TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

May 22, 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

Ms. Greene, Senior Vice President, Federal Reserve Bank of New York
Mr. Sternlight, Manager for Domestic Operations
Mr. Kichline, Associate Economist

Meeting of Federal Open Market Committee

May 22, 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, May 22, 1979, beginning at 9:30 a.m.

PRESENT: Mr. Miller, Chairman
Mr. Volcker, Vice Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Kimbrel
Mr. Mayo
Mr. Partee
Mrs. Teeters
Mr. Wallich

Messrs. Guffey, Morris, Roos, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. Baughman, Eastburn, and Willes, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis, respectively

Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. Petersen, General Counsel
Mr. Oltman, Deputy General Counsel
Mr. Mannion, Assistant General Counsel
Mr. Axilrod, Economist

Messrs. Brandt, Ettin, Keir, Keran, Kichline, Scheld, Truman, and Zeisel, Associate Economists

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

Mr. Coyne, Assistant to the Board of Governors

Mr. Siegman, Associate Director, Division of International Finance, Board of Governors
Ms. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Balbach, J. Davis, Eisenmenger, and Fousek, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Cleveland, Boston, and New York, respectively

Messrs. Broaddus, Burns, Danforth, T. Davis, Ms. Greene, and Mr. Mullineaux, Vice Presidents, Federal Reserve Banks of Richmond, Dallas, Minneapolis, Kansas City, New York, and Philadelphia, respectively

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

Transcript of Federal Open Market Committee Meeting of
May 22, 1979

CHAIRMAN MILLER. Good morning, ladies and gentlemen. Welcome to our FOMC meeting. Initially I would like to inform you--I think everyone knows this--of the passing of Angus Powell last Saturday. He certainly was a dedicated [Reserve Bank] Chairman and was courageous during his years of illness. And we certainly shall miss him.

Second, I would like to call to your attention something that happened in the [intermeeting period] that is of concern to me and I hope is of concern to you. My experience so far at the Federal Reserve has been rather impressive in terms of the security with which our deliberations are handled, but on May 1 there was an article in the Washington Post where two different reporters independently had received information about FOMC proceedings which they quoted as from Federal Reserve sources. I believe they are reliable reporters and I believe they could be expected to be accurate in that respect. The fact that either through inadvertence or sloppiness or deliberate disclosure any activities of the FOMC were reported to the press is of considerable concern to me.

One of the reporters is James Rowe, who now works for the Washington Post in New York, though he was in Washington for a long time. His source may not have been from the New York Bank--I'm not saying that--but he got his information while serving in New York. The other reporter is John Berry, who is here in Washington. The first reported that there was [an intermeeting] vote. That information was inaccurate, so whoever the Federal Reserve source was it apparently was not someone who is directly involved in the FOMC or if so that person was disguising his or her comments. But it would appear more likely that these sources are people on our staff someplace who have picked up information from conversations or reports and have translated that somehow in responding to reporters.

[Let me cite some examples from the articles.] "Informed sources said that today the Board apparently was concerned with world financial markets." That wasn't even discussed in the telephone consultation, as I recall. So that's incorrect. They reported that there was a vote, which is [also] incorrect. "Sources said the Fed's policymaking Open Market Committee held a special telephone meeting last Friday." Well, that's true; it was a consultation. "The Federal Open Market Committee was closely divided on the question during the telephone meeting." "Fed sources said the agency does not believe the $4.1 billion jump [in M1] is cause for alarm." Other examples include: "One source noted...;" "however, sources explain that the action...;" "which sources said...;" etcetera. I think this means that all of us have an obligation to somehow tighten up on our discipline about this sort of thing. It would be very upsetting if we were to get into a posture of trying to imitate other irresponsible agencies of government that do not have any way to maintain confidential information.

[As for how this could happen], there seem to be several possibilities. One is just sloppiness in terms of with whom conversations are held and under what circumstances--too often speaking freely in front of those who are not and should not be privy to FOMC [materials or deliberations]. Another is that there seems to be a tremendous American sensitivity to [a perceived] responsibility to answer any reporter. And that's just false. No reporter has a right to place a call and get you or any of your people on the line; he can be ignored. Here, any reporter who calls my office is referred to Joe Coyne. If it is a legitimate question and it would be appropriate to respond, we arrange to do it. Also, we have found that there are con artists. There are people who call secretaries--and we have had instances of this occurring recently--where consequent information gets out by the caller using a false name and by creating with the secretary the impression that he has some knowledge [about what is going on at the Federal Reserve]. By doing that, suddenly information may get spilled out, because the secretary thinks, "Well, if you know that, you might as well know the rest of it."

I just hope that you share my concern and will be willing to look at how, either through education or better discipline, we can avoid [a recurrence of] this sort of thing.

Next, I want to report that when I was visiting the Federal Reserve Bank of Cleveland recently, Willis Winn had the effrontery to present me with a gift. The thing that impressed me about it, if you look at it [closely], is that I decided Willis had a message. So the message is that when he speaks today, I will turn this [hourglass] over and there will be no sand to run, so he will immediately be cut off from speaking. And for those of you who behave, I will give you your 3 minutes with the other one. But this one is for you, Willis!

MR. MAYO. In proper interbank rivalry, Mr. Chairman, I am deeply hurt that you didn't bring the T-shirt that we gave you.

CHAIRMAN MILLER. Oh, yes, I must bring in the T-shirt. But I haven't got it because immediately when I brought it home my wife confiscated it. And she said she wanted one from every Federal Reserve Bank so she could have 1 through 12, or A through L or whatever it is. Is it L or K? What's San Francisco? It's L. I thought I was right the first time. So I must follow that up.

MR. MAYO. I must add for the benefit of everyone else that this T-shirt is being offered to member banks for $2.00 and to nonmembers for $10.00. It's part of our improvement of service!

CHAIRMAN MILLER. That's a reversal of policy. We have been running the Fed for a long time offering things to nonmembers for $2.00 and to members for $10.00.

MR. BLACK. Mr. Chairman, most of us don't have as much fat in our budgets as Chicago does to buy these T-shirts!

MR. MAYO. Mr. Black, I shouldn't admit this, but the T-shirt was issued by our credit union, which is independent.

CHAIRMAN MILLER. Well, let's move on to our meeting. Our first action is to approve the minutes of the meeting of April 17. These have been circulated. Are there any changes or corrections? Hearing none, we will record those as approved. Second is a report on foreign currency operations since the last meeting, and Gretchen Greene is here today to give us that report.

MS. GREENE. [Statement--see Appendix.]

CHAIRMAN MILLER. Thank you, Gretchen. Any questions? Yes, Dave.

MR. EASTBURN. Take Henry's question first, because I have a question for Ted Truman.

MR. WALLICH. Gretchen, when you operate as agent for the Bank of Japan, can you tell anything from the way the orders are given and what rate indications are given about how forceful they want to be in defending the yen?

MS. GREENE. Not completely because their instruction is based on their close in Toyko. And how that relates to rates in New York depends very much on what has happened between the time of the close in Toyko and our opening in New York. In general I would say their instruction has been to limit the further weakening of the yen in New York, with the greater burden for intervention on them in Toyko rather than in New York.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. This question comes out of the Greenbook Supplement, so I would like to ask Ted if I may. With the improvement of the balance of payments position, why don't you expect a better performance of the dollar?

MR. TRUMAN. The improved balance of payments position does give us encouragement, as Gretchen has pointed out. But our feeling is that we probably have some ways to go. The United States current account position still is in deficit in a world where Japan, Germany, and Switzerland still have--[though it's] less substantial--a surplus. So the feeling is that under current conditions we probably need a surplus to be out of the woods. That's the first point. The second point is that we need the exchange rate adjustment to be maintained in order to get us there. As you know, our staff forecast does show a current account surplus beginning in the first half of 1980. [Another] point though, as Gretchen mentioned, is that inflation rates have come up abroad on average. Taking a longer-term perspective and putting that together with our forecast, inflation rates abroad are still below ours on average and are expected to be below ours over the forecast period. In those conditions a stable dollar in nominal terms will in fact mean some real appreciation. So too much more of that would tend to make the market think we would not quite get there in terms of adjustment. For what it's worth, the forecast for the dollar as [implied by] the forward rate would suggest a 1 to 2 percent depreciation over the next year or so. So we are in some sense more optimistic than that reading of the market.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Gretchen, I've been interested in the strength of the gold price during this same interval when the dollar has been strong. What do you hear about that or what is your view on the movement in the gold price?

MS. GREENE. Well, there is a variety of factors: demand, supply, and psychological. On the supply side, of course, is the fact that the Treasury has announced a halving of its [gold] auction [amounts] and the IMF has announced a modest scale-back in the amount it will auction. There appears to be some lesser willingness on the part of the Russians to sell gold, and that has been going on much of the year. So the supply picture is tighter than it had been. Industrial demand appears to be quite good, even at these higher prices. And, of course, gold reacts very [strongly] in an environment in which there is a sense of scarcity of certain important strategic commodities. It is also reacting strongly to substantial demand for other precious metals, particularly silver. The relationship between silver and gold is extremely important in our [unintelligible] here. So, even as the dollar has improved, the price of gold has continued to go up.

MR. PARTEE. It could also be consistent with your comment that it's not so much that people have improved their opinion of the outlook in the United States but that the outlook has deteriorated everywhere else. So all currencies are looking almost equally bad, which leaves gold as the alternative.

MS. GREENE. Well, the demand for gold is quite strong, interestingly enough, in Zurich and in Paris, too.

MR. PARTEE. Zurich and Paris?

MR. TRUMAN. Where in fact the price of the local currency has gone up much more [than the dollar].

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Gretchen, what is the level of our yen balance at the moment?

MS. GREENE. It's just under $200 million, about $195 million.

MR. COLDWELL. Are we participating in yen intervention?

MS. GREENE. We haven't in recent weeks. We have not for some time. We have not purchased any yen since the last FOMC meeting.

CHAIRMAN MILLER. [Our earlier purchases amounted to] $185 million [equivalent], as I recall. Of course, [their dollar value] changes with the value of the yen, doesn't it? So I'm not sure [what it is] from day to day.

Our next order of business is to ratify the transactions in foreign currency operations since the last meeting. I suppose a historic note on paying off all of our swap debt is in order. You have received the [written] report, I believe. Are there any comments or questions? If there's no dissent, we will ratify the transactions. Thank you very much, Gretchen. Let's move to the report on domestic open market operations from Peter Sternlight.

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

CHAIRMAN MILLER. Thank you very much, Peter. Questions or comments? Henry.

MR. WALLICH. Peter, you mentioned that prior to the Treasury financing there was a change in the funds rate [objective] and you moved expeditiously so that the market would be apprized of that. How important do you regard it generally, other than in circumstances associated with a Treasury financing, that the market be apprized of exactly what the objective is?

MR. STERNLIGHT. Well, the System has its objective and I think we want that objective to be apparent to the market. We felt at the time that it was particularly important that the message get through clearly and quickly or it might otherwise have [been an issue as the Treasury auction] approached. Sometimes it's convenient to let the market tighten on its own if that is the [desired] direction of change and just step in to indicate the bounds of any change that might be indicated. But in this case the change was made on a Friday and the Treasury's auctions were going to be on Tuesday and Wednesday. We wanted to make it known that we were aiming for something higher and, since our initial step would be in the direction of pushing the funds rate higher, we wanted to be sure we would have time to indicate to the market just how high--to indicate an upper bound as well. I'd say it's ordinarily important to let the market know what we want, but at times like that it is particularly important to let it know very promptly.

CHAIRMAN MILLER. Well, Peter, thank you very much. Excuse me, Phil, [did you have a question]?

MR. COLDWELL. Peter, in your visits with the dealers what is your reading now of the dealer market? Are they becoming pessimistic about developments in the economy and market prospects?

MR. STERNLIGHT. I'd say they've become more conscious of the flattening or softening in the economy at least for the near term. Whereas a few weeks ago there was a fair amount of sentiment that rates were likely to push higher in the near term, I'd say that is not the expectation at the moment. At least there is a feeling that for the near term there is likely to be little change, though many people in the market still feel that over a little longer horizon, say the next several months as against a shorter outlook of only the next month or so, there might well be a need for higher rates because of persisting inflationary pressures. The sentiment among quite a few in the market is that the economy has not reached a peak and might well continue on a strengthening course, although only moderately gaining strength.

MR. COLDWELL. I haven't looked over [the data] but have they followed that questioning judgment in terms of their portfolios?

MR. STERNLIGHT. They have. There had been a tendency to keep their inventories of securities very low or modestly short until the time of this last refunding. In that refunding they took on a substantial supply of the 10-year and 30-year issues. As I mentioned, the distribution of those issues was quite slow, although it would appear that even when some retail demand developed some of the dealers at any rate were not all that eager to get rid of their supply. Some apparently are a little more willing now to hold on to their supply in the anticipation that maybe those securities will rise in price. I wouldn't call that--

MR. COLDWELL. Have they been building their long positions?

MR. STERNLIGHT. In the longer area there is a net long position, which was not true a month ago. What they did was to take on a long position--this is in the over 5-year area--with the refunding and it has been whittled down some. But they still have a net long position.

MR. PARTEE. Would they have a negative carry on that, Peter?

MR. STERNLIGHT. Just about even at this point, I would think, or maybe slightly negative.

MR. EASTBURN. Peter, could I ask you a question about the discount rate? Is the market now in a mood to make a distinction between a technical adjustment of, say, 1/4 point and not confuse that with a signal for tighter money?

