people do them differently.

MR. COLDWELL. Jim, what do you use in the Greenbook?

MR. KICHLINE. Well, we present both but generally in the presentations here we talk about fourth-to-fourth.

MR. COLDWELL. And this Bluebook change figure, you use fourth quarter-to-fourth quarter rather than the average?

MR. KICHLINE. That's right--or third-to-third, say. In terms of the policy period, for example, it's the third quarter over the third quarter.

MR. AXILROD. Those are all quarters, depending on the time period, Governor Coldwell, third-to-third, fourth-to-fourth, third-to-fourth. They're all quarter-to-quarter.

CHAIRMAN MILLER. Well, point-to-point is just too sloppy. So it's some sort of period to another period. What is the sentiment here? Is this an issue on which there is a difference of opinion?

MR. BAUGHMAN. Do you contemplate that in the July report you would cast the discussion largely in terms of the change from the fourth quarter to the second quarter?

MR. PARTEE. What's happened so far and what that implies for--

CHAIRMAN MILLER. We wouldn't start one of these new periods from a base in July; we would go back to the fourth quarter of the prior year.

MR. BAUGHMAN. Would you tend to cast the conversation in terms of quarterly averages all the way through as compared with when you're reporting in July maybe getting hung up in a lengthy conversation of June?

MR. PARTEE. Well, it seems to me that it will be in the report. We haven't written the report; and the Chairman will testify and he hasn't testified. But it seems to me that he would talk about how the year has developed thus far and the implications of that for the second half of the year--that is, the second to the fourth quarter--and whether that has implications for the coming year.

MR. BAUGHMAN. But there's an inference, I think, in picking fourth quarter-to-fourth quarter that there is not a shorter period that's really meaningful to talk about. No shorter than a quarter, or about three months.

MR. PARTEE. [No shorter] than a quarter? Well, I sort of agree with that. That bears on one of our later recommendations.

CHAIRMAN MILLER. What is the will of the Committee--to approve this proposal or to disapprove it? John.

MR. BALLES. Mr. Chairman, there is another aspect of this that I would like to spend a minute on. Personally, I'm in favor of Chuck's view that a more meaningful way of measuring the change is from fourth quarter-to-fourth quarter rather than year-over-year. But another consideration that would influence how I would come out on this has to do with the following. Under the current procedures, we've got a certain spread of percentage points [on the ranges] for M1, M2, etc. On M1, it's a 4 percentage point spread, with 2 to 6 percent; on M2, it's a 2-1/2 percentage point spread--6-1/2 to 9. But in terms of actual operational ranges, in fact there is a much narrower spread because it depends on our practice to update these targets each quarter. And so the range, in practice, I think has been only one-fourth as wide as the 4 percentage point spread on M1 and the 2-1/2 percentage point spread on M2. As far as I'm concerned, if we were to retain the same practice of having these present percentage point spreads and go on for a full year, the ranges would be far too wide for me to personally be comfortable with.

[Given] the very short time available to think about this, I would suggest as a kind of compromise that we narrow the ranges if we are going to go from fourth quarter-to-fourth quarter to a 1 percent spread for M2 and 1-1/2 for M1. I'll give you some illustrations: from 3-1/4 to 4-3/4 would have the same midpoint, namely 4 percent, as the present 2 to 6 percent range. An M2 range of 7-1/4 to 8-1/4 for a year ahead, fourth quarter-to-fourth quarter, [has] the same 7-3/4 percent midpoint as our present 6-1/2 to 9 percent range. But the issue I'm concerned with is that in practice the 4 percentage point spread we allow ourselves for M1, and the 2-1/2 for M2 are not really that wide because we update them every quarter. And I think we would have too much sloppiness in the steering mechanism here if we allowed those same percentage point spreads to exist in our specified ranges for a full year ahead.

CHAIRMAN MILLER. Well, I would like to reserve judgment on that. I don't think it really comes up at this point. And I think actually the 4 percentage point spread we have now is a special one. We've had 2-1/2 point spreads on M1, from 4 to 6-1/2. And if you would look at that out for a year, you are still talking about the same scatter; you can be only 1-1/4 percentage points off of your midpoint after a year. And cutting it down to a quarter doesn't change that. It just means that on a shorter period of time you could be 1-1/4 percentage points off. So, I would have strong reservations because I'm the one who will have to explain why we don't hit these things. And the narrower the target, the more we're going to miss it.

MR. BALLES. That's a very good point; the cone gets wider as you go up.

MR. PARTEE. Well, we slip the base every quarter now.

CHAIRMAN MILLER. That's the problem. Where we get the problem now is slipping the base. If we stuck by our original one-year projection and had a 2-1/2 point spread-- Now, we are off the subject, but we may want to create a band rather than a cone. There is a lot to be said for that. But I think that's a separate question.

MR. PARTEE. I do think this is a separate issue.

[MR. COLDWELL(?).] What other recommendations do you have?

MR. PARTEE. Well, there's recommendation 4, which has a great deal to do with the question of whether we can say that what the Committee has done has some relationship with what the President wants done. And I think [following] your suggestion would make it less likely that we'd consider it consistent.

SPEAKER(?). And that comes up in recommendation 4?

CHAIRMAN MILLER. I think it does.

MR. BALLES. In any case, it comes up in February.

CHAIRMAN MILLER. It comes up every meeting because I don't know that you can bind future FOMCs to having only certain spreads. I think any FOMC can put on any spread they want. New people come on and change their minds.

MR. COLDWELL. Chuck, is your base drift on this question?

MR. PARTEE. The only base drift I see has to be very publicly reported. It has to be that we have given up our original expectations per se on 1979 and either intend or don't intend to make up for it in 1980. That's the kind of base drift there will be, an annual base drift.

MR. COLDWELL. No base drift in July against our February?

CHAIRMAN MILLER. No, you go back to the fourth quarter-to-fourth quarter. You just change--

VICE CHAIRMAN VOLCKER. It would be an annual base drift.

MR. PARTEE. Yes, an annual base drift.

MR. COLDWELL. [Unintelligible.]

CHAIRMAN MILLER. Annually there would be a base drift but during the year I think we'd merely move our targets if we decide to change them. We would reaffirm them or say we've moved them up or down; we'd have to admit we were wrong.

MR. BLACK. To put it in slightly different terms, the base drift would become more overt and less covert.

CHAIRMAN MILLER. Yes, being spread out so that you--

MR. MORRIS. It's one of the few real virtues of Humphrey-Hawkins.

