TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

February 6, 1979

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
Messrs. Kichline, Zeisel, and Truman, Associate Economists
Mr. Axilrod, Economist
Mr. Axilrod, Economist
Mr. Holmes, Manager, System Open Market Account

Meeting of Federal Open Market Committee

February 6, 1979

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, February 6, 1979, 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. Mayo, Alternate

Messrs. Balles and Black, Alternate Members of 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. Guy, Deputy General Counsel
Mr. Mannion, Assistant General Counsel
Mr. Axilrod, Economist

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

Mr. Holmes, Manager, System Open Market Account

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

Mr. Coyne, Assistant to the Board of Governors
Mr. Kalchbrenner, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Gemmill, Associate Director, Division of International Finance, Board of Governors
Ms. Farar, Economist, Open Market Secretariat, Board of Governors
Ms. Belton, Secretary, Open Market Secretariat, Board of Governors

Messrs. Fossum and MacDonald, First Vice Presidents, Federal Reserve Banks of Atlanta and Cleveland, respectively

Messrs. Balbach, Boehne, Brandt, T. Davis, Eisenmenger, Keran, Parthemos, and Scheld, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Philadelphia, Kansas City, Atlanta, Boston, San Francisco, Richmond, and Chicago, respectively

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

Transcript of Federal Open Market Committee Meeting of
February 6, 1979

CHAIRMAN MILLER. Good morning, ladies and gentlemen. Welcome to our historic meeting. It's not only earlier [in the month than usual] but also involves for the first time the new Humphrey-Hawkins process. I assume that doesn't mean much [will be different], but it does mean, [since we cancelled our regularly scheduled meeting in January], that we haven't met as frequently. So if I forget your names, it's because I haven't seen you for so long! We do have a couple of absentees because of our rescheduling. Willis Winn is not able to be here, and I understand that Bob Mayo will be voting as his alternate. Is that correct?

MR. MAYO. Yes.

CHAIRMAN MILLER. Okay. And Mr. Kimbrel is not able to attend. So from the Cleveland and Atlanta Federal Reserve Banks, we have First Vice Presidents Walter MacDonald and Kyle Fossum here. I think all the Reserve Banks are covered.

I have a very sad chore to face--it's happened to me twice in my short tour here, which is historic in my experience--and that is to inform you that we have lost another of our close associates. I wonder if we could take just a moment in memory of Tom O'Connell. [Pause] Thank you.

Our first order of business this morning is to deal with the minutes of the last meeting, which was on December 19. They have been circulated. Are there any corrections or additions? If not, we will record them as approved. The next item on the agenda is the report on foreign currency operations from Scott Pardee.

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

CHAIRMAN MILLER. Thank you, Scott. Any questions or comments?

MR. BAUGHMAN. Mr. Chairman.

CHAIRMAN MILLER. Yes, Ernie.

MR. BAUGHMAN. This may not be the appropriate place for this question, but do you see anything [in] the international developments that are affecting currency [flows] that would help explain what we are seeing in the measures of the domestic monetary aggregates?

MR. PARDEE. I don't think I am qualified to answer that, but I don't know of anything.

MR. HOLMES. I'm not sure anybody is, Scott. We have not been able to draw any very close connection between the two, Ernie. It may be there, but we have not been able to find it.

CHAIRMAN MILLER. Yes, Dave.

MR. EASTBURN. Scott, what conditions would be necessary to permit a decline in the funds rate without a serious impact on the dollar? I presume that a decline at this time would have adverse effects on the dollar.

MR. PARDEE. Yes, I think it would. Perhaps more time with a sense of stability in the market and a less jittery atmosphere [would help]. We had a very jittery atmosphere in January. The dollar has shown more resiliency over the weeks since January 1. It was able to absorb the impact of the measures taken by the German monetary authorities. So it's a matter of [some additional] weeks of stability in the market; and, of course, it would help to have some improved fundamentals. Nevertheless, I was surprised myself that the market weathered the German actions as well as it did.

MR. EASTBURN. Would it require obvious indications of a weakening in our economy?

MR. HOLMES. Dave, there are a number of factors on the fundamental side, including an improvement in the trade deficit, perhaps a sign of real moderation in the economy and, of course, less inflation, which nobody expects in the short run. All those things I think would take the onus off a decline in the funds rate.

MR. EASTBURN. I was trying to find out to what extent they really want us to have a recession.

MR. PARDEE. The knee-jerk reaction at the moment in exchange markets is to respond positively to any indication that the U.S. economy is a little less buoyant. After the decline in the leading indicators, there was some buying of dollars. So, any indication that the economy is cooling off is seen as bullish for the dollar by some market participants who are willing [to buy dollars] just after the numbers come through.

MR. BLACK. Scott, suppose we only had continued weakness in the aggregates and we edged the fed funds rate down. Do you think we would still get the kind of reaction you are talking about?

MR. PARDEE. It depends on what else is going on in other places. The same numbers can have a different effect if they come through one day [versus another day].

CHAIRMAN MILLER. If it happens on the same day that there is a large strike in the Baltimore Canyon, the answer is that it would have no effect on the dollar.

MR. BLACK. But I was really asking, other things equal, would the market think [weak money growth] was sufficient reason for our lowering the federal funds rate?

MR. PARDEE. When the Germans tightened, they first had their vice president give a speech that made everybody mad and had people expecting a very sharp tightening of monetary policy. When they did tighten, it was less [than expected] and a lot of people had to scramble to cover positions. So it depends on how it's done and what the context is at the time.

CHAIRMAN MILLER. Larry.

MR. ROOS. If whatever policy we adopted were publicly [announced] by the Chairman or whomever as having certain specific objectives, wouldn't that help clear the air? In other words, do the exchange markets have to function shrouded in mystery about all of this? If we were to let the fed funds rate drift down, why couldn't we make clear to the world why we are doing that?

MR. PARDEE. It's a question of credibility. We have gone for so many months trying to establish credibility and it is a very, very slender reed at this stage. As I said, the initial reaction to the statements coming out of Washington was negative, or skeptical. It was filtered through the various news services. Chairman Miller in his speech to the Economics Club in New York managed to talk directly to market participants and finally they [understood] what he has been saying rather than having it filtered through the press. So if it's just a statement of what you are doing, that won't satisfy people unless you can really impress them.

CHAIRMAN MILLER. Thank you, Scott. Our next step is to ratify, if you are willing, the transactions since the previous meeting. Is there any objection? Hearing none, we will approve those transactions. Next we have the report on domestic open market operations. Peter Sternlight.

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

CHAIRMAN MILLER. Diversity is the spice of life. [In some respects] it's too bad that it's a good thing. Peter, I guess there will be four times a year now when the period between meetings will be a little different than in the past. Should we put your [intermeeting leeway] authority on a per week or per month basis? Would that help or would it add to the problem?

MR. STERNLIGHT. It depends so much on what one expects the particular factors affecting reserves to do that I don't know whether it would be logical to tie [that authority] merely to the length of the intermeeting periods. Maybe we should undertake some further study of it and, if it seems appropriate, come back with a recommendation for a possible increase in that standard leeway.

CHAIRMAN MILLER. All right. Questions or comments? Phil.

MR. COLDWELL. Mr. Chairman, I think we ought to keep the [intermeeting leeway] at $5 billion if there is a substantial possibility that--

CHAIRMAN MILLER It's $3 billion, not--

MR. STERNLIGHT. $3 billion is the standard.

MR. COLDWELL. I know. I'm saying that we ought to keep it at the $5 billion [we authorized for this past intermeeting period] because I think there is a possibility that we may get a very sharp movement in float, especially if the weather happens to clear up, and the Desk will need to do some rather sizable offsetting purchases.

And, anyway, this is a 6-week intermeeting period. So I would suggest we keep it at $5 billion.

MR. PARTEE. I think that's a good idea. I really don't know what great relevance it has, and we certainly can raise it easily enough, but I think Phil's right. It's a 6-week interval and there is a lot of churning in the market. We don't know what the weather is going to be. Why not make it $5 billion?

CHAIRMAN MILLER. Well, we had [increased it to $5 billion and then raised it $1 billion more, which] put it at S6 billion. So, when you say "keep it," you really mean "set it" at $5 billion.

MR. COLDWELL. Set it at $5 billion.

MR. PARTEE. You remember we had it at $5 billion and then we raised it.

MR. COLDWELL. We raised it another $1 billion.

CHAIRMAN MILLER. Any other comments or questions? Shall we authorize $5 billion between now and the next meeting? Will that be satisfactory?

VICE CHAIRMAN VOLCKER. So moved.

CHAIRMAN MILLER. So moved and seconded. All in favor say "Aye." Opposed? So voted. We also need to ratify the transactions since the previous meeting. Is there any dissent from approving those actions as reported to you in the usual [written] report plus the verbal report? Hearing none, we will approve that. Thank you very much, Peter.

Now we turn to the longer-run ranges for the monetary aggregates. A number of presidents and governors mentioned after the last meeting that they liked the experiment we tried of combining the discussion of one's viewpoint on the economy with its policy implications. As I said at the time, if that turned out to be something that people felt was a more useful way to [approach our policy deliberations], we would continue it. We may have to modify it at this meeting because we're dealing with both long- and short-range issues, but I'll take into account the general reaction I got to our effort to lean in that direction and see if we can continue that sort of [approach]. To get into the subject this morning of our long-run ranges for the monetary aggregates, we're going to start off with some reports from Jim Kichline, Jerry Zeisel, and Ted Truman. Jim.

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

CHAIRMAN MILLER. I suggest that we take a few minutes to see if there are any questions of Jim or [his colleagues]. Yes, Larry.

MR. ROOS. I have a question. Jim, on the last page of the monetary policy alternatives section, where you show projected growth in M1 of 6-1/4 percent, the footnote indicates that that is in the absence of ATS accounts. In other words, if you included ATS accounts, that 6-1/4 percent would be considerably higher?

MR. KICHLINE. I'm sorry, the footnote perhaps is misleading. It would be something like 3 percent growth in observed M1.

MR. ROOS. In other words, it's really adjusted.

MR. KICHLINE. That's right.

MR. ROOS. Okay.

CHAIRMAN MILLER. Bob Mayo.

MR. MAYO. Jerry, I find myself quite comfortable with almost every page of this fine presentation except the unit cost indicators. I'm just wondering if you're whistling [in the dark] a bit both on compensation per hour and on productivity. On the trend in productivity, I suppose there's a natural inclination to say: Well, we really don't understand it, so let's level it out. Yet there's also a natural tendency, if things continue tight this year, as projected in other parts of this forecast, for output per hour to decline further. And, of course, if both compensation and productivity should move in the wrong direction, unit labor costs are going to look rather sick.

MR. ZEISEL. You're absolutely right. And, of course, this is one of those areas, among others, about which we know relatively little. We know almost nothing about this, particularly recently. We have an assumption of a 1 percent rate of increase [in productivity]; our feeling is that under the pressures of rapidly rising wages, businessmen will be doing what they can to keep their costs under control. In fact, we're in a sense building in a slight adjustment of employment-to-production levels. We feel that this has gotten out of hand to some extent over the last year, and [that efforts will be directed toward] somewhat more effective control of the size of the labor force and labor costs in 1979 and 1980. But, as you know, it's not a terribly optimistic forecast at 1 percent for growth of productivity.

MR. MAYO. I find it optimistic. That's my problem, I guess. I hope you're right, but I don't believe it at this point.

CHAIRMAN MILLER. John Balles.

MR. BALLES. Jim or Jerry, in an otherwise exceptionally well done presentation, I was startled by only one thing and that was your figures with respect to the impact of fiscal policy. You have a chart that shows the full employment surplus for this fiscal year at $8.7 billion, which is a startling contrast to the Administration's high employment deficit figure of $23 billion. In fiscal 1980, the Administration's so-called high employment deficit, based on a 5.1 percent high employment unemployment rate, is $8 billion and you show a [full employment] surplus of $23 billion. Your expenditure and income figures are moderately different but not enough to account for that vast difference. I'd like you to explain that if you will.

MR. ZEISEL. All right. There are differences between our estimates of the change in the high employment surplus/deficit and those of the Council [of Economic Advisers]. These are not projections of levels; we specifically did not project levels because there is a pretty universal sense that one can get almost any level one likes depending upon the assumptions used. And, in economic terms or analytic terms, a change in the full employment surplus or deficit is more significant. But even taking that into consideration, for 1979 the numbers from the Council suggest a somewhat more stimulative situation than we have [in our forecast]. We have looked into this very carefully and have talked to them in great detail. Part of the answer is that we have higher inflation assumptions than they do, but that's only part of it. The rest is apparently a rather technical problem involving the fourth quarter of 1978 and the first quarter of 1979 in the sense that they got locked into a fourth-quarter estimate of GNP which turned out to be weak, as you will recall. They were assuming something like 4 percent, and we got 6 percent. They had built up their high employment levels from that and then brought them down. I won't go into the details, but basically we feel we're right for 1979. We're trying to work it out. For 1980, we're really not very far off; the change is in the same direction and the differences are not major.

MR. BALLES. Well thanks, Jerry. If you happen to have an explanatory memo on the technical details--we don't have time to go into it now--I, for one, would be very pleased to see it.

