TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

July 11, 1979

Prefatory Note

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

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

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

Staff Statements Appended to the Transcript

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

Meeting of Federal Open Market Committee

July 11, 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 Wednesday, July 11, 1979, beginning at 9:00 a.m.

PRESENT: Mr. Miller, Chairman
Mr. Volcker, Vice Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Kimbrel
Mr. Mayo
Mr. Partee
Mr. Rice
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, Henry, Keir, Keran, Kichline, Parthemos, Scheld, Truman, and Zeisel, Associate Economists

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

Mr. Coyne, Assistant to the Board of Governors

Messrs. Kalchbrenner and Siegman, Associate Directors, Divisions of Research and Statistics and International Finance, respectively, Board of Governors
Mr. Prell 1/, Associate Research Division Officer, Division of Research and Statistics, Board of Governors
Ms. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

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

Messrs. Burns, Danforth, and T. Davis, Vice Presidents, Federal Reserve Banks of Dallas, Minneapolis, and Kansas City, respectively

1/ Mr. Prell entered the meeting following the votes to ratify System open market transactions and left following the vote to adopt the domestic policy directive.

Transcript of Federal Open Market Committee Meeting of
July 11, 1979

CHAIRMAN MILLER. Good morning, ladies and gentlemen. I believe we should start right away because we have a rather difficult task ahead this morning--to resolve all the midcourse corrections and short-term directives.

Let me start out by welcoming Emmett Rice to, I think, his first FOMC meeting. You'll be the swing vote, you will be happy to know. It's nice to have you back in the Federal Reserve fold. I believe you spent some years with the Federal Reserve Bank of New York when it was--I won't say in its prime but--at a high level of achievement. We're delighted to have you here.

VICE CHAIRMAN VOLCKER. We're glad to contribute some people to the Board.

CHAIRMAN MILLER. Before we start on the agenda, I have the sad duty of having to call to your attention what I consider to be a serious and recurring matter. And that is that somehow the tradition and what I consider commitment to keep the deliberations of the Federal Open Market Committee confidential is being breached each month. Yesterday, we had The Wall Street Journal saying that it was learned from sources that at our last meeting, in May, two members of the Committee called for tightening the credit spigot. The article mentions "sources." And this is a different reporter [than last time]. And as I've said, my experience is that reporters don't cite sources unless they've talked to someone in the organization. This is to me a recurrence of what we talked about last time and it is very, very disturbing. It's spreading to [discussion of] the attitudes of international bankers. Henry, we've just had a report that "sources" tell us what the central bankers in the BIS [meetings] talk about and how they instruct the United States on monetary policy. I consider that inappropriate. I wonder if we should bring that to the attention of the Chairman [of the BIS].

MR. WALLICH. I'd like to see what [the reporter] says here. There has been no change in the Basle procedures that [I'm aware of].

CHAIRMAN MILLER. Well, the quote in the newspapers is that sources from that meeting were telling us what our monetary policy should be and were telling what was discussed in the [BIS] meeting.

MR. WALLICH. That's very disturbing because there's an understanding that that doesn't happen.

CHAIRMAN MILLER. I think we ought to get the clippings and perhaps call it to the attention of Chairman Zjlstra and see if we can't tighten up those procedures. I just don't think it is appropriate to go to the BIS and discuss in confidence our policies and have people go outside and start saying confidentially off the record--but for publication, just not for [attribution]--this is what we discussed. This article says that sources noted what was talked about and the United States was urged to do a, b, and c. I just don't think that's proper. This is just one; there were other articles in other newspapers.

I would again ask members of the FOMC to give their attention to this. What is wrong with our system? Why are we getting sources quoted in the newspaper? In this case, [the leak] could be from the people attending or it could be from people who have seen the directive or the draft of the minutes because this is actually an accurate statement. But it indicates that people who are reporting to [the press] have access to the FOMC meetings or its documents. So what do we do? Do we change the way we distribute the drafts [and] the directives? Do we have to go through some educational process? Do we have to restrict attendance? What do we have to do? I won't ask for your answer now, but I wish you would give this serious consideration. This seems to be a trend and if we continue to ignore it, I think it will be read in the System as a new policy where anybody can go out and give their personal appraisal [of policy deliberations and decisions]. A lot of egos will be appealed to by the press and we will have an endless problem.

Well, to turn to the meeting itself, we need first to approve the minutes of the actions taken at the last meeting on May 22. I think those have been circulated. Are there any corrections or additions? If there are none, we will record them as approved and we will turn to Scott Pardee for a report on foreign currency operations since the meeting of May 22.

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

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

MR. BAUGHMAN. Could I ask Scott for a judgment? If we had used, say, a discount rate increase or a small federal funds rate increase in lieu of the market operations, would your guess be that we would have had similar results or better results or none at all?

MR. PARDEE. I think they would have been better. It depends on the timing--when [an action was taken] during the course of these weeks. That would have helped, but we still would have had to intervene. There is a lot of negative sentiment, particularly with regard to the energy situation.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Scott, you said in your comments that this lays to rest the policy of the Bundesbank. Without debating that question, do you have a sense of the Bundesbank position? Would they be willing to let the dollar rate go below 180?

MR. PARDEE. If it gets down there, I think they would. Their approach is not to peg the rate at any particular level. As I indicated, we did have

They have been very forceful in the last week or so and they were forceful this morning. But we are living in a world of floating exchange rates, and I myself am not sure I would advocate holding it at 180 if the pressures mounted that much.

MR. WALLICH. And 185 on the up side?

MR. PARDEE. Well,--

MR. PARTEE. If they want the rate to be [unintelligible] and if the fundamentals won't support that, to try to keep them from doing that would seem to be a very wasteful exercise.

CHAIRMAN MILLER. Larry.

MR. ROOS. Scott, you mentioned "fundamentals" at the end of your report. Isn't the recent expansion of the aggregates, and its portending a less than effective determination to deal with inflation, very fundamental regardless of energy and these other things? Doesn't that come into the minds of these traders?

MR. PARDEE. It's in the minds of some people. You talk to different people, you get different answers. Some people have mentioned that.

CHAIRMAN MILLER. I suppose I should call attention to John Balles' memo that was circulated [on] the question of to what degree rate differentials affect us. I guess you have all seen that. Dave.

MR. EASTBURN. Scott, perhaps you've said all you can say on this but let me try [a different question]. What kind of money policy do you think would satisfy?

MR. PARTEE. Satisfy whom?

MR. EASTBURN. The people who are bearish on the dollar.

MR. PARDEE. Again, it differs with different people. Certainly we have plenty of free advice and you can guess what it is. These are financial people; they're interested in financial flows. And we do have a phenomenon going on in Europe and a ratcheting up of interest rates by the central banks and in the markets. It's partly related to the EMS in that it's very difficult now for these countries to make adjustments in exchange rates within the EMS; and a number of countries have raised their discount rates recently simply to protect themselves within that context. Now, the interplay of forces between the dollar/mark and then the mark and the other currencies leads to combined strains. So if the European interest rates are going up, then they turn and look at us. Again, I am very chary of talking too much about these things because at some stage, we have to turn around and tell the market that we're only part of the economy and the rest of the economy has to be considered.

MR. MAYO. Did you answer the question?

MR. PARDEE. Some people in the market would like higher interest rates and they will tell us so, and they'll tell you so. But you have to consider the broader picture.

CHAIRMAN MILLER. Frank.

MR. MORRIS. Is there a perception in the market that we're headed for a pretty serious recession in this country and that that's likely to improve our fundamentals on the trade side?

MR. PARDEE. Some will admit it. But then again, people I'm referring to are more interested in what's going to happen in the next 15 minutes, the next few days, or next month than over the next 6 months.

CHAIRMAN MILLER. They are looking at their portfolios, not at the economy. Well, we need to ratify the transactions since the previous meeting. Not only have you heard Scott's report but I believe you have been furnished with a copy of a report on these transactions. Is there concurrence in the ratification? Any dissent? Hearing none, that's approved.

We probably will discuss international issues more before the day is over but let's move on to the domestic open market operations and ask for the report since the last meeting from Peter Sternlight.

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

CHAIRMAN MILLER. Thank you, Peter. Any questions or comments? Phil.

MR. COLDWELL. Peter, as you've worked through this period and the seeming expectational swing of bringing rates down in the short area but up in the mortgage area, have you found any kind of fundamental thrust in this package? Or is this just sheer reaction on day-to-day operations?

MR. STERNLIGHT. Well, the downward movement was more than in just the short-term area. If anything it seemed to me the mortgage area was rather an exception in moving up a little further. We had rate declines in the long-term sector as well as in the short-term. I think it was more than just a day-to-day phenomenon. There was a feeling that the economy is likely to be weakening and that at some point the [long] rates are likely to be lower, although I would not say that there was an expectation of an imminent easing throughout [the yield curve]--just in terms of, say, the fed funds rate.

MR. COLDWELL. It was just a happy coincidence that they happened to have securities to sell at a higher price.

MR. STERNLIGHT. Well, some dealers had them, but for the most part they were keeping fairly low inventories. I don't think the dealers made any great killing on this rally because they've been so cautious right along. Taking the dealers as a group they've held rather a lean inventory. They've stocked up when a new issue came along but then they've wanted to sell out their holdings quite soon. They've been caught too many times recently waiting for that great rally and have been disappointed in it.

MR. COLDWELL. Is this true of all the dealers?

MR. STERNLIGHT. No, I was speaking of them as a group. Some have done reasonably well, but as a group they have not held large inventories at the time when prices rose substantially.

CHAIRMAN MILLER. Henry.

MR. WALLICH. During the period since the last meeting there probably have been expectations of an increase in the expected rate of inflation. Do you see this expressed in any way in interest rates?

MR. STERNLIGHT. I have not in this recent period. I think that has often been a factor, particularly in the longer-term markets; but it almost seemed notable for its absence during the past month.

MR. WALLICH. Would you interpret that as saying that interest rates in real terms actually have fallen more than the appearance of the nominal change implies?

MR. STERNLIGHT. Well, that's the implication of the arithmetic; yes, I think that would follow.

CHAIRMAN MILLER. Well, we also need here to ratify the transactions since the last meeting. You've had a report. Are there any questions or comments? Are there any dissents from approving those transactions? Hearing none, we will record the ratification of the domestic transactions since the previous meeting.

Now we turn to our more delicate issue today and that's the longer-run ranges for monetary aggregates, the new Humphrey-Hawkins bill. It gives us the opportunity to make mid-year corrections and to [unintelligible].

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

CHAIRMAN MILLER. Before we turn to any comments on long-run ranges, we might just pause for a moment to see if there are questions about this presentation. Henry.

MR. WALLICH. I wonder, Jim, whether your estimates of future inflation and wage increases couldn't be considerably low. This, of course, has been our experience all along. Here we have 13 percent CPI inflation and somehow we seem to assume that that has a minimal, maybe 1 percent, effect on compensation. That seems to me to imply a very strong effect on wages from rising unemployment and really a very tough government fiscal and monetary policy.

MR. KICHLINE. Well, I guess there are several comments to be made. One, the record is clear: We have underestimated inflation. The record, I think, is also fairly clear that we have tended to run high on inflation relative to many forecasts, which says that most economic forecasters--not all, but most--have tended to underestimate inflation, certainly in the current period. Relative to the Administration's forecast for inflation for 1980, we are considerably higher; and with regard to other forecasts, I think the staff forecast of inflation is also relatively high. The assumptions in the forecast, in my view at least, do imply restraint on the part of monetary policy and certainly fiscal policy. The full employment budget surplus is moving into substantial surplus. It involves further tightening if you take that measure or other measures, simply in that we have not assumed any fiscal initiative, which has clearly accompanied this sort of pattern of activity in the past. So we have a tight policy here in our view.

In addition, I would say that there are important exogenous forces, as Jerry Zeisel pointed out, with regard to energy and food. At times I think forecasting energy and food prices is like a craps game, but at this point in time what we have assumed for OPEC would clearly suggest that 1979 is the bad year. Also, our forecast for 1980 on inflation is much higher than we had shown to the Committee a month and a half ago; we have tried to take account of developments since then. I personally would feel rather comfortable with this forecast as a particular number in terms of not underestimating likely developments.

CHAIRMAN MILLER. Larry.

MR. ROOS. Jim, what weight do you give to monetary induced inflation, the part of inflation that is a reflection of monetary policy versus food and energy? Let's assume we have a deflator increase of 10 percent, just in broad brush. Sometimes I think we like to believe that we are prisoners of exogenous factors. What part of that 10 percent is a reflection of monetary policy and what part is a reflection of energy and food prices?

MR. KICHLINE. Well, I don't think I can answer that question directly. The way the staff has looked at this is to view monetary policy as affecting the markets and economic activity. If we had an "easier" monetary policy, as indexed by faster rates of growth of M1, it would show up in our thinking in higher rates of expansion in real GNP in the short run--assuming we're not at capacity--tighter markets, and with some lag, more inflation. Trying to sort out particularly how much more inflation in this forecast is difficult. I really haven't thought of it in that way.

MR. ROOS. Well, let me rephrase it, if I may. Our economists tell me that if one were going to quantify this, that perhaps 70 percent of our inflation is money policy induced, or a direct reflection of our monetary policy, that energy at its present dimension may be responsible for 1 percentage point of [the deflator] and food 1-1/2 to 2 percentage points. That would mean, if that is a valid assumption, that we still are in a position to affect this in a very real fashion by the decisions we make today. Are these guys way off base, do you think?

MR. KICHLINE. Well, I know some of those guys--

CHAIRMAN MILLER. It's perfectly all right to take the fifth!

MR. KICHLINE. No, that's all right. I think I know some of the people from St. Louis in a way that transcends what I might say here. All I can say to that is that my view is simply that monetary policy has an important role to play. The difficulty in this exercise is looking at alternatives within what I would consider to be a "reasonable range," given past monetary policy responses. If, for example, one option were to reduce the stock of money 10 percent and run that way for 3 or 4 years, I would say we'd get tremendous impacts on the price front. We'd also have a depression, in my view. So, what is missing in this linkage is what happens to the real side and what happens to markets. It's that sort of thing that makes it difficult for me just to translate M1 numbers into rates of inflation. I certainly would not say that I believe money has no influence on prices. That's clearly not our view. It's really a longer-term effect in the way that we look at money affecting activity, which works through markets. And it's quite clear to us that if we had lower rates of money growth over an extended period of time, we would get lower rates of inflation. We'd also have other things happening, such as [effects on] unemployment and real GNP, and I would presume other policy responses outside the control of the Fed.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Well, I was going to ask Governor Wallich's question on the other side. I note that the total price index excluding food and energy shows very little decline as a result of the recession. The chart that you have here doesn't show us what happened in the '74-'75 [period], but I have the impression that there was more reaction in those price indexes in that recession. And when I look at corporate profits in the Greenbook I find that they're very well maintained rather than dropping rather sharply, as I would have expected them to do. So I wonder whether there isn't a possibility that in fact you've overstated the price increase.

MR. KICHLINE. There's always a possibility. I've been humbled over the years in performing these sorts of exercises.

MR. PARTEE. Do you know what happened in '75? Was there, in fact, a decline in the base rate of inflation?

MR. KICHLINE. Oh yes, very much so.

MR. PARTEE. Excluding energy and food?