CHAIRMAN MILLER. Just on the narrow point, do you want to go fourth quarter-to-fourth quarter? Can we get that one solved?

MR. COLDWELL. Can we have the happy medium of fourth-to-fourth on the February and July and an average in July also? Or would that be a problem?

MR. PARTEE. I think that would be a problem. If we shift between February and July [how we define] the year the way you're talking about, I think the [Congressional] committee could very reasonably say that we're trying to obscure what's happening.

MS. TEETERS. Well, actually, if you have fourth quarter-to-fourth quarter, you've got an implicit [number for] year-over-year. By July you're there, and it seems to me that if we're asked, we should give the calendar year [objective].

CHAIRMAN MILLER. Going, going, gone. What's number 3?

MR. PARTEE. Recommendation 3 has to do with meeting periods--a rather sensitive subject. There are really two aspects to this recommendation. One is that we feel it's necessary for the Committee to change its February and July meeting dates so that it will meet at a time in February, for example, when the staff has been able to analyze the President's objectives and yet in time for the report to be written. In July there will be a midyear budget review and perhaps some new specifications or objectives; and in any event a report has to be written and delivered by July 20th. At the minimum we think we have to change the February and July dates as we specified here to February 6 and July 11. February 6 is farther from the deadline of February 20 because we figure it will be a harder report to write. July 11 is closer to the deadline, July 20, because we think it will be easier and, in any event, to have it a week earlier would interfere with the Fourth of July. So, those two changes we thought we had to make.

In addition, we made two changes in dates from the calendar previously sent out to you just to even out a little bit the time intervals. We had to change the May date from the 15th to the 22nd and the August date from the 21st to the 14th. Otherwise, we left all the dates the same. It's on the table here. You'll see that we changed May to the 22nd and that we backed up August a week in order to give us two 5-week intervals rather than a 6-week and a 4-week interval. In future years, I think we could do better with this but we felt some obligation to try to [stay] as closely as we could to what had previously been suggested to you as tentative dates.

Now, the third aspect of this calendar is that it proposes excluding formal physical meeting dates in January and June because they would necessarily have to be at times that would involve only 3-week intervals. We felt that, in view of the fact that a full review of our situation was coming up and the reports would be written and all that, it would be better to skip those and have 7-week intervals, understanding of course, that there could be telephone conferences. In the future, I believe that we will never be able to avoid [a 7-week interval] in the December-January period--assuming we don't want to meet between Christmas and New Year's Day, and I assume we don't. But for the July meeting, I think in the future we'll be able to cut that to a 6-week interval rather than the 7-week period we now have.

So there is first the change in the February and July meeting dates; second, the changes that we made in the May and August dates; and third, the question of skipping the January and June meetings.

CHAIRMAN MILLER. What is the pleasure of the Committee?

MR. BLACK. Mr. Chairman, could I [ask] whether we could consider changing the May meeting to the 30th? You have seven weeks between the May and July meetings and five weeks between the May and April meetings.

CHAIRMAN MILLER. You would rather go to six and six?

MR. BLACK. I'd rather go to six and six.

MR. PARTEE. The only reason we didn't do it was because Memorial Day is a holiday.

MR. BLACK. Won't most people observe Memorial Day on the 28th?

MR. PARTEE. Well, apparently that's not true in every state.

SPEAKER(?). Some places observe it on the 30th.

MR. BLACK. We have Confederate Memorial Day in Virginia.

MR. PARTEE. I seriously considered that and, as a matter of fact, if it had been my choice alone, I would have moved that date.

MR. COLDWELL. Mr. Chairman, I think the arrangement the committee has suggested would be worthwhile. I would suggest, as we've already heard in today's discussion, that we opt for telephone updates in the January and [June] periods.

MR. GUFFEY. Mr. Chairman, this is a troubling recommendation to me in that, among other things, it is cutting the meeting dates from twelve to ten and lengthening the intervals between meeting dates--particularly as we move into 1979. It's going to be a tough year, as demonstrated by the discussion around this table today, it seems to me.

There also appears to be an alternative that may or may not have been considered by the committee but seems to be a reasonable one as far as I'm concerned. And that is that we move all of the meeting dates to the second Tuesday instead of the third Tuesday of the month, thus maintaining a full 12-month schedule and having no interval between meeting dates greater than five weeks--very much the way we have done it in past years. Because of the shortness in coming into this procedure I think we might still adopt the recommendation of a telephone meeting for January, but nonetheless a full-blown meeting in January by telephone.

MR. PARTEE. I have a note here from Murray Altmann that one of our difficulties is that the BIS meeting is every second Monday and, therefore, we would have to make it the second Wednesday, or our people who go to BIS meetings can't get back. Even then it's not all that good to bring them back from Switzerland immediately to an Open Market Committee meeting. We've taken a look at almost every combination, Roger. If you take the first Tuesday, which also might be proposed, then you would wind up with very little new economic data for the month because it isn't out yet. I don't know, but I guess we didn't really look at the fourth Tuesday; that wouldn't fit the need anyway of the July and February dates.

CHAIRMAN MILLER. Have you considered going back to quarterly meetings?

MR. PARTEE. No, not seriously, although some people may think that moving from twelve meetings to ten is a tendency in that direction.

MR. WINN. The second Wednesday--isn't that a possibility?

MR. PARTEE. Well, except that it means that Paul or Henry and staff--Scott or Alan--will be very tired.

VICE CHAIRMAN VOLCKER. The [second] Tuesday doesn't come early enough in February and July, I suspect.

MR. GUFFEY. Yes, I think it does.

MR. WINN. It does in July but we could make an exception.

VICE CHAIRMAN VOLCKER. Maybe in this particular year, but it wouldn't regularly.

CHAIRMAN MILLER. Well, we've heard sentiments around. How many would accept this schedule for 1979 with or without the Coldwell codicil, which is the telephone meeting?

MR. ROOS. Everybody or voting members?

CHAIRMAN MILLER. Everybody. Okay, that looks like it. Is anybody unhappy with that?

MR. BLACK. Mr. Chairman, there is just one element of unhappiness about Memorial Day. I don't know if anybody observes Memorial Day on--

CHAIRMAN MILLER. We will refer the Memorial Day issue to the subcommittee; this will get our schedule going for February.

MR. PARTEE. Yes, although we will have to do it soon, because people like to get their calendars [scheduled].

MS. TEETERS. May I offer another amendment? The official holiday is on Monday the 28th and the natural holiday is Wednesday the 30th. And then there's the 31st, which is a Thursday. You might think of putting the May meeting on that Thursday, the 31st.