MR. ZEISEL. I have three.

CHAIRMAN MILLER. Which one do you want?

MR. BALLES. It really does have a bearing [on our decisions] because if fiscal policy is going to be on the restrictive side--and you may well be right, I'm not challenging you--that obviously has some implications for what we can do on the monetary policy side. So I'm going to be very interested in seeing how you got these different answers.

MR. PARTEE. When you say "change," Jerry, you mean that there's an improvement in each year from 1976 through 1980. You're just bringing them up.

MR. ZEISEL. There's a movement toward [restraint] in each year by differing amounts.

MR. PARTEE. I see. Well, I hadn't quite noticed that earlier.

CHAIRMAN MILLER. From stimulus to restraint, yes. Mark Willes.

MR. WILLES. Thank you, Mr. Chairman. I'd just like to ask one question about the monetary policy assumption. Up until the fourth quarter of 1978, money grew on average about 8 percent. You have an assumption of 6-1/4 percent, adjusting for ATS. Does that also include any adjustment for the 2 percent shift in the demand for money?

MR. KICHLINE. Yes, it does. It's consistent with the Bluebook; in effect, you add 2 percent to the 6-1/4 percent. As you know, in the fourth quarter--and apparently in the current quarter, the way things are shaping up--the money demand function has begun to differ from actual experience. We're picking up some of the drift that Steve Axilrod had assumed a year ago. It didn't show up for 3 quarters, but we held on to that assumption and it eventually showed up. So we do add 2 percent to the 6-1/4 percent.

MR. AXILROD. It's not quite believeable, but we did assume 6 months ago, even 9 months ago, that we would begin to get this drift around the fourth quarter of 1978. It has begun to develop; whether it will continue or not we can't be certain, but we had assumed it and we have continued to assume it.

MR. WILLES. When you say add 2 percent, what I'm trying to figure out is what measured M1 growth will be consistent with this. We can take 3 percent off for ATS?

MR. AXILROD. Right, about 3-1/4 percent. That's all.

MR. WILLES. That's all. Now, what about the shift in demand for NOWs?

MR. AXILROD. Well, if we don't get that 2 percent shift, then at the level of interest rates assumed the actual growth will turn out to be 5-1/4 percent if we're right about the ATS [effect].

MR. KICHLINE. Another way of viewing it, in terms of what you're suggesting, is that the observed 3-1/4 percent rate of growth in money in pre-1974 days has the power of 5-1/4 percent money because of the effect of [the shift].

MR. PARTEE. That's how they get rates as low as they did. If we didn't have that shift in demand for money, interest rates would be higher.

MR. WILLES. And another way of saying it is that if measured money adjusting for ATS is 6-1/4 percent, without the shift it's really 8-1/4 percent.

MR. AXILROD. For this level of interest rates, if we don't get the shift we'd have 8-1/4 percent.

MR. WILLES. For this level of interest rates--which in effect means if that shift takes place, then there'd be no change in monetary policy in terms of M1 from the past two years on your assumption for the forecast period. Right? If that shift takes place, then you're not assuming any additional restriction in monetary policy from what we have had over the last two years.

MR. KICHLINE. That's right.

MR. AXILROD. I think that's correct. The only caveat that I would note is that this isn't a new assumption. We have essentially been assuming that this shift would take place at this time.

MR. WILLES. It wasn't taking place last year.

MR. AXILROD. That's right.

MR. WILLES. And we got 8 percent growth.

MR. AXILROD. That's right.

MR. WILLES. If we get 6 percent growth plus the 2 percent, then we're essentially where we were in '78 and most of '77.

SPEAKER(?). That's right.

MR. WILLES. All right, thank you.

MR. MAYO. Except that we're substituting some velocity for some money supply.

MR. AXILROD(?). Yes. That's right.

MR. COLDWELL. That's what we've been doing.

MR. MAYO. So the published figures are going to come out--

MR. PARTEE. 3 percent.

MR. MAYO. Yes, that's right. In other words, we're sticking our necks out a little on some velocity estimates. We need to pay a little more attention to them this time, if we read the Bluebook literally, than we have before.

MR. AXILROD. That's one way of putting it. It's the other side of the demand for money.

CHAIRMAN MILLER. Let us proceed then to ask Steve Axilrod to give his comments and recommendations on the longer-run ranges. Then we'll go around and have each of you give us your input on how you see the economy and the policy implications in terms of how you see the long-run ranges.

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

CHAIRMAN MILLER. [What about] bank credit, Steve?

MR. AXILROD. Well, I think I would stay with the alternative B range, which is 1 percentage point lower than what we now have; that would seem to me quite consistent with the slowing in growth.

CHAIRMAN MILLER. I would just like to remind everyone--as you know since we've talked about the Humphrey-Hawkins legislation and Steve mentioned this--that what we're really talking about involves one important difference in setting long-term ranges. And that is that we will not in this calendar year have new ranges based upon new base periods. We are now going to operate for the whole year on a fourth quarter-to-fourth quarter basis. So these ranges will not have the famous Henry Wallich base drift that has allowed us to go with the times. We will have [the opportunity for] a mid-course correction; in July we're supposed to report on any changes we think appropriate for the ranges for this year. That does not mean updating the base to the second quarter or [adopting a range] for the third quarter of '79 to the third quarter of '80. It means relooking at the ranges set for the fourth quarter of '78 to the fourth quarter of '79. And we'll be asked to give at that time the first indications of our policy objectives for the calendar year 1980. So that's an important difference.

Specifically, in our report, which the Board of Governors will file in time for us to testify on the 20th of February, we'll need to report on "the objectives and plans of the FOMC with respect to the ranges of growth or diminution in the monetary and credit aggregates for this calendar year, taking account of past and prospective developments in employment, unemployment, production, investment, real income, productivity, international trade and payments, and prices." We also need to provide the relationship of these objectives to the short-term goals set forth in the President's Economic Report. So this is what we're going to be doing.

What I think might be most helpful, having had Steve's recommendation, is to go around the table and have each of you make any comments you wish about the economic outlook and your views on how that should be translated into these ranges. Then we'll be able to see if we can synthesize some decision from that. I think last time we started in this direction [around the table] so this time why don't we start the other way.

MR. ROOS. May I ask a question?

CHAIRMAN MILLER. Larry.

MR. ROOS. Excuse me. Obviously, we're all very much interested in the recent behavior of the aggregates, and I was very much impressed with Steve's eloquence in describing what he considers to be some of the reasons for that behavior. But I don't have the intellectual capacity, Steve, to absorb all this as you say it. Would it be proper procedure to ask Steve to send me at least, and anybody else who wants it, the first part of your report in writing? [I would like to see in writing] your rationalization for why this behavior is occurring because it would be helpful to us.

CHAIRMAN MILLER. Too bad we didn't have a tape recorder on.

MR. ROOS. [Unintelligible] if that's how it works.

CHAIRMAN MILLER. Actually, I think we did have the tape recorder on. Certainly we can have it transcribed and sent to you. That's no problem at all.

MR. ROOS. Thanks.

CHAIRMAN MILLER. I forgot that there's no green light [in front of me, as there is at Board meetings, to indicate that the tape recorder is on]. But we have the recorder on without a green light at the FOMC meetings. So, we'll start with Paul.

VICE CHAIRMAN VOLCKER. Well, so far as the economy is concerned, I have been interested in whether the higher numbers of the fourth quarter are being carried over into a mood of more business buoyancy than we have had in recent months. I have contacted [several people in] the business community recently and they suggest that that is the case. I don't know whether that's just a lagging indicator or whether it's significant. One has the feeling that, without doing anything very dramatic, people may be reaffirming their capital spending intentions anyway and that there's a little less certainty in people's minds that we're going to have a recession. I continue to feel that we could have a recession, but it's by no means certain. I wouldn't rule one out, by any means, in the second half of the year. But in terms of the recession outlook itself, I think the number one problem continues to be the concern about the price level. The greatest risk to the economy, as well as [to actual] inflation, is people having the feeling that prices are getting out of control. I think the tenor of our policy should still be in the direction of reinforcing and building on the degree of credibility that has been gained in recent months, both in the Administration and in the Federal Reserve. That should be our first priority. I don't think we can do much about the uncertainty on the business side by a gesture toward easing policy at this point; I think that would be a mistake. It would probably increase the risks of recession.

When I look at these long-term ranges, let me say that there is one influence on the aggregates recently that hasn't been mentioned and that people at my Bank think might be quite important. And that is the increase in Federal Reserve float; it has been quite sharp and unprecedented. Whether it has had an influence or not depends upon how corporations in particular look upon their bank balances and whether they're operating in effect off their own check book or off the amount of money the bank tells them they have in the bank. If it is the latter--and I'm sure that's true of a lot of corporations--the increase in float has the perverse effect of pushing down the reported money supply in a way that isn't real.

MR. PARTEE. Well, the recipient of the check has less, according to the bank.

VICE CHAIRMAN VOLCKER. The recipient couldn't have less. He has the same as he would otherwise have. He cashes the check but--

MR. COLDWELL. But the Federal Reserve--

VICE CHAIRMAN VOLCKER. The fellow who writes the check has more and he spends the money.

MR. COLDWELL. The Federal Reserve grants the credit.

MR. PARTEE. That's assuming that the bank gives credit for funds not received.

MR. COLDWELL. They do that.

MR. PARTEE. They certainly don't give me credit!

VICE CHAIRMAN VOLCKER. But they do to big corporations.

MR. AXILROD. President Volcker, we've looked into that with your staff. There may be a lot of biases in the money supply. To get a measured bias from what you're talking about, it appears that it has to be transferred between two zero balance corporate accounts. So we don't believe the effect would be very large.

VICE CHAIRMAN VOLCKER. Well, my staff pretty well convinced me that it goes in this direction. Nobody knows, but the change in float has been so big that I think it might have had an [effect]. We'll see when float goes down what it is.

CHAIRMAN MILLER. I assume we're going to get float down, aren't we?

VICE CHAIRMAN VOLCKER. Then we'll have the reverse effect if this explanation is right.

MR. PARTEE. I hope you're right because it certainly would help to explain January if you are right.

VICE CHAIRMAN VOLCKER. In any event, this makes it particularly difficult. We've had this big increase in money market funds along the lines of a change in appraisals of cash balances versus other media. But, in looking at numbers for the long-term aggregates, I come up with ranges for M2 and M3 about like those in alternative A, but the M1 range in "A" looks too high to me. Just adding the 3 percent for ATS produces an upper limit that seems much too high to me. I would suggest something like 1 to 4 percent for M1. So, these numbers that I'm suggesting are about 1 percentage point lower than what Mr. Axilrod just suggested.

MS. TEETERS. It sounds like alternative B.

VICE CHAIRMAN VOLCKER. Well, it's more like "B" for M1, but I would go along with "A" for M2 and M3.

CHAIRMAN MILLER. Thank you, Paul. Chuck.

MR. PARTEE. Well, we're going to have to address a number of issues and make a number of linkages to get to these long-range aggregates. The first is the question of the correctness of the staff's economic projection. I can't say that I see anything much wrong with it except that I was reminded of Governor Shepardson's comment one time many years ago after a chart show like this. There is a tendency, which I noticed throughout your charts, for the dotted lines on the right hand side of the charts, [representing your projection], to be a lot more stable than the solid lines on the left side [depicting actual data for the past]. And I wonder why that is!

CHAIRMAN MILLER. Well, I think the staff can guarantee that their dotted lines will not be achieved.

MR. PARTEE. In a way, that's the problem here. Because although I understand why the dotted lines are fairly straight, the line for the rate of growth in the real economy is straight at an extraordinarily low level. That is, for 6 quarters running the line shows an increase in real GNP of around 1-1/2 percent.

CHAIRMAN MILLER. Plus or minus 3 percent.

MR. PARTEE. And the staff has 6 quarters of industrial production increases of 1-1/2 percent or thereabouts. Similarly, for consumption and investment and business inventories, the [growth] rate numbers are all very stable and really quite moderate. The question I suppose a business cycle economist would have to ask is whether we can have 6 quarters of such low growth without something happening--either [the economy] tipping into recession because of a lack of momentum or something coming, say, from the international area in military preparedness [spending] or something like that which would in some way speed up the [expansion] process. I have to say that I'm inclined to think that we'll tip into recession during this period. But even if we do [not] tip into recession, there is a second problem as I see it. And that is that if the staff forecast is correct--and I still think it's on the optimistic side rather than the pessimistic side from the standpoint of real activity--it is below the Administration's goals, particularly for 1980, and we do have to associate what we're doing with the short-run goals of the Administration. I looked it up, Nancy, and it is clearly two years.

MS. TEETERS. At this time?

MR. PARTEE. Yes, at this time we have to say what the relationship of our policy for the next year is to the 2-year short-run goals [of the Administration].

MS. TEETERS. [Unintelligible.]

MR. PARTEE. No. It's clear if you read the language of the Act, as I did yesterday afternoon.

CHAIRMAN MILLER. Well, Chuck, I think that's another issue. I have the language right here and we are to give our objectives <u>only</u> for 1979.

MR. PARTEE. We are to give our monetary objectives--

CHAIRMAN MILLER. And we're to say what the relationship is to the [Administration's] short-term goals--the relationship for 1980 would be my guess.