MR. KICHLINE. Yes. I think the fundamental question though, if you want to go back to '73, '74, '75, is what sort of forecast do we have overall relative to that period. It's very different. Real GNP declines by a very small amount relative to that which occurred in '74-'75; I think it's about 1/3 the size. And that I think is very important. So we don't have sluggish markets in any way comparable to the '74-'75 period. I think a second factor is that the performance in '74 and early '75 was influenced importantly by large speculative demands--the build-up of inventories, the worldwide boom, a run-up of raw materials prices, and the big collapse as real final sales declined. Then we had a dumping of inventories and more price breaks on the down side. We don't perceive basic conditions in the economy to be similar to that and hence we wouldn't expect to get the same price response from very weak markets. Also, one of the difficulties is that in the current environment we have more indexation of wage contracts than we had 5 or 6 years ago. In my view, there has been much more of an attempt to cope with inflation that would give us stronger feedback effects of current rates of inflation on future wage rates and that I think is an important adverse factor. That certainly has influenced our forecast because for 1980 we believe the price performance hinges very importantly on developments this year.

CHAIRMAN MILLER. Paul.

VICE CHAIRMAN VOLCKER. Well, I'm not inclined to raise the question of whether the staff have overestimated the rate of price increase; I doubt that that's the case. But in looking at the general scenario and listening to you, you have forecast a relatively mild recession, as you suggested, at least by comparison with the previous recession. But it's a very unusual recession, I think, and you can confirm this for me. You get practically no change in the government deficit and no increase in income coming out of the government in that sense. You have very little change in the financial ratios, very little improvement in liquidity or debt positions, which leads me to a very general question and may [involve your] repeating yourself. What keeps the recession so mild? And particularly what gets us out of it when the saving rate doesn't change much? It doesn't go up and then we don't have the room for it to go down. What are the mechanisms to reverse this process once it starts?

MR. KICHLINE. Could I share the wealth and let Jerry answer that question? He presented that part of the forecast.

MR. ZEISEL. I'm responsible for the recovery! It's true that the contraction is a rather sluggish one and our assumption of the lack of fiscal initiatives involves less stimulus from government activity--other than the automatic stabilizers operating, which are an offset in effect.

VICE CHAIRMAN VOLCKER. You haven't even got much of that.

MR. ZEISEL. True, we don't get much of that because of the inflation effect, but we get some--possibly an $8 billion swing in that direction in 1980. But, as I pointed out earlier, we perceive this--other than the OPEC effects--as being a rather sluggish slide into a softer economy without the kind of major distortions that were in place in 1973, preceding that [recession]. And it seems to us that under those circumstances, there is the potential for not only a moderate decline but the beginnings of recovery as well, in business fixed investment for example. We get some help also from the net export side, as Ted Truman mentioned earlier. I might point out, though, as you are no doubt aware, that the recovery we are talking about is about as sluggish as the recession we have predicted. We are talking about a fairly protracted period of very little growth; in a sense it's what we were projecting a couple of months ago overlaid by the effect of the OPEC price increases pushing consumption down and bringing the level down to below where we had it before.

CHAIRMAN MILLER. Frank.

MR. MORRIS. Mr. Chairman, I suppose I'll get the same answer to this question, but it seems to me that the interest rate pattern projected is not very believable in the sense that the staff is suggesting under alternative B that we could maintain a 6 percent rate of growth in M1 with only a very modest decline in the fed funds rate to 9-1/2 percent at the low point. If this were to occur, it would be the only recession that I can recall, large or small, in which we were able to maintain money growth during the recession with very little change in the fed funds rate. And I find that a little incredible.

MR. AXILROD. President Morris, it may or may or not occur as projected, of course, but there is an enormous rate of inflation built in and an increase in nominal GNP of substantial size even though there is a recession. And our evidence thus far, particularly in the second quarter, is that the downward shift in money demand that appeared in the fourth and first quarters doesn't really appear in the second quarter to any real extent. If that has abated and we have the substantial increase in nominal GNP, even in the face of recession, we've got to finance it. So our assumption has been that money will be called out, so to speak, by the economy. That may not develop, as you point out, but I think it's not an unreasonable assumption given the high rate of inflation that's built into these projections.

MR. MORRIS. Well, I guess where I really differ is in my expectation that the recession is going to be much more severe than you're projecting.

MR. KICHLINE. Well, in that instance you'd be talking about weaker money demand. Many times in the past we've had no growth in nominal GNP in the quarters in which real GNP was dropping or was in fact negative when we had massive inventory liquidation. And at those times money demand fell dramatically. But in this forecast we have very different nominal rates of increase, given the price picture that we foresee.

CHAIRMAN MILLER. John Balles.

MR. BALLES. Paul Volcker and Frank Morris have already anticipated most of my questions, as a matter of fact, but maybe I can ask the last part of my final question, Jim. I'm also concerned about the possibility of this recession being deeper and longer and more severe than both you and my own staff are predicting. Our staff view is now pretty close to the one you have. I'll challenge you with the same question I asked them: What is there in this current situation and outlook that makes it different from the experience we had in 1973-74--that leads to a fairly mild recession instead of a deep and severe one such as we had 5 years ago? In other words, how big are the risks? Another way of putting it is: What do you consider to be the downside risks in your present forecast? What could go wrong?

MR. KICHLINE. There are downside risks. In terms of the odds we would place on our forecast, I think we would judge it to have a 40 to 50 percent probability of coming true. I can see a situation where the odds are significant that it might turn out to be better than that. I think it is very difficult, for example, to sort out the extent to which the second quarter was adversely influenced by gasoline lines. And if that fades, we may be talking about underlying demands that are stronger than most people would anticipate at this time. On the other hand, whenever we get into this situation of weak activity we tend to have cumulative effects and it's very difficult to judge how far that may run. It could set off adverse expectations, which would drive the economy down much deeper.

I think the 1973-74 [experience] is not closely comparable to the current one. Clearly, from that earlier OPEC situation we can gain some lessons from looking at what happened at that time. But three very important factors [differ]. One would be the collapse of the worldwide boom. We have not envisaged a collapse in economic activity abroad. That should assist the U.S. economy. The second is this speculation and stockpiling--the hoarding of labor, raw materials, whatever--that led to the big bubble in inventories and the collapse. Our reading of the current data available is that we may have a moderate problem of involuntary inventory accumulation, but it's limited. Businesses have behaved very differently this time around than in that earlier time. And the third factor that to me is of a good deal of importance involves developments on the monetary policy and the financial side. We have not assumed conditions that approximate those in 1974--a crunch. We don't have widespread financial difficulties. And that's very different in terms of the lagged impacts of monetary policy actions over the past year or so and what that may portend for later this year and 1980.

MR. BALLES. Well, thank you. That's a good answer. I guess the one big imponderable I'm still concerned about is the confidence factor in the economy. None of us can really make a judgment on that but my own hunch is that, if anything, the spreading uncertainty in the minds of both consumers and the business community could lead to somewhat worse results than we see here, but I can't prove that.

CHAIRMAN MILLER. I'll just close the list. We'll go through the remaining questions and then turn to Steve. You'll all get a chance, of course. Mark.

MR. WILLES. Thank you, Mr. Chairman. Jim, implicit in your inflation forecast on the table in the last sheet of the handout and, in fact, explicitly in your responses to Larry and Chuck, is a belief that there is a short-run tradeoff between inflation and unemployment. Can you tell me what data there are in the last decade that make you think that such a tradeoff even exists?

MR. KICHLINE. There's very little. I know that most people like to believe the short-run Phillips curve is dead. The Board's model essentially has that construction and it's one of the few models that has worked very well on both prices and unemployment in the last year. If we as a staff had believed it, we would have been right on [the mark] in terms of the inflation forecast and also the strength of unemployment. It's a very difficult area. Frankly, I think one has to look at information from a variety of sources. I do, in fact, believe that there is a tradeoff. At the same time, I believe that expectations are very important. And what will happen in 1980 hinges very importantly, I think, on inflationary expectations, confidence, and market structure. It's difficult to model those sorts of things. So the tradeoff that I think is still there may be waning, frankly. But until there's very strong evidence to the contrary, I would still believe that one has to sacrifice some real performance to get much improvement in prices using aggregate demand management policy.

MR. WILLES. Well, taking a different tack than Chuck did: If people really believed that the policy response this time were going to be different than it has been in the past--that fiscal policy would not be tremendously stimulative and monetary policy would not be tremendously stimulative--how possible would it be in your mind, then, that we could in fact have lower inflation than you predicted without substantially higher [unemployment]?

MR. KICHLINE. Let me just say that I agree that that's a possible outcome. I really don't know that I can quantify it.

CHAIRMAN MILLER. Phil Coldwell.

MR. COLDWELL. Mr. Chairman, maybe I'll just skip [some of my questions in light of] the responses Jim has been giving. The one fundamental question I have on my mind was raised by the Board's staff in the [pre-] FOMC briefing yesterday and that is: Do we fund the price increases of OPEC?

MR. KICHLINE. Do you fund them?

MR. COLDWELL. Yes, do we provide the financing to meet them?

CHAIRMAN MILLER. [Fund] the nominal level of GNP.

MR. KICHLINE. The monetary policy assumption that we have maintained in this forecast is the same as the one that has been running for the last several months. So, with higher prices in effect and the same nominal rate of growth of M1, you are implicitly running a tighter policy and not permitting a complete validation of OPEC price increases. So it's a maintenance of the same policy despite an exogenous change in the price outlook.

MR. COLDWELL. Well, it's a bit difficult for me to accept that on face value, given the rate of change in M1 in the first quarter of the year versus the rate of change in M1 now and the changes in the OPEC and [other] price structures that have been developing over the first half of this year.

MR. KICHLINE. All I can say is that the assumption built in for monetary policy is the midpoint of alternative B on average for 1979-1980. That is, you can run below or you can run over, but for QIV '78 to QIV '79 we have assumed 6 percent, allowing for the shift between ATS accounts and demand deposits. You're right that M1 was strong in QII and it was weak in QI; it all hinges on what happens between now and the next two quarters to determine whether or not the assumption we have will turn out to be correct.

CHAIRMAN MILLER. We'll find out next year. Dave.

MR. EASTBURN. Reverting to the questions asked earlier about the shallow saucer that you have and the sluggish recovery, Jim--

CHAIRMAN MILLER. Shallow, long saucer.

MR. EASTBURN. Yes, shallow, long saucer. It has been said that the way to lick inflation is to have moderate growth for some period of time, 3 to 5 years or something like that. Have you done any work or do you have any views as to how long this type of pattern would have to be continued to have some impact [in the sense that] Mark was talking about?

MR. KICHLINE. We have run a variety of simulations using different monetary policies, fiscal policies, and other options that have extended into 1982. And in most of those, except for policies that have expansive monetary and fiscal policies for an extended period of time, by the time we got to 1982 we were seeing substantial price improvement. I might note that one of the major difficulties--I didn't comment on it this time--is that in 1981 the models would be showing much reduced rates of inflation, but there are two important outside factors in 1981. In January we have the largest increase scheduled for payroll taxes and social security of the whole package; it's double the effect of 1979. And in October 1981 is the largest slug of domestic decontrol of crude oil to the then-current world price. If we [take] those out of 1981, we're showing in the forecast substantial price improvement.

CHAIRMAN MILLER. Bob Mayo.

MR. MAYO. Jim, I have a little problem with your statement that one of the reasons the recession may be milder this time, or that we won't have a great problem this time, is that there might not be an identity this time of recession abroad and here. I would take some issue with the latter statement. Some of the tea leaves tell me--and it's more than tea leaves, I guess--that we may be forced into a situation again with an identity of recession throughout the free world, not just here. That would tend to make me a little more worried about the shallow saucer projections. Also, although this gets into the financial side, I would say that while we don't have REITS this time, there is much more concern about the volume of foreign bank loans by American banks at this point and whether we are getting too close to the saturation point on handling the recycling of the 80 percent increase in OPEC prices. This gives me an additional concern that hasn't been mentioned here yet.

CHAIRMAN MILLER. Well, Bob was our clean-up hitter on this round of questions. I think it might be appropriate to turn to Steve Axilrod to give his comments on longer-run ranges and then we'll turn to the whole Committee.

MR. AXILROD. Mr. Chairman, we are passing out a table that I hope will make my comments clear on this complicated problem facing the Committee. The decision before the FOMC on the long-run ranges is clearly much more difficult than usual. The impact on the ranges of an actual, or impending, recession has to be balanced against a higher rate of inflation, with the increased rate above expectations caused in large part by exogenous factors such as energy conditions that do not respond readily, if at all, to monetary policy. Additionally, the demand for money, given GNP, seems no more certain than usual and perhaps even less so as it will depend in part on Congressional and judicial decisions yet to come that will affect interest-bearing transactions accounts.

[Moreover,] at this meeting, the Committee is asked to look further ahead than it ever has before, giving its first public indication of ranges for the monetary aggregates more than one year ahead. In this case, that means the ranges for 1980 as well as 1979. Growth rates of the money aggregates thus far in 1979, as noted in paragraph 9 of the Bluebook, are within the ranges adopted in February for the year, and near the low ends of the ranges, especially for M2 and M3. Thus, on the face of it there would not appear to be a serious need for the Committee to consider adjustments in the ranges for 1979 to allow for any initial mis-specification of them.

However, there probably has been a mis-specification of the current range for M1, as explained in the Bluebook, because the retarding effect of ATS accounts on M1 growth appears to have been overestimated. Last February we estimated this effect as 3 percentage points, which did in fact turn out to be the first-quarter impact.

But growth in ATS accounts has subsequently slowed. M1 growth was retarded by only 1-1/2 percentage points in the second quarter from this source. And we estimate that the retarding effect for the year 1979 will average out to 1-1/2 to 1-3/4 percentage points. This technical factor would argue for an upward readjustment in the measured M1 range for 1979. We can expect an even smaller retarding effect from ATS accounts in 1980, but obviously uncertainties are vast because of the clouded legislative and judicial outlook.

With regard to economic factors affecting the aggregates, the economy is weaker and this might argue for more stimulation. On the other hand, inflation is stronger, which tends to argue for more restraint to curb the pace of price increases. But since much of the greater-than-expected price increase has been due to a one-time energy price shock, there is also an argument for being at least partly accommodative by providing somewhat more money during a transition period. In any event, the staff expects some acceleration in growth of the aggregates in the second half of 1979, given the GNP projections, partly because of greater demand relative to income as the recent downward shift in money demand abates, and partly because of a slight easing in interest rates.

Taking these various factors into account--and also giving weight to the view that the ranges for this year should be narrowed because the results for half of the 1979 policy period are already known and therefore the outcome for the year as a whole is more certain--I would suggest that the Committee consider the following ranges for the monetary aggregates for 1979: 3 to 5-1/2 percent for M1; 5-1/2 to 8 percent for M2; and 6-1/2 to 9 percent for M3. These proposed ranges are shown in the middle column of the upper panel of the table before you. And they're shown in the second, third, and fourth lines of the upper panel. The top line, in order to make the economic implications clearer, shows the consistent measure of M1 adjusted to include the amount of deposits that were transferred into ATS accounts. As you can see from that line, the proposal for M1 represents a policy that is no easier after adjustment for ATS transfers than does the current range. That is, they're both centered on 6 percent, assuming of course that our estimate for the ATS effect is correct. For M2 and M3 the proposed ranges are 1/2 point higher on the bottom end than the current ones and therefore a little more clearly allow for the greater growth of the aggregates that is expected by the staff to occur in the second half of this year.