CHAIRMAN MILLER. So you want to cancel the May meeting?

MR. BLACK. You'll just not have as good input from me if you have it on that day.

CHAIRMAN MILLER. You'll have a hangover on Memorial Day?

MR. BLACK. Not a hangover, but I've got some complications.

CHAIRMAN MILLER. What will you have, a Memorial Day [unintelligible]?

MR. BLACK. We don't observe it except in spirit; we don't actually leave the Bank. And there is logic to making these intervals six weeks instead of five and seven. I wouldn't have brought it up if there wasn't.

MR. KIMBREL. Bob, you've lost that one, come on.

CHAIRMAN MILLER. We can go another week more and have it on June 5.

MR. WINN. I would just raise the question with respect to January, in view of the uncertainties that are prevalent. I'm wondering what the public relations aspect of it is, even though we hold it by telephone, to say that there is not a meeting in January.

CHAIRMAN MILLER. Wild enthusiasm, I would think.

MR. WINN. I think we are missing the market aspect of this.

MR. PARTEE. Well, I do think we can discuss it really quite well.

CHAIRMAN MILLER. I don't think anybody will know the difference unless we--

MR. PARTEE. Well, not having the January meeting, we won't release the policy record for today's meeting until a little later. Other than that, I can't see--

MR. ROOS. Well, why would that necessarily follow, Chuck? Would that necessarily--

MR. PARTEE. Yes, I think so.

CHAIRMAN MILLER. The release is three days after the next meeting.

MR. PARTEE. The reason we release it when we do is because until then there is an operational instruction.

MR. ROOS. But wouldn't you consider a telephone meeting in January a meeting?

MR. PARTEE. I would rather not.

MR. MAYO. Well, that's the problem. I think it should be considered a meeting. If we are going to have it, I'd consider that we are going to spend several hours.

MR. PARTEE. You know, we do have telephone meetings that--perhaps I should defer to the Secretary.

MR. MAYO. But they are different. This would be a mandatory meeting on a [specified] date.

MR. PARTEE. It's not mandatory. I think the Chairman said that he had every intention at this moment of calling you up on the 16th.

CHAIRMAN MILLER. That's right, to consult on that date. So we wouldn't have an official meeting or we wouldn't have problems with new policy directives and the release of the other--

MR. ALTMANN. Any actions taken at that time would be reported in the policy record [for today's meeting].

MR. PARTEE. Just as we do when we have a meeting by telephone late [in the intermeeting period], it's reported maybe a week or ten days later.

MR. COLDWELL. I think Willis has a good point. I hope we don't advertise that we are skipping--

CHAIRMAN MILLER. If anybody asks about it, don't you tell the truth? It's that we are having it a couple of weeks [later] because we have to prepare for the new presentation to Congress and we have to wait until we get the budget to do it.

MR. BLACK. I think we ought to go ahead and say that because they are going to be waiting for the policy record three days later.

CHAIRMAN MILLER. I'd inform everybody. My first reaction is that I don't think there will be any feeling of letdown because it's very logical. If we have to report on the 20th of February, we don't have the data until quite late in January. It's hard for us to do otherwise.

MR. ALTMANN. Mr. Chairman, our practice has been to respond to questions about the date of the [next] regularly scheduled meeting. We have always given out that date. We don't give out this proposed schedule, for example; it's not regarded as a fixed schedule.

MR. COYNE. We do give out the schedule; we have for the last couple of years.

CHAIRMAN MILLER. Well, Joe, all you have to do in giving out the schedule is to add a paragraph to your release saying that this has been scheduled at this time to permit preparation for the new reporting required under Humphrey-Hawkins.

Okay, where do we stand on meetings? There seemed to be acceptance of the proposal, with I guess a careful hope that you do something about Memorial Day--perhaps cancel it.

MR. PARTEE. I don't know; the careful hope came from both directions.

MR. BLACK. I am prepared to move in either direction; it's that particular time that causes me a problem.

MR. PARTEE. The Board does have to deal with the question of how we organize to be responsive to the mandate of Congress. It is a question we all have raised. First of all, there is nothing in that bill that calls upon the Committee to adopt explicit economic objectives for the calendar year [or] for the two calendar years and we would recommend that the Committee avoid doing so. We in general would; Nancy may want to say something here.

Secondly, there is nothing here that requires that the Committee develop monetary paths that it considers most probably quite consistent with the objectives that the President has set. And we would propose that the staff not be directed to develop that path that would be most consistent with the President's objectives. Rather, we propose that the staff be prepared to talk about the probabilities regarding whether or not the ranges specified for the monetary alternatives for the year are [consistent with or how they are] related to the President's objectives and also the question of the consistency among the objectives. In other words, at this point we are not proposing a major change in the way the staff material is prepared for the Committee nor are we proposing a major change in the way the Committee specifies its objectives. We simply suggest that the staff have in mind in its collective wisdom what it thinks the relationships are between the monetary alternatives and the economic objectives stated by the President. That's our committee's recommendation.

I think Nancy ought to be permitted to speak on this for a minute and I think you might want to hear from Jim Kichline, who is really going to have to organize the research that backs up the Committee's [decisions].

MS. TEETERS. Well, that is my dissent, as I am sure you all have [seen]. I feel very strongly that the object of policy should be toward [achieving] what I consider to be the ultimate goals for policy, mainly output, employment, and prices--and one that we have no control over, which is an acceptable distribution of income. I feel that money is really one of the tools and not the end of the policy and that we should start moving toward focusing the policymaking on our ultimate objectives rather than on an intermediate, in-between type of objective. And it seems to me that one of the major objectives of the Full Employment [and Balanced Growth] Humphrey-Hawkins Act was basically to improve public understanding of economic policymaking and to lay out what it is we want to accomplish rather than to get ourselves hung up on M1 or M2 or something of the sort.

Now, part of the reason that I think we need to do this is that I think there are inconsistencies going on at the present time in the policymaking. One of them is the tendency of the Administration to opt for the most optimistic possible economic forecast that they think they can get by with. And there is also an inconsistency in the conduct of monetary policy because I think there has been a tendency to opt for the lowest rates of growth in the money supply--that [they] can get so low that you can't achieve them and achieve your other objectives. And one thing that I think Humphrey-Hawkins may do is to force both sides to face up to the inconsistencies as they are presenting them to the American public. So I would opt for going forward with saying that here is what it takes to meet the President's objectives and then be very forward in saying we are not going to achieve those objectives because we can't live with the amount of money supply that is implied by the objectives [the Administration] is trying to get to. I'd do it in a probability form because the econometric models are not perfect. I don't know a single econometric model that does not have a great deal of somebody's judgment in it. I know that you are not going to get it directly on the nose as you go through here. But I think it's a mistake to formulate all our policy strictly in terms of money.