MR. PARTEE. But you see, maybe this [requirement] was somewhat deliberate on the presumption that monetary policy has a leading effect on the economy. If you look at this [forecast], you see that although we're not far [from the Administration] for 1979 on the real and the nominal, in 1980 we depart quite a bit further. And the reason for that is that in the second half of 1979 when the Administration goal shows a recovery in housing we don't have one. It's one of the biggest single differences. Therefore, I'm inclined to think that unless policy does something on the real side, we're going to run short of the stated goals of the Administration. Now, it could be argued--and perhaps this is the best thing to do--that we're also going to miss their goals on the inflation side because it certainly seems improbable that the rate of inflation will decline to the extent that they have in their projections. But one of the developments that takes place when we're talking as we are about such a very low rate of increase in the economy is a rise in the unemployment rate. And that gets the unemployment rate to a fairly significant level--over 7 percent in the staff projection--by the end of the forecast period. In my view it will get to 7 percent by the end of this year, not next year. I think the economy is that much weaker. So we do have that problem.

Now, with ATS and velocity and shifts in the demand schedule and all that, we can probably assert that almost anything we put down is consistent with the objectives of Humphrey-Hawkins and indeed it may be because the range of variation and experience on, say, the demand schedule alone is larger than the kinds of variations that we talk about in the growth of the aggregates. But we do have this additional problem, as you said in the beginning, Mr.Chairman, that we're going to have to stick with these ranges throughout the year. And, therefore, they will become a little more binding than before. I think 2 to 5 percent or even 2 to 4-1/2 percent on M1 is okay, but we ought to say we're assuming that ATS and NOW accounts will continue to come in at something like their recent rate, which has had an effect of about 3 percentage points on the observed growth rate in M1. Then, if that changes, which in my opinion it might well do, we will be able to say it has changed and therefore the recorded numbers have changed. But on M2 and M3, I'm inclined to want somewhat higher growth ranges than might otherwise be indicated by the present situation because I think it will be very difficult to say we're going to have substantially lower growth in M2 and M3 as well as M1 in this period to come. So I would take the risk of having a wider range, even though it might result in some criticism from the Congress. I would pick the numbers that Steve last mentioned--5-1/2 to 8-1/2 percent for M2, believing myself that it's more likely to be 5-1/2 than 8-1/2, and 6-1/2 to 9-1/2 percent for M3, believing that it's likely to be 6-1/2. And, as I say, I'd choose 2 to 4-1/2 percent or something on that order for M1. I think we stand a fair chance of being able to live within those ranges as the year goes on.

CHAIRMAN MILLER. Thank you, Chuck. Nancy.

MS. TEETERS. Well, I have the same problem with the staff forecast. The economy is either going to recover or we're going to have a recession. I think the probabilities are on the side of a recession, but I don't see it occurring until the end of this year and the early part of next year. Part of the reason that we deviate from the Administration's forecast for 1980 has to do with the statement in the very opening paragraphs [of Part 1 of the Greenbook] where it says "and we assume that interest rates will not be changed over the forecast period." I know that the Administration has forecast, for the first time on record, a decline in interest rates over the coming two years. So in a way they've really put the monkey on our backs. If we relax interest rates we get better results; we get closer to the Administration's projections though we don't make it completely. There's no combination that we've looked at that resulted in a complete reconciliation of the inflation and unemployment goals of the Administration. On the other hand, it seems to me that the unemployment rates [in the staff's forecast] are going to be politically unacceptable. If we force them up, the Congress will force upon us an extremely [expansionary] fiscal policy, which I really don't think we need at this point.

As a result, I guess I'm more willing to ease a little on interest rates and let the money supply grow. If you look at Appendix I of the Bluebook, the funds rate associated with alternative B rises from the current 10 percent to 10-3/4 percent; in alternative [C] it goes from the current 10 percent to 11-3/8 percent. I don't think we need that. In the current situation, with the continuing strength that's carrying forward in the beginning part of this year, I don't think we need rising interest rates. On the other hand, I'm not at all convinced that we should lower interest rates. So, I would go for a policy that would keep the funds rate at about 10 percent, knowing that in [July], when the FOMC meets again on Humphrey-Hawkins, we can change the ranges. We can't change the base, but we can change the ranges in the middle of the year. And we'll have a lot better idea about where we're going by midyear. That is always true; the world is always clearer six months down the line. So I would opt for 2 to 5 percent for M1, 6 to 8-1/2 or maybe 5-1/2 to 8-1/2 percent for M2, and 7 to 9-1/2 or 6-1/2 to 9-1/2 percent for M3, with the idea that we will keep the federal funds rate at or slightly below 10 percent.

CHAIRMAN MILLER. Thank you, Nancy. Bob.

MR. BLACK. Our assessment of the economy pretty much parallels what I think Paul Volcker was saying. We come out with about the same growth in real GNP as the Board staff but we feel that the inflation rate is going to be above the staff's estimate. We expect the rate for the full year to run somewhere around 8-1/2 to 9 percent. So far as the economy for the year is concerned, I have a lot of sympathy with the views expressed by both Chuck and Nancy. I can't view with equanimity even the lower inflation rate that is forecast by the staff because with that kind of rate it seems to me that the economy is bound to develop excesses either domestically or internationally that might well tip it downward. But for the time being I come back to Paul's original statement that inflation is the main problem at the moment. So we would advocate the same policy that we've been suggesting for the last several meetings of a gradual deceleration in the rate of growth in the aggregates. We have couched this more in terms of M1 and would suggest edging the growth of M1 down in the four quarters ending in each quarter of the year. And for the fourth quarter of last year we had hoped M1 growth would be down to 7-1/2 percent before adjusting for ATS accounts and about 7.2 percent after. As luck would have it, we ended up almost exactly at that point.

CHAIRMAN MILLER. Good planning!

MR. BLACK. Well, an accident really. But we would now suggest that for the fourth quarter of '78 to the fourth quarter of '79, we ought to be thinking in terms of 6 percent [M1 growth] before ATS. Of course, the question of what we really want depends on the estimate of what ATS accounts will do. We think the staff is about right with its estimate of a 3 to 3-1/2 percent [effect on that growth] rate, so we would favor about a 3 percent midpoint [in the range] for growth in M1. This leads us to favor the range under alternative B of 1-1/2 to 4-1/2 percent. We have a lot more trouble with M2 because there is so much uncertainty surrounding it, as has been mentioned by several people. The growth in money market funds may be the main factor at work here, but we have [uncertainties regarding] unit trust accounts, CDs, Eurodollars, money market CDs [at] S&Ls, and Treasury bills. All these things make this very difficult to figure out. But we think M2 clearly ought to come down and we can't think of anything better than what the staff has put down, so we would buy the 4-1/2 to 7-1/2 percent M2 range in "B." We would also buy the staff's "B" ranges on M3 and bank credit.

CHAIRMAN MILLER. Thank you, Bob. Walter.

MR. MACDONALD. Following in Bob's vein, let me say that business activity is relatively strong in our District. Many businessmen, however, are apprehensive about [the economy] later in the year. People are especially concerned about the consumer being over-extended in the housing market. The strengths in our District include steel and machine tools, but inflation continues to be the overriding source of concern for everybody from the consumer to the manufacturer. Among the unknowns are energy, the Iranian situation, and wage settlements coming up this year. For these reasons I would not suggest easing policy; I'd wait until we can better judge the economy and the slowdown in the Ms. I agree with President Volcker on a 1 to 4 percent M1 range and a 4 to 7 percent M2 range, and [then] following alternative B in the Bluebook.

CHAIRMAN MILLER. Thank you, Walter. Dave.

MR. EASTBURN. Well, Chuck has expressed my views about the projections--the lowness and the smoothness of the dotted lines--very well and I won't repeat that. I would say, however, that the often [repeated] statement that we have no imbalances in the economy overlooks the fact that we have an 8 to 10 percent inflation rate, and I think that's a severe imbalance. I suspect we'll have a recession toward the end of the year.

As far as the long-run ranges are concerned, I think we need to give evidence that we are proceeding on a course of systematically cutting back our ranges to deal with inflation over a longer-term period, yet not cutting them back so drastically as to precipitate a recession. That's because I think that a recession could be in the long run the most inflationary thing we could do. I have no strong feelings about the specific numbers that have been cited. But I like Steve's alternate suggestion on M2 and M3 much better than alternative B. Because there is such great uncertainty about what's really going on and what's going to happen to the demand for money, I'd be inclined to be on the upper side. One way to handle this would be simply to knock 1/2 percentage point off our current ranges as an indication of proceeding on a systematic course of getting [the ranges down]. That would come close to what Steve has suggested with the expection of M1, which would then be 1-1/2 to 5-1/2 percent. I think that might be a good middle position.

CHAIRMAN MILLER. Thank you, Dave. Kyle.

MR. FOSSUM. We certainly see no signs of impending recession in the Sixth District, and this view is supported by almost all of our directors at our head office and branches who seem by and large to feel that their own areas of business are apt to fare better than the national economy. This attitude is particularly prevalent in Florida which, unlike the situation in '73 and '74, has seen little or no speculation or overbuilding. I would add our voice to Bob Mayo's, however, in that our projections on the economic outlook are somewhat less optimistic than the Greenbook's. We expect real growth more in the 1 to 1-1/2 percent range and we think 6-1/2 to 6-3/4 percent on unemployment seems more likely. But our chief disagreement would be on the inflation outlook where we see it somewhat worse than the Board's staff; we estimate that it will probably be in the 8-1/2 to 9 percent range.

As for the long-term ranges, for M1 we would be inclined to go with the 1 to 4 percent that Paul Volcker and others have suggested. But we'd be inclined to support the ranges in alternative C for the other aggregates; those somewhat higher ranges I think would be consistent with our appraisal of the outlook.

CHAIRMAN MILLER. Alternative C for M2 and M3?

MR. FOSSUM. Yes, for M2, M3, and bank credit.

CHAIRMAN MILLER. Thank you, Kyle. Larry.

MR. ROOS. Mr. Chairman, we just concluded a series of meetings with the chief executive officers of major industrial companies in our area and, as many others have said, we saw practically no evidence of anything but a strong economy. They were almost unanimous in that point of view. However, while the economy is strong, at least in our part of the world, we do have some concern about the abruptness and extent of the decline in the basic money supply over the past three months. Our concern arises from a belief that if the money supply were to be reduced abruptly for several quarters from an 8 percent rate to a 4 percent rate or less--those rates being for the old M1--we would indeed have a recession. We also feel, of course, that through monetary policy we are capable of guiding the extent of the decline in the money supply. The recent decline could be attributed to what Peter pointed out, that we have been sellers of a significant amount of dollars--$5 billion plus--out of our portfolio as a means, I would assume, of pegging our fed funds rate at a rate of 10 percent or slightly above. What I am driving at is that, although the jury is still out, I think we should very carefully watch these money trends in the next two to three months. I really am more concerned right now with the fact that if we set the lower level for the M1 range at something like 1 percent and add 3 percentage points to it [for the ATS effect], in round figures we could be reducing the rate of money growth rather quickly from 8 percent to 4 percent. And I think that could precipitate the type of recession that all of us would like to avoid.

So specifically, I would suggest a narrowing of the M1 range to perhaps 2-1/2 to 4 percent. I would very strongly urge that we permit the fed funds rate to drift down, if necessary, in order to attain the growth in the aggregates that we prescribe. To do that I would welcome, and in fact would recommend, a widening of the fed funds rate range. I wouldn't even be concerned--although you will probably feel this is a radical point of view--about a fed funds target of something like 9 to 10-1/2 percent and a narrowing of our attention to the aggregates, with specific concern on the lower parts of the ranges for those aggregates. As far as M2 and M3 are concerned, I could live with the alternative A specifications proposed by the staff.

CHAIRMAN MILLER. Thank you, Larry. We'll hop across the table to Roger.

MR. GUFFEY. Thank you, Mr. Chairman. With respect to 1979, we agree rather closely with the staff's projections, except that we think the first quarter may not be quite as strong as suggested by the staff. But for the year as a whole we are fairly close--perhaps a bit more pessimistic but in a range that probably doesn't make much difference.

In meetings with businessmen and others in our part of the country, the sentiment is fairly strong that we will escape a recession in 1979--that these straight lines projected by the dots might really come true. Philosophically they believe that there is a little better chance that that will be the case [than not].

With regard to the aggregates, I noticed that Steve mentioned the possibility of some political problem with widening the ranges from what he put into the Bluebook. But he ended up with a range of 3 percentage points range rather than 4; he went from a range of [2 to 6] percent to a range of 2 to 5 percent. But there are a lot of uncertainties about M1 specifically that have been mentioned around the table. One, for example, is the shift in demand for money; that might amount to 2 percent. Another relates to the effect of ATS accounts, about which we know very little--we are 3 months into this--and the projection is that it could be as much as 3 percent. Given these uncertainties, it seems to me that even under the new Humphrey-Hawkins bill there would be some advantage to having an M1 range a bit wider than 3 percentage points; perhaps we should maintain the 4 percentage point width that we went with in October because of uncertainty. So, I would like to see the width of the M1 range at 4 percentage points, with a range of 1 to 5 percent. Hopefully, as we get more experience with ATS accounts we can narrow it a bit. But I don't see that there will be a great deal of criticism in maintaining that 4 percentage point span for M1. With respect to M2 and M3, I would agree with those around the table who would like to see the numbers increased a bit from those in alternative B of the Bluebook, again because of various uncertainties. As a result, I'd have an M2 range of 5 to 8 percent, which again is a 3-point band, and an M3 range of 6 to 9 percent.