MR. STERNLIGHT. It might well be because I think there is an appreciation [of the current situation] among market players. Even though they don't see the grounds for a general push to higher rates, they are conscious of the growth in the volume of borrowing, and they are aware that borrowing has gotten up to the level that on some past occasions has triggered a rate increase. So I think that might be a fair characterization.

CHAIRMAN MILLER. Thank you. Our next action is to ratify the transactions on the domestic side since the previous meeting. You have the reports. Are there any comments or questions? If there is no dissent, we will record the transactions as approved.

I asked Murray Altmann at the last meeting to give me a rundown on how we've been doing with our individual forecasts. Did you distribute this to everyone? Well, I must arrange for you to get this [tabulation], which has your forecasts from March of last year when we looked at the period from quarter four '77 to quarter four '78. It turned out that the actual increase in real GNP was 4.3 percent. The staff had 4.4 percent. So, Jim, I must say that's fairly close. However, only 5 of those governors and presidents who were then participating had [4.3] percent within their ranges. Now, on prices, the actual increase was 8.8 percent. The staff had 6.6 percent, not so close. Nobody had a figure as high as 8.8 percent. The highest were our perennial optimists, Henry Wallich and Willis Winn, who had 8 percent as the top of their ranges. But they were the only ones with an 8 even showing.

VICE CHAIRMAN VOLCKER. What period are you talking about?

CHAIRMAN MILLER. This was the fourth quarter of 1978 over the fourth quarter of 1977. We were meeting in March of [1978] and [since] that time we haven't done any update. Unemployment at the end of the period, in the 4th quarter of 1978, was 5.8 percent. The staff had forecast 5.9 percent. And five of the participants had 5.8 percent within their ranges. Now, in June [of 1978], we looked at the [first] quarter of '78 to the [first] quarter of '79. The growth in real GNP was 3.1 percent and not a single person came in that low, nor did the staff. Everybody was higher. The staff had 3.8 percent. No one was as low as 3.1 percent. Prices rose by 9.1 percent. No one even came close. The staff had 7.3 percent. And the unemployment figure was 5.9 percent and, of course, the staff was at 5.9 percent, having figured that precisely!

MR. PARTEE. But not knowing the real GNP!

CHAIRMAN MILLER. There were four of us who had that also. In the future when you consider the staff forecasts and criticize them, remember they're not too bad compared to those made by the rest of us. So we turn to you now, Jim, for your new forecast and how you see things.

MR. KICHLINE. I don't know what to do after that!

MR. MAYO. I assume the staff put these figures together!

CHAIRMAN MILLER. No, we didn't want the staff [of the Research Division] to do this; Murray did it so we'd have an objective [observer]. The other members of the staff didn't even know it was being done.

MR. KICHLINE. [Statement--see Appendix.] That completes my presentation, Mr. Chairman.

CHAIRMAN MILLER. Thank you, Jim. Are there any questions before we go on? Yes, Larry.

MR. ROOS. Jim, do you have any specific figure that you are using to reflect the effect of energy price increases on inflation? Have you quantified that even in a rough way?

MR. KICHLINE. You're talking about in something like the deflator?

MR. ROOS. Yes. What has happened?

MR. KICHLINE. Well, in the second quarter of this year, for example, our estimate of the business product deflator in total is 10.3 percent. If we exclude food prices, in the second quarter of this year it goes down to 10 percent. Excluding food and energy, it's 8-1/4 percent. So the energy component [accounts for] about 1-3/4 percentage points in the second quarter alone on the aggregate inflation rate. Energy in these accounts are only worth something like 7 percent by weight, but we're getting increases of 40 to 50 percent at an annual rate in many of the energy components.

CHAIRMAN MILLER. Phil Coldwell.

MR. COLDWELL. Jim, I assume you saw that note sent to me concerning the parallelism between 1973-74 and 1978-79 on retail sales and real sales versus the peaks and troughs. How do you interpret that?

CHAIRMAN MILLER. Sent by whom?

MR. COLDWELL. It was sent to me by one of the members of Jim's staff in response to a question I asked at a Board meeting.

MR. KICHLINE. I think it has been distributed to all the Governors. I would interpret the data with some degree of confusion, I guess, in the sense that there are a number of major differences. As I believe the memo pointed out, retail sales peaked in February of 1973--

MR. COLDWELL. On a real basis.

MR. KICHLINE. --on a real basis, which was about 10 months before the trough in economic activity. The peak in real terms [in the current cycle] would be December of 1978, so we've experienced four months of declining sales. But there are a number of major differences. One is the behavior of consumers. In that earlier period, the saving rate was considerably higher and consumers seemed much less willing to take on goods and spend as freely as they have this time around. So I'm a little disturbed about trying to make that comparison because of different consumer behavior. Secondly, though the energy situation was a bit similar as 1973 went on, that was a period when we had the storage situation by early 1974 combined with very rapid price increases. And it strikes us that at this point the situation is considerably different from what we experienced in 1973.

MR. COLDWELL. One point that struck me was the percent of real disposable income being devoted to energy and food. The data show a quantum jump in '73 and it looks as if we're getting another one now, although the figures aren't complete nor are they [measured] in precisely the same fashion.

MR. WALLICH. But what is really impressive is the reduction over the years in the fraction [of disposable income] people have to spend on food and gasoline. Since the '60s standards of living have risen enormously in that respect and what's happening now is just a small catch-up.

CHAIRMAN MILLER. Well, we need higher prices for food!

MR. PARTEE. Higher for [food] and for gas.

CHAIRMAN MILLER. John Balles.

MR. BALLES. Jim, we've had this unexpected bad news for the first quarter in terms of real growth at about .4 percent. It's evident that real final demand actually declined and that what skimpy growth we had was in fact in inventories. In view of that and of the weak news we've gotten so far for the second quarter for those series for which we have data--I don't think there's a single strong report out so far that I'm aware of--what is the case for a bounceback of real GNP in the second quarter? I must admit I'm getting pretty skeptical. This is a devil's advocate type of question, but there are weak spots in the economy and that is spreading--

CHAIRMAN MILLER. John, you mean a bounceback to 2.2 percent?

MR. BALLES. Yes, a bounceback.

CHAIRMAN MILLER. A hop?

MR. KICHLINE. One major area to point to is business fixed investment. The first quarter was quite depressed in the construction area [but] the March numbers came roaring along with a bounceback. I would suspect that in the second quarter both shipments and, importantly, nonresidential construction activity will average substantially above the pace in the first quarter. That's one area. Housing may well turn out to be less of a negative in terms of expenditures in the second quarter compared to the first. It's not that I expect it to be rising and contributing to growth, but it may well be less of a drag on average for the quarter. Consumer spending, I think, is a very questionable area. We do anticipate a bounceback, but it is by no means a certainty. [If we don't begin to see that,] I would say that over time one would have to get concerned about that.

State and local construction activity is also an area that was depressed in the first quarter due to weather effects. The evidence seemed to suggest a bit of an increase in March, but not a great deal. We are banking on the view that that sector will perform similarly to business fixed investment, particularly the construction part. The bounceback that we have forecast is nothing like that in the first quarter of 1978, when [GDP growth went from] about zero to 9 percent. We're really talking about fairly small changes. Also, I think the information coming in has to be discounted to some extent. Industrial production is a clear case where we know the nature of some of the problems. But, as this [reported weakness] goes on, I'd say one would have to be more concerned about the possibility of a weaker picture than a stronger one.

CHAIRMAN MILLER. Jim, the information on durable goods orders will be released at 2:30 today. Do you have those data yet?

MR. KICHLINE. No. We've tried--unsuccessfully--for the last two months to get them and have not been able to.

CHAIRMAN MILLER. They will show a significant decline in orders in April.

MR. PARTEE. Including defense?

CHAIRMAN MILLER. I don't have the details. Overall it is quite a significant decline. Bob Mayo.

MR. MAYO. Thank you, Mr. Chairman. Jim, to what extent do your figures embrace the latest increases in crude [oil] prices by the individual OPEC countries? And, secondly, do you allow anything for the increased pressure on the oil companies to deal in effect in the black market on the spot market?

MR. KICHLINE. Well, let me [defer to] Ted to answer the first question. With regard to your second one, I don't know quite how to answer that. Implicitly we have built in huge increases in crude oil prices and we have also built in a change in Department of Energy regulations on the pricing as well as pricing between various grades of gasoline. Putting all that together makes us come out with a big number. That's the sort of thing we've done. It's very clear that the gasoline that is being imported directly has gone up substantially in price. There are reports now of gasoline reaching New York that has an Amsterdam spot price of 85 to 87 cents a gallon. So if you're talking about dealing in the spot market in that way, at the margin it is very expensive crude and very expensive in terms of refined products.

MR. MAYO. But you feel that has already been built into your forecast?

MR. TRUMAN. I was going to answer that in part, President Mayo. The forecast went to bed a little over ten days ago or so, and in the Greenbook we had forecast a fourth quarter-over-fourth quarter increase of 23-1/2 percent on the OPEC market for crude adjusted, compared with a little under 21 percent in the previous [Greenbook]. The announcements have come out since the Greenbook forecast was finalized, so essentially [what has happened] in the last week would add another 1 percent [or maybe a little less] to that.

MR. MAYO. That's all?

MR. TRUMAN. Well, to the extent that we've kept track of the increase in the surcharge, which we've tried to do, [that is our estimate].

CHAIRMAN MILLER. Frank.

MR. MORRIS. Mr. Chairman, I just want to say that I am pleased that Jim had such a good record last year because I have a very strong feeling that his record is not going to be as good in the next twelve months. It seems to me that we have--

CHAIRMAN MILLER. Do you want me to tell you your record?

MR. MORRIS. It wasn't so good in the last twelve months. It seems to me that we have a classic cyclical decline; the [evidence] is almost overwhelming. And I think the latest piece of evidence that you cited--that there was a [big] decline in durable goods orders is the last straw. Now, the staff projection does assume--as it has all along--a 6 percent rate of growth in M1 adjusted for ATS, and we have not gotten that for seven months.

MR. PARTEE. Except for April.

MR. MORRIS. Yes, there was one month. But that was generated by the IRS and not the FRB. So I think we have not created the financial climate that you've been predicting. Would you want to comment on that?

MR. KICHLINE. Sure. I'd make two comments. One is that in terms of a concern about the cyclical turn, I could perceive three possible scenarios right now. One is that we will have a situation of continued very strong growth that presses against resource availability and intensifies inflation. I would say that the information coming in tends to weaken that case, if not remove it. The second possibility is that we have a situation with serious distortions and one would anticipate either a deep or a prolonged contraction in activity. I don't think we have those sorts of distortions. So what I am left with then is the middle course, which we believe is reasonable at this time; it involves small real growth. Now, whether or not that will turn out to be a technical recession in the sense of two consecutive negative quarters, where those negatives are very small, is not really a big issue as far as we're concerned. It's the general pattern of what happens that is important, and we think the economy is in for that kind of period of small real growth. But it may well slip into a mild contraction in the technical sense.

With regard to the monetary aggregates, one of the things we have been getting that we did not anticipate is a further downward shift in the money demand function. So what we have in effect with the slower growth of the aggregates is interest rates that have been about on track with our forecast for some time. In addition, we've assumed that the rate of growth for M1 at 6 percent adjusted for ATS was over a fourth-quarter-to-fourth-quarter period so that if there were shortfalls we would get back within the ranges and stay on track. Hence, to the extent there was a difficulty, we assumed it would be very short-lived and we'd have a resurgence of growth.

CHAIRMAN MILLER. Henry.

MR. WALLICH. Jim, am I right in thinking that among the various price indexes--the deflator, the business fixed weight deflator, and the CPI--there has been an unusually wide discrepancy in the recent months? I see the CPI increase for the first quarter of this year was 13 percent. The other indexes are in the 10 to 11 percent range.

MR. ZEISEL. I think mortgage interest rates probably played a part in the differential. They have a heavier weight in the CPI and are driving that measure up; they don't play that kind of role in the gross business fixed weight price index. I think the difference in weighting is probably the most significant variable.

MR. WALLICH. It does make a difference whether the rate of inflation was 10 percent or 13 percent over the last three months, even if we give it the usual Federal Reserve discount.

MR. PARTEE. Was it a 13 percent increase on average over the [first] quarter?

MR. WALLICH. No, it was [measured] end-of-quarter to end-of quarter.

MR. PARTEE. Well, that's one difference.

MR. WALLICH. That accounts for some of it, probably.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. I just wanted to say that I think Jim gave an admirable answer to Frank on probabilities except that we do have the energy situation, which is very, very difficult to [judge]. It is such a new factor. Obviously it's going to lead to more inflation than otherwise. It's also obviously going to lead to less spending than otherwise. But how far either will move, I just don't think there's any way of knowing. One can imagine that the inflation effect will fan out because it will show up in wage demands and automatic cost-of-living increases and that kind of thing, and we may get as much secondary effect from it as initial effect. One can imagine on the spending side that not only will people have to lower spending for other necessities, but that it will have a great psychological effect on spending, as you say, for durables, for housing, for vacation homes, and for tourist travel. We're getting into the summer season when tourist travel is a very important element in budgets. Who knows what's going to happen? So there's an unusual amount of uncertainty connected with the energy situation today. But I think it's on the negative side.

CHAIRMAN MILLER. Nancy.

MS. TEETERS. Have you evaluated the economic impact of sharply rising interest rates, Jim? Have you looked at what the Wall Street Journal or [people on] Wall Street have said? Suppose the prime rate went to 13 percent. What would be the effect of that on your forecast?