Turning to ranges for 1980, arguments can be made both for lowering and for raising the ranges relative to those for 1979. On the one hand, the need to make progress over time in reducing the rate of inflation and in breaking inflationary psychology argues for adopting slower growth rates in 1980 than in 1979. On the other hand, the continuation into next year of exogenous upward price pressures related to the energy situation and the need to contain the apparent weakening in real economic activity argue for raising the ranges for 1980 and then lowering them gradually in later years.

On balance, taking account of these conflicting arguments, the following monetary ranges for 1980 might be considered--and they're shown in the last column of the upper panel: M1, 3 to 6 percent; M2, 5 to 8 percent; and M3, 6 to 9 percent. The bottom line of that upper panel has a proposal for the bank credit range that is simply a smooth version of the alternative B/B' projection of the Bluebook. The monetary ranges suggested for 1980 are wider than those proposed for 1979 because of the greater uncertainties in projecting 18 months ahead. The ranges also encompass some further technical upward adjustment of the measured M1 range to allow for the gradual re-emergence of more normal demands for money following the introduction of ATS accounts late last year. Finally, these ranges retain an upper limit high enough to allow for the probability that the aggregates next year may in practice grow somewhat more rapidly than this year, given the inflation built into the economy and our assumption of some growth in economic activity.

The bottom panel of the table compares midpoints of these proposals with the growth of the aggregates in recent years to provide the Committee with some perspective on the ranges. As can be seen, the odds are pretty good, given what has already transpired this year, that growth of the aggregates in 1979 will slow for the second consecutive year--looking at either measured M1 or M1 adjusted to include ATS transfers. The growth rate was at something of a recent peak in '77, was lower in '78 and will very likely be lower in '79 [than in] '78. This is true for all of the aggregates shown. Except for measured M1, the midpoints of the proposed ranges for 1980 would imply a further slowing and thus might have some beneficial announcement effect. However, there is some reasonable probability, as just noted, that actual growth would be in the upper halves of the proposed 1980 ranges. Even so, the proposal for 1980 implies a policy of restraint on money growth relative to demands and, therefore, rising interest rates [over] the course of the year. Thank you.

CHAIRMAN MILLER. Thank you, Steve. A statistical question? All right.

MR. COLDWELL. Steve or Jim, do you happen to have the 1973 and 1974 figures that would [compare with] those in the bottom part of this table for M1 and bank credit?

CHAIRMAN MILLER. For '73 and '74? Let's all write these numbers down.

MR. AXILROD. For '73 the rate of growth in M1 was 6.2 percent and for '74 it was 5.1 percent. Bank credit growth for '73 and '74 was 15 percent and 10.2 percent. M2 for '73 was 8.8 percent and for '74, 7.7 percent.

MR. PARTEE. Are these fourth-quarter-to-fourth-quarter in all cases?

MR. AXILROD. Yes.

CHAIRMAN MILLER. One comment I should have made on the supplemental table that Jim called to your attention comparing the [forecasts of the] staff and the Administration: I know you realize all the figures here are confidential but these are particularly sensitive because they will not be released by the Administration until Friday. And the Administration would be very upset if any [disclosure] of these took place before that time. They are quite sensitive, and I just wanted you to know that.

Now, before we break, I would suggest that we try to do a go-around on your views. My suggestion is that you give us any thoughts you have on the economy if significantly different from the staff's. We don't need detail but I'd like to get the flavor [of your thinking]. And then [indicate] what policy implications you see and also what would be your recommendation for the longer-term ranges--a mid-course correction for 1979 or for the 1979 ranges to be maintained--and what you see for 1980. I think we will have to take each of those up separately later but I'd at least like to get down in black and white how each of you sees it.

As an opening observation, I feel that what has happened since earlier this year--the unexpected degree of oil price increases by OPEC and others has been quite a blow to our anti-inflation efforts. We've probably been set back by a year or two in the program to wind down inflation. And that makes our problem particularly difficult because what was already a need for a multi-year sustained effort becomes an even longer effort, and we cannot yet predict what policy responses the Administration will make in the energy area or otherwise. But whatever they [do], there's a lag time of policy getting implemented into action and it seems to me that we're going to have a much longer course to go. We are going to be on trial and have a test in this country for a longer period of time on whether we have the will and the capacity to wind this [inflation] down. I rather think that there is a more sober sense of the urgency and the peril [involved]--a more sober sense that we're all going to have to give up something. There is going to have to be some loss of real income in the short term if we're ever going to get real income going up again in the long term. But that remains to be seen.

My ouiji board tells me, based on what we did at the last few meetings, that we probably should be starting with Henry going clockwise this time. I think the last time we started with Roger and went this way and the last time [we started on] the other side. So we will start with Henry and go around this way.

MR. WALLICH. Well, I'm not as well prepared as I should be, having just come back last night from Basle. I continue to think that we may be underestimating inflation. For the first three months [of this year] we didn't have very much OPEC input into this inflation and nevertheless the CPI was going up at 13 percent. Now, that was food [prices], which have improved. But we see the food area deteriorating again because of Russian import needs and I am fearful that food inflation will actually be higher.

Second, I very much agree with what the Chairman said just now. Bringing inflation down under these deteriorating circumstances is not just a question of taking more time to do it but it will be more costly in terms of real income. And the cost of that real income means less growth, higher unemployment. It need not mean more social problems from unemployment, if that's properly compensated, but it does mean less output. On the recession, I [agree] with those who think there are many reasons to believe it will not be deep; there are none of the antecedents we had in '73 and '74. There are no very powerful things to pull us out of it unless we make a mistake stepping on the gas very hard, but my concern is more that we should achieve some lasting effect on inflation.

Finally, as for accommodation of the exogenously imposed inflation, I sense a growing consensus outside this body that we should do much less accommodating than we did in 1973-74 when we accommodated in terms of money supply, in terms of financing payments, and in terms of trying to offset the domestic recessionary effects of the oil price increase. Wherever I go I sense that there is less willingness this time around to accommodate the OPEC shock monetarily.

As far as the aggregates are concerned, I have a very strong suspicion that we are dealing here with numbers that don't encompass reality. We know about RPs; we know about the Euro-market. I understand that the staff is on the track of some new kind of overnight deposit device in the Cayman Islands, which if we integrate it into M1 would account for a good part of the failure of M1 to grow for the first half of the year, although I'm not fully up on the latest data on this research. We have other variables such as money market funds. We have devices that individuals now can use outside money market funds to keep money outside of M1, such as Merrill Lynch-type cash accounts. All this suggests to me that the numbers we have here are simply too low and that the true money supply--if it could only be made to stand up--would be a great deal higher than these numbers show.

CHAIRMAN MILLER. Do you have any specifications that you--

MR. WALLICH. Well, under those conditions, Mr. Chairman, I lean toward keeping the specifications that we have now. They may seem very low, given what--

CHAIRMAN MILLER. What would you do for 1980 then, Henry?

MR. WALLICH. I find that a real quandary. I am very reluctant, however, to indicate that we are going to raise the rate of money growth. We can still [change the 1980 ranges later]; we are not casting this in cement.

CHAIRMAN MILLER. No, we will do another [review] in January.

MR. WALLICH. But I would be very reluctant, unless convinced by the discussion here that we should, to raise the rates of money growth.

CHAIRMAN MILLER. So you would keep the same ones we now have for '79 and [carry them forward for] '80?

MR. WALLICH. Yes.

CHAIRMAN MILLER. Thank you very much. Phil.

MR. COLDWELL. Well, Mr. Chairman, I agree with much of what Henry said. There are a couple of outside points I would like to make. Much of the discussion here has been about exogenous factors, outside influences. I still think our fundamental policy response is responsible for some of this inflation and I wish we had been tighter. A policy response now to fund some of the OPEC move I think would be a mistake; I'd prefer not to fund as much. In regard to Jim's comment about inventory, I think what is going on is an inventory of labor--not the normal [concept of] inventory, but an inventory of people.

The sense I get out of this forecast is almost a sense of hopelessness. There's nothing anybody can do. We have a high rate of inflation, a rising rate of unemployment, and a low rate of growth. And you tell me that you want to hold this for three to five years. I don't think that's politically [feasible]. I strongly doubt that this country is willing to stand still for five years, much less a year. So I guess my answer, Mr. Chairman, is that it may take some more difficult medicine than what we have on the horizon right now. Whether this body wishes to contribute its share of that castor oil or leave that to the political side of life, I don't know. I wish we knew what the President will be coming out with in his proposals; I think those might have an important bearing.

CHAIRMAN MILLER. Well, you see, he cancelled his speech because he wanted to hear what the FOMC would do! Everyone was wondering what the reason was.

MR. COLDWELL. If he wants to play the game that way then I'm perfectly willing to step up to the policy [plate] and say that it's time for us to quit--not validate these things. My preferences for the '79 long-term growth ranges would be 3 to 5 percent on M1 and 5 to 7 percent on M2. I would hold bank credit down. I think it may slow but I don't have any confidence that it is going to slow at all. On 1980 there is a possibility we could edge [the ranges] down and I would prefer to go another step further, perhaps to 2-1/2 to 5 percent [on M1], leaving the possibility of a lower range of growth. I admit this is likely to exacerbate some of the recessionary tendencies in the economy [but] I'm not yet convinced that we're heading toward the doom and gloom that some people are portraying.

CHAIRMAN MILLER. Thank you, Phil. Frank.

MR. MORRIS. Well, Mr. Chairman, as I indicated earlier, I think we're facing a bigger recession than the staff has projected, primarily because of the consumer sector. When Jim talked about the other sectors that were not as vulnerable, he neglected to suggest that we have a major sector that is more vulnerable. And that is the consumer sector, where the debt burdens of the consumer are substantially higher than they were going into the '74 recession. The staff's projections show that the bulk of the consumer adjustment is already behind us in the second quarter and that hereafter the consumer is going to play a pretty much neutral role in the recession. That's where I would differ. I think we are going to see a rising saving rate. We are beginning to see it now; we've been very surprised to see in the last few weeks an upturn in ordinary savings accounts after a long period of steady decline. So I think the move toward a higher saving rate has already started. I believe we could see the unemployment rate go as high as 9 percent next year rather than the 8 percent the staff has projected. In my view that would be counterproductive to the long-run anti-inflation fight. If we have that big a recession, the hope of keeping some constraint on fiscal policy is going to be diminished, inevitably. I would like to postpone my comments on what we ought to do in the short term. As far as the long-term ranges are concerned, I would be happy with Steve's proposals.

CHAIRMAN MILLER. Steve's proposals for both years?

MR. MORRIS. For both years.

CHAIRMAN MILLER. Thank you, Frank. Ernie.

MR. BAUGHMAN. Mr. Chairman, [let me mention] a couple of elements on the economy that might be of interest. We are beginning now to see a little pickup in drilling activities, after a fairly long period of accumulating idle rigs.

CHAIRMAN MILLER. Is this for oil or for gas?

MR. BAUGHMAN. It's both, but with gas being the strong end of it. And we're told by a few firms that they are making plans for a further significant step-up in that area, even to the extent that firms that normally do not own or control rigs but for the most part use leased rigs are anticipating enough shortage of supply of rigs about 6 months down the pike that they are now undertaking to acquire control so they will be able to get good rigs at that time. The other thing I'd mentioned in terms of a local situation is that we are seeing indications of very strong retail sales in El Paso and San Antonio. And this is attributed to heavy buying by Mexican nationals who are coming back into those markets in substantial numbers at the present time, after a period when such buying had been fairly low. Those are the only two markets on which I have some data. I guess similar comments on other markets [unintelligible].

As for local labor markets, they are almost in disarray. There's raiding and bidding away [of workers] and job hopping, which is distressing. It's a hard market to work in. We've passed the 50 percent annual rate of turnover in the Houston area--which is not a big increase from where it has been--but [employers] are having difficulty staffing. The electronic firms in the area are having great difficulties staffing. One of them characterized the market to me recently as follows: For electronic engineers the standard offer--the offer they make to engineers currently employed in other shops--is whatever you're getting now plus 20 percent, if you will come on over.

CHAIRMAN MILLER. Three job changes and you're in pretty good shape, aren't you?

MR. BAUGHMAN. It's even reached the point now where firms are considering setting up shops in residential areas so these people won't have to travel more than 5 minutes to work as compared to 20 minutes.

As to the general economic outlook, [my views] don't differ substantially from what the staff has projected. I recognize the possibility, of course, that their projection can be off and I would share the view that Jim Kichline mentioned that it could be off in either direction. I think there's a possibility that looking back 6 to 9 months from now we'll be talking in terms of a rolling adjustment as compared with just slipping into a recession. I wouldn't give it a high probability, but I think it's a possibility we should keep in the back of our minds.

As to monetary policy--what it has been, what it may be now, and what it should be--my thought process was pretty well outlined by Henry Wallich. It seems to me that we have not seen the usual indications of credit stringency and monetary tightness that we get in a full employment economy. And consequently, I think the numbers that we are looking at are not capturing what's really been happening [judged by] the effect of the money stock. Bankers continue to talk almost universally in terms of no credit restraint. They have money to lend and, of course, the figures on bank credit are showing the results of this. It seems to me that there are two major factors in the picture: One, the continued prohibition of outright interest on demand deposits and continued low ceilings on savings deposits; and second the ongoing strength in inflation, which has stimulated people to find ways of circumventing the effects of these restraints to a degree we have not previously known. This leads me to [favor] on the [ranges] for '79 Henry Wallich's suggestion to stick with what we have and for 1980 to go with alternative C in the Bluebook.

CHAIRMAN MILLER. Thank you, Ernie. John.

MR. BALLES. I'm reminded of sitting here in '74 and '75 through the deepest and longest recession in the postwar period and my friend Mr. Baughman kept raising the question, "What recession?"

CHAIRMAN MILLER. Well, it's nice to live in Dallas.

MR. BALLES. As a matter of fact, we didn't feel it as badly on the West Coast as Messrs. Willis Winn and Bob Mayo.

MR. PARTEE. It was just a regional recession.

MR. BALLES. In any event, as far as the national outlook is concerned, despite my "doubting Thomas" type questions to Jim a little while ago, I agree that the most probable outcome is the scenario of a one-year long, fairly brief, and fairly mild recession. But if there are any risks in that, they're probably on the down side, in my view, although I'm not quite as pessimistic as Frank [Morris].

Turning to the appropriate monetary policy in view of this, my specifications would be very similar to those that Steve laid out, with two qualifications. I think I would go further than he would in narrowing the ranges for the rest of this year for the same reason he would narrow them. We have half of the year behind us and unless we do narrow the ranges, we would allow for the possibility of some pretty extreme growth numbers during the second half of the year, as high as 15 percent and as low as 5 percent or thereabouts. So I think there might be some merit in giving assurance to the market that we're not going to go off the deep end in either direction. To be quite specific, for the second half of 79, I would like to see the M1 range at, say, 3-3/4 to 5-1/4 percent and the M2 range at 5-3/4 to 7-1/4 percent. I'm just carrying Steve's [suggestion] one step further. And as far as the rest of the specs that he set forth, while they are a little different than the ones I came in with, they would be acceptable to me.

CHAIRMAN MILLER. Thank you, John. Mark.