CHAIRMAN MILLER. Thank you, Roger. My list says "Boy" Mayo, but I think it's supposed to be Bob.

MR. MAYO. Thank you, Mr. Chairman. As one of the elder people around the table, I do indeed thank you!

First, my answer to Chuck on the Shepardson phenomenon is that this merely indicates again that people on the staff are more comfortable with actuals than they are with estimates, and my solution is to make the solid lines straighter instead of putting more jiggles in the dotted lines.

CHAIRMAN MILLER. A little seasonal adjusting.

MR. MAYO. Right. I find that this phenomenon is typical of a lot of businessmen, too. That is, they say: Well, we might have a recession, but I don't see it in my business; I'm not going to have one. And by gum you can go back to 1973 and 1974 and they were saying exactly the same thing. So they have a dotted line problem as well; it isn't just us economists.

I have one question and one observation before we get to the figures. The question, Steve, relates to the assumption of a 3 percentage point adjustment for ATS accounts--and I assume New York

NOWs--throughout 1979. What is your feel on this? I would have come to the conclusion independently, without doing any real work on it, that this would be a declining percentage during 1979 and that by the end of the year it might only be 1 or 1-1/2 percent. But I don't know what I am talking about; it's just a feel.

MR. AXILROD. We have it declining in 1980. At the end of 1979 ATS accounts in total are, on our assumption, around [$26] billion. If half of that comes out of demand deposits that's about $13 billion. The total amount of deposits that are eligible about that time is $100 billion. So it's fairly modest if you look at it that way. It's a little more than 12 percent of the total that can be transferred. So I don't feel too bad about it as an estimate. In part, the reason I recommended 2 to 5 percent as a possibility to consider is that my instinct is a bit like yours. It may be wrong, but my instinct is that in the 3 to 3-1/2 percent area it's more likely to be 3 percent or a perhaps shade under.

MR. MAYO. That's all it could be at this time, that's true. My other point is an observation on the President's Economic Report. It's terribly obvious, at least to me, that the Council was trying very hard to come up with figures that somehow will tie in with the Humphrey-Hawkins goals down the line and has concluded that it is impossible. This is more evident, obviously, in '81 and '82 than it is in their look at '79 and '80. But to me that explains why we are a little more pessimistic.

MR. PARTEE. I think, Bob, that '79 and '80 are legitimate projections and the next three years are nothing but a straight line [extension].

MR. MAYO. Well, that's true. But even in '80 I think one of the main reasons we are more pessimistic than the Council relates to their attempt to have a dotted line again.

MR. PARTEE. They're aware that it's an election year also.

MR. MAYO. I have heard about that, yes! My second observation on the Council report, which hasn't been mentioned here, is that there is a [notable] lack of discussion in the report of the whole capital investment problem, and investment is one of the items in Humphrey-Hawkins that gets a pretty high priority as I read the Act. I sympathize with the Council's inability to figure out what can be done to achieve a proper level of investment and productivity, but they really haven't come up with anything.

To turn to the issue of the moment, I have no real objections to Steve's prescription for M1 of a 2 to 5 percent range. I originally thought we could perhaps get away with 2 to 4 percent, but I think narrowing the range by 1 percentage point is about all the discipline we should enforce on ourselves with the lesser flexibility in our goal-setting procedure than has been the case under the joint resolution. So, 2 to 5 percent is all right with me. I feel a little differently than Steve does, though, on M2 and M3. I think once we deviate from the range we might just as well not be timid about it. I'd deviate a little more and not just by 1/2 percentage point as he suggested. So, I would go to 5 to 8 percent on M2 and 6 to 9 percent on M3. The importance of the analysis in the eyes of the public, in the eyes of the market, and in the eyes of the Congressmen is perhaps a 10 to 1 on emphasis on M1; that's the critical measure. They will accept our reasoning more logically on M2 and M3 if indeed [the ranges] do turn out that [way]; some would criticize us for, in effect, undermining the housing market and so forth by goals that were too low on M2 or M3.

CHAIRMAN MILLER. Thank you, Bob. Mark.

MR. WILLES. Thank you, Mr. Chairman. I won't quibble with the staff's forecast. I would simply point out that we think they have done an incredibly good job on a horrendously difficult task. In terms of the probabilities, there is the possibility that the economy could be stronger as well as weaker. If businessmen really were convinced that we were doing something about inflation, then those business numbers could come in significantly stronger. That's what we keep hearing in some of our Districts at least. They are telling us that's a possibility.

With regard to policy, I have been fascinated by the discussion today. Humphrey-Hawkins presents both a major dilemma and a major opportunity, it seems to me. I feel very shaky about simulating econometric models out into 1980. In fact, [at our Bank] we happen to feel shaky about simulating them period. We are not sure they work. But, clearly--and I think the staff would agree--they work less well for 1980 than they do for 1979. On the other hand, given our view of the world, if we were to announce and then follow through on a credible policy, our feeling is that we can have a very salutary impact on what happens in 1980. Without boring you with all the gory details, our theory would tell us that we can in fact have less inflation without more unemployment in 1980 if we have policies in 1979 that are consistent with that [objective]--policies that are firmly held to so that people really believe we are going to follow through on them. That suggests to me that while the staff's forecast for 1980 shows relatively little [improvement] on price performance and rising unemployment--and I think that may well be the case--we have the possibility in 1979 to lay the groundwork for a much better performance on prices. That better performance would not depend on slack in the economy but on the way people operate given what they think is going to happen with government policy on inflation.

In our view, then, that makes what we do with the long-run ranges this time absolutely critical because this is when we announce them to the world and then have to deliver on them. Ignoring the politics for a minute--I know I play these numbers games and somehow they seem very important to me and maybe not so important to other people--let's look at the range that Steve gave for M1, which was 2 to 5 percent. If you take the 5 percent, add 3 percentage points for ATS and 2 percentage points for a downward shift in the demand for money, that's a potential maximum growth of 10 percent. If you take the midpoint of 3-1/2 percent [in Steve's range], which presumably would be our target, and add those 5 percentage points for the same reasons, that would give us an 8-1/2 percent target for 1979. That's exactly [the growth] we had in '77 and '78, and I think that was too expansionary. We got too much inflation by allowing money to grow on average at around 8 percent. So I, for one, would feel very uncomfortable with a target of 3-1/2 percent. If we just follow through the logic for a minute without thinking of the politics, which

I am not equipped to do, a desirable range for M1 would be something like 0 to 3 percent. That would give us a midpoint of 1-1/2 percent; and if the assumptions on ATS and the shift in the demand for money are right, then we get 6-1/2 percent growth at the midpoint.

MR. PARTEE. What if they are wrong?

MR. WILLES. Well, I'm getting to that. If they are wrong--if all we get is ATS, for example, and not the downward shift in the demand for money--we then move up to the top part of the range which would be 3 percent plus the ATS, which is again 6-1/2 percent. If there is a greater shift in the demand for money then, of course, it would go the other way. We are all guessing at this point but there seems to be the possibility that the shift could be greater as well as smaller. So it seems to me that if we want to change policy--and maybe we don't--from the 8 percent growth we have had, then we have to move the M1 range down to something below what anybody to this point has suggested. I would suggest that the range be 0 to 3 percent which in my mind says, given the most likely set of assumptions, that we would really be going from 8 percent to 6-1/2 percent under the old rule. For M2, whatever you all decide is fine with me; I can't understand M2 or M3 or any of the other aggregates, with due apologies to my friends from San Francisco.

MR. PARTEE. But you do understand M1.

MR. WILLES. Well, with a rather wide range of uncertainty.

MR. BALLES. I'll just send you that M2 [study], Mark. Maybe Frank will do the same thing.

CHAIRMAN MILLER. Thank you, Mark. John.

MR. BALLES. With regard to the business situation, our staff forecast is quite similar to the Board staff forecast in broad outline. The differences are not worth talking about because they are all within the range of the forecasting errors. So we have no problems there. Given that essential agreement, the issue comes down to the appropriate posture for monetary policy. When I first took a look at the Bluebook, Steve, I got quite a jolt. I thought you might really be arguing for what was in alternative B or even alternative A. But in summarizing the advantages and disadvantages of different ranges here, I think you have landed by coincidence or mental telepathy or something else almost exactly where I came out in wrestling with this. On M1 I would perhaps be inclined to go down to the alternative B level, given the staff's estimate on the ATS effects, which I have no reason to quarrel with and I know that's a difficult estimate to make. I could settle for either 1-1/2 to 4-1/2 percent as in alternative B or what you suggested, Steve, which was 2 to 5 percent. And for much the same reasons, which I won't take up your time to repeat, I think we would be well advised to come out with the [other] specifications Steve ended up with on balance--and considering what he called the PR effects or the Congressional relations effects--6 to 8-1/2 percent on M2 and 7 to 9-1/2 percent on M3. Among other things, Steve may remember that I tend to be one of the doubting Thomases around the table on shifts in money demand. Such a shift is plausible and possible; it may even be a fact. But the trouble is, as we all know, that we don't know for sure until after the game is over. Sometimes we are wrong and sometimes we are right. It's a difficult bet to make. So, I concur with the way Steve came out as a means of hedging our bet. I think we would be well advised to do that, particularly in view of Steve's remarks that if we make too radical a downward shift in the ranges--even though policy within those ranges may, and I hope will, remain relatively on the tight side in view of the inflation problem--we could get some very severe public reactions, setting in train a whole new set of expectations of a credit crunch. So that's why I come out where I do, Mr. Chairman.

CHAIRMAN MILLER. Thank you, John. Ernie.

MR. BAUGHMAN. Mr. Chairman, on the general economic picture I think the staff projections are about as defensible a set of projections as one can put together at the present time, and I would not pick on any particular aspect of them. I have made a concerted effort since our last meeting, in view of my judgment that the prospects were rather good that we would have greater capital expenditures in '79 than was being forecast or than the surveys were suggesting, to engage businessmen in discussion on this point. I have to report that I was unable to persuade even one of them that the prospects for capital expenditures are higher than are currently being forecast.

MR. PARTEE. In the Dallas area?

MR. BAUGHMAN. That's where I had most of my conservations. And this is on the grounds that they are playing their cards close to their chests. They would much rather fix up, patch up, or put in a new machine when an old one breaks down and in fact go to overtime on their labor costs as compared with expanding basic capacity. It leaves them in a much more flexible situation. Also, they are able to pass on cost and price increases without much difficulty. The market takes it. So they just feel that's the better way to go in the present environment. That substantially increases the possibility that we may have a sustained low growth situation, at least until that attitude is changed, because that seems to me to be a key element in [downturns]. And a major determinant of periods of economic expansion has been a surge in capital investment, which has brought very heavy pressure on the labor markets, materials markets, and credit markets. We do not see that at this time and, if our forecast is reasonably dependable, we are not projecting that we will see it for some time yet to come.

There is another element in the picture that seems to increase the possibility [of a low growth outlook], and that is that neither consumers nor businessmen nor financial managers have yet fully adjusted to an expected ongoing rate of inflation somewhere near what we have forecast and, therefore, I think we will see a continued rapid buildup of debt. I'm concerned that the debt structure will become increasingly shaky and that to me is one of the bad aspects of a sustained period of either high optimism or rapid inflation. It means that when [inflation] does come to an end, we will have much more widespread debt distress and a much more difficult economic problem to handle. But it seems to me that we are likely to see that [buildup of debt] continue for the next couple of years before we get into the painful adjustment part of it.

One other general comment is that I think a set of economic programs and policies proposed by the government, which contemplates 7 to 8 percent ongoing inflation, is quite inadequate and quite unacceptable, particularly in this country. I believe there is a set of policies that could enable us to move promptly to wring inflation out of the economy without going through a recession and without substantially increasing unemployment, but thus far we seem to be committed to the idea that we must disavow using it.

Well, having accepted the economic prospects and what seems to be a consistent set of monetary data along with them, I would opt for alternative B. Nevertheless, I am somewhat concerned about the sort of thing that Mark Willes mentioned--namely, that it's possible if we were at the top of the range on M1 to have growth that I think would be too much. That's all I have, Mr. Chairman.

CHAIRMAN MILLER. Thank you, Ernie. Frank.

MR. MORRIS. Mr. Chairman, I have a very different perception of the economy than the staff has presented to us. I would like to think we could fine-tune the economy as nicely as our projection. But it seems to me that in the past month we have seen a very unusual combination of numbers. We've seen indicators not only in December but continuing in January that suggest the economy is coming on very strong. At the same time we have had an unusual deceleration in the growth of the monetary aggregates and bank credit. And the latest unusual phenomenon to add to these other two is that we have seen, despite a steady federal funds rate, a decline in short-term money rates. Now, this combination of a very strong economy, very weak monetary growth, and a decline in short-term money rates is rare. I looked back in history to find out when we usually get this combination, and I find that it typically occurs in months immediately preceding a business cycle peak. I think the closest parallel was January, 1960, when the economy was charging ahead following the resumption of steel production. Everybody was talking about the sizzling '60s. Both monetary and fiscal policy were moving toward restraint. And to me the first indicator of the 1960 recession was the surprising weakness in short-term money rates in January of that year. So I have concluded that the most probable expectation is a cycle peak in the second quarter and a mild recession in the last half of this year.