CHAIRMAN MILLER. I'm not sure I understand this issue. Under the Humphrey-Hawkins we are to make our report with respect to the ranges of growth or diminution of monetary and credit aggregates, taking account of past and prospective developments in employment and unemployment, etc. So, won't we have to look at the prospective [developments] as we see them?

MR. PARTEE. But the President will have specific short-run objectives for the economy.

CHAIRMAN MILLER. But we'd say here's our monetary policy and it is based on the fact that we expect unemployment to be slightly different or substantially different [than the President's objective]. Won't we have to say that?

MR. PARTEE. If we think it will be.

CHAIRMAN MILLER. So are you arguing about what you know in advance [as to] whether we are? Because if it happens to be consistent, Nancy, we have covered your point, haven't we?

MS. TEETERS. Not the point. The President will present a rather full-blown economic forecast and you can read this Act in such a way that the Federal Reserve is to look at that forecast and say what kind of growth in the money and credit aggregates will be necessary to achieve it. And it may be that the--

CHAIRMAN MILLER. No, I don't read it that way. Do I misread it?

MR. PARTEE. It's really point 3, I think, Mr. Chairman. The relationship of the aforesaid--

CHAIRMAN MILLER. Yes, first we say what our plans are--the objectives and plans of the Board of Governors and the FOMC.

MR. PARTEE. And that has to do with the monetary aggregates.

CHAIRMAN MILLER. [It says] the "relationship." It doesn't say that we tell what it takes to get the President's [objectives]. We say what we are going to do, and then we give the relationship to the President's [goals]. Either it's going to be consistent or inconsistent.

VICE CHAIRMAN VOLCKER. I don't think it necessarily implies forecasting a Committee forecast.

CHAIRMAN MILLER. [It says] taking into account the prospective relationship of our objectives and plans. Take into account [prospectively].

VICE CHAIRMAN VOLCKER. We can take account of the future, but we don't have to say this policy will produce X GNP.

CHAIRMAN MILLER. No, but you can't hardly say that you have taken into account prospective employment unless you have taken it into account.

MS. TEETERS. I think we have a real danger here. We may very well be in a situation where we will state our monetary policy and it's only going to take the outsiders about two seconds to figure out that because of our monetary policy the President can't achieve his objectives.

CHAIRMAN MILLER. If that's the case, we ought to be saying so under three.

MR. PARTEE. I think that's right, if it is obviously that [inconsistent]. I don't think that it is. Many times before, the outsiders have said that the monetary policy was not consistent with general objectives, and in fact it turned out to be consistent. So who knows?

CHAIRMAN MILLER. But our reports to the Congress this year have rather consistently been at variance with the Administration on growth of the economy, for example. We said here are our ranges and we expect the economy to grow at this rate and it was always less than the Administration's. I don't think that will [lead to] any particular crises.

MR. PARTEE. It may lead to more of a crisis in this period [unintelligible] because then the [Congressional] committee will make its recommendations for different policies to the Congress, so Congress could instruct us to do this.

VICE CHAIRMAN VOLCKER. But most of the time it will be in the range of uncertainty anyway. Nobody can say with full conviction whether it's consistent or inconsistent.

CHAIRMAN MILLER. I'm just trying to reconcile this difference of opinion. It seems to me, having decided what our objectives and plans were, if we then came to the point of what is their relationship to those in the President's economic report and found a variance, I think we would have to report that.

MS. TEETERS. Which means then you would have to give your forecast. Yes.

CHAIRMAN MILLER. No, if you're at variance. If you're not at variance, you're really saying you are consistent with that forecast.

MR. PARTEE. Yes.

MR. ROOS. Have we actually, in our own practices, ever discussed or agreed upon what our ultimate economic objectives would be and then attempted to make our monetary policy decisions consistent with the achievement of those objectives? Or have we really sort of played around with our monetary policy and then asked our people to project what they think will be the result of that monetary policy. This has disturbed me.

CHAIRMAN MILLER. I don't [know], Larry. We may have gone procedurally one way or the other. But it has been my experience that we have been adopting monetary policy for the conscious purpose of achieving a slower growth rate in the economy than was in the Administration's forecast. And we have been reporting this publicly all year.

MR. PARTEE. But we haven't been prepared to say that the Committee's economic--

CHAIRMAN MILLER. Oh yes, I understand. What we have said is that I have listened to everybody and I've said what I think. That's correct.

MR. PARTEE. You remember we passed that through.

VICE CHAIRMAN VOLCKER. That's what we contemplate continuing.

CHAIRMAN MILLER. Okay, I see. Now I'm getting the point.

MR. PARTEE. And then furthermore not directing the staff to develop an economic plan that would be consistent with the President's but to develop reasonable alternative economic and monetary plans and then talk about what the relationship [to the President's economic goals] might be.

VICE CHAIRMAN VOLCKER. Well, this language "the apparent consistency or inconsistency of alternative monetary growth rates with the President's economic goals"--isn't quite clear to me, Chuck, just semantically. In the discussion I think we made clear that what we did not want the staff doing is coming in and saying that X is consistent and Y is inconsistent. Then if we get asked, we'd have to quote that.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. My point has been covered.

CHAIRMAN MILLER. Are we covered? Anybody else?

MR. WILLES. Well, is Jim going to describe how he proposes to do this?

CHAIRMAN MILLER. Yes.

MR. KICHLINE. I think our intent is to use the econometric model more intensively to sort out the impacts of alternative monetary policies. So there would be more extensive and in-depth analyses of the alternatives on the real side and price side of the economy, given rates of growth of the aggregates that would be in the Bluebook. And in that process we'd be sure that we have covered in one of the alternatives or one of the ranges explicitly the forecast of the Administration, so that qualitatively we'd be able to talk about where that fits. We are talking about aggregate ranges ultimately so I think in most cases we won't have a great deal of difficulty. I would perceive much of the difficulty not to rest with rates of growth in nominal GNP but probably in the real and price split; I view that as being a potential source of problems.

So within the ranges we would anticipate that we will cover and provide the Committee with information that would discuss explicitly the nature of the Administration's forecast for the next two years I guess it is. We have tended to go out, as you know, three years or so using the econometric model. We would want to give a somewhat longer flavor to that exercise using the model.

MR. WALLICH. Jim, say for instance that we had a range of 4 to 6-1/2. Would you then indicate how 4 and 6-1/2 would be implemented [relative to] the President's program?