MR. KICHLINE. Well, if it went to 13 percent, one would have to ask why. If it went to 13 percent because all these numbers are wrong and we have a rip-roaring economy under way, that's a different situation than if it went to 13 percent as a result of policy actions. But I don't see a rip-roaring economy in the cards. Given available information, I'd presume we'd be talking about a substantial increase in the funds rate to get the prime to 13 percent. And I think we would be talking about a substantial downward push on real activity over the period ahead and some improvement in our inflation forecast--but for the time period of a year and a half, relatively little on the inflation side.

MS. TEETERS. My other question is: Is there a reason for the peculiar pattern that you have on real disposable income? It seems to have a quarterly pattern that comes and goes.

MR. KICHLINE. It comes and goes with social--

CHAIRMAN MILLER. It's the July 1 factor.

MS. TEETERS. The social security?

MR. KICHLINE. It's social security, which is worth about $9.8 billion in July. So there's a third-quarter blip upward--

CHAIRMAN MILLER. That will fill many columns of newspapers in July. Willis Winn.

MR. WINN. May I borrow a little sand to feed my machinery? I still get the reading that the financing of [housing] has been turned off almost absolutely. And there is about a 3-month lag between financing and starts. On that basis, starts should [fall] very sharply starting by the end of June. Insurance industries, in contrast with the banks, report very little demand for financing at the moment, which is rather surprising. All of that leads me to feel that commercial construction is in for a rather sharp decline, though maybe not until the third quarter.

The other comment I'd make is that the trucking industry reports rather sizable declines in the last two weeks. Now, whether that's the adjustment to the after-strike effect or whether there's something basic happening, I don't really know.

CHAIRMAN MILLER. Thank you all for your questions and comments. Let's turn now to Steve for his observations. Then we'll do our go-around.

MR. AXILROD. Mr. Chairman, [we've had] stability in the federal funds rate and short-term rates in general since the beginning of the year, except for the most recent 25 basis point increase in the funds rate. [However], an apparent worsening of inflation and inflationary expectations presumably would have the effect of reducing real rates of interest. These two factors together raise questions about how to interpret monetary policy with regard to [whether] it is restrictive or not in relation to credit markets. The Committee, of course, has worried in the past about interpreting M1 and M2, but there are similar problems I believe in interpreting the credit markets. It might be helpful in that context to review what might be elements of restraint and elements of nonrestraint, so to speak, in the credit markets.

If you accept the proposition that market interest rates have been declining in real terms because of increases in rates of inflation, I think you have to look for elements of restraint in lender and borrower attitudes in relation to those interest rates. And I believe several elements of restraint have emerged since the beginning of the year and even since the last meeting. The most evident one perhaps is in the mortgage markets, as Jim has mentioned, and probably stems in part from the action taken in mid-March to eliminate the differential on money market certificates. In the six months prior to April, inflows to savings and loan associations for the most part had been running at annual rates over 10 percent, generally between 10 and 12 percent. In April, the annual rate of increase in deposits at S&Ls was 3-1/2 percent and our estimate is that it will be around 6-1/2 percent in May. So that rate of inflow halved from around 10 percent to 5 percent, and there has been a similar change at mutual savings banks. We don't have the latest commitment data, but in view of this [reduced deposit inflow] and the need for S&Ls to rely more heavily on Home Loan Bank borrowing, it's unlikely that we're going to have an increase in outstanding commitments in any lasting way. The declining trend in commitments that has been in evidence since November probably will continue.

I would also point out that at smaller banks, loan to deposit ratios have been rising steadily thus far in this expansion. We don't have data beyond the end of 1978, but at that point they were well above the ratios in the 1973-74 period. There's not a marked cyclical trend in such ratios at small banks, but after being flat they had been going up steadily in this expansion. And I think that's beginning to imply some restraint on availability [of funds at] these banks, which of course have less access to the money market than larger banks. Their [reduced] access would in [turn] cut down on federal funds sales to large banks.

With regard to other factors affecting attitudes, these [developments] affect the attitudes not only of suppliers but also of borrowers. The debt burden on consumers, [taking into account] both mortgage debt and consumer credit debt, is well above what it was in the 1973-74 period. Of course, that [concern] is in part alleviated--[analytically at least]--by inflation expectations, which make the debt burden seem light. On the other hand, any uncertainties about future income will make it seem very heavy. Furthermore, we've had very recently a continued step-up in the deterioration in business liquidity; the ratio of liquid assets to current liabilities of businesses is approaching very closely its '73-'74 lows. Another ratio, short-term debt to total debt, is pretty much at its high of the '73-'74 period. So in that area too we're now getting what might be characterized under more ordinary circumstances as a strained situation in business liquidity. Its actual impact on spending will depend, of course, on how businesses assess their future cash flow.

Finally, I would add that attitudes toward credit may also be being influenced by the impact of the gasoline shortage. Whether that would dissipate if, through a miracle of bureaucratic manipulation, the gas shortage turns out to be transitory, [I don't know]. In any event at the moment I believe it's making people very conservative with regard to spending, and thus borrowing would not appear attractive or needed at current interest rates.

Offsetting those elements of restraint is the general point that there has been no change in private short rates. There's considerable availability of bank credit at current prices and bank credit has been strong, as large banks have been able to borrow through fed funds, RPs, and Eurodollars. And corporate bond yields are up since year-end by about 60 basis points. I would estimate that a third of that is because of the nuclear power plant failures, which have made lenders more cautious with regard to financing utilities. But I would guess that most of that increase probably reflects the worsening of inflation and should not be interpreted as a tightening of the bond markets.

I would venture the judgment, Mr. Chairman, that on balance one can say that nominal interest rates have not become more restrictive since the beginning of the year, or even since the small action taken a couple weeks ago. However, I would say that lender and borrower attitudes toward credit have worsened in a sense and that given the level of interest rates and those attitudes, the posture in credit markets should be characterized as somewhat more restrictive. That is, it seems to me that there's less of an inclination to use credit and more of an inclination on the part of certain institutions to restrict the supply of credit at current interest rates.

One approach to policy when there are uncertainties about interpreting credit [conditions] is to put a lot more reliance on the aggregates. That is the reverse of the other approach, which is to look at credit when there's uncertainty about the aggregates. The aggregates have their problems, but perhaps they're gradually being resolved. I would point out that M1 now has moved back up into the 1-1/2 to 4-1/2 percent range that the Committee has adopted, as can be seen on the charts on page 10 of the Bluebook. M2 has moved up close to the bottom [of its range]. And if the staff's forecast for the May-June period is in the right direction, M1 will be moving up closer to the middle of its range and M2 might actually touch the bottom or move up into the range.

I think it continues to be the better part of wisdom for the Committee to take account of both credit market conditions and the aggregates in its policy deliberations and instructions to the Manager. And in view of the recent developments in the aggregates and the uncertainties about credit conditions, one approach might be to have a rather wide range for the aggregates--that is, not to take any tightening actions unless the aggregates were moving close to the middle of their long-run ranges or above, and not to take any easing actions unless they were falling clearly below the bottom of the long-run ranges. One way to do that would be to widen the ranges from the 4 to 4-1/2 percentage points that the Committee has been using to 5 or 5-1/2 or even 6 points, and to put most of that widening on the upper ends and not on the lower ends of the ranges. This could be accomplished with either a money market directive or a monetary aggregates directive, depending on how sensitive the Committee wants to be to changes in the aggregates. Under current circumstances, and [given] my interpretation of the restrictiveness of credit conditions, I would recommend a money market directive.

CHAIRMAN MILLER. Thank you, Steve. I would suggest we begin to go around the table. I think last time we started with Larry [Roos], didn't we? We'll switch over this time and start with Roger [Guffey] and come around the other way. I think the procedure we've been using recently has been helpful and I would suggest that we follow it again. That is, let's limit comments on the economy to any variance from what has been projected by the staff. Then each of us should give a general indication of the policy posture that should be followed without specifying the exact numbers. Just say generally whether it implies steady as we go, a tightening or easing up, or any other thing. So let's start with Roger and go around.

MR. GUFFEY. Thank you, Mr. Chairman. First of all, we have very little quarrel with the staff projections, particularly as to the pattern, but our forecast is perhaps a bit weaker in the latter part of 1979. Our analysis suggests that the housing figures might be weaker in 1979. In talking with some savings and loan people in our District, the impact of this money market certificate change has been very dramatic. That, coupled with usury rate ceilings that apply in several of the states in the High Plains region, essentially has closed down any future housing commitments by the savings and loans. There is apparently nothing in the works that would pick up that slack. Thus, we would anticipate that overall the housing projection by the staff might still be a bit high, even after the adjustment they made this time. In looking at the Board's model and trying to work through the housing starts and the potential for a bit of an increase in the saving rate, the [growth] drops off very quickly it seems. So our best judgment would be that in the latter part of 1979 and into 1980 we would have somewhat lower growth than the staff has projected.

With respect to policy, [my view is] cast against the background of growth in the aggregates being very slow. Given the numbers that have been published for the first quarter and what the April numbers now show, there is not a great deal of strength--even if the April numbers are adjusted. It would be my judgment that now is certainly not the time to take any additional tightening actions. And perhaps not until we see the figures in May and June would it be time to consider easing. As a result, it seems to me that for policy purposes we ought to be looking at [maintaining] the interest rate level and adopting [a directive based on] money market conditions without regard to where the ranges may be.

I've not thought about Steve's proposal for wider ranges. It is not very attractive to me at the moment. Nonetheless, I'd like to see interest rate levels stabilized as they have been in the recent past. I'd also like to endorse a proposal that I think [was implied in] Dave Eastburn's question. And that is that it is time for the Board to consider an increase of 1/4 percentage point in the discount rate, which is merely an alignment. We're seeing considerable pressure. Loan to deposit ratios are increasing in our part of the world, and understandably so. It's that time of the year. But I think the pressures are getting fairly strong. Lastly, if one looks at bank credit, which some apparently are prone to do, our information, as best as we can track it down, is that a great deal of the support for bank credit may be coming through the Eurodollar market. And if there is an increase in the reserve requirements for RPs, as the Board has proposed, it's going to make the Eurodollar market much more attractive--a cheaper source of funds. Unless there's some way to police the movement of funds offshore that come back in through the Eurodollar market, I think we would just be worsening that problem rather than making it better with that [proposal], Mr. Chairman.

CHAIRMAN MILLER. Thank you, Roger. Bob.

MR. MAYO. Well, I'll start off where Roger left off. I, too, feel that an increase in the discount rate would not be inconsistent with a policy position that is essentially a stable one. I think it would have some announcement effect in terms of our continued concern about inflation without really having a substantive effect, if I make myself clear. I think we have passed a [cyclical] peak in this current quarter. My guess, for what it's worth, is that in the years to come the National Bureau of Economic Research will record this quarter as the turning point. It has all of the ingredients, without some of the distortions, of the early '74 period. Credit expansion and many of the aspects of the real economy, as pointed out by the staff, indicate a turning point.

I'm not ready, however, to see us respond to a recognition of that turning point--even if all of us agree that it is here--by a significant move toward easing. I think that would be premature because of our continued very high levels of inflation. It would be misinterpreted. I'm not sure yet whether I buy Steve's widening of the range for M1. I'm more inclined to narrow it and be willing to jiggle [the funds rate] up another eighth of a point or so if indeed the aggregates come in strong in the rest of May and June, although I don't expect them to do so. I am more ready than I have been in many months to see us ease, but I'm not ready to do so today. Let me put it this way: I have opened my mind a little more in that direction.

CHAIRMAN MILLER. Thank you, Bob. Mark.

MR. WILLES. Thank you, Mr. Chairman. I'd like Murray's record to show that we agree substantially with all of the portions of Jim's forecast that are correct and disagree violently with those portions that are incorrect!

MR. MAYO. That's pretty good. Keep going.

CHAIRMAN MILLER. And give us the wisdom to know the difference.

MR. MAYO. And let us pray.

MR. WILLES. Well, somebody told me that's [all] we're left with! I just have a couple of quick comments. We're very much in the staff's camp with regard to business spending. We still think that it could turn out to be a plus for the year and could be the sector that will carry us through with positive real growth. I must say that your report on new orders doesn't sound very consistent with that. I hope that turns out to be a fluke. On the inflation side, we think a case can be made that is slightly more optimistic than the staff's--not in the near term but in the longer term. If you think as we do that the basic rate of inflation is determined primarily by the size and direction of the federal deficit and by the stance of monetary policy, both of those basically have been moving in the right direction. That would suggest that the long-run outlook for inflation is a little better than we might suppose. Food and OPEC and all these other things somehow keep making life less orderly than we would like. But even so, our feeling is that we may be moderately pleasantly surprised on the inflation side.

As for policy, we certainly wouldn't want to tighten up, whatever that means. I'd like to suggest that a tightening of monetary policy can be done in a number of ways, in our view at least, including a change in the rules of the game. And we would put the application of reserve requirements on RPs and things like that as a change in the rules of the game that would have a tightening effect. So we hope that will not be done. In terms of interest rates, I agree with what Steve said. In terms of the aggregates, I almost thought he was going to say that given what has been happening we could start to give more credibility to M1 and, therefore, we could narrow the range. He went in the opposite direction and he lost me. So, I'd like to think about that for a minute.

CHAIRMAN MILLER. Thank you, Mark. John.