Now, in that environment, I think the projected decline in the demand for money is not going to happen. So, Mark, I don't think you have to worry too much about that 2 percent. I was concerned, too, when I looked at the Bluebook. I think we should lower the ranges modestly. But the Bluebook reductions looked awfully big to me, given my expectations. But Steve has saved the day, after writing the Bluebook, by immediately disavowing it as imprudent. I think the numbers that Steve--

CHAIRMAN MILLER. He just wanted to check to see whether you read it!

MR. MORRIS. Yes. I think the numbers he came up with [today] are very prudent; I would like to see a widening of the M2 and M3 ranges to 5-1/2 to 8-1/2 percent and 6-1/2 to 9-1/2 percent but [otherwise] I think his suggested ranges are very appropriate.

CHAIRMAN MILLER. Thank you, Frank. Phil.

MR. COLDWELL. Mr. Chairman, I guess I have a bit of a biased view of the world at the moment.

CHAIRMAN MILLER. Join the others!

MR. COLDWELL. The prospects are highly uncertain but still couched on the favorable side. The hard evidence we have had to date is for a strong economy with a very high rate of inflation. As for the monetary aggregates, I must admit I have never had much hope for them. And what they're showing right now I would say is of doubtful validity. We are uncertain as to the implications and we can't even describe why the changes are occurring. The information we have about the Administration's estimates for 1979-80 suggest that those projections are unrealistic. I don't think we are going to get a reduction in the rate of inflation, the rate of unemployment being held down, and a resumption of growth as promptly as they show. Even our own staff's forecasts I would quarrel with in terms of the rate of inflation; I don't think it will go down that smoothly. In my view the possibility is high that our rate of inflation will be in the 9 percent range.

On net, then, the result is that we may face a problem of communication with the Congress, a little communications gap. In terms of [our objectives], I hope the Committee comes out somewhere in the area of 1 to 4 percent on M1, 5 to 8 percent on M2, and 6 to 9 percent on M3. I'm coppering my bets a bit but I wouldn't go as far as Mark has. I don't think it is desirable to hold out to the rest of the world that there is the potential of a 6 to 10 percent increase in M1 if we are going to tell them that we have a 3 percent shift because of ATS and another 2 percent downward shift; that I think is unrealistic. I don't like the idea of narrowing the ranges in a period of extreme uncertainty.

CHAIRMAN MILLER. Thank you, Phil. Henry.

MR. WALLICH. Everything that can be said is bound to have been said. I'm impressed by the fact that in the two quarters before what must be the best advertised and predicted recession, if it comes, the economy has been growing well above potential--at 6 percent and 4 percent rates--and we have had a steady pattern of underpredicting inflation. The rate of inflation is always worse than we think it is. We have, as we have learned from the Economic Report, far less room on the up side in terms of where the potential limits are than we thought. The Council cut that from 5 or 5-1/2 percent, I think to 2-1/2 percent. The outlook may well be as the staff describes, but I have the impression that outside forecasters are postponing the timing of the recession, pushing it ahead. As for the signals that frequently are implicit in the soft money supply or weak aggregates that Frank Morris referred to, while I think our staff reads those too, those signals seem to me to have been somewhat disavowed by the course of events. Meanwhile the dollar is still very vulnerable even though it has improved. And on the financial side we are told by many observers that monetary policy really isn't biting. I personally think that real interest rates are barely positive and they're negative after taxes. Nonprice terms of lending are gradually being tightened, but that's the main biting element, though some restraint may be coming from the weak liquidity position of corporations. Those are the elements of restraint that I see.

Well, in the light of this, I think we do have considerable risks on the up side, more on inflation than on GNP. I'd like to fix the aggregates accordingly, and I share the numerology that Mark Willes engages in. I see three factors of shift, as it were. One is the ATS shift of 3-1/4 percent; two seems to be the demand curve shift. The third, which of course others have recognized too, is the increase in velocity that comes with rising interest rates. So these three things really have to be factored in. When you are concerned about where this added velocity is coming from, bear in mind all the quasi-monies that are being increasingly used now--the Euro markets, RPs, and money market funds. We overlook what are sources either of money or of increases in velocity which make that 2 percent shift not at all that ambitious, it seems to me. So my numbers would be 1/2 to 3-1/2 percent on M1--this is alternative C, which I have modified just a little--4 to 7 percent on M2 and 5-1/2 to 8-1/2 percent on M3.

CHAIRMAN MILLER. Thank you, Henry, and thank you all. I would suggest, before we try to synthesize this and before I give you my own reaction, that we take our coffee break. The coffee has been cooling for the last half hour. So, why don't we do that and then we will resume.

[Coffee break]

CHAIRMAN MILLER. Let's see, are most of us here? All those who count are. Well, let's see if we can resolve the problems that we face on these long-run ranges. I was first guided by the eloquence of the discussion that has already occurred. Then to be practical I looked at the numbers that come out on paper and the eloquence goes away and the practicality comes out. I don't think we will be able to bracket everyone's first desire and have numbers that will be supportable. Perhaps we should try to do something unusual, and that is concentrate first on M1. If we throw out a lot of numbers, we may get confused. It seems to me that I heard perhaps less immediate concern about--or firmness in people's views on--the ranges for M2 and M3. If you are agreeable, I would like to see if those of us on the Committee could [reach a consensus] on what we should use for M1 and then see if we can adapt the M2 and M3 to it. Will that be all right with everyone? That's an unusual procedure, I know. As I looked down the numbers [you suggested] and then asked myself what I think is desirable, considering the probabilities on ATS and a shift in the demand function of money, it seems to me that 1-1/2 to 4-1/2 percent brackets most people's views [for M1] and is probably a range that we could live with in terms of our own objectives. Now, there are a few people outside that range but that seems to be most compatible with [the preferences of] most of the members. I'd like to try that out and see if it is supportable. It happens to be exactly consistent with Ernie Baughman's suggestion. He's the only one, I guess, who had the right number! The rest were bracketed around that.

MR. BAUGHMAN. But maybe for the wrong reason!

CHAIRMAN MILLER. Chuck came close with 2 to 4-1/2 percent. I don't know whether he's willing to drop his bottom number to 1-1/2 percent.

MS. TEETERS. Gentlemen, may I point out that that implies rising interest rates on our--

MR. PARTEE. 1-1/2 percent?

MS. TEETERS. The 1-1/2 to 4-1/2 percent.

CHAIRMAN MILLER. The [lower] end of that, yes, but it depends. If we are at the upper end of that and if some of these other things take place, our money rate growth will be faster than it has been.

MR. PARTEE. That's right.

CHAIRMAN MILLER. On the up side [M1 growth] will be faster than it has been; on the down side it could be consistent with what we have had or it could be lower. So, what we are really doing is widening the [range], which just means I will catch a little devil from the Chairmen of the [Banking] Committees, but I am willing to do that. They won't like this spread, but if we take this spread plus the variables and add them, we have a range of minus something to plus 10 percent. That's how I read it, as I look at the mathmetics or make certain assumptions. That's why it seems to me to be a range we can live with. Now, I also believe that we have to be sincere about being willing to rearrange these ranges at midyear. At that point we may be wise to begin to narrow them because we will have six months of actual data and we will be looking at what we should do for the balance of the year within the same cone. Whether the cone should go out and then close in after midyear when we've seen [some data], I don't know. Anyway, how many of the voting members could support a range of 1-1/2 to 4-1/2 percent now?

MR. PARTEE. I would point out, Nancy, that there was no reference made to this table on page 14 [of the Bluebook].

CHAIRMAN MILLER. We should [adopt] that, I think, although that's short term.

MR. PARTEE. The midpoint of it, yes, but not really [the whole range].

CHAIRMAN MILLER. It looks to the fourth quarter.

MR. PARTEE. It looks to June and to the middle of the fourth quarter. It tells us how much growth we have to have in the future to make up what has happened to date. And I believe the midpoint of the M1 range is what's now being proposed [as our objective], isn't it?

MR. AXILROD. That's correct.

MR. PARTEE. So, to get up to the midpoint of the proposed long-term range--

CHAIRMAN MILLER. Which is the 1-1/2 to 4-1/2 percent.

MR. PARTEE. --we'd have to have 8.3 percent growth between now and March and 5.1 percent between now and June. And those are--

MS. TEETERS. That's only because we had negative rates of growth for--

MR. PARTEE. I understand that, but we've got that behind us.

CHAIRMAN MILLER. Yes, and that's why it can grow faster from here on.

MR. PARTEE. I don't think the comment you made that it implies higher interest rates is necessarily true, Nancy. It depends on the economy. If the economy is strong and we get a lot of inflation, they probably would go higher; but otherwise I think it is fairly neutral.

MS. TEETERS. The [projected funds rate] ranges [shown in Appendix I of the Bluebook] are 10 to 10-1/2 percent for the first quarter, 10 to 10-3/4 for the second quarter, 9-3/4 to 10-3/4 for the third, and 9-1/2 to 10-1/2 for the fourth.

VICE CHAIRMAN VOLCKER. That may not be the most reliable projection.

MS. TEETERS. Well, I don't think any of these projections is reliable, Paul.

MR. AXILROD. If I may say so, Mr. Chairman, on our projected interest rates perhaps we've swung too much to giving ranges. We thought they would be helpful. But, Governor Teeters, while we have allowed for some increase, it's the midpoints that we think are the most likely [for the funds rate] and the midpoints are 10-1/4 and 10-3/8 percent [for the first and second quarters respectively]. We've allowed for the possibility of some upward drift in the midpoint because we think the economy looks stronger in the first half than in the second half. Basically, the staff feels that interest rates would be essentially unchanged over the year, with a possibility of a little upward drift in the first half and a little downward drift in the second half. That's how we have been interpreting it. If we had just put down the midpoints down, that table would read 10-1/4, 10-3/8, [10-1/4], and 10 percent, in essence.

MS. TEETERS. Well, Steve, in my limited experience on the Board I have found that the interest rates are always at the top of the range.

MR. PARTEE. Your experience only covers a very short period.

MS. TEETERS. That's right. I thoroughly agree with you, but--

CHAIRMAN MILLER. Well, these ranges have been created from the fourth quarter, without the *expectations of the low rate of growth* we have had in the aggregates so far in the year. Is that correct?

MR. AXILROD. Well, no, the interest rate assumptions take all of that into account. They were merely meant to express the staff's view that if interest rates were going to go anywhere, it is more likely to be up than down in the first half and more likely to be down than up in the second half given the GNP projections. This was just meant to give that sense to the Committee.

CHAIRMAN MILLER. All right. Let's try the 1-1/2 to 4-1/2 percent again. How many of the voting members would be willing to support that? I saw Paul's hand, and I count Chuck, Ernie, Bob, Dave, Phil, myself--oh and Nancy. How many is that? Okay, thank you. How many would not? I count two. That sounds like a pretty overwhelming concensus. Now we will have to work on the other two members to get them straightened out so we can have a unanimous vote! Before we decide on that, however, let's look at M2 and M3. It's hard to make much of the figures and it's tough to come up with the right numbers. The question of widening the ranges is with us again. If we were willing to widen them, Steve's suggestion, if I interpret it correctly, was for ranges of 5-1/2 to 8 percent and 6-1/2 to 9-1/2 percent.

MS. TEETERS. No, it was 5-1/2 to 8-1/2 percent.

CHAIRMAN MILLER. Excuse me, did I say something wrong? It was 5-1/2 to 8-1/2 percent and 6-1/2 to 9-1/2 percent. Jot those down. Put along side them two alternatives of 5 to 8 and 6 to 9. That is shaded down just 1/2 point. How many of the voting members would like the widened Axilrod numbers of 5-1/2 to 8-1/2 percent and 6-1/2 to 9-1/2 percent? Two members. How many would like the 5 to 8 percent and 6 to 9 percent? Three. How many could accept it? Four, and I could accept that, so it's five. Five and two is seven. Apparently three want something else. Is that right?

MR. PARTEE. Mark, I think, wants it much lower.

CHAIRMAN MILLER. I'm just looking [at my notes]. You would want something lower, [Mark]. Who didn't vote? Dave, what would you like?

MR. EASTBURN. I'd prefer something a little higher.

MR. PARTEE. So you ought to be put at least in the Axilrod group.

MR. EASTBURN. I would prefer Steve's original [suggestion].

MR. BAUGHMAN. Given the presumption, Mr. Chairman, that we have a consistent set of numbers in alternative B, so far as one can argue there's consistency there.