MR. WILLES. I think Henry and Phil have put their finger on the basic decision we have to make and that is: Do we bite the bullet and really try to do something about inflation or do we get deflected by a host of other problems? I would like to assert, without taking the time to prove it--because the Committee has neither the time nor the patience--that there is very little evidence that monetary policy can do anything to offset an oil price increase in terms of ameliorating its real effects on the economy. In our judgment, there is little if anything we can do systematically to offset increases in unemployment or to offset declines in real growth. Therefore, the one thing we can have a systematic impact on, and should have a systematic impact on, is the rate of inflation, and that should be our primary objective. And I think we can do that without making unemployment worse than it would otherwise be. That's the assertion.

The implication of that is that I very much agree with what Henry said for the long-run range for 1979. I was going to argue that we ought to lift the bottom of that range so that we don't let money grow too slowly but he scared me away from that with his reference to whatever staff investigation is going on that has identified some other factors and if that's right, that would worry me. I would just point out that even if we keep the existing ranges and assume 1 percent for ATS we could have money growth between now and the end of the year at 6-1/2 percent and still fall within the 4-1/2 percent ceiling range, which I think would be an appropriate rate of growth for the second half of the year. If we took what was alternative B in the Bluebook, we could have money growth--with ATS--at 10 percent between now and the end of the year, which I think clearly would be the wrong response in the face of the inflation problem that we have.

With regard to 1980, heaven only knows. I guess without information of the kind that Henry was talking about, I'd be inclined at this point to keep '80 the same as '79 until we figure out a bit more about what's going on.

CHAIRMAN MILLER. Thank you, Mark. Perhaps I should pause to make a couple of comments. One is that if we make any change in the ranges for '79, it would be a restatement for the whole year, fourth quarter to fourth quarter. We are not rebasing; I think everyone understands that. And my intention in dealing with '80 in our report to the Congress--I hope it's the staff's intention--is to do so in the text and not present a graph because then we would have to find a base point. And that we don't want to do, if you follow me. No chart, in other words. We'll say we are going to have this range for '79 and here is the chart for '79. But for 1980, then, we are going to have a range of so-and-so and it's just going to be in the text. We will not, therefore, pick the point from which we have that growth. I think that will give us a little less trouble when we set the ranges firmly in January or February when we do it for the year. Then we present it as our real target for the year and now we are just giving a preliminary indication. So I think that will be helpful. Bob Mayo.

MR. MAYO. I find Mark's assertion congenial and I--

CHAIRMAN MILLER. You're not going to prove it either.

MR. WILLES. We are prepared to prove it.

MR. MAYO. Yes, I think it can be proved, but I will make the same caveat that Mark did. Although the staff forecast is a reasonable one, I find myself a little more pessimistic. I am concerned about both the likelihood of less real growth and more inflation. I really feel at this point that if we can beat 12 percent this year we will be lucky on the inflation side. I think we will improve on that next year, but I don't hold much hope for getting materially under 12 percent for this year as a whole. Having said that, and having agreed with Mark's basic assertion, I find the 3 to 6 percent range for M1 this year a pretty good range. I wouldn't change that. For next year, if we have to do something--which we do--intellectually I would say that we should widen the range and make it 2 to 7 percent. I would go the other direction from some of the others. But I don't think it is a practical approach.

CHAIRMAN MILLER. I still have some confusion. For the M1 measure you said 3 to 6 percent.

MR. MAYO. Yes, 3 to 6 percent for '79 or 3 to 5-1/2 percent --I wouldn't quarrel with that.

VICE CHAIRMAN VOLCKER. Why not 1-1/2 to 4-1/2 percent? That's what it is now.

MS. TEETERS. He's adjusting it for ATS.

MR. MAYO. I'm adjusting it.

CHAIRMAN MILLER. That's what I had in mind.

MR. MAYO. I am talking about the second line in the material distributed--the "M1 measure," as it is called here.

CHAIRMAN MILLER. For '79, it's 1-1/2 to 4-1/2 percent now.

MR. MAYO. It's 1-1/2 to 4-1/2 now and it would be 3 to 6--

CHAIRMAN MILLER. For '79.

VICE CHAIRMAN VOLCKER. You said leave it unchanged, and then you said you would--

MR. MAYO. Well, that's [no] change. It's the way Steve has it down here.

MR. AXILROD. I was interpreting such a move as unchanged because the midpoint remains 6 percent after [adjustment] for ATS.

MR. MAYO. And that's the way I am looking at it--through the old ATS.

MR. PARTEE. You are accepting the upward adjustment in the average.

MR. MAYO. Sure.

CHAIRMAN MILLER. But 3 to 6 and not 3 to 5-1/2 percent.

MR. MAYO. I prefer the 3 to 6 percent, but I find that a minor point of difference. Now, since we are required to go out to 1980, I would say that if 3 to 6 percent is okay for '79, intellectually the range should be something like 2 to 7 percent for

'80 because [it seems logical to] widen the band. But I find this insulting to the process that we are being asked to do. It's sort of a throw-away bid. So with that in mind, I would find 3 to 6 more congenial again--or 3 to 5-1/2--for 1980. I see no reason to try to encourage a lot of journalists to interpret whether a half percent more or less has any significance for 1980. I think that's foolishness. So whatever we come up with for '79, I'd leave it that way for our first stab at '80.

CHAIRMAN MILLER. Thank you, Bob. Roger.

MR. GUFFEY. Thank you, Mr. Chairman. First of all, I think it's perhaps difficult to quarrel with the staff projection for the economy. But our independent look at the same figures they apparently are looking at--with some of the assumptions different, however--would suggest that we may have a bit less strength in the economy than in the staff projection, particularly starting in the 3rd quarter and running on into the 4th quarter. And just to throw another variable into it, there is a very good possibility that we will be facing an auto strike starting in September or sometime in early October, and that could further weaken retail sales and thus turn the economy down further than even we would project. Secondly, we would have some quarrel with what I believe to be the staff's assumption that there will be no substantial inventory reduction. We believe that there may be one--short-lived to be sure, but nonetheless rather sharp.

With those very few exceptions to the staff's forecast, it seems to me as far as policy is concerned that monetary policy has to work against the inflationary aspects of our economy, much as Mark Willes has described essentially. On the other hand, in view of the weakness of the economy that I have just described, it doesn't seem to me that we should go overboard even through the remainder of 1979. I would also suggest that the chances are that we will not get the growth in the aggregates, particularly M1, at the midpoint [unintelligible]. Thus I have no reason to quarrel with Steve's suggestion for the ranges for 1979. And to agree with Bob Mayo, I don't understand the exercise for 1980. So what Steve has suggested is perfectly all right.

CHAIRMAN MILLER. Thank you, Roger. Larry.

MR. ROOS. Yes sir, Mr. Chairman. I find this an extremely interesting exercise because we are looking ahead and we are trying to function on a longer-term basis. I also find most interesting the handout from the staff on past and prospective rates of growth in the monetary aggregates. And I think those figures, to a great extent, explain what has happened. We had money growth [in] '77 and '78 significantly in excess of 7 percent and we are reaping some of the inflationary consequences of that rate of money growth. We jammed on the [brakes]--the rate of money growth dropped significantly early this year--so we should not be in any way surprised by the recession that we are experiencing. The recent and continued upsurge in the rate of money growth also would signal quite clearly that probably this recession will be a "shallow saucer" configured recession.

As regards what we should do, I believe very sincerely that what we do--in spite of what OPEC does or has done--can have a very real effect on future price levels. I think it can have a 70 to 75 percent effect, with energy maybe affecting this scenario somewhat--maybe 10 percent on a scale of a 100. I would have to respectfully disagree with you, Mr. Chairman. If we really were determined to [clamp] down on inflation gradually, we should feel greatly frustrated by the OPEC action--I think it's a contributing factor--but I think it would be a shame to feel ourselves inhibited in monetary policymaking by that occurrence.

CHAIRMAN MILLER. I didn't realize I had said that.

MR. ROOS. Well, I thought earlier that you--

CHAIRMAN MILLER. I thought I said it would put us back by adding to inflation; we start from a higher base.

MR. ROOS. Well, all right. Specifically, I believe that inflation is still our most serious problem. If we are able to signal to the world that we are determined to do something about inflation, I think that will have a very real and salutary effect on our dollar exchange problem. I think it will stimulate much needed capital investment in this country. So, I think our number one long-term objective must be to wind down inflation on a gradual basis. I find the alternative C scenarios preferable, both in terms of the policy for the remainder of this year and for 1980, assuming we can--and I believe we can if we want to--in a very real manner affect money growth. I don't think we [ought] merely to respond to how money grows due to something that people outside of this room do. If we hold money growth--and perhaps this involves a widening of the fed funds range, which I know is heresy--close to the midpoint of the alternative C ranges, I think we will have struck a real blow for freedom. I think we can do it and that would be my preference, sir.

CHAIRMAN MILLER. Bones.

MR. KIMBREL. Mr. Chairman, several segments of the economy in our District are reflecting unusual strength. But I think the composite would come out not significantly different from that described in the other [Districts] and as envisioned by the staff. If anything, we are impressed by both bankers and businessmen in their escalating frustration with the regulatory environment. That seems to be spilling over into consumer pessimism and if anything we read that as somewhat more [prevalent] than the staff has reflected. At the same time we detect also a sense of considerably more willingness to accept some restraint to try to deal with our inflation difficulties.

Against that background, I would very much prefer, for both international and domestic reasons, to attempt to accomplish some stability. And it's my feeling that the ranges suggested by Steve Axilrod would involve maintaining something [close to] our present posture and for that reason I would accept completely the numbers proposed by him.

CHAIRMAN MILLER. Thank you very much. Dave.

MR. EASTBURN. My guesses on the economy are about the same as the staff's. The exception is that it's my sense that the staff may have underestimated the fiscal stimulus that might be coming along. In that context, I think the statement to the Congress should reaffirm our intention to move the monetary growth rates down in a consistent, gradual way. And I think the specifics that Steve has suggested would conform with that kind of general thrust, so I would agree with them.

CHAIRMAN MILLER. Thank you, Dave. Willis.

MR. WINN. I haven't any quarrel with the staff's projections and I have only two comments on that. One is that the continuing inflation may force greater financial problems for some of our public bodies--schools, cities, and so forth--and we may get some reactions in that area that aren't really factored into the formula. Second, there is a potential that energy and some of the other problems may be a greater stimulus to real investment on the part of the corporate sector--if the growing recession talk doesn't scare them off on that score--so that might be a potential stimulus.

On the aggregates, I would certainly like to echo Henry's comments on the meaning of these numbers and our not getting trapped by putting too much emphasis on these as we make our projections because of changes [occurring] everywhere. Maybe it's all these other [financial instruments] getting into those aggregates measures. I have trouble with drift. And I have trouble trying to explain April and June in spite of the [staff's] explanations. I don't find them very satisfactory as to what really has happened, which makes me uncertain as to the future. I would stay with the recommendations of Steve Axilrod; I would go perhaps a little lower in 1980 because of the uncertainties with respect to what's happening to ATS plus the growth and magnitudes of these other numbers. So I would be more cautious with the '80 number I think than he was, but I have no quarrel with extending the '79 ranges.

CHAIRMAN MILLER. Thank you, Willis. Bob Black.

MR. BLACK. Mr. Chairman, for some months we have felt that a turning point was near and I think we would buy what seems to be the consensus forecast, or the assessment that we have passed that point. So far as severity is concerned, I think the developments in the petroleum market do strongly enhance the possibility that this could be a worldwide downturn. And if this is true, I think our downturn may well be more severe than the staff is projecting. I would also add to that Frank Morris's fear that the consumer will be another source of weakness here. So, given our inflationary problem and the recent emergence of the downward pressure on the dollar, we of course have to be very careful in trying to cope with this downturn. In particular, we have to avoid any conclusion on the part of the markets here or abroad that we have thrown in the towel on inflation.

I would be especially concerned if the downturn did turn out to be an international [one]. I'm remembering back to '75 and '76 when the recovery began and Japan and Germany opted for a slower recovery than we did and we pumped in more money in late '77 and '78; I think that has exacerbated the problem we have had with the dollar. In a similar situation I think we can count on the Germans, the Japanese--maybe with a change in government--the British, and the Canadians too, to exert more restraint in trying to come out of the recession. If that scenario should develop, and if we adopt overly vigorous anti-recession policies, we could have a very, very serious foreign exchange situation.

So when we get to the long-run part of [our decision], I think what Steve has suggested is just about what we view as appropriate. We had slightly different figures in mind. We agree that we ought to adjust the old targets because of the revisions in the estimates on the ATS and NOW effect. Our original thought was that we would simply accept those specifications for 1979 outlined in alternative B. I say that but I also express the hope that we are not creating another form of base drift here. And if we do get enabling legislation, I hope that we will be just as quick in reducing those [adjustments] on the other side.

The 1980 targets pose a particular problem because we don't know what the base is, but I think the main effect of those is really psychological at this point. So I think we ought to be very careful to point out as we explain the '79 objectives that they have been raised because of a mechanical problem and that we have not raised our targets at all. Similarly, I believe it's important that the '80 targets be somewhat lower than those we had for '79. So our feeling was that it would be best just to take 1/2 percentage point off the alternative B specifications for 1980. But, again, we could live with Steve's specifications quite well, though I might want to play around with that 6 percent top on the range he has on M1. People will look at that and not go beyond it to find the explanation of why it really represents a 5-1/2 percent midpoint excluding ATS transfers, as compared with a 6 percent midpoint in '79.

CHAIRMAN MILLER. Thank you, Bob. Emmett.

MR. RICE. Mr. Chairman, consistent with my tenure on the Board, I will be brief. Generally, I agree with the projection of the staff; it seems to me that almost all of the data now point to a recession. I would expect a more serious recession than the staff seems to expect. I believe the effect of inflation on household balance sheets and liquidity will probably produce a somewhat steeper recession than is projected. In other words, the saucer will be somewhat deeper but not nearly as deep as '74-'75. I, too, would like to see a policy that is as effective as possible against inflation. I think we should do all we can to resist a high inflation rate but, as has been observed by some others, there seems to be a limit to the effectiveness of monetary policy as an anti-inflationary instrument given the kind of inflation we are facing at the present time. Because we are in a situation now that is turning toward recesssion but obviously with very strong employment figures--as a matter of fact employment is still rising, though not as rapidly as in April and the first quarter, and unemployment actually seems to be declining somewhat--I would favor holding with the current ranges for 1979. That is, since we are some distance into 1979, since the data still show a great deal of strength in employment, and since the inflation rate is very high, I would favor for 1979 staying with the current ranges, which is alternative B.

CHAIRMAN MILLER. Current ranges?

MR. RICE. Yes, the current ranges. That was alternative B, I believe, in the Bluebook. However, for 1980, I find it hard to imagine that we would want to follow a more restrictive monetary policy in a situation of recession than we followed when we were resisting inflation in a booming economy. I would prefer to see us be prepared to follow an easier policy in such circumstances. I would, therefore, be inclined to follow alternative A for 1980, recognizing that it's very difficult to make meaningful projections or to have meaningful notions about what the proper ranges should be out that far ahead. Nevertheless, I think our posture should be one that contemplates some easing. I would like to emphasize that our current monetary policy is still a restrictive one and alternative A in 1980 will still be a restrictive monetary policy.