MR. BALLES. Well, when I asked the question of Jim Kichline about what the case is for a bounceback in the second quarter, I probably tipped my own hand as to my increasing skepticism. I'm afraid that what I see is pretty much what Bob Mayo sees in terms of a probable cyclical peak in this quarter. As a matter of fact, our forecast for some time has been showing a short, shallow recession beginning in the second half of this year and going into the first quarter of 1980. But that's obviously just as judgmental as yours, Jim, and I don't know that it's any better than yours. Nevertheless, it is different. The recent news that has come in for the second quarter when we were expecting what I mistakenly called a bounceback and was corrected by the Chairman--it's more of a little hop, if anything--gives me some real concern. This is the time in the business cycle when we could get some very unpleasant surprises. We certainly got one in the first quarter and I would be prepared to see one in the second quarter, I'm afraid.

As for what to make of this troublesome development whereby bank credit has been growing more rapidly than the aggregates, our staff has recently updated their analysis in that area. I must say, after looking at it, that I don't really think the strong growth of bank credit proves very much. If we look back at earlier cycles, we find that bank credit tends to be more or less coincident with the cycle. It peaks very shortly before a downturn. That was certainly true in the '73-'74 recession where the deceleration of monetary growth preceded the peak in that business cycle and the formal recession by quite a few months. There are all sorts of reasons why bank credit would accelerate at this time in the cycle. Corporate liquidity is down, as Steve has correctly pointed out, and corporations wish to avoid locking themselves into high long-term rates. Hence, they turn to their banks for credit accommodation and try to wait out the period of high rates and plan to do some funding when long-term interest rates are coming down. So on balance I'm really not impressed at all by the fact that bank credit has been growing faster than the monetary aggregates.

During April we fought the "battle of the bulge," as I call it, on M1. It is said to have gone up at a 17 percent annual rate. [But] as the staff knows well, in view of the history of earlier Aprils, in our monetary theories it's tremendously difficult to compute seasonal factors for the month of April. I sympathize with the staff on this. But 17 percent could later turn out to be 8-1/2 percent or something like that. If we look at Aprils of preceding years, seasonal factor corrections have been made following the benchmark revisions and have involved some pretty [big] downward revisions. Whether that will occur for this April remains to be seen. But it's probably the most unreliable month in the year in terms of getting a good fix on what is really happening. Since the May figures as now projected by the staff--correct me if I'm wrong, Steve--show a 1 percent rate of growth for M1 and a 5.4 percent rate for M2, I wonder if it isn't time to unwind the snugging up of the funds rate that we did in April. We were leaning against what at that time appeared in the best judgment of the staff to be a bulge in the money supply. In view of the figures that we already have for April and those projected for May I wonder if we should inch the federal funds rate downward a bit. In short, based on my perceptions of spreading weaknesses in the economy and on the long cumulative impact of monetary growth well below the target range, even considering the April figures--and with May coming in on the weak side and the June projections weak--in my opinion this is no time to be snugging up any further. If anything, I would lean toward reversing the April action on the funds rate. That's all, Mr. Chairman.

CHAIRMAN MILLER. Thank you, John. Ernie.

MR. BAUGHMAN. Mr. Chairman, I, too, missed the turn in Steve's comments. I thought it was [going to be a recommendation] to lean more on the aggregates and he winded up [suggesting] a wider range on the aggregates. But I assume--

MR. AXILROD. If I may, President Baughman, I did want to lean more on the aggregates but I didn't want to [suggest] that the Committee should tighten with growth rates as low as they are under these alternatives. That's why I [proposed] a wider range on the high side.

MR. BAUGHMAN. I'd like to toss in a couple of points which seem to suggest something a little different than some of the points that have been made thus far. One, we were advised that Sears Roebuck recently sent out mailings to most of its credit customers raising their [credit limits]. Sears apparently inspected its records and discovered that a high proportion of [its cardholders] were at the maximum amount authorized. It has been reported that they got a nice response, which I construed as indicating that those consumers at least were still willing to use credit that was made conveniently available to them. I have also encountered--and it seems impressive, possibly because it's surprising to me--a number of instances of what I would call small speculators on houses. People are acquiring ownership of several units of housing. Frequently a part of the explanation given is the recent increase to $100,000 in the amount of capital gains. I don't know how they're going to hitch that to gains on more than one unit, but in their minds they seem to be able to do it.

A development that I am still unable to explain is the persistent decline in the number of active drilling rigs. In an attempt to check into that, we heard a whole array of what seem to me rather peripheral explanations. In total I suppose they have to add up to the fact that for increasing numbers of owners of these rigs--most of them are for lease--people who would hire them apparently are not willing to accept the risks and the costs involved in drilling. But that seems to me to be an incongruous development.

The housing bounceback that I've been inclined to expect in Texas in particular, with the revision of the usury law which seemed to be moving through the legislature satisfactorily, may not now materialize. We have a phenomenon in Texas at the present time which has been rather colorfully characterized as the "killer bees" where a miniority interest in the state legislature--but a group still large enough so as to prevent a quorum from being constituted--has simply absented themselves from the chamber. That has consequently stopped the forward motion of legislative action.

MR. PARTEE. Where else but in Texas would the legislators be fugitives from justice?

MR. BAUGHMAN. Well, the speaker of the Senate under his interpretation of the law has called the Texas Rangers into action and sent them out to find these fugitives and bring them back. But it's reported that they have crossed the border. And unless he's willing to create an international incident, he probably cannot reach them.

I have no particular quarrel with the staff's projection. It seems to me about as reasonable as can be made in the circumstances. However, in our discussion I think it might be appropriate for us not to focus exclusively on whether real economic activity is going to be a small plus or a small minus--the difference is possibly not very great--but to continue to focus a little more on inflation. Inflation is probably doing more damage now and has more potential to do damage to our economy than whether the rate of economic growth is a small positive or a small negative. That's all I have, Mr. Chairman.

CHAIRMAN MILLER. Thank you very much, Ernie. Frank.

MR. MORRIS. Mr. Chairman, as I indicated earlier, I think we are close to a cyclical peak. Conceivably, it may already be behind us, with weakness in consumption and housing being covered up temporarily by inventory accumulation, the classic form of a peak. I don't think we should casually assume that the recession is going to be very mild. We talk about the lack of imbalances in the economy. Very often we don't recognize the imbalances until sometime into a recession. For example, in late '73, I think no one forecast as severe a recession as we had in '74-'75. If we are seeking a soft landing, then I think we've got to move monetary policy now in a less restrictive direction. If we're going to recognize the lags of monetary policy, we have to do what we've never done before and that is to move before the evidence is overwhelming that we are in a recession. Now, this would take some explaining to the public because it would represent a radical departure from the past practice of always overstaying a policy of either ease or restraint. That has been the record of the past 15 years and I would hope that in this go-around we could break out of that cycle. [To do so] it seems to me that we have to move toward ease at this meeting. A modest easing in rates now, although coming at a time when inflation is very high, could very well forestall a need for very sharp declines in interest rates later on. So I think the moment is now. I'm sure I won't get much support for this proposition, but I feel very strongly that now is the time.

CHAIRMAN MILLER. Thank you, Frank. Phil.

MR. COLDWELL. Mr. Chairman, I am delighted to see the slowing in the economy. I've been hoping for it for a year. I think we're getting some reduction in the level of activity and I hope it continues for a while longer. I think we need to look at our basic objectives here because we have a problem of whether we are aiming to maintain a semblance of real growth or to contain inflation or a combination thereof. It seems to me that our current posture has some elements of restraint but those elements of restraint are coming in the housing field, largely in the usury ceilings and the thrift flows, which of course are the traditional ways. I think we run a risk on two sides. We run a risk of recession, of course, and we run a risk of some acceleration in inflation. The latter stems primarily from what I'd call an energy tax, because we are being hit with a very sizable tax thrown at us by energy costs. I suspect we can weather the food cost problem, especially to the extent that we can open up our borders to further imports, if there is anything to bring in. But I don't think the energy cost impact is going to go away and it is going to [spread] throughout our economy. You may recall the last time around that it took several months if not a year or more [for the energy shock] to [exert] its full impact. I suspect that the retail sales picture is giving us the signal that things are being slowed by energy costs and agricultural or food costs. Frankly, I welcome the slowdown. I'd prefer it hadn't come from further energy cost increases, but maybe over the long haul this will do us a favor and force us into some actions we should have taken six or seven years ago.

As for our monetary policy posture, I still believe that inflation will be our principal problem in the coming months and years. Whether we can achieve a reduction in inflation by a nice slow pattern is something we have not yet proved. I suspect it's going to require more strenuous efforts than have been mounted so far.

CHAIRMAN MILLER. Thank you, Phil. Henry.

MR. WALLICH. I share Phil Coldwell's feeling. I think we're in some danger of excessive preoccupation with the business cycle. It matters much more whether we come down from 7 percent to .4 percent growth than whether we go from .4 to -1 or -2 percent. So in that sense an important move is already behind us. I think inflationary expectations have increased substantially in the last quarter. The leading models have raised their projections of inflation for the next two years by about 1 percentage point. And as we know, we've always been below on our projections. I think we're now building inflation into the economy to a degree that we've never had it; consumer behavior shows that. We also have evidence that inflation in the American economy is much less variable than it is in other countries and is, therefore, much harder to bring down. What we see in our own forecast is that at best we have to look forward to a period of a very slow deceleration of inflation. I think that will be regarded as unsatisfactory. And I expect that this situation is going to cause us to adopt wage and price controls sometime this year or next year. People are sufficiently excited about the inflation and sufficiently disenchanted with the actions in the fiscal and monetary fields. If we don't succeed in bringing inflation down, then the predictable pattern is that after a mild dip we'll go into a renewed expansion starting from an inflation base of 8 to 10 percent, whereas last time we started at 5 percent. And that will land us in an area where not even Italy is today. We are now the country with the most inflation among the major countries except Italy, I believe.

As far as monetary policy is concerned, I think we still believe that somehow there's a free lunch--that we can accomplish our objective of reducing inflation at no cost--and I believe that's no longer true. We will have some costs, either in terms of much more inflation or in terms of reduced economic activity and a less than soft landing. I agree with Steve that real interest rates are falling; and that I think is the basic stance of monetary policy. We are [now] accommodating an external shock from food and oil. It's no longer the view of the economics profession that external shocks should always be accommodated, but our policy is doing that. It's not surprising, therefore, that in the ranking of inflation fighters we find ourselves near the bottom of the scale, as the Redbook among other things shows.

As is obvious from my remarks, I would urge a tightening, even though it is late in the game. I think the impact on the real sector would be very slight. The real sector is going its own way with little benefit from monetary policy. [A tightening] will have some favorable effect on expectations. I think we have to look at interest rates at this time. The aggregates have become so unstable; for six months there has been no growth [in M1] and then we get 17 percent in one month. Why should we allow our funds rate decisions to be triggered by that kind of mechanism? So I would agree with Steve to have a wider range--I think that is fine--and a money market target, with a rise immediately in the rate. Thank you, Mr. Chairman.

CHAIRMAN MILLER. Thank you, Henry. Paul.

VICE CHAIRMAN VOLCKER. I have heard a great deal of wisdom even without our getting around the rest of the table, Mr. Chairman. I'm not sure it has yet resolved all of the uncertainties in my own mind. I do share a lot of the feeling that has just been expressed about inflation; I think we tend to duck that issue. Something was said earlier about there not being much precedent for bringing down the rate of inflation rapidly. I'm afraid there isn't much precedent for bringing it down slowly over a number of years either, which is a measure of the difficulty of our problem. I'm impressed by the degree that inflation is now built into thinking in terms of the business outlook. I'm also impressed--the supporting factor--by the degree with which capacity problems and backlogs exist. But certainly the outlook is uncertain. The recent news hasn't been very buoyant. So I would conclude that the time is not very propitious for much of a change in either direction. There's a fair amount of time before our next meeting.

CHAIRMAN MILLER. When is our next meeting?

SPEAKER(?). July [11].

VICE CHAIRMAN VOLCKER. I would think that with either new financial or monetary data or business news, the Chairman might see an occasion for at least a telephone consultation some time in that interim.

CHAIRMAN MILLER. Paul, there's some sentiment that we should act like Congress and go home for six months and everything would get better!

VICE CHAIRMAN VOLCKER. Well, I sometimes agree with that, particularly if the Committee were to make precisely the decision that I'd like; then, I'd like to go home for 6 months, too. I can't foresee that. Frank Morris said that we can't casually assume the recession will be mild. I suppose we can't casually assume it, although it looks that way to me now--if we're going to have one. But we can't always be looking at the worst. If we're going to balance these risks of inflation and recession we have to run not too scared that the recession is going to be worse than we expect. So it is a question of bringing about a balance. As I thought about what to do, I arrived at the same conclusion that Steve did up to a point--that maybe for lack of anything better we should go back and look at the aggregates a bit. I certainly think we ought to widen the range. I just don't see how we can operate on a narrower range even with less than the extreme volatility that Henry just mentioned. My disagreement with Steve would be that I was thinking of widening the range mostly in the downward direction rather than widening it on the up side. But I do think that's a reasonable approach as we watch both the aggregates and the business news in the next six weeks.

MR. PARTEE. Well, I come to exactly the opposite conclusion that Steve did. I think we ought to pay careful attention to the aggregates and the growth in the aggregates in the period ahead. I'd widen the range on the funds rate and guard to see that we don't have undue weakness in the aggregates. There's a good chance that the turn has already occurred in the economy, that March will have been the high in industrial production and that the second quarter--and we're two-thirds through the second quarter--will be the high in real terms.