CHAIRMAN MILLER. I just want to get the votes again. These were straw votes. There were two for the wider Axilrod ranges and five for the slightly lower ones. [One] would like to be higher than either of these and I gather the other two would like to be lower, is that right? Having heard all of that, let's put together another proposal of 1-1/2 to 4-1/2 percent for M1, 5 to 8 percent for M2, and 6 to 9 percent for M3, with an associated range of 7-1/2 to 10-1/2 percent for bank credit. Maybe I should have left that off. We can come to that separately, if you like. I didn't find anybody differing from what Steve suggested [on bank credit]. Well, in fact there was only one suggestion that was different. Kyle, I think you suggested shading it a bit. But I think everybody else either accepted it or ignored it. Now, forgetting bank credit, just taking M1, M2, and M3, let's do a tentative vote by roll call to see if we could get support for that. I would support that package.

MS. TEETERS. What interest rates go with this?

MR. PARTEE. Well, it's for a whole year. We can't really tell.

MS. TEETERS. I mean what does it imply?

CHAIRMAN MILLER. For the upper end of the ranges, it could imply, I would assume it would imply the higher--

MR. PARTEE. The staff thinks that the interest rates in Appendix I go with it, assuming that their GNP projection is right.

CHAIRMAN MILLER. Except that we have M2 and M3--

MR. PARTEE. A little higher.

CHAIRMAN MILLER. --a little higher than the staff's "B."

MR. WALLICH. With the M1 range, I think we can get to 10 or 10-1/2 percent growth here, which is equal to nominal GNP growth and therefore would require no rise in interest rates. I'm talking about 10 percent, not the midpoints.

MR. PARTEE. On the other hand, if we get a cyclical decline of the kind Frank was talking about--

CHAIRMAN MILLER. We'll have lower rates.

MR. PARTEE. --rates are going to come down.

MR. ROOS. Mr. Chairman, are you planning to elaborate on the adjustments in M1 as has been discussed at the staff level? Or are we going to go public, in effect, with these M1 figures, making some allusion to the ATS effects in the--

CHAIRMAN MILLER. These will be disclosed publicly in the written report to Congress. That will be the first and only public disclosure. It is contemplated that the report will make it very clear that the M1 numbers are based upon an adjustment for ATS and it will say something about velocity and demand, but I don't think--

MR. PARTEE. We're hopeful that velocity will grow more than normal but we won't put that in those numbers.

MR. ROOS. Will the 3 percent figure be described or the 5 percent on the--

CHAIRMAN MILLER. I don't think the 5 percent will be but 3 percent will get discussed because if it isn't in the report I will be asked specifically what we have assumed. We can't be deceitful about it; we have to tell them the truth. The truth is that on the basis of [our estimate of the effects of] ATS accounts, forgeting any change in demand curve, we have 4-1/2 to 7-1/2 percent for M1.

MR. COLDWELL. Which is an increase.

CHAIRMAN MILLER. Which is what we were trying to do before, so we could get within it.

MR. COLDWELL. The prior M1 range was 4-1/2 to 6 percent.

MR. WALLICH. No, 4 to 6-1/2.

MR. PARTEE. And we were taking 6-1/4.

CHAIRMAN MILLER. We were going from 4 to 6-1/2 percent and we were always on the upper side or out of the range.

MR. WALLICH. We were essentially ratcheting it up by first going to the upper side of it and then by chosing a range that would make the upper side fall in the middle.

MR. PARTEE. Assuming that ATS accounts continue to grow.

MR. ALTMANN.

Vice Chairman Volcker	Yes
President Baughman	Yes
Governor Coldwell	Yes
President Eastburn	Yes
Governor Partee	Oh, I guess so
Governor Teeters	Yes
Governor Wallich	No
President Willes	No
President Mayo	Yes

CHAIRMAN MILLER. Now let's take an official vote.

MR. ALTMANN. Do you want me to call the roll again?

CHAIRMAN MILLER. No. Does anyone wish to change his or her vote from that?

MR. PARTEE. I'll change my "I guess so" to "yes."

CHAIRMAN MILLER. Okay, thank you. That was a pause brought to an affirmative.

MR. WALLICH. Is it appropriate to ask, Mr. Chairman, whether this dissent would cause you any serious inconvenience in the hearing?

CHAIRMAN MILLER. Well, I don't think so. We should operate on a rule that everyone votes as they see fit; that has been our policy. We are in a time when we see foolish stories about this sort of thing in the press that people love to play on, but I don't think we should let that change our desire to vote our conscience. I don't see any embarrassment. It always is better to have stronger support, but it isn't essential.

MR. WALLICH. Thank you very much.

MR. ROOS. May I ask Scott a question, sir?

CHAIRMAN MILLER. You certainly may.

MR. ROOS. When the Chairman describes the adjustment for ATS accounts and so forth, if that is perceived as being a more expansive policy than the one we had last year, would that have a depressing effect on the dollar?

MR. PARDEE. If it is perceived that way, but I'm not sure it would be written that way.

MR. PARTEE. All these numbers are lower than before, and the foreigners might perceive it--

CHAIRMAN MILLER. Well, no matter what we say about M1, the fact is that M2 and M3 are lower. So in that sense the people who don't want to listen to us on M1 are people who just don't want to listen, because we are just getting a more logical M1 range consistent with monetary restraint and the other ranges are coming down. So if they are willing to give us even the first opening statement, they have to see this as a posture that is consistent with what we have been trying to do.

MR. COLDWELL. What these numbers say is that we can go as low as 1-1/2 percent and as high as 9-1/2 percent and still be within the range.

MS. TEETERS. No, it means we can go as low as minus 5 percent.

MR. COLDWELL. No, we won't publish it, but if we add the 3 percent plus the 2 percent shift, that gets it to 9-1/2 percent.

MR. PARTEE. 1-1/2 percent is not the bottom.

MR. COLDWELL. If we don't get either one of those it could go to 1-1/2 percent, so I say the range is 1-1/2--

MS. TEETERS. No it's a minus--

MR. PARTEE. It's below that because we might have a negative on the demand shift.

CHAIRMAN MILLER. Yes, I think that's right. The ATS doesn't go the other way but we could get--

MR. PARTEE. The ATS won't reverse; it can stop, but it won't reverse.

CHAIRMAN MILLER. So we are talking 0 to 9 percent.

MR. COLDWELL. Yes.

CHAIRMAN MILLER. That's what I said when I introduced the subject. I said we have widened the range. The probability of hitting it is better.

MR. PARTEE. This kind of a range, of course, is just for discussion inside this room.

CHAIRMAN MILLER. Of course. I hope we don't hear about it elsewhere or in any other way. Dave, do you have a question?

MR. EASTBURN. Yes. Can I assume, in the part of the report that asks us to talk about the consistency between [our objectives] and the Administration's program, that this will pose no problem of inconsistency?

CHAIRMAN MILLER. Well, the question is not the consistency, but the relationship.

MR. EASTBURN. All right, the relationship.

CHAIRMAN MILLER. If one looks at the Administration's short-range goals, I would say based on our own [projections] that for '79 those goals could be achieved within this [set of ranges]. Now, I think that we have more possibility of divergence in 1980, but we have not yet locked in our 1980 ranges. And, therefore, I think our report can indicate that kind of posture.

MR. PARTEE. I think we can say it's supportive but that we will have to review it as time goes on.

CHAIRMAN MILLER. And it depends, of course, upon real events in the economy over the period of time as distinguished from goals. They have changed and shifted a little, of course. We have been talking about our projections of what will happen under certain assumptions. But our comments are to be against what the Administration might be intending to accomplish. And they may not be able to achieve what they are hoping.

MR. PARTEE. It's goals rather than projections on their part.

CHAIRMAN MILLER. That's right. So they have an out. They can say well that's what we tried to do and then we got higher or lower--

MR. COLDWELL. I'd tell them it's unrealistic even to try.

CHAIRMAN MILLER. Well, we will get into the report next week. Did we have any final shifts one way or the other? We didn't pick up any more positive votes. All right then, that's a vote.

Let's turn to the next subject on my agenda which is to deal with current monetary policy and the domestic policy directive. We will turn to Steve again for his recommendation. As you know, [on the long-run decision] we have been referring to the alternatives as "A," "B," and "C." We now will go through alternatives "I," "II," and "III" on page 11, which is also relevant to page 14.

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

CHAIRMAN MILLER. So are you suggesting alternative I for M1 or are you suggesting 4 to 9 percent?

MR. AXILROD. I would think about 4 to 9.

CHAIRMAN MILLER. And leaving the fed funds range where is is. Is that what you're saying?

MR. AXILROD. And an asymmetrical interpretation of the directive--that is, to permit tightening if growth moves above the midpoint of the 4 to 9 percent range but not easing until growth got to the bottom of the range. That was [the bias] the Committee adopted last time in its directive at the December meeting.

CHAIRMAN MILLER. May I ask the Committee, all members, whether there is any sentiment for the alternate directive, which would deal with the proposition of not reducing the funds rate between now and the next meeting but would look to the possibility of raising it? That is, in effect, putting upper side limits on M1 and M2 and upper limits on the fed funds rate. This is the alternative [directive wording] that's on page 21 in the Bluebook. If there is a sentiment for that, we should go into depth on it; if there is not we might turn back to the more--

VICE CHAIRMAN VOLCKER. I like it.

MR. PARTEE. I would prefer the other.

CHAIRMAN MILLER. Would you raise your hand if you are interested in this [alternative language] on page 21 and then we will see who is not.

SPEAKER(?). Voting members only?

CHAIRMAN MILLER. Well, let's just get everybody's sentiment for the moment.

MR. ROOS. What are we voting on right now, sir?

CHAIRMAN MILLER. Just whether you'd be interested in--not that you are voting for it--what's on page 21. If there is no reason to discuss it, we needn't waste our time. One, two, three, four, five. How many would not be interested in it? Okay. We'd better do that again with voting members, hadn't we? How many voting members would not be interested in the directive type on page 21? One, two, three, four, five. That's going to make it tough. Why don't we see if we can work out the other [directive formulation] to everyone's satisfaction?

If I could give you a little guidance, my preference, if we go for the directive language on page 19, is to have the same sort of asymmetrical directive we had last time. My reasons are simply that all of the discussion today, taking into account both domestic and international considerations and the confusion about what the real economy's performance means in relation to the performance of the aggregates, would indicate that we should be in an even keel stance until we see some reason to change. Or to put it another way, when you don't know what to do, do it very cautiously. Therefore, that would be my approach. Do you want to say something, Chuck? I was going to say if that is the case, then I think Steve's suggestions of 4 to 9 percent for M1 and 5 to 9 percent [for M2], looking at the possibilities indicated on page 14, would seem to be reasonable. That would mean that if we got toward the upper end of those ranges we'd be looking at tightening; but we'd have to go to the bottom and through it before we thought of relaxing. I would also like to say that, considering the time between this meeting and the next, if there is any real reason to shift policy, it seems to me that we should have a telephone conversation. I feel that we shouldn't get ourselves too locked into these numbers with the situation so fluid. We have a good telephone set-up now--it seems to work well--so it's not so hard to get everybody on [a conference call] to discuss [a policy move]. Now, if we do what I've just described, the question I'd like to hear discussed is: Should we leave the fed funds range at 9-3/4 to 10-1/2 percent or should we change it to 9-3/4 to 10-1/4 percent, looking at the fact that an even keel approach means we're not going to be putting much room on either side. Why don't we just get inputs.

MR. PARTEE. I was simply going to point out that I agree totally with what you said about even keel--that is, I think this is a time for a sticky funds rate unless we see something big happening. But then your specific proposal was a biased proposal, that we raise the funds rate if the aggregates are strong in the range and not [reduce] it if they are low. I see no reason for that asymmetrical treatment when, looking at that table on page 14, we are well below the lower end and indeed won't be getting up to the midpoint of the [longer-run] range by March unless we are at the very top of the [February-March] M1 range. I'm speaking of M1 now. So it seems to me that the idea at this stage of the cycle of an unbiased approach to rate-setting, depending on the performance of the aggregates is the one--

CHAIRMAN MILLER. Yes, Chuck, I'm probably influenced a bit by the concern that if we reduce the fed funds rate in the next few weeks--unless something is happening that we can explain--I'd be worried about the international situation

MR. PARTEE. I agree with that, but I don't see why we should raise the funds rate if the aggregates are strong.

CHAIRMAN MILLER. Paul.

VICE CHAIRMAN VOLCKER. Well, I suspect that is the issue more than any particular numbers we put down. I would want to be biased, so I'm on the opposite side of this from Mr. Partee. I might just interject that I consulted very carefully with my resident monetarist guru in New York and he assured me that he is not worried about the money supply figures at all at this time; [this weakness] would have to go on for several more months.

CHAIRMAN MILLER. He is absolutely purist.

VICE CHAIRMAN VOLCKER. He is absolutely purist. He is as pure as he can be. He looked back at historical experience and these one-quarter deviations don't mean anything.

MS. TEETERS. Only on the up side.

VICE CHAIRMAN VOLCKER. I think this is precisely the point. We have had a pattern where the deviations on the down side have not been a one-quarter deviation but a one-cycle deviation. And we now have a one-quarter deviation on the down side and I want to be asymmetrical.

CHAIRMAN MILLER. Bob Black.