MR. AXILROD. That's what we have now.

MR. WALLICH. So if you found that the President's program fell within that range, that would be the conclusion to be drawn.

MR. PARTEE. That it's reasonably consistent.

MR. WALLICH. If we found that it fell outside, we'd tell the truth. But are we sufficiently sure to be able to assert that the President's program is unachievable by our policies? I doubt very much--

MR. PARTEE. I think any nominal GNP is achievable. I think it's the price/real [GNP] relationship that comes to [unintelligible]. If he said he wanted a 20 percent increase in nominal GNP, I'm sure you could achieve it with monetary policy. Then he might say it would be 8 percent real and 12 percent prices. We might think it would be 4 percent real and 16 percent prices.

MR. WALLICH. Then there are real possibilities. Suppose he proposes a 20 percent nominal increase. Wouldn't we then say we don't want to pursue that objective?

MS. TEETERS. It seems to me that the other thing generally that you can do on this is to state that you are not going to hit it 100 percent. Jim this morning was using some probabilities as to what the chances of a recession are, for example. And it seems to me that we would want to use that route in order to convey the degree of uncertainty that I think is still associated with this sort of thing.

MR. WALLICH. Well, I think very much we should convey the degree of uncertainty because our model results are just one point in a wide spectrum.

MS. TEETERS. It depends on how wide a spectrum.

MR. KICHLINE. I might note that in this exercise that I reported today on probability distributions we would hope to do some more experimenting. But in the future, obviously, we can talk a little bit about confidence intervals associated with the model forecast. We do have the standard errors. And we can indicate the uncertainty of a point forecast.

CHAIRMAN MILLER. Mark.

MR. WILLES. I'd just like to point out--I think it supports the subcommittee's recommendation--that we do not currently have any place that I know of in the country, let alone in the Federal Reserve System, an econometric model that can be used with any great confidence through the kind of simulation that we are talking about. So while we go through the exercises, I think the real point we ought to understand is that there is no way we can say on the basis of those exercises whether our proposed policy is consistent or inconsistent with the President's programs. So in a way we have a dilemma that isn't as bad as we think because we don't have to lie or anything else. We really don't know based on those models whether we are inconsistent or not. It's an entirely different kind of discussion than I think would be implied by what we have been talking about so far. My fear is that we are going to mislead ourselves into thinking that we can determine with more precision than we can exactly what the options are that we face.

We hope to have for the Committee, in a few months, some simulation views in the MTS model to indicate that there is really nothing we can say about the breakdown in nominal GNP between prices and real output, with any degree of confidence at all, based on the way that model is currently working. And that's not a criticism of that model any more than any other. It's just a fundamental difficulty we are having [in] how these things are being done.

CHAIRMAN MILLER. We are going to face some serious problems on our first go-around because the Administration's plan will face the dilemma of whether it's opportune to forecast more inflation and therefore to have a lower budget deficit. It is an interesting dilemma because the more inflation they forecast, the more they meet their target on the fiscal deficit. And the more they are optimistic on inflation, the more their deficit will go up.

MS. TEETERS. However, there is a lag. The entire inflation catches up about 18 months later on the expenditure side.

MR. PARTEE. Well, is it okay if this first time we go about it the way that is described here?

CHAIRMAN MILLER. Well, we will have to see.

MR. PARTEE. Yes, I think this will have to be a probing thing.

CHAIRMAN MILLER. We may have to spend all day on the 6th.

MR. PARTEE. Well, number 5, I think is pretty easy.

CHAIRMAN MILLER. You said that about the [meeting] dates!

MR. PARTEE. We went out of [order]; I lost my page. Oh, there it is. We just have [proposed] some minor word changes in the directive to conform to the expressions used in the Humphrey-Hawkins Act. It might be possible also, in the future, to discard the first several paragraphs of the directive. The [rest of the] committee impressed on me the wisdom of waiting until we find out what the Merrill decision is before we decide on that. So this involves just a few minor word changes.

CHAIRMAN MILLER. This is on the ranges only, not the directive in the--

MR. PARTEE. Yes, really the main thing is the phrase used in expressing our long-term monetary objectives, which follows the Humphrey-Hawkins language. A couple of other word changes [are suggested] because of other factors; we are talking about annual rather than moving 12-month targets. So I don't think there should be any discussion.

CHAIRMAN MILLER. Anybody have any problem on 6? Larry, do you have something? [Unintelligible] can't believe it.

MR. ROOS. I always have been, Mr. Chairman. Some of them don't fly well. But 6 is where I have really very serious concerns and I'd like to express them. In 6 the recommendation the subcommittee made, in effect, provides that the long-term aggregates decisions and the short-term decisions on targeting the fed funds rate really need not be related by a fixed rule. I feel that the spirit of the Humphrey-Hawkins Act is--even if it isn't written into law, it is the intent of this Act--to call on us to set specific annual aggregate target ranges. And I believe that our ability or inability to accomplish those ranges, at least under ordinary circumstances, will be judged very critically by the Congress.

Certainly if you look back, our record in setting ranges and staying within them has been rather spotty since 1975 when we had the Concurrent Joint Resolution 133. We have computed that out of 44 attempts to stay within certain short-term aggregate ranges we missed 22--50 percent of the time. I don't think in this new Humphrey-Hawkins arrangement, we are going to be able to remain as invisible or as unaccountable in this regard as we have in the past. And in order to achieve the objective that we read into Humphrey-Hawkins, I think the short-run aggregates targets must be closely tied to these longer-run objectives. And I think that we must be prepared--whether it's on a fixed basis or on an automatic basis--to do everything humanly possible to see that the funds rate is adjusted almost automatically whenever aggregate growth deviates from the prescribed ranges. This is the fundamental disagreement we have had.

MR. PARTEE. I think it is fundamental. I think the last sentence of recommendation 6 is the one to read. We wanted to assist you in saying what the Committee decisions ought to be from meeting to meeting by tracking what has been happening in a very explicit way and by having the staff provide alternative feasible routes for getting back [within the ranges]. We had in mind maybe a 3-month adjustment period and a 6-month adjustment period. That may have to vary some, but we don't want to be caught with a fixed rule that forces the Manager to do something between meetings that hadn't been anticipated. And that's all we are saying here.

MR. ROOS. Chuck, I would agree totally with the wording of your last sentence; however, it's the early part with which I strongly disagree. And if it's in order, Mr. Chairman, I'd just like to either circulate or read a very brief substitute in wording that I would recommend for the early part of Chuck's number 6. It would read, unless I am out of order, sir--

CHAIRMAN MILLER. No, please read it.