There is a very good chance that that's true. We've always, with no exception that I can recall, had great difficulty keeping the aggregates growing in the early stages of a recession. To go to an interest rate target now at this turning point in the economy would be exactly the wrong prescription for the Committee to follow. So, I would say that we ought to have an aggregates target with modest growth. What we ought to do to fight inflation is to see that we have only modest growth in the aggregates over a sustained period of time, not crunch the economy into what--I agree with Frank--could be a very serious recession. I think we could be in a much more serious recession this year than the one in '74-'75. So I would like to see quite modest growth in the aggregates over a sustained period, and I think that probably means that we ought to have a wider funds rate range. If I could echo what was said I guess by John Balles, it may be that a somewhat lower funds rate would be consistent with the discount rate.

CHAIRMAN MILLER. Thank you, Chuck. Nancy.

MS. TEETERS. I find it interesting that everyone is saying that they agree with the staff projection but we're all, almost to a person, talking recession for the first time. I don't see the strength from the consumer side to keep [the economy] going at the rate that is being projected by the staff. These low levels of disposable personal income are such that they won't support an expansion in that range. In essence, I think we have accomplished much of what we started out to do last fall, which was to slow the growth in nominal GNP. Now, it came out of real growth and not inflation, but that shouldn't surprise any of us given the action by OPEC. I also think a move to tighten at this time is just out of the question as far as the domestic economy is concerned. And it would be the wrong prescription for the international situation; I think it would make things worse in trying to keep the [exchange] values of the yen, the mark, the Swiss franc, and the dollar all together. Evidence of further tightening here would just lead to a further appreciation of the dollar in the international market. However, I'm not quite ready to back down [completely]. I think we should be backing down a little. And the only reason I think we should move [the funds rate] down a bit is that it's six weeks until the next [meeting]. I believe the rest of the information coming in over the quarter is going to be poor. But we do have our telephone network. Consequently, I would recommend staying where we are and, if anything, I would probably widen the fed funds range. And if I understand it, I can understand why [Steve was] calling for a widening of the ranges on the monetary aggregates.

CHAIRMAN MILLER. Thank you, Nancy. Bob.

MR. BLACK. Mr. Chairman, we have various [developments], all of which have been mentioned but in slightly different combinations. For some months now we have been fearing that [the economy] might be near a turning point, and we could argue that conceivably we might have passed it now. We could see a little more weakness in consumer spending because of attrition in real income and less [strength] in residential construction. This flurry of indicators that we have had, ending with a decline in new orders that you reported to us, creates more than just a mere suspicion that the economy has weakened significantly. So, our guess is that it is right at a turning point or even beyond it.

Now, having said that, I end up in roughly the same position as Governors Coldwell and Wallich in saying that I think inflation is still the major policy problem that we have to confront. I think it's good to bear in mind the fact that following the November 1973 turning point inflation accelerated for some time, credit demand expanded, there was a lot of upward pressure on interest rates, and M1 grew fairly rapidly. So I think we've got to be concerned about this and, as Chuck was suggesting a while ago, our objective ought to be to get the rate of growth in the aggregates down--gradually, but nevertheless down. So far as the discount rate is concerned, Mr. Chairman, I recognize the arguments posed by the current spread [between the discount rate and the funds rate]. I wish that in the past we had adjusted the discount rate more promptly to keep it more closely in alignment with the federal funds rate, but we have not done that. If at this particular juncture we are in fact near a turning point, [to move the discount rate up now] would look rather bad on the record, so I would not favor it for that reason.

CHAIRMAN MILLER. Thank you, Bob. Willis.

MR. WINN. Mr. Chairman, I sense a growing ugly mood in our society. I don't know whether the reaction is going to be in the political sector or in the economic sector or in the racial area, but I suspect it won't be a moderate reaction. So I think we are in for some rather volatile times ahead that could throw these estimates off, but I certainly don't want to predict them. My feeling would be that this is not the time to tighten. But in view of the uncertainties and the inflation problem and other problems, I would say that we would be well advised to stay where we are in terms of the current status of policy. I would favor a slight increase in the discount rate because of the position of the banks; the inviting differential there is hard for them to resist.

CHAIRMAN MILLER. Thank you, Willis. Dave.

MR. EASTBURN. I continue to think that we are going to have a recession of probably moderate dimensions and I believe we may be pretty close to a turning point if not there. I would agree with Frank that ordinarily we should be anticipating that and should not run the risk of overstaying the expansion as we have often done. In view of that, I have spent a little time trying to think through the strategy for the next year or so. In thinking about that I am assuming that we will continue to have substantial inflation and that the dollar will continue to be in some jeopardy. And if we do have a recession, even of relatively modest proportions, the budget situation will turn around and we'll see increased deficits. So we will be getting more stimulus from fiscal policy. Given the characteristics of the situation that we will be confronted with in the next year, I think we should probably have less easing in monetary policy than we ordinarily would in a recessionary environment. This leads me to feel that we should not be as hasty to ease as we ordinarily might be. And when we do ease, we should perhaps not be overzealous in easing and should strive for what Chuck has suggested--the kind of moderate increases in the aggregates that we need to have for some sustained period of time. With that kind of a strategy for the longer range, it seems to me that the message for today is that we ought to hold where we are. I'd watch [developments] and not be hasty to ease. So, I would stay where we are.

CHAIRMAN MILLER. Thank you, Dave. Monroe.

MR. KIMBREL. Mr. Chairman, we have just concluded a series of meetings with business leaders around the District and two impressions continued to come through almost monotonously. One was the fear of continuing and even escalating inflation and the other was concern about the supply of gasoline. Coming from those meetings I guess we have more reason to believe that we are now in or very near some business slowdown. I'm not saying that that's bad; it may be bad or it may be timely. Frankly, we have reason to hope it's true and that the slowdown will be moderate and last for some modest period of time. Our projections are pretty close to those of the staff. We [agree with] those generally.

Moving [on to other] concerns that we heard in these discussions, many related particularly to the recreational field. Cruise ships are altering drastically their pattern of going to ports where they cannot be refueled. For the first time since it opened, Opryland in Nashville, Tennessee had motel rooms available over the weekend before last. Travel in the area is limited over the weekends, not because gasoline is unavailable but because people fear that it may not be available. The coal operators that we talked with characterized [their business] as a disaster area. Inventories are tremendous; even at reduced [prices] there are no markets available. Some of the mines are simply discontinuing operations temporarily. In the natural gas area they are talking of abundant supplies and no limit until maybe it all comes to a screeching halt in late '81 or '82. Residential activity, particularly in South Florida, is of boom proportions. The activity there is just unbelievable, with much of it coming from offshore Caribbean interests that are buying not one, but four or five units at a time. Some are occupying units and some are not even bothering to occupy them. There is no restraint for funds that we detect from the banks; however, we are beginning to learn more and more of some restraints at the thrift institutions. In terms of the major feeling that came through in our discussions with these people, it was not one of recession but rather a modest [slowdown].

We are inclined to believe that the widening of the ranges that Steve is suggesting is fine; we don't have any difficulty with that. But, frankly, we would be very anxious to maintain the present posture with regard to the funds rate. We rather like it where it is and think it is taking its toll. If we had any strong feeling, it would definitely be against any downward drift [in rates]. We think that would be wrong and would be interpreted in the market as a feeling that we are giving up to some extent on our tug against inflation. As for the discount rate, we would favor a slight increase simply as an adjustment move.

CHAIRMAN MILLER. Thank you very much, Bones. Larry.

MR. ROOS. Mr. Chairman, those of us who watch the longer-term behavior of the aggregates are not in the slightest surprised by the fact that we are seeing a softening in the economy. There is absolutely no question in our mind that this problem is with us; the only questions that we see are how deep the downturn or recession will be and how long it will persist. Of course, we believe that the key to how deep this recession will be and how long it will persist lies in the control of growth in the aggregates. We do not believe that the aggregates have a life of their own; we think they are controllable. We believe that as long as the Committee continues to attempt to stabilize the federal funds rate, we are going to have the volatility in the behavior of the aggregates to which some of the preceding speakers have referred. If we were controlling and concentrating on aggregate growth, we would seek a 2 to 3 percent rate of growth in M1; that may be [equivalent to] a 6 percent rate in the old pre-ATS days. We don't think the upturn in M1 in April is necessarily conclusive evidence that growth will continue. We should watch it. The way we see it, any one month uptick or downtick in the monetary aggregates is not very indicative of anything. If we had our druthers--and we don't have our druthers--and were really concentrating on control of the aggregates, we would encourage a widening of the fed funds range and a narrowing of the target ranges for the aggregates.

Finally, in anticipation of the inevitable tendency to swing [policy] around the other way and become expansive if a recession occurs--and we think one will occur--I would hope that in the calm of this day we can resolve not to repeat past errors. Let's resolve not to panic at that time, not to move aggressively toward expansion or to respond to the political pressures to get ourselves out of a softened economy. Basically, I think we ought to be firm. I'd like to see us target on the aggregates; I don't think I will live to see it, but that would be our prescription, Mr. Chairman.

CHAIRMAN MILLER. With life expectancies what they are today, Larry, who knows? Thank you all very much. With that degree of wisdom--I cannot say unanimity--perhaps we should take a break and think about it. We can come back in 15 or 20 minutes and make a decision. Is that all right with everybody? We will recess now.

[Coffee break]

CHAIRMAN MILLER. Are we all back? Anyone who is not here please speak up! We are missing Phil. Are any other chairs vacant? The durable orders figures are now available; they will be released at 2:30 p.m. so we should keep them confidential until then. I haven't seen the details but you now have them, Jim, so why don't you just give us the rundown.

MR. KICHLINE. Durable goods orders are down 8-3/4 percent in total.

CHAIRMAN MILLER. This is April over March?

MR. KICHLINE. Right, and this is the advance number. As you know, the numbers have been bouncing around.

CHAIRMAN MILLER. March was revised, incidentally.

MR. KICHLINE. That's right, March is now up 2-3/4 percent. I don't have the earlier number with me, but that is not a big change. Primary metals are down 8-1/2 percent; they were up 1-3/4 percent in

March. Most importantly, nondefense capital goods orders are reported in this advance number as down 13-1/2 percent for April and they were up 6-1/4 percent for March. Even if one strips out aircraft, the numbers are very weak; so [the total] is not bouncing around because of aircraft orders. It is a general picture of negatives across the board.

CHAIRMAN MILLER. Thank you, Jim. To proceed with our discussion of current monetary policy and the domestic policy directive, I have asked Steve to take his unpopular theory, which didn't exactly gain wide support and enthusiastic applause, and reduce it to something specific so at least we can start off this discussion with something before us.

MR. AXILROD. Thank you, Mr. Chairman. I would recommend for Committee consideration the alternative B range for the federal funds rate, which is 10 to 10-1/2 percent centered at 10-1/4 percent--the prevailing federal funds rate. With regard to the aggregates, I would suggest an M1 range of 0 to 5-1/2 percent, which is a wide range, with more of an increase on the up side compared with alternative B than on the down side. That would mean, if the Committee adopted a money market directive as I would also suggest, that easing would occur until M1 got above the midpoint of the long-run range. With regard to M2, in view of recent events and to provide some room for the shifting of funds to banks because of the regulation Q action taken in the spring, I would recommend a range of 4 to 9 percent, one percentage point higher on the upper end than the alternative B range. In terms of M2 then, no tightening would occur until M2 was well into its long-run range. And as I indicated, Mr. Chairman, I believe that a money market directive is desirable under the current circumstances.

CHAIRMAN MILLER. Steve, thank you. I think it might be helpful for the Committee to turn to page 10 of the Bluebook. There you have, in effect, a display of the alternative B ranges. Jot down in pencil that the alternative B range for the federal funds rate is 10 to 10-1/2 percent. All the other data for alternative B are there. You will recall that Steve is suggesting 0 to 5-1/2 percent [for the M1 range] but alternative B as printed is 1-1/2 to 4-1/2 percent; and the dotted line shows that 3-1/2 percent is the rate of growth we would need in M1 from April for six months to get us to the midpoint of our long-term range. Likewise, for M2 the alternative B range shown is 4 to 8 percent and Steve is suggesting 4 to 9 percent. Again, the dotted line--going out to 8 percent in the future--is the rate at which M2 would have to grow for six months to be at the midpoint of our long-term range. Why don't we start with our Vice Chairman. Paul, what would be your suggestion?

VICE CHAIRMAN VOLCKER. I just want to raise a technical question and make a technical point. You estimate that about 10 percent of the April growth was due to the tax business?

MR. AXILROD. Yes, that's right.

VICE CHAIRMAN VOLCKER. You have assumed that will be washed out in the next month or so?

MR. AXILROD. That's right. We have a little stronger growth rate on average for April and May together than we think is the underlying trend. June itself, at around 5 percent, is closer to what we think is the underlying trend, even though that's a shade above it. So we washed out the April--

VICE CHAIRMAN VOLCKER. These numbers that we're looking at for May and June are really below normal in some sense.

MR. AXILROD. Well, we have zero for May. At current interest rates we think the normal rate would be more like 3-1/2 to 4 percent on average if the ATS stays as it is.

VICE CHAIRMAN VOLCKER. I wouldn't be all that far from where Steve is. On the funds rate, I have no problem. As I suggested earlier, taking account of the unwinding of the tax effects, I would prefer to see the M1 range go from a minus number up to 4-1/2 percent and I'd keep the M2 range near where it is. I would treat it during the period very much as Steve suggested: If [money growth] really goes down, I'd lower the funds rate; and if it goes to the up side, I'd move up pending some dramatic business news. Each meeting we get [at least] one piece of disappointing news. Housing starts [are disapointing]; durable goods are even more so.