MR. BLACK. Mr. Chairman, I was just going to ask for some clarification and maybe offer an alternative solution. If I understood what Steve was saying, we would treat it on the down side as a money market directive; that is, we would ease the funds rate down if the rate of growth in the aggregates came in below 4 percent. Now, at the top, if we used a money market directive, that would not trigger [action] until [M1 growth reached] 9 percent. But if we treated that as if it were an aggregates directive, the midpoint would be 6-1/2 percent and it would trigger action at 7-1/2 percent. So as an alternative, it seems to me that if we took a straight money market directive, using 4 to 7-1/2 percent [for the M1 range], we wouldn't have to think about treating it asymmetrically. Action would be triggered at the top and the lower points at the two extremes.

CHAIRMAN MILLER. Thank you, Bob. Dave.

MR. EASTBURN. It seems to me that we get caught up in the formality of our system here as against the reality of the way we operate. In reality, the way we operate is that we have a federal funds rate that we more or less peg. We've been pegging it at 10 percent plus. If I interpret your recommendation right--and I would agree with you that we should keep it there--it seems to me that we can put any ranges in here that we want and we're going to peg the funds rate at 10 percent plus and we're going to have a telephone call if it varies.

CHAIRMAN MILLER. Our directive would be even keel and we would [have a conference] call if we think a change [is needed]. That solves our directive because it gets us ready for the Merrill case. If we lose the Merrill case, that will be our directive for the future. Go forth and do well and we'll be in touch.

MR. MORRIS. I think that's more of a description of how the Committee feels about all of these ranges because it seems to me that if we have a telephone meeting it will take something really tremendous to trigger us off the 10 percent [funds rate] in the next few weeks.

CHAIRMAN MILLER. That's not a bad point. Maybe we ought to have a directive that says we will even keel it and if there are any significant changes, we'll consult.

MR. WALLICH. Well, if Steve is right, we should have a month of very large increases [in monetary growth]. And it seems to me that that might very well trigger either a telephone conversation or--

MR. PARTEE. It would. I have great confidence in Steve but, on the other hand, there just isn't a wisp of evidence of what he's predicting.

CHAIRMAN MILLER. On average Steve is always right, but not from month to month. Larry.

MR. ROOS. I just can't resist pointing out that, as I read this, there isn't very much sentiment within this group to use the Humphrey-Hawkins situation to signal a relatively important change in how we [handle] this--in other words, to widen the fed funds ranges significantly. By doing so we can be masters of the aggregates' destinies to a greater extent than we are. Apparently a great majority of us is still committed to pretty much sticking to doing business as we have in the past on these fundamentals.

CHAIRMAN MILLER. Well, Larry, I don't know what the sentiment is, but I have a bit of a trouble thinking that we know enough about these aggregates and their stability to operate that way. We have this phenomenon that at some point, for some reasons, the money function shifts around on us. And how one measures that in a particular week or at a particular time I think is a very tricky business.

MR. ROOS. Your St. Louis guru would suggest targeting more on the base but--

CHAIRMAN MILLER. Yes, but you keep adjusting the base so that you go back to a constant situation and give no effect to the shifting around of the demand function of money. I would have very deep trouble [with that] because that isn't what is happening in the economy. The economy is shifting its preference as to how it holds these funds. If we say we're going to ignore that, yes we can operate that way. But I think we'd be out of touch with reality.

MR. EASTBURN. And there is a significance attached internationally to what happens to the funds rate.

CHAIRMAN MILLER. Absolutely.

MR. ROOS. I will shut up [after this], Mr. Chairman, but I think there are a lot of sophisticated people who are trading in the dollar foreign exchange market who are aware of the realities of the aggregates too and who are somewhat suspicious [of our commitment to these ranges], due to the fact that our past practice has permitted the aggregates to overshoot. And I believe those people would welcome, in a dollar-supportive manner, some basic shift in our manner of functioning, although I perceive that we don't feel now is really the time to do that.

CHAIRMAN MILLER. Well, if we want to put reserve requirements on mutual money market funds, that would be one place to start in order to get our aggregates back under the same definition and so forth. Mark.

MR. WILLES. I have a feeling that I'm about to vote for a money market directive, which means that in the years I've contested with this Committee the Committee has won and I've given in.

CHAIRMAN MILLER. If we could only get other members to give in we would--

MR. WILLES. I would like to say that I'm very sympathetic to the suggestion Dave made; I think that's probably right. But I wonder if we ought not have some concrete notion just among ourselves as to what magnitude of growth in the aggregates would tend to precipitate a call. I say that because if Steve is right on the shift in demand for money in the first quarter at 3 percentage points and we have the ATS effect at 3-1/2 percentage points, we could have zero growth in measured M1 for the first quarter and [in effect] M1 would still be growing at 6-1/2 percent. So if M1 growth were coming in at 6 percent on average during the first quarter, that would be [equivalent to growth of] 12-1/2 percent, and I don't think that's what we want.

MR. PARTEE. Which is what the nominal GNP is; that's how it gets there.

MR. WILLES. I understand. I just think we ought to have a notion--

CHAIRMAN MILLER. Well, we ought to have an understanding and I don't know how best to articulate that understanding. Each of you sees the money numbers as they are published each Thursday. Having seen them, if we haven't called a meeting and you think we need to talk, just call us. I think we can leave it to communication; if anybody feels that it's time to talk, we'll talk. That's one way to do it. Then we don't have to [set] numbers.

MR. PARTEE. You're talking about a real money market directive without any aggregates specified. It has been a long time since--

MR. BALLES. Has anybody thought about "tone and feel of the market"?

CHAIRMAN MILLER. No, we haven't thought of that.

MR. AXILROD. May I suggest, if the Committee's sentiment is moving that way, that you might want to reconsider the virtues of the optional paragraph we put [in the Bluebook]. It's quite consistent with holding [current conditions in] the money market but it permits some tightening, which I assume the Committee wouldn't object to, if the aggregates were exceptionally strong. The Committee merely has to make a decision in advance of what [exceptionally strong] is. And that language would be quite consistent with reconvening through a telephone conference if the aggregates [were weak]. It really doesn't specify how weak they would have to be, but that could certainly be developed with the Committee.

MS. TEETERS. Steve, that doesn't give us any leeway if they are exceptionally weak.

MR. AXILROD. No, but as I say, if--

MS. TEETERS. It seems to me that we'd want to have both options at this time.

CHAIRMAN MILLER. We're talking about discussing either direction.

MR. PARTEE. I think we want to look even-handed, too, and that [Bluebook] directive would not look even-handed.

MR. COLDWELL. I don't want to look even-handed.

MR. WALLICH. There is a strong reason for not letting the rate drop if we think the dollar is vulnerable. So I think we ought to limit that possibility--not cut it off absolutely, but not allow it without further discussion. We can make that decision, but it shouldn't come about through the automatic workings of our instructions.

MR. PARTEE. But it's equally true, Henry, that there is a strong reason for not letting the rate rise if we think the economy is vulnerable, and I think the economy is vulnerable.

CHAIRMAN MILLER. Well, if the directive were even keel, then we would not have any change from that even keel unless there were the votes for that. So it's decided by whether more people think [the funds rate should be moved] in one direction or the other.

MR. BAUGHMAN. I think it would be a mistake at the present time to adopt a directive, which would then be published, that does not have a reference to monetary aggregates. It will touch off a wave of speculation and concern as to what this group is doing and what changes we have made either in our mode of operation or our concept of how the system works. That would be unfortunate. Even if we are not going to pay attention to them, I think our statement should incorporate some aggregates.

VICE CHAIRMAN VOLCKER. It's going to have the long-term ranges in there and it makes some reference to--

MR. BAUGHMAN. I mean the short-term ranges.

MR. PARTEE. We could refer to the improved telephonic system.

CHAIRMAN MILLER. Bob.

MR. BLACK. Mr. Chairman, Mark has said that he would go for a money market directive and I dislike them as much as he does. But to me something like 4 or 4-1/2 to 7-1/2 percent would make sense, so that we wouldn't let the aggregate fall below 4 or 4-1/2 percent without doing something about it. I think that's really the crucial issue on the low end at this time. If they should grow at 7-1/2 percent, in view of the [recent] weakness we would still be pretty much around that 3 percent long-run growth path that we projected; in fact we wouldn't be up to the midpoint.

CHAIRMAN MILLER. Well, there is no reason we can't design a money market directive in the traditional sense with the understanding that if we get near the [limits] on either side [of the ranges] we won't really move until we consult. It's very simple. That will serve everybody's purpose, and then if something is happening in the economy or something is happening that we don't understand, we can have a telephone conference. How would you all like that?

VICE CHAIRMAN VOLCKER. Not too well. That definitely seems a little too neutral. I like that less than just saying that we're going to stick with [a funds rate of] around 10 percent.

CHAIRMAN MILLER. Well, we are going to even keel and we're going to have a money market directive, but we're going to have an understanding that we are not going to move the funds rate until we talk to each other.

VICE CHAIRMAN VOLCKER. In practice, I'm not sure it makes a lot of difference; obviously it's not going to be published for another month anyway.

MS. TEETERS. That raises another problem, though. You're testifying on the 20th of February, and I'm sure you're going to be questioned fairly closely.

CHAIRMAN MILLER. Well, this information will not be published. They never have bothered us on that.

MS. TEETERS. They never bother you on the short-term rates?

CHAIRMAN MILLER. No, they really haven't; they've been very good about that.

VICE CHAIRMAN VOLCKER. My problem is that there is a reference [to neutrality] in the directive but the fact is that I don't feel neutral. And to word the directive like that sounds as if we're operating entirely biased against any change at all and that the only thing that's going to [trigger a] change is the aggregates. It ignores the foreign exchange market aspects entirely and ignores the fact that the risks to the domestic economy are on the inflationary side anyway. And we should be able to--

CHAIRMAN MILLER. I'm not sure I follow that. If this were a regular directive with ranges for fed funds and ranges for M1 and M2, why would it seem neutral?

VICE CHAIRMAN VOLCKER. Because it tells me that--

CHAIRMAN MILLER. It's tied in to the aggregates.

VICE CHAIRMAN VOLCKER. Well, that's my problem. My problem is that it's tied entirely to the aggregates when I'm not indifferent on whether [the funds rate] goes up or down. I think the adverse risks of [the funds rate] going down are greater, due to the foreign exchange situation, than the adverse risks of it going up.

CHAIRMAN MILLER. The trouble with that argument, Paul, is that we have a directive out now that has the same characteristic. [Money growth is] below the bottom of the range we published and yet we haven't reduced the fed funds.

VICE CHAIRMAN VOLCKER. Is the directive we have out now symmetrical or is it written in this asymmetrical way?

MR. AXILROD. We've ignored the asymmetry. It was written with asymmetrical wording.

VICE CHAIRMAN VOLCKER. I understand we've ignored the bottom limit but it has some asymmetrical language.

CHAIRMAN MILLER. It's money market on the down side and [refers to the] aggregates on the other.

VICE CHAIRMAN VOLCKER. Okay. That sounds all right to me. I'd want to repeat that performance.

CHAIRMAN MILLER. All right. Let's go around to the voting members and ask what you want to do. I'm not talking about the range now but I think we need to crystalize this one way or the other. Are we going to have a money market directive, are we going to have just an understanding, or are we going to have an asymmetrical directive or what? Let me go right down the list. Ernie.

MR. BAUGHMAN. I could go either with the suggestion Bob Black made, which seems to me to capture--

CHAIRMAN MILLER. Okay, that would be a money market.

MR. BAUGHMAN. A money market directive with a 7-1/2 percent top on the range.

CHAIRMAN MILLER. We'll come to the top of the ranges in just one second.

MR. BAUGHMAN. Or I can go with the biased alternative where we have essentially a money market on the down side and aggregates on the up side.

CHAIRMAN MILLER. Okay, the type we had last month. Dave.

MR. EASTBURN. Well, I would hold the funds rate at 10 percent plus and consult if any of us feels that the aggregates are getting out of hand.

CHAIRMAN MILLER. I'm sorry, I skipped Phil Coldwell; I just missed the initials here.

MR. COLDWELL. I would revise it upward, Mr. Chairman. I would go with 10 to 10-1/4 percent as a range for the federal funds rate in the coming months primarily because I think now is the time we run the greatest danger of an additional inflationary problem. Down the road we may have some chance to reduce [the funds rate range].

CHAIRMAN MILLER. You have a narrow bias upward. Chuck.

MR. PARTEE. Well, I would like an unbiased money market directive. I would accept some language about taking account of foreign exchange market developments but that's as much of a bias as I would want.

CHAIRMAN MILLER. Nancy.

MS. TEETERS. I would take a money market directive with a funds rate range of 9-3/4 to 10-1/4 percent and consultation if the aggregates really get out of hand either way. I'd also have an eye on the foreign exchange market but [act] only upon consultation.

CHAIRMAN MILLER. And, Paul, you've expressed the view that you would prefer the asymmetric directive. Henry.

VICE CHAIRMAN VOLCKER. Right.

MR. WALLICH. I'd like something that, if the aggregates strengthen, would quickly raise the rate into the 10 to 10-3/4 percent range and wouldn't trigger [action] on the down side. So my preference, if it has to be done in an asymmetrical form, would be a money market directive on the down side--and I'd want a very low limit--and aggregates on the up side. That would suit me.

CHAIRMAN MILLER. Mark.

MR. WILLES. I think I'd like an unbiased--

CHAIRMAN MILLER. An unbiased money market directive?