CHAIRMAN MILLER. Thank you. Nancy.

MS. TEETERS. Well, on the long-run ranges, I don't have any trouble accepting the staff's projection as long as we adjust them for ATS. If we stick to 1-1/2 to 4-1/2 percent, that implies a tightening short-run monetary policy and I don't think we need that at all at the present time. So, I strongly favor adjusting the M1 [range] to take account of our changed projection on the automatic transfer effect. I do have some sympathy with Emmett's point of view that we should probably be signaling in our long-term ranges a slightly easier policy next year. I'll come back to that when we talk about short-term policy. It seems to me that it's only a matter of time--when to give the signal and when to do something--and that our first move toward ease probably will be our most important one. We should give thought to the timing and how much we are going to do rather than [unintelligible] when and where we have the most effect. [The question is] whether we [signal] it more strongly with these long-term ranges by putting them up a nominal amount for the off year or by other actions in our short-term policy. So I would endorse the staff's ranges at this point.

CHAIRMAN MILLER. Thank you, Nancy. Chuck.

MR. PARTEE. Well, I think we ought to hold with our current ranges for 1979 in a rather strict sense. And I think we ought to say that we are adjusting them simply for our changed ATS estimate. As I understand it, [that estimate] is down from about 3 percent to about 1-1/2 percent. And I would state that in the document. I'd say that the assumption is now a 1-1/2 percent rate of increase rather than a 3 percent rate of increase, and I would then adjust M1 literally to 3 to 6 percent. That would be [the equivalent of] 1-1/2 to 4-1/2 percent or whatever it was--plus 1-1/2 on each side. I think M2 ought to remain at 5 to 8 percent, and I would leave the M3 range at 6 to 9 percent. And I don't think I would change the bank credit numbers, although that's not very significant and that could very well be done.

For 1980, I agree--I think it was Bob Black who said this--that it is more PR than anything else at this stage. It's very, very provisional. I would prefer to say that we would hope to have or we would expect that we could have monetary growth within about the same ranges in 1980 as in 1979. I'd make some very general statement like that. One of the reasons I think we need to be provisional about [the 1980 ranges] is that there has been very little attention to this hand-out that shows our forecast against the Administration's forecast. And that does indeed create a considerable problem. That is, we have to indicate whether our policy is reasonably consistent with the Administration's goals, and it doesn't look as if it is in 1980. Therefore, I think we have to be somewhat provisional to be consistent with those goals.

I also think we have to be very careful about 1980 because this recession that's being projected is an unusual one for two reasons. The first is that, as I understand it, given a fundamental shift in consumption that is being predicted, I don't think there is enough accelerator principle effect--that is, the reverse accelerator effect on the business side. That is to say, [the downturn] may well turn out to be deeper. Secondly, I know of no previous instance where at this "going in" stage--in the face of a major change in income distribution and loss in income as well as a significant external increase in the rate of inflation--there is no adjustment in either fiscal or monetary policy to accommodate to that. And if that in fact occurs--that is, if we don't have a $20 billion tax cut to consumers to offset the loss [of income] from petroleum shifting to OPEC, and we don't have a high rate of growth in the money supply--I think the recession could be much deeper and much longer, and we may well have to have an adjustment later on. So, right now we ought to be concerned about the appearance of these ranges for the aggregates that we show to the public. I would think that we ought to make just that simple adjustment in 1979, and I wouldn't want to alarm the market or anybody with talk about an easing, although it may well occur, Emmett.

MR. RICE. You're not talking to the market?

MR. PARTEE. Yes, but we are going to be talking publicly here about our projections for 1980 and I just think it would alarm the market. I would rather do it in January when, in fact, we could see how deep the recession is likely to be.

CHAIRMAN MILLER. Thank you, Chuck. Paul.

VICE CHAIRMAN VOLCKER. Well, let me be very quick on the business side. A lot of people have talked about the risks of a recession, and I think they are there. There are also some risks of financial disturbances arising perhaps out of some nonfinancial companies. I think there are risks in the balance of payments and on the dollar side. I just mention those to say that I recognize them. But I believe the overwhelming purpose we should have in mind now, which seems to me to be shared from the comments that I have heard around the table, is that [our policy] should in substance and appearance be steady. I might say in terms of the risk of a larger recession, if some policy initiative became necessarily desirable, I'd rather see it myself on the fiscal side than on the monetary side--specifically on the tax reduction side, not on the expenditure side. I think that could have some long-range benefits despite an adverse effect on the budget in the short run. But I do think in substance and appearance that we ought to be steady.

What I'm disturbed about is that while the tone of many people's comments seems to say that, their precise recommendations don't seem to convey it. I frankly think the numbers that have been put before us by Mr. Axilrod would be confusing to the market. The market would only interpret this as an easing of policy. We're raising some numbers on the bottom side of our ranges and [growth is] already running toward the bottom, so we must be saying that we want to get easier. The M1 number is clearly higher on the surface than at present in any event. I think it would convey the wrong impression.

What are we trying to do here? As I understand it, we are reviewing some projections we set forth early in the year. Has something happened to change our minds about what we thought about then? It seems to me that the answer we should be trying to give is "no." We happen to be within the ranges. Why change them? And that is the message we want to give. And I would leave M1 unchanged, too. Now there is this technical argument about the NOW accounts and ATS--

MR. PARTEE. It's not a [matter of substance]; it's a measurement [issue]. It's [how it is] measured.

VICE CHAIRMAN VOLCKER. Well, it's measurement. But I have this feeling that this is [only] one technical factor affecting the measurement of M1. Meanwhile, money market funds payable by check are going up $3 billion a month, which nobody anticipated at the beginning of the year and must have had a bigger effect on M1 than ATS. Well, it must have had an effect, will you grant me that?

CHAIRMAN MILLER. May.

MR. PARTEE. I think it has almost none on transactions balances.

VICE CHAIRMAN VOLCKER. Well, you ought to talk to my wife. But you know, there are other factors--RPs and other things that Henry mentioned. And it just seems to me a mistake to react to this one technical factor at the risk of confusing people, when the basic message we want to give is: We have looked at our targets, we are within our targets, we are not changing policy at this point, and we are reiterating our figures. So I would urge that that be the approach we take.

As for next year, I agree with all the comments that it is much more uncertain. And I am happy to rest on the same figures but with a more general comment of the kind that you made. We do have the M1 legislative uncertainty even there. If we want to widen the range for next year, I have no problem with that. I don't think we [should] make a major change; we ought to signal essentially a steady policy. But I do think it would be a mistake to change the ranges for this year; I think it's going to confuse the issue, if indeed we want to convey the notion that I assume [we do, which is] that we are basically holding steady.

MR. ALTMANN. Same [for all] three?

VICE CHAIRMAN VOLCKER. Same ranges as we have at present.

CHAIRMAN MILLER. In '80?

VICE CHAIRMAN VOLCKER. Well, for '80 as well, [though] maybe widening M1 to recognize those [uncertainties]--

MR. WALLICH. In order to be consistent between M1 and M2, we may have to shade the M2 downward a little. I haven't really examined that.

CHAIRMAN MILLER. Well, today we are going to have to come up with some precise answers. Before we break, let me just make sure we have the right numbers down here. Let me read what Murray has down for each of you. I am going to do '79 only. For John Balles he has: M1, 3-3/4 to 5-1/4; M2, 5-3/4 to 7-1/4; and M3, 6-1/2 to 9. Is that correct?

MR. BALLES. [For M3] 6 to 9 percent, Mr. Chairman.

CHAIRMAN MILLER. Okay, 6 to 9. That's why I want to [check] these. Bob Black was 3 to 6, 5 to 8, and 6 to 9.

MR. BLACK. That's correct.

CHAIRMAN MILLER. For Phil Coldwell I have 3 to 5 and 5 to 7 and I didn't get M3.

MR. COLDWELL. I didn't specify.

CHAIRMAN MILLER. All right. Bones is 3 to 5-1/2, 5-1/2 to 8, and 6-1/2 to 9. Bob Mayo is 3 to 6 on M1, and we don't have M2 or M3.

MR. MAYO. 5 to 8 and 6 to 9.

CHAIRMAN MILLER. Chuck is 3 to 6, 5 to 8, 6 to 9. Emmett is 3 to 6, 5 to 8, 6 to 9. Nancy is 3 to 5-1/2, 5-1/2 to 8, 6-1/2 to 9.

MS. TEETERS. Could I change that to 3 to 6, 5 to 8, and 6 to 9?

CHAIRMAN MILLER. Sure. That's why I wanted to get these down. So that's 3 to 6, 5 to 8, and 6 to 9.

MS. TEETERS. Yes, I changed them.

CHAIRMAN MILLER. And Paul Volcker is 1-1/2 to 4-1/2, 5 to 8, and 6 to 9. Henry is 1-1/2 to 4-1/2, 5 to 8, and 6 to 9.

MR. WALLICH. Yes, I may want to shade my M2 to bring it more nearly in line with M1, but I have to check the numbers.

CHAIRMAN MILLER. I am going to go through the others. Ernie, 1-1/2 to 4-1/2, 5 to 8, and 6 to 9. Dave, 3 to 5-1/2, 5-1/2 to 8, and 6-1/2 to 9. Roger Guffey, 3 to 5-1/2, 5-1/2 to 8, and 6-1/2 to 9. Frank Morris, 3 to 5-1/2, 5-1/2 to 8, and 6-1/2 to 9. That's a pretty good team; they are all together there. Larry, 2-1/2 to 5-1/2, 4-1/2 to 7-1/2, and 5-1/2 to 8-1/2. Correct me if I'm wrong. Mark, 1-1/2 to 4-1/2, 5 to 8, and 6 to 9. Willis, 3 to 5-1/2, 5-1/2 to 8, and 6-1/2 to 9. Do I have them all right? Let's break for twenty minutes and come back at noon.

[Coffee break]

CHAIRMAN MILLER. Let's pick up from what we did just before the break. We looked at M2 and M3 for which there are no adjustments because of this ATS matter. It would appear that among voting members there's a rather overwhelming sentiment for staying where we are for

'79. In the case of M2 only three of you indicated any variation from staying where we are now at 5 to 8 percent. John Balles suggested 5-3/4 to 7-1/4, Phil Coldwell suggested 5 to 7, and Bones Kimbrel suggested 5-1/2 to 8, all of which are still not terribly far off from the 5 to 8. On M3, we had one abstention and only one person who indicated anything other than maintaining the 6 to 9--Bones, you suggested moving up the bottom to 6-1/2. I don't know how you all want to proceed on this, but just looking at it, there's an overwhelming [preference] to stay where we are on M2 and M3.

MR. KIMBREL. Mr. Chairman, just a point of clarification there. Paul Volcker's comments left an impression that we were not going to be staying the same if we used the numbers that Steve Axilrod had suggested. During the break I spoke to Steve Axilrod and I really would like to be reassured that indeed we are staying the same by [using the numbers he suggested]. So I guess I'm trying to reconcile [the comments of] Volcker and Axilrod.

CHAIRMAN MILLER. Let me take a stab at reconciling them and see what you think. I'm coming to M1 last because, as you know, it has this question of an adjustment that has to do with changes in the estimates of the effects of ATS accounts. There again if we just go by the numbers, it looks as if all but two of the voting members indicated that they would make the technical adjustment for the change in ATS. Paul Volcker and Henry Wallich suggested we make no such adjustment; everyone else suggested we make an adjustment and there are two very minor variations on what that adjustment should be. My suggestion as to a way to handle this is as follows: The intention of an adjustment is not to change the course of the ranges for M1 in a substantive, bottom line, sense. But in these kinds of announcements we deal not only with the analysts who understand that, but with those who want to [use] every excuse to effect their own personal preferences and would read this kind of adjustment as some change in policy. And when I hear it discussed around here, I see how many people have a hard time coming to grips with explaining that adjustment even to other professionals, so I wonder how it's going to sound publicly.

So, it seems to me that an alternate way to do it would be to stick with our present range on M1 and say in our report to the Congress that this range was set on the basis of a 3 percent ATS effect [but] it now appears that it will be less. In guiding monetary policy we're going to be looking at it on the same basis we were always looking at it, but the result is that the actual measured number may be high in the range or outside the range depending on how ATS comes out. We don't have to predict [that effect]; we don't have to give them a number; we can just say that with the ATS adjustment we are going to stay where we were in substance.

MR. PARTEE. [We'll be] high in the range or above the range if ATS slows or stops.

CHAIRMAN MILLER. But we'd come out the same on an adjusted basis as we would have previously. Now, that's one way to approach it. We've made the full disclosure but haven't got the press putting out new numbers with all the confusion that goes with them. I don't know whether that's satisfactory or not [but it's] a possibility.

MS. TEETERS. Aren't we just delaying the explanation? When we get to next January and we're 1-1/2 percent above where we said we were going to be, then we're going to have to give the same explanation. And in the meantime we're going to get all the adverse press on having been outside the long-term ranges.

CHAIRMAN MILLER. Well, that could be. I don't know. Every period of time has its problems and I agree with you that no time will be good to explain these complicated things. My second assumption is that, with the pending legislation and the pending redefinition of the aggregates, it would best at this point to say that for 1980, given the uncertainties, our current posture is to be within the same general brackets of growth [as this] year, adjusted for any changes in definitions or accounts. And we don't give numbers. Then when we come to February, if we agree to redefine the aggregates, we would have a whole set of numbers that are different anyway. We wouldn't have a set of numbers that changes twice. We would only have one new set that is based on something that we can look at then. Now we are liable to say that we are going to have [a certain range for] M1 next year and adjusted it's going to be a little different and then we will redefine M1 and then we will have another set of figures. I think it adds to the confusion.

Now, this is just a suggestion; I am not wedded to it. We are trying to think through what the risk is of this being misread. M2 and M3 won't be misread if everybody seems to feel that we should stay pat. But if M1 is misread, what's the risk? I think the main risk is that it comes at a time when there is uncertainty and unsettlement in the foreign exchange markets and I think there are people looking for excuses to believe that the United States is changing its policy. And whether we are going to change our policy [is] something we want to keep close to our chest, as far as allowing that to be used against us to create a rate for the dollar. I wouldn't be very happy to have that happen right now. I don't know if any of you who deal with foreign exchange markets have any views on that. We haven't asked you, but--

MR. PARDEE. It sounds sound to me.

CHAIRMAN MILLER. Pardon me?

MR. PARTEE. It's more a question of the impressions that people have rather than some [number of] basis points.

CHAIRMAN MILLER. I don't think foreign exchange traders are analysts. I don't think they care about facts. They care if they can use the device to maneuver a market in order to make a profit. Ted, do you have any view on it?

MR. TRUMAN. Well, I think I agree that the first impression of the market, if you didn't adjust [the M1 range], would be negative and that could lead to [unintelligible] basically because they're looking for what comes across the ticker first.

CHAIRMAN MILLER. Henry.

MR. WALLICH. I would think that staying with the same ranges in the face of higher inflation is something that people will understand. They will see that there's resistance, non-accommodation, [to that higher inflation]. I think it ought to have a good response.

CHAIRMAN MILLER. But I would do this only on the basis that we follow the majority will here. And I'd indicate in our report to Congress that we are going to guide our policy based on the original viewpoint that 1-1/2 to 4[-1/2] percent was 4-1/2 to 7-1/2 percent on an adjusted basis, and it stays that way. Mark.