CHAIRMAN MILLER. Thank you, Paul. Did you say you would agree with the money market directive?

VICE CHAIRMAN VOLCKER. I could go either way on that.

CHAIRMAN MILLER. Now let's start alphabetically. John Balles.

MR. BALLES. I wonder if I could ask first, Mr. Chairman, for a clarification by Steve to make sure I understand the ground rules regarding how this money market directive would work within the broader ranges that we're talking about. I'm not sure I got that.

MR. AXILROD. As I would understand it, President Balles, the Manager would raise the funds rate from 10-1/4 toward 10-1/2 percent, at as deliberate a speed as the market could bear, when M1 and M2 on average got toward the top of their ranges. There would be a degree of flexibility as to whether he would start moving with M1 at either 5 or 5-1/2 percent. If it was over the range, he would then have to be at the top of the federal funds rate and would have to come back to the Committee for instructions. It's symmetrical reasoning, of course, on the down side. So a money market directive would imply a less prompt movement relative to the aggregates than a monetary aggregates directive.

CHAIRMAN MILLER. You mean an old money market directive instead of the managed money market directive we've been using.

MR. AXILROD. Yes, that's correct.

MR. BALLES. I thought I understood you to say, Steve, with respect to your 0 to 5-1/2 percent M1 range that no easing would occur until M1 got down to the zero.

MR. AXILROD. That's right. But zero or half--

MR. BALLES. Close to it at least.

MR. AXILROD. Yes, that's right. That would get [M1] to the bottom end of the long-run range.

MR. BALLES. No tightening would occur, however, until M1 was growing at around 5-1/2 percent. I wish you hadn't called on me first. I could think about it.

CHAIRMAN MILLER. Do you want us to skip you for a moment?

MR. BALLES. May I?

CHAIRMAN MILLER. Sure. Bob Black.

MR. BLACK. I'll be glad to help him out, Mr. Chairman! It seems likely to me that any further tightening could certainly aggravate any recession that might be developing. At the same time, I don't think we ought to abdicate to the forces of inflation. So I think Steve has done remarkably well in choosing the proper ranges. Though mine were slightly different, I can buy his ranges completely.

CHAIRMAN MILLER. That is helpful. I didn't think I'd see that.

MR. BLACK. Well, it's for unusual reasons; I didn't get there by the same route he traveled.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Mr. Chairman, the ranges Steve suggested are just about one half point off my suggestion. I thought we ought to go from 0 to 5 percent on M1. On M2 I had 4 to 8 percent rather than the 4 to 9 percent; I could accept 8-1/2 percent. It seems to me that the 10 to 10-1/2 percent range on federal funds is a bit narrow, but given the way we are consulting I guess it doesn't matter if we're going to move it up [as necessary].

CHAIRMAN MILLER. Why don't we just do away with the Desk and have a daily conference?

MR. COLDWELL. That's a possibility! I do want to understand a little more [precisely], Steve, whether we're talking about the Desk not moving until we reach the 5 percent or the 8 percent levels or conversely the 0 or 4 percent levels. That means we're using up the entire range on the aggregates before there is any move off the 10-1/4 percent funds rate, which is the midpoint of the funds range you're talking about.

MR. AXILROD. Yes.

MR. COLDWELL. In other words, we hold the market steady until we hit the outer bounds, whatever they may be.

MR. AXILROD. Or are very close to them.

MR. COLDWELL. A 16th or a 32nd of a point?

MR. STERNLIGHT. Within 1/2 percentage point.

MR. AXILROD. I think within 1/2 point, [as] in the past, depending on how much certainty we have regarding the data on the aggregates.

MR. COLDWELL. Well, I just wanted the ground rules straight this time so we don't have another--

MR. AXILROD. That's with the money market directive.

MR. COLDWELL. That's all I have. I'd go with a money market directive.

CHAIRMAN MILLER. Thank you, Phil. Bones.

MR. KIMBREL. I like the idea of a money market directive. I, too, had in mind for M1 that maybe a range of 0 to 5 percent would be fine. And for M2 I had thought maybe 4 to 8 percent--

CHAIRMAN MILLER. And otherwise the same? The fed funds range is okay as proposed?

MR. KIMBREL. Yes.

CHAIRMAN MILLER. Thank you very much, Bones. Bob Mayo.

MR. MAYO. I don't have any particular problem if we use a money market directive in going with 0 to 5 percent. On M2 I'm indifferent on whether the range is 4 to 8 or 4 to 9 percent. If we did go to a monetary aggregates directive, I would narrow the ranges on both M1 and M2. There is a little quirk here that probably should be mentioned, but it may not be of any importance. And that is that our present directive has a fed funds range of 9-3/4 to 10-1/2 percent. Granted, we don't let out the new information until after the next meeting, which is a long time from now. But I'm just wondering if it would look as if the Committee had indeed tightened up from 9-3/4 to 10 percent on the lower bound of our funds rate range. So I'd prefer an asymmetrical midpoint of 10-1/4 percent and I'd keep the 9-3/4 percent as the lower bound.

CHAIRMAN MILLER. Thank you, Bob. Chuck.

MR. PARTEE. I think that's an important point you made, Bob, about the funds rate range having been at 9-3/4 to 10-1/2 percent, so there would be an appearance of tightening if we went to 10 to 10-1/2 percent. Of course my view, as I expressed before, is that we ought to ease. So I would put the funds range at 9-1/2 to 10-1/2 percent, making it a little easier than last time. There has been plenty in the news to justify an immediate reduction of a quarter point in the funds rate. I'm referring not only to the new orders figures, which are going to hit like a ton of bricks, but also to housing starts, which were disappointing, and to industrial production, employment, and retail sales data. All those data have come out since the last meeting of the Committee and in addition we have the fuel shortage. In effect, it's all new news that we're looking at in today's meeting. So I would take 9-1/2 to 10-1/2 percent as the range, with a 10 percent midpoint and a prompt move to the 10 percent.

On the aggregates, just judging from this longer-term chart, I would not like to see M1 as low as zero for the two months, which would put it below the bottom end of the range again. So I would suggest 1 to 5 percent for M1. On M2 I think we ought to recognize that money market certificates are doing much better in the banks because of our success in getting rid of the differential, and for M2 I think we ought to have 5 to 9 percent, which would also move us about to the bottom--perhaps just slightly above the bottom--of the range by the end of the projection period. And as I said before, I would take the aggregates directive. I think it's much more clearly indicated now than it has been at any time in the last six months.

CHAIRMAN MILLER. Thank you, Chuck. Nancy.

MS. TEETERS. I'd keep the funds range at 9-3/4 to 10-1/2 percent because if we do need to [ease policy], that gives us more leeway to do it. Also, I think Bob's point is right; I don't think we want even the appearance of tightening at this point. And I have no preference on the ranges for the monetary aggregates; 0 to 5-1/2 percent is fine and 4 to 9 percent is fine. I would go with a money market directive.

CHAIRMAN MILLER. Thank you, Nancy. Henry.

MR. WALLICH. Well, the news isn't very conducive to [focusing on] what I think is important. The news that we hear is all about the business cycle and very little about inflation. I think monetary policy at this time doesn't do very much to the real sector; it doesn't shape expectations. So I would go for a mild tightening. I agree with Steve on a widening of the ranges but I'd widen them at the lower side so as not to trigger a reduction [in the funds rate] if the very unreliable aggregates should come out [on the low side]. On M1 I'd say -1 to 4 percent and on M2 2 to 7 percent. I'd move the federal funds rate up to 10-1/2 percent within a range of 10-1/4 to 10-3/4 percent and adopt a money market directive.

CHAIRMAN MILLER. Thank you, Henry. Ernie.

MR. BAUGHMAN. Mr. Chairman, I would prefer alternative B as specified in the Bluebook and with an aggregates directive.

CHAIRMAN MILLER. Thank you, Ernie. Dave.

MR. EASTBURN. I would agree with Steve's proposal.

CHAIRMAN MILLER. Thank you. Roger.

MR. GUFFEY. Mr. Chairman, I would go for an M1 range of 1 to 5 percent rather than zero on the bottom with the anticipation that we may get weak growth that would trigger a downward movement [in the federal funds rate]. I'd go with 4 to 9 percent on M2 and 10 to 10-1/2 percent on the funds rate with a money market directive.

CHAIRMAN MILLER. Thank you, Roger. Frank.

MR. MORRIS. Mr. Chairman, I agree with Chuck Partee's aggregates of 1 to 5 percent and 5 to 9 percent but I think his federal funds range is a bit too timid. History tells us that in a recession it's very difficult to get monetary aggregates to grow unless we push interest rates down. So I think the funds range ought to be 9-1/2 to 10 percent with a move to 9-3/4.

MR. PARTEE. Of course, Frank, if the aggregates come in really low--if they come in minus, say--we'd have to take another look.

MS. TEETERS. Do we have another month coming up like April, where we don't know what the seasonals are?

CHAIRMAN MILLER. Every month is that way!

MR. AXILROD. The next month that's like that [typically] has been July.

CHAIRMAN MILLER. Larry.

MR. ROOS. I would prefer alternative B with a wider federal funds range of 9-3/4 to 10-1/2 percent. And in order to help the unreliable aggregates become a mite more reliable, I'd go with an aggregates directive.

CHAIRMAN MILLER. Thank you. Mark.

MR. WILLES. I have a preference for "B" as it stands.

CHAIRMAN MILLER. Okay. Willis.

MR. WINN. I support Steve's recommendation.

CHAIRMAN MILLER. John Balles.

MR. BALLES. I've wrestled with Steve's compromise because I have great respect for his recommendations. When everything is said and done, I do like a couple of things he recommended. I like the money market directive and the widening of the ranges. But to be true to my own convictions with respect to M1, I really have to be in favor of a 1 to 5 percent range and on M2 5 to 10 percent. The lower number of 5 percent is with a view to not driving [M2] further below our long-range target. On the federal funds range, my preference would be 9-1/2 to 10-1/2 percent with an immediate move to 10.

CHAIRMAN MILLER. It's another one of those months! Looking at fed funds, six voting members have indicated a preference for leaving the fed funds rate at 10-1/4 percent. Of those, four want to have the range at 10 to 10-1/2. Two members want to move the rate immediately down to 10 percent and one wants to move it immediately up to 10-1/2 percent. Those who want to move down to 10 percent also want a range of 9-1/2 to 10-1/2 percent. And Governor Wallich wants to move the range up to 10-1/4 to 10-3/4 percent.

As far as [preferences on] the ranges go, there's a mix. [For M1] zero is the bottom on five of them. There are ones and minus ones. I don't know if we can synthesize this or not. It looks easier to do the fed funds range than the aggregates ranges.

MR. COLDWELL. I suspect you could do it by testing Committee sentiment on the boundaries. Take the boundaries on the top and bottom: 10 versus 9-3/4 percent; 0 versus 1 percent; and 5 versus 6 percent.

CHAIRMAN MILLER. Well, nobody suggested 6 percent.

MR. WALLICH. I thought Bob Mayo came out with 0 to 6 percent.

CHAIRMAN MILLER. Bob Mayo, according to my list, had 0 to 5 percent. Did I get that right?

MR. PARTEE. Yes, I think [most] were for 0 or 1 percent on the bottom and 4 or 5 percent on the top.

CHAIRMAN MILLER. Well, 4-1/2 to 5 percent. Let's try to specify [the ranges] for a moment. People have different [preferences but] let's still try 0 to 5 percent. That seems to be the most predominant one. The next most predominant one seems to be 4 to 8-1/2 or 9 percent [for M2]. On the fed funds range, the midpoint seems to be predominantly 10-1/4 percent. And one could make a case that if we combine those who want lower with those who want higher [limits], we might maintain the 9-3/4 to 10-1/2 percent range and have an asymmetrical midpoint. I'm not sure that fits anybody's definition but we might try that in terms of a tentative look.

MR. AXILROD. Mr. Chairman, may I make one suggestion? If it's a question of the publicity of [a change from] 9-3/4 to 10-1/2 percent, as I believe both President Mayo and Governor Teeters mentioned, you could marry that with the 10 to 10-1/2 percent by simply indicating that there might be a telephone conference if the rate got down to 10 percent--before a move to 9-3/4.

CHAIRMAN MILLER. In other words, we could leave the 9-3/4 percent [lower limit] and merely say that we'd have a call if it got down--

MR. AXILROD. That way you wouldn't have--

CHAIRMAN MILLER. We'd have an understanding to that effect. Well, it looks as if we'll probably have a telephone conversation anyway. With that caveat, let's see who would buy that: Aggregates ranges of 0 to 5 and 4 to 9 percent, and 9-3/4 to 10-1/2 for the funds rate, with the 10-1/4 percent rate maintained for the time being and a conference call if it gets to 10 percent and is going down. What would be the sentiment on that?

MR. ALTMANN. Do you want a show of hands or do you want me to call the roll?

CHAIRMAN MILLER. Why don't you just call the others; don't call me.

MR. ALTMANN. Vice Chairman Volcker.

VICE CHAIRMAN VOLCKER. Well, I guess this is within my limits of tolerance. If we go down to 9-3/4 percent on the funds rate, we ought to go to 8-1/2 percent on M2. That would make me a little happier but you're right about the understanding on the funds rate.

MR. ALTMANN. President Balles.

PRESIDENT BALLES. No.

MR. ALTMANN. President Black.

MR. BLACK. Yes.

MR. ALTMANN. Governor Coldwell.

MR. COLDWELL. I agree with Paul. I prefer 8-1/2 percent [on M2] but the rest of it is acceptable.