MR. WILLES. --but I'd like to retract what I said earlier; I think we have to have some aggregates in it.

CHAIRMAN MILLER. Bob Mayo.

MR. MAYO. Surprisingly, I agree with Mark for a change. I think it would be a mistake, Mr. Chairman, to cut [the upper limit of the funds range] from 10-1/2 to 10-1/4 percent. When it is published, it would give a wrong signal.

CHAIRMAN MILLER. Well, if I read this right, Ernie would accept the money market alternative, Dave would prefer just the consultation--

MR. EASTBURN. I have no particular concern about how we express this as long as the policy action--

CHAIRMAN MILLER. Nancy was for a money market directive, as were Mark and Bob, and Chuck--one, two, three, four, five, six. I think that's the way we're going to have to go if we are going to hang this together. Can we just look at this and see if we can get some agreement on the ranges and a money market directive? The suggestion that Steve made was 4 to 9 percent on M1, 5 to 9 percent on M2, and the present range for fed funds, which is 9-3/4 to 10-1/2 percent. Perhaps I'd better have another go-around now that we've decided what we're going to do [on the directive wording]. Assuming we're going with a money market directive, what is the sentiment on those ranges?

VICE CHAIRMAN VOLCKER. Too high on the aggregate ranges.

CHAIRMAN MILLER. Ernie?

MR. BAUGHMAN. I share that feeling; I think 9 or 9-1/2 percent [money growth] is too high for a money market directive.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Too high.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. I would buy these.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. I would take a somewhat lower range on M1 and M2 than those suggested, but I would want to cut the funds range to 10-1/4 percent, [not retain] the 9-3/4 to 10-1/2 percent. I'd focus on aggregates around those ranges, which I think is very close to what Dave proposed to us.

CHAIRMAN MILLER. Nancy.

MS. TEETERS. I would buy 4 to 9 percent and 5 to 9 percent for M1 and M2 and cutting the upper limit on the funds range to 10-1/4 percent.

CHAIRMAN MILLER. Henry.

MR. WALLICH. The aggregate ranges are too high for me, particularly the midpoints.

CHAIRMAN MILLER. Mark.

MR. WILLES. I agree with what Chuck said, assuming he meant a low enough range on the aggregates.

MS. TEETERS. How low is low?

MR. PARTEE. I was thinking of cutting a point off.

CHAIRMAN MILLER. Both ends or just on top?

MR. PARTEE. Both ends.

MR. COLDWELL. 3 to 8 and 4 to 8 percent.

CHAIRMAN MILLER. All right. Bob.

MR. MAYO. I would buy the 3 to 8 and 4 to 8 but I would stick to the 9-3/4 to 10-1/2 percent funds rate range.

CHAIRMAN MILLER. Okay. Now, we're in good shape. Let's leave the rate question; the rate question sounds as if it's whether to leave the top side at 10-1/2 percent or cut it back to 10-1/4 percent. What we're going to do now is see if there's a majority who will accept 3 to 8 percent and 4 to 8 percent.

MR. WILLES. Sorry, Mr. Chairman, may I just ask a question? I'm not sure what Steve is assuming in these numbers about the demand shift for the first quarter.

MR. AXILROD. A lot--3-1/2 percent.

MR. WILLES. So if we got 8 percent growth for the 2 months, what would that be for the quarter if we get the 3-1/2 percent shift?

MR. AXILROD. The quarter is about 3/4 percent, so add 3-1/2 to that plus 3 percent [for ATS], if you want to put it in those terms.

MR. WILLES. So we'd get 6-1/2 to 7-1/2 percent.

MR. AXILROD. Somewhere on that order.

MR. PARTEE. I must say, Mark, that I really do think we're talking about an arithmetic--

MR. WILLES. I'm just trying to understand, Chuck, what the numbers are. I think we're talking about policy and not arithmetic.

CHAIRMAN MILLER. Well, Steve is frank to say that he is expecting these aggregates to pop back up and adjust this process. He is very frank to say so and is worried about dealing with that, right?

MR. AXILROD. Well, also, a considerable pop back up is needed to get them back on the Committee's path.

MR. PARTEE. Yes, we're way below.

MR. COLDWELL. Good.

CHAIRMAN MILLER. We had a lot of sentiment going for ranges of 3 to 8 percent and 4 to 8 percent. We had at least 3 or 4 folks who said they would buy that.

MS. TEETERS. May I ask a question? If we went with that, what would that do to the funds rate? Does that continue to make the ranges consistent with a funds rate of around 10 percent?

MR. AXILROD. We think a 10 percent funds rate will yield about a 7 percent growth rate [for M1]. The odds on that are not extremely high, so what the Committee is discussing is where it may wish to trigger a funds rate movement. I would interpret this [M1] range to mean that if M1 were growing at a rate close to 7 percent or above, the Desk would probably be raising the funds rate.

CHAIRMAN MILLER. Well, I want to be sure we understand that we're going to consult before we move [the funds rate]; we're going to do that in any case. So these are triggering consultation more than they are triggering action, and I think that should be borne in mind in trying to resolve this.

MR. PARTEE. That's why I think we ought to cut the funds rate range to a range [centered] around where we are, [by going to] 9-3/4 to 10-1/4 percent. I must say my notion for accepting these lower aggregates is associated with [the presumption of a centered] funds rate--with the idea that [we will consult] if we run up toward the high end or down toward the low end.

MR. COLDWELL. How would you like 9-7/8 to 10-3/8 percent?

MR. PARTEE. Where is it exactly now?

MR. HOLMES. About 10 percent or a little above.

MS. TEETERS. What are you suggesting?

MR. COLDWELL. 9-7/8 to 10-3/8 percent--1/8th on either side to play with--

MS. TEETERS. I would be much more liberal.

MR. MAYO. I'll bid 3/8.

MR. MORRIS. Well, all this not very important if we're going to have a consultation before we move.

CHAIRMAN MILLER. Here is a proposal, and you've got 3 minutes to decide and then we're going to lunch. Steve is suggesting that we could say this: "System open market operations are to be directed at maintaining the weekly average funds rate at about the current level, provided that over the February-March period the annual rates of growth of M1 and M2, given approximately equal weight, appear to be within ranges of 3 to 7 percent and 5 to 9 percent, respectively. If growth of M1 and M2 for the two-month period appears to be outside the indicated ranges, the Manager will promptly notify the Chairman, who will then consult with the Committee for supplemental instructions."

MR. PARTEE. So we use the full range of 3 to 7 percent?

CHAIRMAN MILLER. Yes. And there is no fed funds range.

MR. COLDWELL. But he has 5 to 9 instead of 4 to 8 percent [for M2].

CHAIRMAN MILLER. But he compromised; he gave you 3 to 7.

MR. COLDWELL. On M1.

VICE CHAIRMAN VOLCKER. This says we don't do anything while they are within the range but consult when [either] is outside.

MR. MILLER. And if any of you wants to consult earlier, give me a call. I'm a very good consulter; I'll consult with the Committee on whether the situation calls for supplementary instructions.

MS. TEETERS. And leave the funds rate alone.

MR. BLACK. Did you specify a range or not?

CHAIRMAN MILLER. No range on fed funds; leave it alone and if we're within these ranges, we hang in there. If growth moves out of those ranges we consult with the Committee to see if anybody wants to supplement the instructions. This is known as "copping out."

MS. TEETERS. With the general understanding that we expect the rates to stay approximately where they are right now.

CHAIRMAN MILLER. Well, the instruction would be to do that.

MR. PARTEE. Maintain about the current rate.

CHAIRMAN MILLER. Alan, do you have any problems with that?

MR. HOLMES. None at all, Mr. Chairman.

CHAIRMAN MILLER. Well, we could have said it in fewer words, couldn't we? Let's call the roll. I'll vote for that, which is known as the Axilrod compromise.

VICE CHAIRMAN VOLCKER. There is no mention of the federal funds rate in here at all except it says we stay where we are.

MR. ALTMANN. Maintain the funds rate.

MR. WALLICH. It [sounds] a slightly ominous note because it suggests that if the aggregates behave for another period of time as they have behaved so far, then we'll make a decision to ignore them.

CHAIRMAN MILLER. Just as we've done in the last seven weeks.

MR. WALLICH. That's what one can read into that.

CHAIRMAN MILLER. What we can read now is that we've decided after our consultation not to lower the rate despite the aggregates. If anybody wants to read that the reverse is true now, they haven't read recent history. I'll vote for it anyway.

MR. ALTMANN.

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

CHAIRMAN MILLER. Okay, we have two recalcitrants who can finally redeem themselves by shifting their votes.

VICE CHAIRMAN VOLCKER. [I'd like to] get a little more language in there about foreign exchange. It's in there but as such it says we look at the foreign exchange market.

CHAIRMAN MILLER. We'll give you up to 6 words to improve that if you change your vote.

VICE CHAIRMAN VOLCKER. We might improve it just by eliminating the words that follow the foreign exchange--those on the domestic financial markets.

MR. PARTEE. Who cares about the domestic economy? We're only concerned about the foreign exchange rates!

CHAIRMAN MILLER Well, what it says is "while giving due regard to the program supporting the foreign exchange value of the dollar, to developing conditions in domestic financial markets, and to uncertainties associated with the introduction of ATS."

MR. BLACK. Mr. Chairman, could I just ask if we shouldn't elaborate beyond ATS and also mention money market funds? That has been a very powerful force.

CHAIRMAN MILLER. Well, we could say "to the uncertainties associated with the introduction of ATS and other shifts"--

MR. PARTEE. I really think we could do away with that whole phrase.

CHAIRMAN MILLER. That phrase could be left out, really.

VICE CHAIRMAN VOLCKER. Leave out everything except the foreign exchange market.

CHAIRMAN MILLER. We probably should take out the reference to ATS; I think you're right, Bob. We're singling out something that's a dead horse. We can just say "due to uncertainties," the fact that we don't really know. Phil, we're up to you. Did you shift your vote?

VICE CHAIRMAN VOLCKER. Where are we? Did we leave out these phrases or what?

CHAIRMAN MILLER. While you're thinking about it, we'll go on to consideration of the Manager's recommendation with respect to foreign currency operations. Alan Holmes.

MR. HOLMES. [Statement--see Appendix.] [Secretary's note: Mr. Holmes recommended an increase from $150 to $500 million in the Committee's informal limit on foreign currency holdings.]

CHAIRMAN MILLER. Alan, as I understand it, this informal limit is really a limit [within the formal amount] of what otherwise could be held under the Foreign Currency Authorization. So what we're doing is saying that if we're on the long side, it will be less than the total allowable position--which could be bigger if we were on the short side. And I think that's a reasonable proposition, particularly if it is to be coupled with your proposal to bring us a memorandum on this so we can give it more careful attention. I don't think we run a risk during the period until you submit that memorandum, at the next meeting or so, in contemplating that we could hold up to $500 million of currencies. Does anybody feel differently?

MR. HOLMES. I would guess that we wouldn't get to that amount. But the markets are so volatile these days.

CHAIRMAN MILLER. I don't think we will either. But we have [acquired] a billion dollars of D-marks in a couple of days which was very favorable to us. And we might have other occasions where we want to continue--

MR. PARTEE. Well, I don't think we ought to get ourselves into a substantial long exposure willy nilly, but I think what Alan is suggesting is within the range of operating necessity. Nevertheless, I would hate to see us acquiring $500 million, [going] up to $1 billion and then to $1.5 billion. Those things sometimes happen.

CHAIRMAN MILLER. Also, we don't want to make such a decision unless we intend to look at it in depth; this is not something we are trying to sneak up on. I just think we need some operating room.

MR. WALLICH. But we do need to look at this in depth at some point because we are getting to the point where we are operating in foreign currencies.

CHAIRMAN MILLER. Absolutely.

VICE CHAIRMAN VOLCKER. We have to look at this question; I don't think this $500 million implies that we've answered it.

CHAIRMAN MILLER. That's right.

MR. COLDWELL. Well, Mr. Chairman, I'd be satisfied as long as we don't get beyond the debt we now owe in any single currency.

CHAIRMAN MILLER. Then you are going to be long.

MR. COLDWELL. Well, we're buying right now.

VICE CHAIRMAN VOLCKER. We have yen and we don't have any [yen] debt.

MR. COLDWELL. I meant in terms of the $500 million cumulatively.

MR. WALLICH. You mean overall total debt equal to total balances. We have a large D-mark debt and we have yen balances. The $500 million will be much smaller than the D-mark debt.

MR. COLDWELL. Well, that would be true for today, assuming we come back to this subject.

CHAIRMAN MILLER. Any other comments? Alan, we need approval on the rollover of some our maturing swaps, right?

MR. HOLMES. I recommend that they be rolled over on maturity if we can't pay them off before.

CHAIRMAN MILLER. Is everyone familiar with this? [Information on] this has been circulated. May we have approval of that? Hearing no dissents, it is so approved. I must say the vote on our short-range specifications in the directive was 9 to 1. We had a famous switch for the final count.

MS. TEETERS. Who switched?

CHAIRMAN MILLER. Paul switched; Phil decided to be lonely. I thank you all for your patience. It has been a very difficult task to cope with this and we're breaking some new ground. I hope we can continue to make the process work to your satisfaction. We will now adjourn for lunch.

END OF MEETING