MR. WILLES. I'm just wondering if it would be consistent with what you suggested, which I think is a move in the right direction, if we indicated that what we would look at would be adjustments for ATS and other things that might influence the demand for money. The market is very concerned and some of us are very concerned about some of those other things.

MR. PARTEE. We didn't cut the money growth [ranges] for the other things.

MR. WILLES. But we allowed substantially lower growth in the first half because of those other things.

CHAIRMAN MILLER. Dave.

MR. EASTBURN. I think these are very real concerns. The main concern on the other side, drawing from our experience with these targets in the past, is that once we get locked into a certain range it's very difficult to change. And the longer we go without changing, the more difficult it is to change. So if we go this way, I think we should do so with the understanding that if policy has to change, we will change the numbers. Let's not find ourselves locked into that same old situation as in the past. If we suspect at all that there's a danger of getting locked into that, there's some advantage in changing the numbers simply for technical reasons just to change the numbers.

CHAIRMAN MILLER. Yes, that's the other side of it.

MR. COLDWELL. Mr. Chairman, it seems to me that given the uncertainties--the idea that we started out with a 3 percent adjustment earlier this year and it's now down to 1-1/2 percent--. I don't know what the staff was actually forecasting--

CHAIRMAN MILLER. It may be something else by the end of the year. That's one of the problems.

MR. COLDWELL. Maybe. It may be back up to 5 percent. I don't know which way this [adjustment] could turn.

CHAIRMAN MILLER. That's what bothers me. We could end up with something we did [not expect] and be fouled up again.

MR. COLDWELL. That's why I wonder if it isn't possible just to use 1-1/2 to 4-1/2 percent and then in parenthesis say "adjusted for ATS."

CHAIRMAN MILLER. Sure, that's the kind of--

MR. COLDWELL. Whatever it may be.

MR. PARTEE. Yes, but we've got to explain that.

CHAIRMAN MILLER. Yes, we have to be prepared to explain it.

MR. COLDWELL. My point is that we end up leaving the figures the same, but with a parenthetical adjustment.

CHAIRMAN MILLER. Yes, adjusted for deviations from the estimate as to the ATS effect. It's adjusted for deviations because we've already adjusted it [by] 3 percent.

MR. AXILROD. Mr. Chairman, may I ask two questions on that? In explaining it to the public in the report, I assume we would say something like: Given what has happened in the second quarter, it is now expected that ATS growth may be somewhat less than originally thought and, therefore, growth in M1 may be somewhat higher in the range than at the midpoint. But more importantly from the point of view of material presented to the Committee--in terms of a tracking path for M1 to judge against--would I be wrong or right in assuming that the tracking path would center not so much on 3 percent if we had evidence that the ATS effect is running at 1-1/2 percent, but would center more on the 4-1/2 percent top of the range? In other words, the staff would have a question of what we would present to the Committee for it to judge how it is going to--

CHAIRMAN MILLER. You're asking, Steve, for the Committee to show internal consistency and that's a big demand!

MR. AXILROD. From the discussion, absent any other instruction, I would assume that we would track essentially on the 3 to 6 percent measured range.

CHAIRMAN MILLER. I think what I'm saying is that that's true if we look at ATS only. But some members may want to adjust their policy thinking to other things that have happened. But on ATS only, I think you're probably right. We probably made a mistake. For internal purposes we probably should have put your estimate in for the effect of ATS every month. Pardon?

MR. PARTEE. We can't really make out where we are.

CHAIRMAN MILLER. We probably should have used--what is it, 4-1/2 to 7-1/2 percent--from the beginning, making an adjustment each time.

MR. PARTEE. Added in ATS.

CHAIRMAN MILLER. Yes, added in ATS just for internal purposes. Maybe we should still do it--or do it as a supplemental chart. Steve will say that we don't have a measured way to do that, but if you make an estimate that the effect is X amount, you have to add in a number that would do that.

MR. BLACK. Mr. Chairman, as one who advocated adjustment, I think your plan is really better and I would go along with that.

CHAIRMAN MILLER. I'm trying to accomplish both [objectives]. I'm trying to accomplish the adjustment without scaring people and leave us some running room so that if the adjustment turns out to be different than we now think, we don't have a second go-around.

MR. BLACK. I think that's an important consideration, as Paul pointed out very clearly. It also gets to be a consideration, I think, when we select the range for 1980.

CHAIRMAN MILLER. Yes.

MR. BLACK. I would want that [1980 range] on the surface to appear to be somewhat lower; others wouldn't, but I would for psychological reasons. I think it could have a very therapeutic effect on the market.

MS. TEETERS. Are you proposing that we go to 1-1/2 to 4-1/2 percent for '80?

CHAIRMAN MILLER. No, for '80 I was proposing that we indicate that our current thinking is to continue the same ranges, adjusted for the impact of ATS. So it isn't 1-1/2 to 4-1/2, Nancy; it could be that 4 to 7 or 4-1/2 to 7-1/2 on an adjusted basis.

VICE CHAIRMAN VOLCKER. Are you going to be that vague for next year consistent with--

CHAIRMAN MILLER. I could be that vague now, but I wouldn't be that vague in February. I'm sort of hedging my bets because I assume that by the end of the year we will have completed our project. We'll have some redefinitions and we'll have a new series, which will be tracked back in time. And that series will come into--

VICE CHAIRMAN VOLCKER. Mr. Chairman, I'm just worried about M1. But if the [Humphrey-Hawkins] Act does not require that we specify in numbers--

CHAIRMAN MILLER. Well, where's the Act? Who has [the language]?

MR. AXILROD. I have a copy, Mr. Chairman.

CHAIRMAN MILLER. It specifies that we are to indicate our ranges and I don't think it requests that we--

MR. AXILROD. It says that as a part of its report on July 20 of each year in addition to [the ranges for the current year], the Board of Governors shall include a statement of its objectives and plans with respect to the ranges of growth or diminution of the monetary and credit aggregates for the calendar year following the year in which the report is submitted.

CHAIRMAN MILLER. I think we can do it by saying we intend to stay on the same track, with an adjustment for ATS. I don't know how that appeals to the Committee. If you'd like to have a discussion of that, I'd be happy to do it. Is there sentiment along with Bob's that this is perhaps the best way out of a box?

MR. PARTEE. I would accept it.

MR. BALLES. I'm not quite sure, Mr. Chairman. If we try the tack you are suggesting to avoid specifying the numbers for '80, which I would approve, what I can't really make a guess on--maybe you can tell me--is whether the [Congressional] Committee will try to smoke it out of you. If they do, then you're going to have to face the problem of the explanation of why it's 1-1/2 to 4-1/2 percent now and 3 to 6 or 3-1/2 to 6-1/2 percent next year. I hope you can avoid the problem but I'm not--

CHAIRMAN MILLER. I think I can because in the verbal answers I can say: Look, when we were putting [the objectives] down last year we were thinking of M1 in the old way of 4-1/2 to 7-1/2 percent. And whatever the ATS effect turns out to be at the end of the year--whether it's 3 or 1 or 7--[that] is really the adjustment [unintelligible]. I think I can kind of fudge that one in answering the Committee. One thing to avoid is to get at what the 1-1/2 to 4-1/2 would be and keep referring to the whole thing as based upon 4-1/2 to 7-1/2 percent on the old series for M1.

MR. BALLES. One other observation if I could, Mr. Chairman? For those who just look at the numbers and don't bother to read the explanations, as clear as they might be, if we move to 3 to 6--if what had originally been the majority view here prevails--[there will be] those who are concerned about what the Fed ought to be doing to ease things up during a recession. And I assume the facts of the recession no doubt will surface during the testimony. We'd appear to be easing without really doing so. There will be some advantages in terms of announcement effects for those who take a superficial view of what we are doing just as it might have a contrary adverse effect to foreign exchange traders who don't read the explanation. That's the other side of the coin.

CHAIRMAN MILLER. Sure. I think for internal purposes we ought to prepare each month a chart on the old series basis so that we don't get confused. The world may get confused, I suppose.

MR. BALLES. The only thing that might appear to be a little queer is that we'd have a stand pat hand in terms of ranges--if, let's say, Paul Volcker's and Henry Wallich's proposal were adopted--in the face of a developing recession. It might look a little odd.

CHAIRMAN MILLER. Yes. Any other comments? Roger.

MR. GUFFEY. Just to [follow] on that, I don't know how you would intend to avoid testifying as to the numbers--that we're indeed looking at 3 percent for the ATS adjustment early in this year and perhaps only 1-1/2 in the latter half of 1979. That can be read, if we maintain these ranges, as a tightening of policy.

MR. PARTEE. Well, we would adjust the ranges.

MR. GUFFEY. Pardon me?

MR. PARTEE. We'd adjust the range.

CHAIRMAN MILLER. No, what we do is this: If we were actually shooting for the midpoint of our ranges and we had a 1-1/2 percentage point ATS effect, then 3 percent on the current range equals 4-1/2 percent, and we'd be at the top.

MR. GUFFEY. But it's going to be very difficult to explain, and the--

CHAIRMAN MILLER. It's hard to explain to ourselves! That's why we're going to explain if we change in the numbers. It may be easy.

MR. BLACK. Mr. Chairman, we refer to those old rates as pure rates in Richmond, before we fool around and adjust them.

CHAIRMAN MILLER. Pure rates.

MR. BLACK. It's not very descriptive, but it's easy to recognize what we are talking about when we use that term.

MR. PARTEE. It seems to me you'll do a better job than the Dow Jones ticker does.

MR. BLACK. Yes.

CHAIRMAN MILLER. Well, one thing is that the written report will [unintelligible]. Yes, the Dow Jones will take the written report and put it on the wire. What I say will be lost in the shuffle so that--

MR. PARTEE. Well, except that you are reporting to an oversight committee and they may well understand what you're saying.

MS. TEETERS. I think you ought to explain very carefully what we're doing because it could be very misleading. I think we've had a bad reputation for being misleading and not forthcoming in saying what we're doing. We should put all the cards on the table and tell the [Congressional] Committee exactly what's going on.

CHAIRMAN MILLER. Sure. I have no disagreement with that. These ranges were set with the impact of ATS estimated at 3 percent. [The Congressional Committee] will have to take account of the fact that there may be a deviation from that particular estimate and that to the extent there is a deviation the ranges will be inappropriate. Therefore, Mr. Chairman, you should look at M2 as much better to track.

MR. BALLES. Amen.

CHAIRMAN MILLER. Then we'll go back and have another argument. Henry Wallich has been trying to get in a word.

MR. WALLICH. Two things. One, to automatically add to our 1-1/2 to 4-1/2 the difference between 3 and the current ATS [estimate] wasn't quite my idea.

CHAIRMAN MILLER. No, but you--

MR. WALLICH. I think we are getting ourselves here in the spirit of [believing that] in a recession we've got to accelerate the aggregates. Now, that way, there will never be a reduction in inflation. In a recession interest rates should come down, but at constant rates of expansion of the aggregates; otherwise prices will go up indefinitely.

VICE CHAIRMAN VOLCKER. Historically, the aggregates virtually always come down--

MR. WALLICH. That is what gives you assurance that you [can] ease; if you just keep the aggregates growing at a constant rate, you get very low interest rates.

CHAIRMAN MILLER. What is the pleasure of the Committee? Let's just take a quick poll.

MR. BLACK. Is this just for '79, Mr. Chairman?

CHAIRMAN MILLER. Just for '79 to start with, and then we'll turn to '80. The proposition is to report that we have decided to stand pat on '79, but with a clear explanation that there is an inaccuracy in the M1 range. That is, we will make clear that the M1 range has been adjusted for estimates of ATS and will have to be adjusted to the extent that there is a deviation from that original calculation. What's the sentiment on that? It's my proposal and I guess I would go along with it. I'm not sure.

VICE CHAIRMAN VOLCKER. Yes.

MR. BALLES. Well, I had a preference for the adjusted range of 3 to 6 percent. I would go along with anything that makes your job of explanation easier, so--

CHAIRMAN MILLER. It's our mutual job.

MR. ALTMANN.

President Black	Yes
Governor Coldwell	Yes
President Kimbrel	Yes
President Mayo	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Teeters	Yes
Governor Wallich	No

CHAIRMAN MILLER. Okay. I think that is strong enough that we should just probably stick with that.

How about 1980? What is your pleasure for that? Again, looking at the rundown here, it looks as if we have about the same lineup. Practically everybody who specified [numerical ranges] was at 5 to 8 and 6 to 9 percent, or very close to it, for M2 and M3. And the same thing for M1, with a 3 to 6 percent range. My thought [with respect to the 1980 ranges] was to indicate that there are a number of uncertainties, not only in the economy--whether it may be at a turning point and the effects that have not worked through yet--but also with regard to the Administration's policies and pending legislation. So, at this point in time, it would appear reasonable to continue to seek growth of the aggregates in 1980 within the ranges that have applied for 1979, adjusted in the case of M1 for deviations [relating to our estimate of] the effects of ATS.

MR. PARTEE. That's our present plan.

CHAIRMAN MILLER. That's our present plan. And I'd say that because of the number of uncertainties, the Committee could expect revisions to this when we re-present [our ranges] in February.

MR. BLACK. Mr. Chairman, I don't want to dissent on this and I wonder if you could throw a few crumbs to those of us who would like to see some little move toward slowing because of our oft stated position that we want to get growth of the aggregates down over the longer run.

CHAIRMAN MILLER. Well, I'm open to suggestions. Can you give us a--

MR. BLACK. Well, if we just knock a half point, say, off the top on each one of those [ranges], I think that would psychologically give us a big boost in the market. We might want to change the ranges later on, but I would certainly like to see something in that general direction.

MR. MAYO. I would leave the figures the way they are, Mr. Chairman, but say in your text that we are still firm in our desire over the longer run to see the aggregates [slow].

MR. BLACK. But if we did only that, wouldn't people say why didn't you put the ranges a little lower?

MR. MAYO. Because we were in a recessionary period.

MR. BLACK. Oh, you're just saying depart from that during the recession.

MR. ROOS. Well, I was going to parallel somewhat what Bob Black said. I think the first question you'd get--and you're much more experienced than I in appearing before those people [on the Congressional Committees] is: Mr. Chairman, you've said repeatedly that gradually over the years you are going to try to phase down inflation, so how will these figures you've just given us conform with that? In other words, will doing the same thing next year as we're doing this year really be a meaningful first step to gradually cranking this [inflation] down? That's what I would [expect].

CHAIRMAN MILLER. I would say in response that the record shows that we have had two years in a row of reduction in growth of the aggregates. And, within the ranges that have been specified, the prospect for a further year of reduction would still be available if economic conditions make it possible. Therefore, we are able to pursue our long-term aim within the ranges that have been indicated by this Committee. That's how I would probably answer. Again, I think the record is more powerful than promises. The record is that two years in a row now we've had significant reductions in the growth rates of these aggregates. On M1 adjusted, we've gone from 7.9

percent to 7.4 percent to an estimated 6 percent for this year and that's probably more impressive to the Committee than [any] promises we can make.

MR. BLACK. You know, strange as it may seem, I think we've decelerated a bit too rapidly, and I wouldn't like to see it continued. I think the market is going to be watching that very carefully.

CHAIRMAN MILLER. Yes, M2 [has gone down] from 9.8 to 8.4 to probably 6-3/4 percent.