MR. ALTMANN. President Kimbrel.

MR. KIMBREL. I could buy it, but I would prefer the 8-1/2 percent also.

MR. ALTMANN. President Mayo.

MR. MAYO. I also would prefer the 8-1/2.

MR. ALTMANN. Governor Partee.

MR. PARTEE. I can't support it.

MR. ALTMANN. Governor Teeters.

MS. TEETERS. I can support it.

MR. ALTMANN. Governor Wallich.

MR. WALLICH. No.

CHAIRMAN MILLER. Do the same thing with 8-1/2 percent.

MR. ALTMANN.

Vice Chairman Volcker	Yes
President Balles	No
President Black	Yes
Governor Coldwell	Yes
President Kimbrel	Yes
President Mayo	Yes
Governor Partee	No
Governor Teeters	Yes
Governor Wallich	No

CHAIRMAN MILLER. Well, John, to make it acceptable to you what changes would need to be made?

MR. BALLES. Some that are not acceptable to the clear majority. I have felt for several months now, and have so recommended, that we should be edging down on the funds rate. And I think this time I've got to stick to my guns.

CHAIRMAN MILLER. Okay. Chuck what change would you need to be satisfied?

MR. PARTEE. I could accept it all if we had a monetary aggregates directive.

CHAIRMAN MILLER. All right, we'll test that. Henry, you're [in a position similar to that of] John Balles, I suppose. You want to tighten and he wants to go lower and you can't change your philosophical position I suppose.

MR. WALLICH. I could compromise on a small increase in the funds rate, to 10-3/8 percent, but I don't see anybody who is much inclined to go that way.

CHAIRMAN MILLER. Well, let's just see what the vote would be if it were an aggregates directive instead, with 0 to 5, 4 to 8-1/2, and 9-3/4 to 10-1/2 percent.

VICE CHAIRMAN VOLCKER. Would the aggregates directive be consistent or inconsistent with the Axilrod caveat?

MR. PARTEE. Oh, no it can't be consistent with that.

MR. MAYO. No, then it's a money market directive.

MR. WINN. [Unintelligible.]

CHAIRMAN MILLER. We'd have to get rid of that.

MR. PARTEE. He said we wouldn't go below 10 percent--

CHAIRMAN MILLER. Without consulting.

MR. PARTEE. With a monetary aggregates directive, if the aggregates are weak, we're going to go below 10 percent.

MR. AXILROD. The caveat was "without consulting."

MS. TEETERS. But if we go to a [monetary aggregates] directive, Steve's scenario would change. How would it change?

MR. AXILROD. Yes, we would move the funds rate up or down well before the aggregates got to the outer limits of the ranges. We'd move more promptly.

CHAIRMAN MILLER. If the aggregates are strong, we would tighten sooner; and if they are weak, we would ease sooner without consulting until the funds rate gets to 10 percent and then we'd consult.

MR. WALLICH. But these [aggregates] are very unreliable now. I don't know why we should expose ourselves to that.

CHAIRMAN MILLER. Well, that's just the sentiment--

MR. PARTEE. I don't know why you say they're so unreliable. They haven't been unreliable at all except for one month--April. They've been very reliably weak every month.

CHAIRMAN MILLER. If you want to tighten, that's not reliable!

VICE CHAIRMAN VOLCKER. I don't think it's quite as good, but I can go along with it.

CHAIRMAN MILLER. John?

MR. BALLES. No.

CHAIRMAN MILLER. Still "no." Bob Black?

MR. BLACK. I cannot [agree to it], Mr. Chairman, if I interpret it correctly that this would mean we would raise the federal funds rate if M1 started coming in at 3-1/2 percent. That would be a tightening. If we had a money market directive on the top and an aggregates directive on the bottom, I could live with it a lot better. I would not want to tighten. If we tighten [with growth in M1] at 3-1/2 percent, we don't even approach--

MR. PARTEE. All we would do is move the funds rate 1/8 point at 3-1/2 percent [on M1]. That's right at the borderline isn't it, Steve?

MR. AXILROD. Yes. The usual zone of indifference has been that or sometimes a little larger, depending on the uncertainty we feel about the aggregates.

MR. PARTEE. And M2 would [have to] be up there, too.

MR. BLACK. At 6-1/4 percent, the way I figure it.

MR. COLDWELL. About a 4 point zone of indifference.

CHAIRMAN MILLER. Anyway, Bob, your sentiment would be--

MR. BLACK. I would vote against that, Mr. Chairman. As I interpret an aggregates directive, this is much tighter on the top side and it's easy on the down side. I'm more concerned about the weakness in the economy and I wouldn't want to tighten that soon.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Yes.

CHAIRMAN MILLER. Bones.

MR. KIMBREL. I really don't like it.

CHAIRMAN MILLER. We're losing ground, Chuck. We gained your vote and lost three. Stop the count; let's forget it.

MR. PARTEE. I thought it was clever.

CHAIRMAN MILLER. Not clever enough. Have you another suggestion?

MR. PARTEE. No, I don't. I'd rather cut the funds rate to 10 percent right now, so I feel unhappy if I'm not permitted to do that. I would rather [vote against] the directive if that is not called for.

CHAIRMAN MILLER. Well, we have a majority, I gather, of six to three. I wish we could narrow that spread. Is there anybody here from the State Department who knows how to put Israel and Egypt together?

VICE CHAIRMAN VOLCKER. We're not doing very well.

CHAIRMAN MILLER. Couldn't we promise Henry that at the proper time we will tighten and promise Chuck that at the appropriate time we will ease?

MR. MAYO. That's good. Let's leave it there.

CHAIRMAN MILLER. And get the vote on that.

MR. MORRIS. How do we know when the appropriate time is, Mr. Chairman?

CHAIRMAN MILLER. Leave it up to the Chairman! Well, I think we better conclude this so we can go to lunch. We now have before us a proposal, which we are going to vote on officially. Maybe somebody will be kind and at the last moment switch. The range for M1 would be 0 to 5 percent and the range for M2 would be 4 to 8-1/2 percent. The fed funds rate would initially be at 10-1/4 percent and would move in a range of 9-3/4 to 10-1/2 percent but not below 10 percent without consultation. And the movement within the range would be based upon a money market directive. I shall vote for that.

MR. ALTMANN.

Vice Chairman Volcker	Yes
President Balles	No
President Black	Yes
Governor Coldwell	Yes
President Kimbrel	Yes
President Mayo	Yes
Governor Partee	No
Governor Teeters	Yes
Governor Wallich	I wish I could but I can't.

CHAIRMAN MILLER. Put down a maybe! Thank you very much, I think. I suppose we will be calling up for a new directive in the interim period.

MR. PARTEE. Especially with a 7-week interval.

CHAIRMAN MILLER. Yes, I'm sure we will be. Now we'll move to consideration of the Manager's recommendations with respect to foreign currency operations. I'm very sorry that we have no swaps to renew this month, Alan!

MR. HOLMES. That's exactly what I was going to say!

CHAIRMAN MILLER. Well, I'm sorry.

MR. HOLMES. It is rather nice to be out of swap debt for the first time in almost ten years--the first time going back to the pre-71 period [unintelligible] Swiss franc debt.

MR. MAYO. You're not going to retire on that note!

MR. HOLMES. No, I don't think that will be possible.

It might be worthwhile, Mr. Chairman, to say a few words about our market operations on behalf of the Treasury as well as the Federal Reserve. As you know, earlier this year we were sharing with the Treasury any purchases of Deutschmarks that we made in the market, typically on a 50/50 basis, although different proportions were used at different times. After the Treasury was able to repay its remaining swap debt to the Bundesbank in late March, all March purchases, as noted, were for System account and were used to repay swap debt. After April 27 when that [swap] debt was finally repaid, all purchases have been to cover the Treasury's Carter bond indebtedness. A total of 5-1/2 billion Deutschmarks were involved in that and the Treasury had spent 1.2 billion of that amount in intervention earlier this year. The Treasury has already covered a billion of that amount. That means they only have about 210 million Deutschmarks to go. Once that has been accomplished, I think there would be a real possibility of the System once again sharing with the Treasury any Deutschmark purchases. That's all I have, Mr. Chairman.

CHAIRMAN MILLER. Any comments or questions?

MR. PARTEE. What do you mean by once again sharing Deutschmark purchases? We have shared them in the past?

MR. HOLMES. Oh, yes.

MR. PARTEE. Deutschmark purchases?

MR. HOLMES. Yes. All year, up until the time the Treasury got out of debt, we were sharing.

MR. PARTEE. I see.

MS. TEETERS. Does that mean that we'll be accumulating D-mark balances?

MR. HOLMES. That would mean we would be accumulating. The amount, of course, would depend on what the Committee decides.

MR. WALLICH. Alan, could you recapitulate quickly how much the Treasury accumulated over what period of time so that one can get an idea of how fast this accumulation occurred?

MR. HOLMES. The accumulation comes very fast on some days and then it just disappears. So I think one can't really take an average that's meaningful here. But the billion Deutschmarks have been accumulated since April 27, including purchases on April 27.

MR. WALLICH. Is there some flexibility, if we should be [approaching] our limits on that accumulation, of pushing more of the intervention on the Bundesbank? My impression is that they have been reaching for it anyway.

MR. HOLMES. I don't think there is any problem in pushing the Bundesbank to sell dollars. They are quite happy to do that.

MR. WALLICH. Until they reach a liquidity constraint problem which--

MR. HOLMES. Which is [some distance] away yet.

MR. WALLICH. We could find ourselves accumulating in a couple of weeks an amount that we have debated about over a month on whether we should or should not. I just would like us to be aware of that.

CHAIRMAN MILLER. Well, we have [agenda item] number 9 coming right up for debate again.

MR. PARTEE. It could easily amount to a couple hundred million dollars a week, couldn't it?

MR. WALLICH. Easily. It could be that in a day.

CHAIRMAN MILLER. The alternate choice is to have a strong dollar and, therefore, cut our inflationary pressures in this country. That would be rather unfortunate because it would show that we're interested in fighting inflation!

MR. WALLICH. That's our only hope now.

CHAIRMAN MILLER. Well, shall we move to item 9? We have [on the agenda] a discussion of the System's holdings of foreign currency balances. We have a memo, which I assume has been circulated to everyone. It's a very short memo. Steve and Alan will you [introduce the subject]?

MR. AXILROD. Mr. Chairman, the Committee had a discussion of three memos [on this issue] at the last meeting. Following that discussion, the Committee asked us to present a specific proposal. This memo, briefly put, is our specific proposal. I have nothing further to add. Mr. Holmes?

MR. HOLMES. Mr. Chairman, I might just say a word about our current understanding with the Germans on the accumulation of Deutschmarks. At the very beginning the Germans

At the May BIS meeting, however, Chairman Miller and Dr. Emminger agreed that it

I

understand, too, that Under Secretary Solomon reached an agreement with the German finance ministry just last week for the United States

That's for the United States, either the Treasury or the Federal Reserve. I'm not sure that all these agreements are engraved in stone and there seems to be some uncertainty as to who agreed to what. But I believe that is the position.

CHAIRMAN MILLER. There's no misunderstanding on the 4.1 billion.

MR. HOLMES. The 2 billion I think--

CHAIRMAN MILLER. The 2 billion is news to me.

MR. HOLMES. It's news to the Bundesbank, too. So I think that is left to be discussed. But in general the Germans are agreeable to the United States--the Treasury or the Fed--building up a certain amount of balances.

MR. WALLICH. Are there similar agreements with the Japanese?

CHAIRMAN MILLER. No, we're going to come to that in a second.

MR. PARTEE.

CHAIRMAN MILLER. Well, Chuck, there are policy issues. And there is also a question of buying [marks] without any place to invest them, which isn't very attractive. So we need a little cooperation because having the Treasury holding sterile balances of marks is not attractive.

MR. HOLMES. Now we have reinvestment facilities for--

CHAIRMAN MILLER. They can deny [us the use of] these investment facilities.

VICE CHAIRMAN VOLCKER. We could invest in the Euro market.

CHAIRMAN MILLER. Yes, but that creates all kinds of [complications]. We've already agreed not to [do] that, so it's more complicated. There is no problem on the 4.1 billion, which just brings the Treasury back to where it was on November 1. The policy memo presented sets forth the recommendation of our task group that we authorize the Federal Reserve System to hold up to $2 billion in foreign currencies concentrated in the principal currencies of DM, yen, and Swiss francs, with no more than $1 billion in any one currency and only relatively modest holdings of any other currencies that might be useful in transactions. Now, as for the Germans, as far as I know we have no understanding or commitment to accumulate balances at the moment for the Federal Reserve.

MR. HOLMES. I think the Bundesbank has said that they have no problems if it's a small amount.

CHAIRMAN MILLER. But we haven't crossed that bridge in terms of [understandings with] us. The Japanese government, both their ministry of finance and their central bank, have been urging that we go into joint intervention with them to show a force in the marketplace. The Treasury has been urging this upon us. We have been consulting with the Japanese as to whether a package could be put together that would be directed toward strengthening the yen, which seems to have depreciated too much and may result in aggravating surplus problems again later this year or next year. We originally had consulted to see what could be in such a package. They have taken some initiatives on their own to give guidance on capital outflows. They also have taken some liberalizing steps at the same time. That may [produce] countervailing forces but at least their consultations with their banking system now would begin to [set a] program schedule [relating to] some of these outflows [that will] take a little pressure off. They still desire that we announce a program of joint intervention with them--a program designed to counter the excessive depreciation of the yen and assure an orderly market.