MR. ROOS. "The spirit of the new law clearly requires changes in the present procedure for formulating short-term tolerance ranges. The change in the formulation of the long-term ranges will tend to focus greater attention on actual performance relative to these ranges when setting short-term policy objectives. Therefore, we endorse proposals to relate short-term tolerance ranges to the long-term growth ranges by a mechanism that would ensure that the agreed-upon long-term ranges are achieved on an annual basis." And then we would follow the exact wording of the last sentence. I will be glad--

MR. PARTEE. Well, I think that ought to be subject to a straight vote, Mr. Chairman. He is suggesting changing the recommendation to the inverse of whether or not that's--

VICE CHAIRMAN VOLCKER. I think that might be said about this recommendation, Mr. Chairman. We did look at this thing entirely aside from Humphrey-Hawkins. These last six months, however, have reflected some considerable thinking by the Subcommittee on the Directive, right or wrong, as to what the substance of this should be apart from Humphrey-Hawkins.

CHAIRMAN MILLER. Dave, you have [a comment]?

MR. EASTBURN. Yes, if I may speak just briefly.

CHAIRMAN MILLER. Yes, please.

MR. EASTBURN. A good deal of what Paul referred to was produced in the Philadelphia Bank because we were concerned about the slippage between short-term and long-term [objectives]. We did a good deal of research on this and we were persuaded that the only way discipline could be introduced into the process was to have some very direct linkage between the short- and long-term ranges. However, Humphrey-Hawkins came along just about the time we were in the midst of this discussion. And in considering the impact of Humphrey-Hawkins on this, I am persuaded that that itself introduces enough discipline into the process that I don't think we need to do it by mechanical means. Now, I may wish a year from now that I felt the way I used to feel about this. But I think that we do have that kind of discipline in the Humphrey-Hawkins process and that we don't need that [automatic] kind of mechanism. And that mechanism does have other disadvantages.

CHAIRMAN MILLER. Well, how many prefer the--

MR. COLDWELL. May I ask a question before you take the vote, Mr. Chairman? May I ask what in your view, Chuck, Humphrey-Hawkins actually does require? You started out your comment that the new law "does not require" and Larry started his with the spirit of the new law "clearly requires." Maybe you could say literally that yours is correct and his is, too, if the difference is that he's looking at the spirit and you are looking at the literal parts of the law.

MR. PARTEE. Well, he changes a sentence in another part of it. But I think what the new law requires us to do basically is to say what kind of economic results we are going to have--not what kind of monetary aggregates [in terms of] target estimates, but what kind of monetary aggregates we have in mind as a means in the process of getting to the general economic results [we want]. And I think, since we won't be slipping the base, that is what it requires us to do and what I would expect the Chairman to say--

CHAIRMAN MILLER. What do you expect me to say?

MR. PARTEE. Many [times in the] middle of the year it doesn't look as if we are going to have monetary aggregates for the year that we thought in February were appropriate. And the reason is that the way things have developed they are no longer appropriate and, therefore, we are changing our target for the year. I think that is quite a different thing than saying we are going to live by a fixed monetary rule, which is really what Larry is suggesting.

MR. COLDWELL. Is this required? Do we have to have this one way or the other on this matter?

CHAIRMAN MILLER. It's subject to change at any time.

MR. COLDWELL. I understand that.

CHAIRMAN MILLER. But I think there needs to be some understanding on how we are going to be operating.

MR. PARTEE. If we are going to have a fixed rule, we have to have it in place in February.

MR. COLDWELL. I'm certainly not prepared to vote for a fixed rule, but I'm not sure I'm prepared to vote for the other one either.

MR. ROOS. Would there be a way--and this is what I was driving at earlier--whereby those of us who saw fit could communicate to Chuck in writing a point of view on this? [I ask] because I always feel that we have mass resources in our research departments and I would like to have some of our professionals, who can articulate this a hell of a lot better than I, put something down in writing before this decision is made. And they didn't have time to do it. I think this is a very gutsy decision that we will have to live with.

CHAIRMAN MILLER. I have trouble with it on two counts. I don't see how the Committee can lay down a rule that requires future Committee members to vote a certain vote. I don't see how you can do that. As a matter of procedure, I don't see how you can vote today and say that next July every member of this Committee is now committed to a certain mechanical process. Even if you voted that, I don't think it would be valid. Members could throw it out because it's just wrong procedure. No Committee can bind a future meeting--

MR. ROOS. How we perform in February in setting the directive will be affected materially by what our attitude is on an issue such as this. All I am saying is that we should have as much background as possible made available to the Committee prior to taking whatever action it takes in February.

CHAIRMAN MILLER. Yes, that's fine. It seems to me that what is being suggested is that at each meeting of the FOMC there will be available data as to a track that could return us to our range, if we are off it. And at that point members of the Committee can vote to get on the track or vote not to get on it. I think that's the only procedure we can accept. We will have new members; we will have two new Governors coming on. They can't be bound to vote [a certain way] later.

MR. PARTEE. Also, Mr. Chairman, there's a question of what we decide at the meeting as to what we authorize the Manager to do. We think the time for the decisions is at the Committee meetings and not--

CHAIRMAN MILLER. But if you present the choice, the Committee has a choice to decide to return on a 1-month basis, a 3-month basis, a 6-month basis, or to say in its reports that we have decided for factors that have come up to change our long-range objective.

MR. ROOS. But, Mr. Chairman--and I'll promise I'll hush up after this--

CHAIRMAN MILLER. No, this is very important. Don't hush up.

MR. ROOS. It seems to me that the very reason that Chuck's committee developed this paper was to give some guidance to this process even though they can't bind future FOMCs. And if there's a purpose in this memorandum being circulated, I think there's a purpose in certain aspects of the memorandum being debated even though we can't bind anybody. That's my only point.

CHAIRMAN MILLER. Yes. Well, I think the point has certainly [been made]. I think Ernie Baughman had a [comment].

MR. BAUGHMAN. Mr. Chairman, it seems to me that a way of handling this today--and I would propose a motion unless there is already one on the table--is to accept number 6 as an interim posture but not as a policy action at this point in time. That will leave the door open for continuing exploration.

CHAIRMAN MILLER. Yes, I think that's right.

MR. BAUGHMAN. [Unintelligible] and a number of others, which I suggested in the conversation. In fact, I'll have to admit that as I read the discussion pertaining to 6, I found it on balance a little more persuasive to come out a little differently on it than this specific recommendation. It seems to me there is something there and we need to keep the door open for further exploration, but at the same time we must move ahead to get a February statement out.