MR. BLACK. That's pretty darn fast, really.

CHAIRMAN MILLER. It's fast, yes.

MR. BLACK. It's faster than I would like.

CHAIRMAN MILLER. That's why we could moderate [the decline] a little next year and still keep it in the right--

MR. AXILROD. Mr. Chairman, if I just might add a comment. In no way am I trying to interrupt the decisionmaking process nor am I claiming to be a market psychologist, but it's my impression that in 1977 the credibility of the System was undermined more for having set low ranges that it didn't hit than for having set [unintelligible]. I think that had more of an impact than anything else in that period.

MR. PARTEE. I wouldn't be prepared to support anything except an expression of hope, in much the way you did. Frankly, I don't think we'll be able to do it.

MR. COLDWELL. I don't believe the figures anyway. The figures are going to jump around and ATS account adjustments are going to jump around.

CHAIRMAN MILLER. But we're going to have a new definition of M1 and it's going to affect this. Well, again, it's a very hard thing for us to do. If we get very specific, we run the risk that Steve just pointed out. Our credibility would be hurt [more] if we put out some very specific numbers and can't come near them than if we put out some generalized statement of policy intent, which we know is about the best we can do at this point really.

MR. BLACK. Well, I think maybe we can improve the faulty procedures of the past and do a little better in hitting what we say we [want]. That's what really deserves criticism rather than the other, I think.

CHAIRMAN MILLER. Certainly.

MR. COLDWELL. Well, the band is wide enough to encompass almost anything we can do.

CHAIRMAN MILLER. It really is. If [growth] came to the low side of the band, we can satisfy all of one group and if it came to the top we can satisfy all of another group. So all of you can be satisfied.

MR. COLDWELL. We'd be better off just to stay where we are.

CHAIRMAN MILLER. It's [going to be] a low-keyed report as I see it: Not "we are out there to do so and so," but we need some time to observe how the real economy behaves and to complete our study of the components of the money aggregates, how they [should be defined], and what their proper alignment is.

MR. BLACK. Mr. Chairman, could we point out pretty clearly that we've had a rather rapid deceleration [in the growth of the aggregates] and that, as you indicated before, maybe we can pause a little for now? But we still have that goal.

CHAIRMAN MILLER. Steve, it seems to me that what we were planning--we haven't seen that chapter [of the report] yet, but I think you and I talked about this--was to have a long-range chart on each aggregate to show what we have done to bring each one down as well as a shorter-term focus. We need to focus on the year because it gets lost. But in a long-term chart we are intending to show that we have been winding this [monetary growth] down as promised.

MR. BLACK. If we can show that clearly, I can live with what you are suggesting, but--

CHAIRMAN MILLER. I think we ought to cover the whole decade. Isn't that what we're going to do on these?

MR. AXILROD. Well, at least back to the early '70s so it can be--

CHAIRMAN MILLER. Well, yes. We want to go back so we catch the earlier cycle too and show how the money growth came up and then we have been bending it downward. And the ranges that we're suggesting, if we say we are going to continue the same ranges, allow us to continue that trend. I don't want to get locked into promising that. I think Chuck's right. I don't want to get locked into promising anything. I just want to say that all things equal, and with our ambition to fight inflation being what it is, we can live within those ranges to accomplish what's appropriate. What is your pleasure?

MR. COLDWELL. Verbalize steadying the boat.

CHAIRMAN MILLER. Do we need a vote on [the ranges for 1980]? Perhaps yes.

VICE CHAIRMAN VOLCKER. Steadying the boat with a hope that in time we will get [money growth] down.

CHAIRMAN MILLER. Okay.

MR. ALTMANN.

Chairman Miller	Yes
Vice Chairman Volcker	Yes
President Balles	Yes
President Black	Yes
Governor Coldwell	Yes
President Kimbrell	Yes

President Mayo	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Teeters	Yes
Governor Wallich	Yes

CHAIRMAN MILLER. May we consider those votes now? Henry, would you like to go unanimous with the first [vote on the 1979 ranges]? There's always a chance.

MR. WALLICH. I'd like to stick with that because I disagreed on that one the last time.

CHAIRMAN MILLER. Foolish consistency is the hobgoblin of a little mind and everyone knows that you're a big mind!

MR. BLACK. You should say, therefore, that it isn't foolish inconsistency.

MR. AXILROD. I was going to ask, Mr. Chairman, whether you wanted to worry about the wording of this matter now that the vote is settled. Or should we settle that with you later?

CHAIRMAN MILLER. I think we can do the wording [later]. And if we feel we should circulate it to the Committee, we can do that. I don't think we should take the time now to do it. We need to turn now, I think, to the next issue. Perhaps it would be worthwhile to circulate the wording early, even before we put out the whole--

MR. ALTMANN. Normally we would be sending this directive to the New York bank today. But I suppose we could leave that portion out; it's not operational for the short run.

CHAIRMAN MILLER. It's not operational until it goes into the report next week.

MR. ALTMANN. What I'm saying is that normally this directive is transmitted today.

CHAIRMAN MILLER. But this [part of the] directive is concerned with the long-term ranges; it has no operational effect. So we could have time to consult with the Committee. On the short-term directive [regarding operations] until the next meeting, yes, it must be precise.

Now let's turn to the next item on the agenda, which is the question of short-term ranges. And I believe the first thing is to turn to the staff's recommendations. Steve.

MR. AXILROD. Well, Mr. Chairman, to be very brief it seems to me that alternative II on page 10 in the Bluebook would be quite consistent with the long-run decision the Committee just made. The federal funds rate range we show there is the one currently in place, 9-3/4 to 10-1/2 percent. But of course the operating funds rate level has been 10-1/4 percent, so it's an asymmetrical midpoint so to speak. That's what I would recommend to the Committee, given its decision just now.

CHAIRMAN MILLER. Well, why don't we just go around the table the same way quickly and get your individual recommendations. We will start again with Henry on this.

MR. WALLICH. [I'd prefer that you] don't start out with me, Mr. Chairman; I haven't had the benefit of education around the table.

CHAIRMAN MILLER. You want us to skip you and come back to you at the end?

MR. WALLICH. Well, I think I lean more to alternative III, although modifying the funds rate there downward. My thought is this: If we have a crisis in the exchange market, we should be free to move. I don't think it's worth a great deal getting the funds rate up in the absence of such overriding necessity, but I think we may very well face that over the next month. What I would really like is something that gives that kind of instruction. That would mean beefing up the language of the directive--not just saying that we take account of foreign exchange markets--but I have not found a good way of wording it. I would enhance that, as I said, and give high priority to the program for supporting the foreign exchange value of the dollar and due regard to developing conditions in domestic financing markets. That's not an optimal [way of saying it] but it's a distinction that I am trying to draw.

MR. PARTEE. You could have "giving due regard to the domestic side" overriding attention.

MR. WALLICH. If we have a major boil-up, there is no way of putting together a package this time, as was done last time. And we can't do it with intervention; I don't think we should do it with intervention. So we then just have to face a possibly substantive decline in our currency, adding to inflation and adding to the problems of the world. That's how I would like to shape this: Stay at the present funds rate level, give more room on the up side--in other words, 10 to 10-3/4 percent--with some proviso that would give us a chance to move up readily to a higher rate if the exchange market should boil up, but otherwise not go up on the funds rate.

CHAIRMAN MILLER. Yes, Phil.

MR. COLDWELL. Henry said a good share of what I was going to say, so I won't pursue it. I wouldn't put the words quite the way he did, in an "overriding" sense, although I think the dollar depreciation risk is a high one in any policy that portrays any picture of ease. Curiously enough, we came out precisely the same on the fed funds range, 10 to 10-3/4 percent. We're at 10-1/4 percent now, so it would be asymmetrical on the bottom side. I really don't see much need for [a range]. As far as I am concerned, it's 10-1/4 percent unless something overriding develops either to force it on the up side or on the low side. I'd almost just as soon say 10-1/4 percent.

CHAIRMAN MILLER. Let me just put out a thought. It seems to me that an international disturbance is a serious [concern]. It could require that we take some action. I don't know what that action would be. To try to [address that] in the short-term directive is almost impossible. It seems to me that we should get on the phone and we should make a decision in a meeting. So maybe we ought not be trying to shape this directive to deal with an international crisis but have a commitment to ourselves that if there is such a crisis, we will call a meeting promptly and deal with it. To anticipate what it will be, why it occurred, what will start it, what the response should be, and what else is going on, is very, very hard. Anyway, that's just a thought. Frank.

MR. MORRIS. Well, Mr. Chairman, this Committee has traditionally overstayed policy both in the direction of ease and of restraint and I would like to see us violate this tradition once. It seems to me, with the economy clearly in a recession, that we ought to start moving to try to mitigate the amplitude of the recession--to try to take out some insurance that the recession will not be bigger than the staff has projected. So with that in mind, I would propose that the funds range ought to be 9-1/2 to 10-1/4 percent with instructions to the Manager to move to 10 percent immediately. I think history gives us assurance that the aggregates are not going to run away from us in a recession, even with an aggressive interest rate policy. Now, I recognize that this is going to be disturbing to the foreign exchange markets in the short run. But once the markets understand that our economy is turning down while the rest of the world is still moving up, I think it will turn out to be a short-run phenomenon. And we can use our open market operations in the foreign exchange area to mitigate the shock. But I believe we have a conflict between our domestic and our foreign objectives. I think we have to sacrifice one, and I would sacrifice the exchange market at the moment.

CHAIRMAN MILLER. Thank you, Frank. Ernie.

MR. BAUGHMAN. Mr. Chairman, alternative II seems acceptable to me.

CHAIRMAN MILLER. Thank you. John.

MR. BALLES. Well, even though I dissented in May because I wanted the funds rate down to 10 percent, I find myself in a position now where I think the rate ought to be up to 10-1/4 percent. That's more or less fortuitous and it's because of the recent surge in the aggregates. The level of M2 is now near the midpoint and is forecast to grow, as you know, at 8-1/2 percent over the July-August period. That should put it slightly above the midpoint. And the M1 level in June was below the midpoint but is projected to grow 4.2 and 4.9 percent in July and August, which if it happens--and I hope it does, Steve--will bring it right to the midpoint by August. I think that's good; we need [growth] to get back up to those midpoints and that's in part what tends to offset the fact that we have a recession going on now.

From that point on and within the ranges that we have specified, I would argue two points very strongly. [One is] that we ought to aim for those midpoints, in terms of having a moderate and stable policy, steering a middle course between the dangers to the dollar in foreign exchange markets on one hand versus the sagging economy on the other hand. And I would argue secondly, picking up on a point I was glad to hear you make earlier, Mr. Chairman, that we ought to be paying more attention to M2. With all of the uncertainties that we know have plagued M1, I guess I'm distressed by the fact that in the formal directive we are still calling for about equal weight to be given to M1 and M2. At least two years ago, we circulated a paper calling for greater emphasis on M2 and I would like to see that as a formal proposal at this time. So, I'm going to make it: I think we should start giving closer to two-thirds weight to M2 rather than the present 50/50 [to M1 and M2]. Having said all of that, the specifications of alternative II would be satisfactory, but qualified by what I have just said.

CHAIRMAN MILLER. Thank you very much, John. Mark.

MR. WILLES. I would find alternative II acceptable.

CHAIRMAN MILLER. Thank you. Bob.

MR. MAYO. Alternative II is fine with me. I don't share the position that we should try to adjust the ranges to reflect the possibilities of an international crisis of any kind, basically for the reasons that you have outlined. It seems to me that to try to do it just by jiggling up the upper [limit of the funds rate] by a 1/4 percentage point wouldn't solve anything really. We should have it much higher than that if we were going to assume that we will have no telephone communication over the next four weeks. I'm not willing to make that assumption, so I would go with alternative II the way it is, with a money market directive.

CHAIRMAN MILLER. Thank you, Bob. Roger.

MR. GUFFEY. Alternative II, Mr. Chairman. Just a comment with regard to the international situation: If I heard Scott Pardee correctly this morning, he suggested that any move by the Federal Reserve, whether in the discount area or an upward movement in the funds rate, would have some salutary effect [in countering] any weakness in the dollar that might develop. Again, I would like to propose that serious consideration be given to a discount rate increase if that develops rather than moving to an upper limit of 10-1/4 percent [on] the fed funds range.

CHAIRMAN MILLER. Larry?

MR. ROOS. I'd just like to suggest that we broaden the fed funds range symbolically to 1 point, and I would be perfectly happy with alternative II and 9-3/4 to 10-3/4 percent. But if we are going to signal a substantial and real interest in controlling the aggregates in any way, somewhere along the line we will have to move toward a broadening of the fed funds range.

CHAIRMAN MILLER. Thank you, Larry. Bones?

MR. KIMBREL. The activity in the foreign exchange markets continues to disturb me, Mr. Chairman, but I believe the suggestion that you made deals with that directly and forthrightly. Meantime, alternative II just as it is shown [in the Bluebook] is acceptable to me.

CHAIRMAN MILLER. Thank you very much. Dave?

MR. EASTBURN. Alternative II.

CHAIRMAN MILLER. Willis has alternative II, also. Bob.

MR. BLACK. Mr. Chairman, I guess my preference is based more on intuition than anything else. My inclination is to hold the funds rate where it is and hope that the aggregates do slow from the excessive pace that they recorded in June. But more than most people around here, I think our [actions] ought to be guided by the behavior of the aggregates; that ought to be what triggers our operations on the funds rate. In that connection I think we ought to recognize that the aggregates are well within their ranges. However, it's not entirely the points at which the aggregates rest, but rather in part the slope of the aggregates. And for the last four months there have been some pretty steep positive slopes. If that continues, which I don't really anticipate, I think we ought to be prepared to move on up [on the funds rate]. So, in short, I would buy alternative II with the money market directive.

CHAIRMAN MILLER. Okay, alternative II with money market. Emmett.

MR. RICE. Alternative II.

CHAIRMAN MILLER. Thank you. Nancy.

MS. TEETERS. Mr. Chairman, if it were not for the international markets, I would be recommending alternative I. What I am worried about is that we are never going to get to a point that we start easing that the money markets are not going to get upset. It's just a matter of picking our time, and--

CHAIRMAN MILLER. When we want to upset them.

MS. TEETERS. When we want to upset the foreign exchange markets and how much of an upset is going to occur, even if we keep with a constant policy at the present time. And as I said earlier, I think our first move is going to have the most impact. When we start moving [rates] down, subsequent moves aren't really going to have the announcement effect. I guess I'm not quite ready yet to make the move in the international markets. But [the time] is going to come and we are not going to avoid that upset in the international markets.

MR. WALLICH. Well, we don't have to take the week in which the Bundesbank is going to raise their discount rate.

MS. TEETERS. Well, you'll always find someone who's moving up. If it's not the Bundesbank it'll be England or something. I would go with alternative II. It is not my preference; my preference is alternative I.

CHAIRMAN MILLER. All right. Chuck.

MR. PARTEE. Well, I agree with Nancy. But in deference to the international situation, I would postpone the reduction in the funds rate until next week. [But] the fact of the matter is it's going to get worse and worse and worse. And if those people are going to follow a policy of deliberate appreciation in their currencies, which is what the British are doing certainly, and I think the Germans are also--

MR. WALLICH. Very, very reluctantly, they are doing it.