The scale of such an intervention would be governed by [our decisions regarding the recommendations in] this memo. [Under this proposal] the most we could accumulate in yen would be $1 billion, which means that the most that we could accumulate beyond what we now have is about $813 million. The Treasury is prepared to intervene to the tune of $200 million in aggregate. It would seem to me that if we were interested in doing this, it would have a desirable market effect. Then we should limit our intervention to 10 percent of the aggregate. So if we were doing $1.2 billion, there would be $12 billion of total intervention before we did $1.2 billion, and the Japanese would do all the rest. We would not be running each account in that ratio but we'd be balancing out week to week to make sure that that relative ratio was maintained. Alan or Gretchen, do you have any views on how effective this would be in the market or whether it would be desirable?

MR. HOLMES. I think the idea of the joint intervention probably would be impressive to the market. I start with that. As far as the operational side is concerned, if we can really work out a flexible system where we keep to the right proportions but not day by day, I think we can do it. But, Gretchen, you may have more operational problems with this than I'm suggesting. There are operational problems, but I think they're manageable. We were able to do that before with the Japanese when we were intervening on the other side--when we were acquiring yen we had joint intervention--and I think it can be done.

CHAIRMAN MILLER. Gretchen, any particular comment?

MS. GREENE. I just wanted to say that on a day-by-day basis we are going to need operating flexibility because these formulae are very difficult to maintain in an ongoing operation.

MR. WALLICH. Also with respect to the Treasury's share there would need to be flexibility.

MS. GREENE. Yes, Henry, I'm afraid we do need that. We've come into a tremendous amount of paperwork problems, particularly when the proportions are so tight as 10 percent and 20 percent.

MR. WALLICH. Yes.

CHAIRMAN MILLER. Now, there are two questions before the Committee. I'm told by our Secretary that on the first one what we need is an understanding that the policy set forth in this memo is acceptable. We have not before had formal votes and Mr. Altmann's recommendation is that we not have a formal vote but have an understanding that we will abide by this policy. Is that correct?

MR. ALTMANN. That's correct. We've had informal understandings about limits within the overall $8 billion open position allowable under the Foreign Currency Authorization.

CHAIRMAN MILLER. We have an authorization for $8 billion; this is a policy decision we would follow if the Committee agrees.

The second issue is whether we should enter into an understanding with the Bank of Japan on this joint program and announce that we would be operating for our own account--the Treasury and the Fed--in coordination with the Japanese. We wouldn't put the percent in such an announcement; we'd merely say we will operate together.

MR. PARTEE. Can't we separate these two issues?

CHAIRMAN MILLER. Surely. As I said, we're going to have two issues--

MR. PARTEE. Well, my point is perhaps a little different from what you're thinking. I might be prepared to undertake a joint operation with the Japanese. But that's separate from the question of how much open position we can have in currencies, absent the special arrangements such as that.

CHAIRMAN MILLER. Sure, we can decide not to have the--

MR. PARTEE. We could stay with the $500 million [limit] on one [currency] and then have an additional $1 billion approved in a special arrangement. I just want to indicate that that's the way I probably would come out. I didn't want to--

CHAIRMAN MILLER. Yes, Paul.

VICE CHAIRMAN VOLCKER. I'm not sure it is going to help Chuck, but it may help me. I have no problems with the first understanding, but I want to make explicit what seems to me implicit here. And that is that the balances we acquire we don't acquire for the sake of acquiring balances but mostly as the by-product of what we want to do in intervention.

CHAIRMAN MILLER. That's the only reason to acquire them--to counter the appreciatiation and work on both sides of the market.

VICE CHAIRMAN VOLCKER. Whatever [side] it happens to be.

MS. TEETERS. May I ask a question? Does the 10 percent refer to total United States participation--Treasury and Federal Reserve--or is it 10 percent for [each]?

MR. HOLMES. As I understand it--

CHAIRMAN MILLER. Both. U.S. intervention would be a maximum of $1.2 billion. If the Committee wants to do a billion dollars, the Treasury is merely indicating [a willingness to do $200 million]. Why does the Treasury want to go in for such a small amount? Is it because they already have a large--

MR. AXILROD. They have large amounts of yen already.

CHAIRMAN MILLER. They got them through the sale of SDRs and through the IMF drawings. So it isn't that they're declining to hold yen balances; they really are showing good faith. They already have yen balances and that's why they would do a smaller amount at this point. Phil.

MR. COLDWELL. Mr. Chairman, I'm agreeable to the Committee approach [outlined] in this memo. I would be much less happy with the Japanese approach because I'm not at all convinced that the Japanese yen is undervalued and I'm not at all sure I want to jump into a joint intervention for the purpose of improving the Japanese yen position.

CHAIRMAN MILLER. Well, why don't we separate the issues? First let's see what the sentiment of the Committee is regarding the recommendation on the agenda. I think the best thing is just to get a vote on it.

MR. ALTMANN. A vote?

CHAIRMAN MILLER. I mean a count on whether we agree on the policy, not a vote.

MR. PARTEE. This is on going to $2 billion [on outright holdings] and with these limits [on individual currencies]?

CHAIRMAN MILLER. Chuck, if you want to suggest a modification you may.

MR. PARTEE. Well, my preference would be $500 million. I think there's a great deal of exposure involved here. I believe the dollar may be considerably undervalued and that there could be a very considerable appreciation of the dollar over the next year, and I wouldn't like to see us lose this much money. I also have a feeling that the shoe ought to be pretty binding on the other side. That is, when a currency is declining as sharply as ours did last year, it ought to be up to the country involved--

CHAIRMAN MILLER. I'm laughing because all during the year up until November 1 we said it was up to the foreigners to straighten out the dollar.

MR. PARTEE. Well, that's right. It finally went so far that I agreed to it. I think a country has its reservation points. And it seems to me that it ought to be the concern of the country as to what that reservation point [is when its currency is] on the decline.

CHAIRMAN MILLER. Chuck, I didn't mean you had that atttitude; I meant that as a nation we were taking that attitude.

MR. PARTEE. Well, I had that attitude, too. I was very much opposed to it until [the dollar's weakness] went so far that I knew it was oversold.

CHAIRMAN MILLER. Let's run down [the list] and ask the members if they are for the policy and if so, if they have a preference for the $1 billion or the $500 million limit per currency.

MR. KIMBREL. [I would agree] with the memo.

CHAIRMAN MILLER. The maximum is $2 billion in any case, but the question is whether you want a maximum of $1 billion per currency or $500 million.

MR. PARTEE. I meant I wanted the $500 million in the aggregate.

CHAIRMAN MILLER. In the aggregate? Oh, I misunderstood you. Well, then we'll have to ask again.

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

CHAIRMAN MILLER. Yes, we already have that. In other words, you would not want to expand it to $2 billion. Then the question is: Do you like the proposal in the memo? Paul.

VICE CHAIRMAN VOLCKER. Yes, it is reasonable.

MR. ALTMANN. President Balles.

MR. BALLES. I share Chuck's view. I have real reservations about going up to $2 billion, based on a very skeptical attitude regarding decisions on what constitutes excessive movements one way or another vis-a-vis what the market is saying. I'd keep it where it is.

CHAIRMAN MILLER. Okay.

MR. ALTMANN. President Black.

MR. BLACK. Mr. Chairman, I'd rather cut it in half. I worry about the Constitutional issues on this since the executive branch of the government clearly has the responsibility in the foreign area. And I worry about the point that Chuck raised about criticism we would get from taking any losses on this.

VICE CHAIRMAN VOLCKER. May I come back with an argument?

CHAIRMAN MILLER. Well, it's not necessary. The Treasury is with us on this; we're working with the Treasury.

MR. ALTMANN. Governor Coldwell.

MR. COLDWELL. I'd be willing to go with the billion dollars. And I guess I could be talked into the half billion dollar limit on individual currencies.

CHAIRMAN MILLER. In other words, you are going with the Black proposal. Anybody for the White proposal?

MR. ALTMANN. President Kimbrel.

MR. KIMBREL. Yes.

MR. ALTMANN. President Mayo.

MR. MAYO. Yes.

MR. ALTMANN. Governor Partee.

MR. PARTEE. No, I would remain with $500 million.

MR. ALTMANN. Governor Teeters.

MS. TEETERS. I would go with this proposal.

MR. ALTMANN. Governor Wallich.

MR. WALLICH. I would remind you that we didn't flinch when were short $6 billion but here suddenly, when we're gong to be long, $500 million gives us pause. I go with the [proposal in the] memo.

CHAIRMAN MILLER. We have 5 votes in favor and there are 10 members. That makes it very neat, doesn't it? They're not really votes but sentiments. I have a swing "vote" but I really don't think this sort of policy ought to be followed unless we're fairly uniform. Could we all agree on doing $1 billion with a $500 million limit at least to keep this [going] and then we can review it from time to time? I don't think this is the sort of policy we ought to pursue on a split [opinion]. Does everybody agree to that?

MR. BALLES. That's a $1 billion total limit?

CHAIRMAN MILLER. Yes, for the total limit and $500 million per currency, except that which is approved outside of this. [Hearing no objection] let's turn now to Japan and take that as a discrete item. Apart from the authority we just granted, would it be your sentiment to enter into the program with Japan? Go down the list again.

MR. ALTMANN. Vice Chairman Volcker.

VICE CHAIRMAN VOLCKER. Yes, I would like to give that authority but we [now] have the limit so small.

CHAIRMAN MILLER. This would be a separate understanding.

MR. MAYO. This is separate from the $1 billion?

CHAIRMAN MILLER. This would mean [only] as to Japanese yen. We would go to $1 billion and be outside the authority, but no other yen would be held. We wouldn't add the $1 billion here and the $500 million and have [$1.5 billion]. This would be the sole authority for the yen.

VICE CHAIRMAN VOLCKER. We are making an exception to the policy just adopted.

CHAIRMAN MILLER. This would be for yen [only]; and no yen would be held under the other policy.

MR. PARTEE. I think that's a good way.

MR. AXILROD. This would also be an exception to the total.

MR. ALTMANN. The current balances?

CHAIRMAN MILLER. Including the present balances.

MR. AXILROD. It would also be an exception to the total. That is, if the Manager had a billion dollars in yen he could still have $500 million in DM.

CHAIRMAN MILLER. The first policy we just approved would no longer include yen. We'll pull yen out of that and approve a specific--

MR. BALLES. What are the amounts involved for Japan, Mr. Chairman?

CHAIRMAN MILLER. A maximum of $1 billion of balances [held by] the Federal Reserve.

MR. HOLMES. Of which we have roughly $200 million.

CHAIRMAN MILLER. It's $187 million, or about $200 million now.

MR. PARTEE. So $800 million more--

MR. HOLMES. It's $800 million.

MR. PARTEE. And a couple of hundred million for the Treasury, so it's about $1.2 billion

CHAIRMAN MILLER. In the program we described. Paul.

VICE CHAIRMAN VOLCKER. Yes.

MR. ALTMANN. President Balles.

PRESIDENT BALLES. Yes.

MR. ALTMANN. President Black.

MR. BLACK. I'd rather not go this far.

MR. ALTMANN. Governor Coldwell.

MR. COLDWELL. No.

MR. ALTMANN. President Kimbrel.

PRESIDENT KIMBREL. Yes.

MR. ALTMANN. President Mayo.

MR. MAYO. Yes.

MR. ALTMANN. Governor Partee.

MR. PARTEE. This would be in concert with the Japanese? They would be in, doing 10 times what we're doing?

CHAIRMAN MILLER. Ten times what this nation is doing--a combination of the Treasury [and the Federal Reserve].

MR. COLDWELL. That's your biggest exposure, Chuck.

MR. PARTEE. Well, I know. On the other hand they've had quite a decline in their currency. So, yes.

MR. ALTMANN. Governor Teeters.

MS. TEETERS. I have one question. Does this give us any idea at what level we're going to support the yen? Are we going down to the two hundred--

MR. HOLMES. That I don't know. But certainly the Japanese feel that the yen has depreciated far too much. It's back toward the 200 level. Whether 200 is the [right] level I think one has to judge from what happens in the market.

CHAIRMAN MILLER. Nancy, I don't think we can peg it. In the present market conditions I think it would be desirable to get it in the 200 to 210 area. But that's subject to [conditions] changing. I wouldn't hold to that if we felt there were a really massive change because there is no use fighting it if it's really massive.

MS. TEETERS. I'm a little concerned that the Japanese seem to be pegging it. They sort of put out a target and I don't want to be dragged in unless we're really sure we want to do it.

MR. HOLMES. Well, although the Prime Minister said "go back to 200," they found they couldn't do it. And they spent billions.

CHAIRMAN MILLER. They're accumulating massive profits now because they've sold their products on the 200 basis. If they don't get it down again, we're going to see price cutting in yen and we're going to have another flood of Japanese imports. We're going to have that problem all over again with surpluses. That's the problem.

MR. HOLMES. That's the basic underlying problem.

MS. TEETERS. I would approve then.

MR. ALTMANN. Governor Wallich.

MR. WALLICH. Yes.

CHAIRMAN MILLER. Okay, I'll approve it then also. I think we have a fairly strong sentiment to do that. We'll circulate to the governors a suggested statement that might be made with the Japanese perhaps at the beginning of next week.

That is the end of our meeting unless there is other business. The date of our next meeting is July 11, which is a Wednesday. That's an odd one. That was worked out because of the BIS meeting. Well, thank you all. We'll have our luncheon immediately, and we're on time!

END OF MEETING