CHAIRMAN MILLER. Paul.

VICE CHAIRMAN VOLCKER. Well, I think this comment of Ernie's makes half the point I was going to make. I think there was a lot of sympathy, which should not be overlooked, on the subcommittee for paying more attention to the long-term averages. I felt that and I think some others did. That may not come through here very strongly because you read the [conclusion] of rejecting the mechanical [link] and I think that is precisely what the subcommittee did. It had sympathy for paying a lot more attention to the long range but it followed a different track in saying any of the mechanical devices we fooled around with have flaws and we shouldn't be bound by a particular mechanical device. And that's precisely where I came out: We should pay more attention, just don't have a particular mechanical device. And I would say semantically in this proposal of Larry's that I just don't agree that the spirit of the new law clearly requires changes in the present procedures. As a matter of fact, I don't know of anything in the new law or in the discussion that implies that. It may be a good idea to change them, but I don't think we can refer back to the spirit of the law.

CHAIRMAN MILLER. Well, what is your pleasure here? Do you want to vote on this or do you want to keep it as an open and continuing discussion from meeting to meeting? Or do you want to settle one?

MR. PARTEE. I like Ernie's proposal.

MR. BALLES. I do too, Mr. Chairman. And I must say, going back at least three years ago, I have been harping on this lack of getting from the short run to the long run. And one time I suggested a mechanical rule, which got sympathy but no action, and a number of other people around the table have subsequently come up with various devices. But when everything else is said and done, we really have had such big overshoots--or undershoots, as the case may be--because we haven't disciplined ourselves sufficiently on this Committee to get from the short-term to the long-term [objectives]. If we can do that by a means other than a strictly mechanical rule, that's fine. But I think we have to do it by one means or another and, therefore, I support Ernie's general proposal that we leave the matter open for further discussion. I think it is one of the most important procedural aspects of this whole shooting match.

CHAIRMAN MILLER. Would that be satisfactory to everyone?

MR. MAYO. It's a big step forward, I think, Mr. Chairman.

CHAIRMAN MILLER. To keep it open?

MR. MAYO. Well, no. To work in the direction that Chuck's committee has given us here.

CHAIRMAN MILLER. I think that's absolutely right. And in any case, we will be getting options before us in every meeting. All right, we will proceed to 7--before we have another dissent.

MR. COLDWELL. I would like to dissent on number 6, Mr. Chairman.

CHAIRMAN MILLER. You dissent on keeping it--

MR. COLDWELL. I'm not prepared to vote on that matter yet.

MR. PARTEE. I don't think number 7 has to be decided. What it means, in effect, if we don't decide it, is that in February we will continue as we have today to have a short-run 2-month growth range that is the trigger range for determining action. We tried simply here to develop an arithmetic equivalent that will be more stable for cosmetic public relations purposes. It wasn't to have any effect on the way the Manager responded or the speed with which he responded to changes but simply to give something that would reduce the amount of instability in the reported monetary aggregates we are looking at as our specialized targets. But there is disagreement. President Volcker doesn't care for it too much; I really pushed this in part because of the people, like President Eastburn, who wanted to have a long-run profile for the Committee, but he's not sure about it. So I would suggest that we just drop this.

MR. BALLES. Before you do that, I'd like to strongly support that. Going back to the predecessor committee on which I served and the ideas that surfaced, we had all sorts of conversations about the instability you get in looking at a 2-month horizon. Not only the weekly numbers but even the monthly numbers are 90 percent random fluctuation. In all the statistical tests we made, you have to go to something like the 3-month average to get some idea of the true underlying trend. I think this is a great step forward and I would recommend not to deep six it.

MR. MAYO. I feel much the same way, Mr. Chairman. I would say if number 6 was a great step forward, this is even a greater step forward.

CHAIRMAN MILLER. Paul Volcker. Go ahead.

VICE CHAIRMAN VOLCKER. I don't want to prolong this, but I think there's a certain confusion here. I agree that looking at the trend over a period of time is the only way to make sense out of the way these numbers are moving. The question here, as I see it, is what you are looking at in a particular decision at a particular Committee meeting. And what you are looking at then is what will happen before you can make another decision next month. And I think the typical question that you are asking is the one that Mark asked earlier, and which somebody asks at almost all these meetings: Should we react to a 10 percent rate of growth in the money supply next month or should we react in the other direction if it only goes up 2 percent? What is that relevant range? Now, mechanically these things come out the same. I just think it's a little more confusing in the communication among ourselves to obscure the next month by this long-term averaging the chairman of the subcommittee referred to. Where we are discussing annual averages or quarterly averages, the trouble with the averaging procedure is that it is so elongated that there is very little time left to affect the average. That's precisely the problem.

MR. PARTEE. Let me add, the baloney is what the baloney is, no matter how you slice it.

CHAIRMAN MILLER. I won't say anything about [unintelligible]. Frank Morris.

MR. MORRIS. I want to support John Balles. I think this recommendation represents a big step forward. I think it will not only improve our performance and prospective monetary policy by adding a longer period for the short-term objective, but I think it will also make communications to the public much easier to understand.

MR. PARTEE. That is the main intent.

MR. MORRIS. For example, at the current meeting, the 6 to 10 on M2 in the directive for the 2-month period means [something] like 6 to 7-1/2 on the 3-month period. I submit that the latter will be much [easier] for the public to understand and will give us a better perspective of what we are doing than the 6 to 10. So I really strongly believe that's the best thing in the whole report.

CHAIRMAN MILLER. The [subcommittee] chairman was about to throw it out.

MR. MORRIS. Yes.

CHAIRMAN MILLER. Steve.

MR. AXILROD. Mr. Chairman, I consider the [unintelligible] for M1 as against [M2] at the end--

SPEAKER(?). I was talking about M2.

MR. AXILROD. Yes, I understand, but it doesn't always come out the favorable way. And without speaking for or against one approach or another, I just wanted to be sure that the Committee understands that there is absolutely no difference between the two approaches. If we have done our math right, the Committee is going to be reacting in absolutely the same way as it reacted in the past with absolutely the same weight. We have adjusted the ranges, given the projections now. This is not something that makes any substantive difference in the procedures.

MR. MORRIS. I beg to differ on that point. And the reason is this. In the 3-month period you have three pieces of information plus one guess. That is, you have the one month that's known, the second month where we have a lot of information, and then the third month, which is sheer guess work and for which the information value is extremely low. Now, I submit that is better than having one month for which we have some information. For example, we don't know much information about December; we have a little information on it but our December projections could be way off.

VICE CHAIRMAN VOLCKER. There is nothing in this procedure that affects how much information you have. You know every past month, you know half of the present month, and you don't know the next month. Whether you add it up together or not, that's what you know.

MR. WALLICH. It's like putting a constant in an equation; it doesn't make any difference.

MR. MORRIS. I think the difference is that the longer the short-run guideline and the more months of information we have in that guideline, the more likely the Committee is to make up for any past undershoots or overshoots. And that I think is--

CHAIRMAN MILLER. Dave has been trying to get the floor.

MR. EASTBURN. I would just like to say that I did, as Chuck indicated, have sympathy to this at the outset. I've had some reservation since and it seems to me it is not central to the whole Humphrey-Hawkins process and procedure. And I would suggest, given the differences that there are, that we not pass it at this time and come back to it.

MR. PARTEE. I would [note], Mr. Chairman, that this was in the Bluebook this time. But it was so far buried that I at least didn't find it the first time through. It's Appendix 4 that presents the information in the new style. I would suggest that next time we ask [the staff] to do it in Appendix 1, as an alternative, and we can discuss it more in February.

VICE CHAIRMAN VOLCKER. Why not even bring it right up into this text here?

MR. PARTEE. Well, we'll bring it up into the text, then.

CHAIRMAN MILLER. All right, now I want to hear from Bones.

MR. KIMBREL. Mr. Chairman, many of the regional Banks have [unintelligible] but we, too, heartily support this. I guess if there's anything that hasn't been said, it's that we feel any significant developments during that period would tend to balance out. Any one monthly variation would not have the significant impact, so we do support [this]; some of our staff did some work early this spring related to this, so we are supporting it.

CHAIRMAN MILLER. Well, for something that is being tossed out, it sounds like there is a lot of support. Steve, do you have any preference?

MR. AXILROD. I don't have any preference. I really believe strongly--and we thought about this [hard but] I don't know how to get it through to the Committee--that it makes not one bit of difference. We're narrowing the range to make up for the averaging process. The different multiplication, if we have done our math correctly, should [result in] the same degree of responsiveness.

CHAIRMAN MILLER. Were you saying that if the aggregates are too high, a longer period will keep them high longer?

MR. PARTEE. No, it won't go as high, but they will be not as high longer.

CHAIRMAN MILLER. Bob Mayo.

MR. MAYO. Mr. Chairman, I think it makes two bits of difference, if I may use the phrase, with regard to Frank's point on communications with the public. I think that is the main advantage of this. I hope we are all smart enough around this table that we can divide by 2 and divide by 3. [If] not, we are in trouble.

MR. AXILROD. It isn't all that clear, because for example this time your M1 would be a very low range. You'd have to explain to the public that really, we are letting the growth in, but the growth is going to be in January. But it's going to be below because we are averaging January with a low November and December; you have that slight problem.

MR. MAYO. But we always have this problem. Again, I'd rather use it that way--the bigger figure.

MR. EASTBURN. I move that we not pass 7.

CHAIRMAN MILLER. Is everybody more or less willing to accept that at the moment, despite the preferences?

MR. MAYO. Just so it doesn't die.

CHAIRMAN MILLER. It's not going to die; it's going to be immaterial. All right, put it in the Bluebook someplace.

MR. PARTEE. The last recommendation, Mr. Chairman, is a non-recommendation. It had been proposed by some that we add to the long-term targets specified under the Humphrey-Hawkins bill something like reserves or the monetary base or one of the basic monetary aggregates. We can see no particular purpose for doing so because whatever problems there are in specifying the long-term money numbers for M1, M2, M1+, and M3, and so forth, will exist also in specifying the monetary base. So we don't see any advantage to doing that.

MR. ROOS. Mr. Chairman, my stomach is too empty to argue vehemently, but I'd like to express a weak disagreement with Chuck.

CHAIRMAN MILLER. I'm surprised it's weak. It's only physically weak. Does anybody else have any comment on that? Yes, Willis.

MR. WINN. I, too, would share the feeling that this is sort of a back-of-the-hand treatment to a problem. I grant that it's not a good guide and I don't insist that it be in the targets or ranges, but I think we have made a mistake in the past in ignoring the supplemental information that this provides for us. And I'd like to see an examination in somewhat more detail of whether this supplemental information tells us something about what's going on in the aggregates, particularly with respect to the future, that we have chosen to ignore. I don't advocate that it be part of the specs.

MR. AXILROD. Mr. Chairman, if I may make a suggestion. We have been somewhat neglectful recently in the analysis of reserves and the monetary base in the Bluebook. And actually I think it might be desirable to put, without specific figures even, some analysis of what's going on in there.

MR. WINN. That's really all I'm talking about.

CHAIRMAN MILLER. Bob, you had a point.

MR. BLACK. I was just going to say that I agree the committee didn't have time to address this. But I would hope that it would continue to push on and address it not so much as a target but as an operating variable in lieu of, or in combination with, the fed funds rate.

MR. PARTEE. We have been trying to do that. And I must say it's a very complex question.

MR. BLACK. I know it is. But there's a substantial volume of opinion that this will be a better way to [operate] and I think we need to explore it.

CHAIRMAN MILLER. Henry.

MR. WALLICH. I'd like to register some sympathy for reserves, not for the base. Particularly if we should have the Merrill decision going against us, I think we'd have to take a serious look at this.

MR. PARTEE. As an operating variable.

MR. WALLICH. As an operator.

VICE CHAIRMAN VOLCKER. We are going to look at the use of reserves as the operational variable, are we not, Mr. Chairman?

CHAIRMAN MILLER. Your committee is going to be looking at that. That's very nice. Bob, is the memo that you circulated being handled in any way?

MR. BLACK. Well, I think this addresses many of the same questions.

CHAIRMAN MILLER. That's what I was wondering.

MR. BLACK. And I really prefer this method of doing it. The reason I couched it in the form we had it before is that that's the way we've been discussing it.

CHAIRMAN MILLER. Do you feel they are making progress on your viewpoints?

MR. BLACK. Oh, yes.

CHAIRMAN MILLER. Okay.

MR. BLACK. In Larry's case, the mechanistic tying of the short-term [growth] rates with the long-term rates did not bother me quite as much because I do think it will force out into the open a more conscious consideration [of the] relationship.

[Secretary's note: The raw transcript ended at this point. It seems likely that the meeting ended here, but there may have been additional discussion.]