MR. PARTEE. Well, I don't think we ought to get dragged along with them into a worldwide depression. And I think we ought to stop it. So I agree, but what I would do is take the aggregates specifications--. Well, I would take all of the specifications.

CHAIRMAN MILLER. In which [alternative]?

MR. PARTEE. Those of alternative II, but I'd call for an immediate reduction in the funds rate to 10 percent.

CHAIRMAN MILLER. Okay.

MR. PARTEE. A reduction in the funds rate next week.

CHAIRMAN MILLER. Now we got it. Next week--in one week or 7 days. You want the President to get a speech off first.

MR. PARTEE. We have had one of the sharpest declines [in retail sales], as far as I can recall, over 4 or 5 months. It's really staggering when you consider the size of that component in GNP, to have a 6-1/2 or 7-1/2 percent decline over a 5-month period.

MR. WALLICH. Think of what people are going to be buying once they get gasoline again.

MS. TEETERS. They can't afford anything else.

MR. PARTEE. At $1.25 a gallon.

CHAIRMAN MILLER. Paul.

VICE CHAIRMAN VOLCKER. If that's really the explanation for the declining retail sales--and there must be something to it--I don't think the remedy is monetary policy but rather fiscal policy. My main concern here would be that we not move right away on the funds rate without some considerable provocation. I think we have to keep in mind the international situation but always against the perspective of accelerating inflation. It may yet require some action in raising the fed funds rate, but that leaves me happy with a 10 to 10-1/2 percent range--that will do--and I'd do nothing at the moment. Probably I'd have the money market directive. I am bothered by the ranges under alternative II simply because this month our own staff's projections for aggregate growth are much lower than the Board staff's. They are outside the ranges proposed here already on the low side, which will be contrary to the idea of not changing the fed funds rate if those [projections] came out to be right. I don't think one can put much weight on either of these projections; this just indicates that the money supply unfortunately is pretty much a random number for the month. So I would stick with the money market directive, and I would prefer a wider range on [the aggregates]. I would really prefer 0 to 6 or 6-1/2 percent or 1/2 to 6-1/2 or something like that [on M1] and 5 to 9 percent on M2.

CHAIRMAN MILLER. Okay, thank you. Phil did we get your specifications on M1 and M2?

MR. COLDWELL. I took all of alternative III, Mr. Chairman.

CHAIRMAN MILLER. Alternative III, okay. Let's get those in there. Now, let me ask two questions first. [Unintelligible] even with the specifications of leaving the funds rate at 10-1/4 percent. One is that we didn't get a complete indication--though I believe we covered everyone--of preferences for a money market or an aggregates directive. Is it critical to the ranges that we resolve that first? John.

MR. BALLES. I forgot to mention, Mr. Chairman, a monetary aggregates directive [is my preference].

CHAIRMAN MILLER. Aggregates. Okay. Bob Black, you said a money market directive, I believe.

MR. BLACK. I tend to think we ought to have different ranges when we have a money market directive than when we have an aggregates one because the trigger points are different. Others apparently don't see that distinction, which I see.

CHAIRMAN MILLER. It is supposed to be that way. We haven't operated that way much, recently. Phil, you wanted which one?

MR. COLDWELL. Money market.

CHAIRMAN MILLER. Money market. And Bones you wanted an aggregates?

MR. KIMBREL. I have a slight preference for a money [market directive].

CHAIRMAN MILLER. I'm sorry, we just got it down wrong. See, that's why we need to check these. Bob Mayo is for money market.

MR. MAYO. Yes.

CHAIRMAN MILLER. And Chuck.

MR. PARTEE. Well, I guess I'll take money market this time.

CHAIRMAN MILLER. Emmett.

MR. RICE. Money market.

CHAIRMAN MILLER. Nancy.

MS. TEETERS. Money market.

CHAIRMAN MILLER. And Paul said money market. Henry.

MR. WALLICH. Money market.

CHAIRMAN MILLER. Well, that's very interesting. So it looks like everybody is for a money market directive except John Balles--or me, and I haven't said what I'm for.

MR. BALLES. It's clear I'm out-voted.

CHAIRMAN MILLER. I don't know that I'll add too much to this conversation. I do think that one of the things that will affect our actual short-term policy, as distinguished from what we direct today, is the outcome of the President's announced program. If it is a powerful program that causes a positive reaction in markets, it may give us more running room to look at this differently. On the other hand, if it's a weak program and perceived to be so, we may have enormous pressures on us in another direction. I think we are likely to be in consultation next week one way or the other. My preference would be for all of us to bear in mind that we shouldn't get too locked into what we say until we hear what comes out of that and then we should probably re-assess our thinking because we just can't predict what we will think.

Having said that, [according to my count] a lot of you are for alternative II with a few variations. There doesn't seem to be much disagreement on maintaining the present level of the fed funds rate at 10-1/4 percent. Of the voting members, Chuck, I think you are the only one who suggested--Frank did as a nonvoting member--a near-term move down on the [funds rate].

MR. PARTEE. Well, I take it on the fact that we don't know what the President is going to say on the oil crisis.

CHAIRMAN MILLER. Okay, then that gives us everybody standing still here. There's an overwhelming preference for a money market directive. This gives us on M1 a preponderance of preference for the 2-1/2 to 6-1/2 percent range. On M2 there is a preponderance of 6-1/2 to 10-1/2 percent and on the range for fed funds a preponderance of--it really looks like alternative II is it.

Before we vote on that, I would like to take seriously John Balles' suggestion that in the directive we give more weight to M2. And I would like an expression of sentiment from the voting members on whether you would be so inclined or whether you would prefer to continue with the equal weight.

MR. AXILROD. Mr. Chairman, before the Committee votes on that, I ought to bring to their attention special factors in this area. The most obvious is that what will affect M2 particularly is whether the 6-month bill rate happens to be just below 9 percent or above 9 percent. That has turned out to have a very pronounced effect.

CHAIRMAN MILLER. Increased M2.

MR. AXILROD. That's right.

CHAIRMAN MILLER. Now it's back to where there is no rate advantage.

MR. AXILROD. If it goes below 9 percent, then the S&Ls will have a greater advantage which can take funds away [from banks]. If it goes above 9 percent, the banks have an advantage. There's considerable uncertainty in our projections in that area. I just wanted to explain that.

CHAIRMAN MILLER. Nevertheless, with that caveat and all the other things [involved], what is your preference? Let's just go down [the list]. Paul, would you want to change the weight?

VICE CHAIRMAN VOLCKER. I think not.

CHAIRMAN MILLER. We heard from John. Bob Black.

MR. BLACK. No, in view of Regulation Q. If that were removed, I think I would.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. No.

CHAIRMAN MILLER. Bones.

MR. KIMBREL. I think not. It might be difficult. I'd rather have no change at the moment.

CHAIRMAN MILLER. Okay. Bob Mayo.

MR. MAYO. I'd have no change. We are going to redefine the aggregates in January or sometime soon, anyway, and I think this would just be confusing. But John's point is basically correct.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. I think that's right. I wouldn't do it now.

CHAIRMAN MILLER. Emmett.

MR. RICE. No change.

CHAIRMAN MILLER. Nancy.

MS. TEETERS. No change.

CHAIRMAN MILLER. And Henry.

MR. WALLICH. I'd like to see it examined because the idea has merit but I wouldn't do it now because I can't [assess] the implications.

CHAIRMAN MILLER. Okay, it looks as if the preference is to stay with equal weight. Now having done that, let us see what our vote would be on alternative II as is with the fed funds rate at 10-1/4 percent and a money market directive.

MR. MAYO. With the same range [for fed funds] of 9-3/4 to 10-1/2 percent?

CHAIRMAN MILLER. Yes, 9-3/4 to 10-1/2 percent, the range we now have. Correct.

VICE CHAIRMAN VOLCKER. Is this a formal vote?

CHAIRMAN MILLER. No, a straw vote. Let's get things going.

MR. ALTMANN. All right. Vice Chairman Volcker.

VICE CHAIRMAN VOLCKER. I find it very difficult with those ranges that high especially. It depends on how permanently fixed that 10-1/4 percent rate is or how much provocation it takes to move it.

CHAIRMAN MILLER. You would like to lower the bottom side of that?

VICE CHAIRMAN VOLCKER. Yes, I think so.

CHAIRMAN MILLER. Okay. John.

MR. BALLES. I'll gulp and say yes.

MR. ALTMANN.

President Black	Yes
Governor Coldwell	I have some reservations, but I'll go with it
President Kimbrel	Yes
President Mayo	Yes
Governor Partee	

MR. PARTEE. Well, I'm right on the edge. I can vote for it; it's lower ranges that I'd have to vote against.

CHAIRMAN MILLER. That's on account of Paul.

MR. ALTMANN.

Governor Teeters	Yes
Governor Wallich	

MR. WALLICH. Are we going to stick by your suggestion, Mr. Chairman, that if the exchange markets destabilize, we will have a meeting?

CHAIRMAN MILLER. We will have a meeting, yes.

MR. WALLICH. All right. If we will have a meeting, then I will go along.

CHAIRMAN MILLER. Okay, that means at the moment we have everybody voting for this except Paul, who could gulp and [unintelligible] you can do it without a gulp.

VICE CHAIRMAN VOLCKER. I can gulp and vote with it, if you gulp several times before changing the funds rate.

CHAIRMAN MILLER. You've noticed how we have gulped all year long. If Paul will go with it, I will go with it. That will make a demand on us. I think that's pretty good. That's fantastic. I knew we would be unanimous this month! Remember, I told you that on the phone. Now do you believe me? Please don't change your votes now.

There is one other issue and that is the recommendation with respect to foreign currency operations. Do we have [any renewals]?

MR. PARDEE. No, the swap drawings that we have outstanding are simply from this last month, so there's nothing--

CHAIRMAN MILLER. We don't have any renewals. We have the Mexican swap line situation on which you received a memo. We have made no promises except to get [the Committee's] sentiment. If you've read the memo, the consideration is do we signal to the Mexican central bank that we'd be willing to expand the swap line to $700 million from the present $350 million and then work out the details? That's on the basis that this seems to be something they would like--to improve their general relations with the United States. They claim they don't need the swap line and don't intend to use it, but they would like to signal a cooperative spirit and the capacity to be prepared in the future if they should need it. Again, I don't have any particularly strong sentiment. There is some thought on our staff that usually the swap lines are changed at the time of their renewals in December. The memo indicates that that hasn't been the record. The record seems to show dates in August and various other [times]. So I'm not sure that we can base our decision on whether the right time to do it is at year-end.

MR. WALLICH. I have great doubts about it, Mr. Chairman, because it is a political move. If we do this, I fear we will find ourselves approached by the State Department and maybe the Treasury on behalf of other countries. That has already been the case at a very low level of planning. One person from the State Department has raised questions on whether some other countries could be included in the swap network.

CHAIRMAN MILLER. Could it be foreign policy that--

MR. WALLICH. [Unintelligible] foreign policy and developmental and so forth, I think, if we do what is probably sensible to improve relations with And I think we ought to resist this.

CHAIRMAN MILLER. The request to us did not come from the State Department.

MR. WALLICH. No, this came from the Mexicans.

CHAIRMAN MILLER. Directly from the--

MR. WALLICH. But if we do it for a reason that the State Department plainly understands to have a political element, I think they will want to have some say in future swap changes. Now, unless you've indicated to the Mexicans a great degree of good will and intention, I would suggest that we say we'll raise the swap line if appropriate, if and when they want to draw on it, but not give a bigger credit line in a vacuum, as it were. On top of that, there's my own uncertainty as to what the Mexicans really are up to. They're borrowing enormously. They need to because they're financing the construction of the oil infrastructure. Whether or not this borrowing is going well or not, I don't know. I have the impression that it is going well. I have no contrary indication. But they may be uncertain and they may want this as a backstop. And they may want it as a means of improving their own borrowing posture in the market. I would hesitate to be drawn into that.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Well, I have some of the reservations Henry does. I see it not costing us anything to add more onto their swap line. And if this were a crucial position of the State Department and foreign policy--that we add to the Mexican swap line--I guess I'd swallow and do it just because it doesn't cost me anything at the moment. But I think there is a politicizing of this swap line arrangement that we have fought, especially with such countries as wanted a swap line because they wanted to be a part of the club. Mexico now wants to be a part of a bigger club. So I guess I'd have to say that if we are going to do this, we do it only as a political reason.

CHAIRMAN MILLER. Any other sentiments?

VICE CHAIRMAN VOLCKER. My conclusion happens to be the same as Governor Coldwell's. I think I would do it if it serves some sort of positive purpose. I don't know about just doing it without getting some confirmation that it is some kind of useful signal. I suspect they have some real purposes in mind, along the lines that Governor Wallich suggested. They want an additional backstop during a period in which they are borrowing very heavily. I would not refuse to give it to them if it serves some positive purpose from the standpoint of U.S. policy.

MR. MAYO. I agree with Paul's statement.

MR. RICE. I agree, too, but I think the purpose that it serves from our point of view is perfectly obvious. And I think it would help us at the present time to seem to be willing to be forthcoming to the Mexicans. Because I would be willing at this time to be forthcoming, that does not mean that I would be willing to see it politicized with respect to that does not have the oil potential that Mexico does. I don't see that as politicizing. I see that as economic.

MR. COLDWELL. We've had a Venezuelan request too, as I recall.

MR. RICE. Well, that depends again on whether it costs us anything and whether it would be helpful in future relations.

MR. WALLICH. Technically, these things are limited to countries that have convertible currencies so that those we mentioned here, including ones I myself mentioned, aren't really eligible. My concern is that once we get into the political game of doing this to pursue a U.S. political advantage we won't be able to hold to that line.

MR. COLDWELL. Is there a possibility, Mr. Chairman, of saying to the Mexicans that we will consider this at the year-end renewal of these lines and in the meantime do some checking around in this government to find out if this is an important element--

CHAIRMAN MILLER. Ted?

MR. TRUMAN. Mr. Chairman, in preparation for the meeting, I checked with the Treasury Department on two points. One was whether they had been approached to increase their swap line. They have not been approached,

in a conversation down there. Their reaction on the question of whether there is political interest--and I only checked with Treasury--was that there probably would be some political interest on this side but it's not clear at the moment whether this is the right time to put it in the pot. So their advice was to hold off, to indicate that even if there was positive sentiment on the Committee we might not make a final decision today.

MR. COLDWELL. You triggered one other thing I meant to ask, Ted. What is the Treasury line now?

MR. TRUMAN. It's $300 million though only half of it is drawable [under normal circumstances].

VICE CHAIRMAN VOLCKER. Maybe Treasury ought to--

MR. COLDWELL. It might be logical for both of us [to act] or for Treasury by itself--

MR. TRUMAN. The Treasury was not pushing us. I asked the political questions since they're a little closer to those. I did not check with the State Department on this case.

MR. COLDWELL. The reason I'm pushing a bit on this, Mr. Chairman, is that we had a discussion with

We sent him over to the Treasury Department saying that it's their job if they want to make loans for political purposes. He was pleading his [case] on the basis that we had led him and his poor country into a democratic election and that was upsetting all of the financial--

CHAIRMAN MILLER. We, the Federal Reserve had?

MR. COLDWELL. We, the United States government.

MR. PARTEE. I feel closest to the same reasoning Henry [cited] unless somebody says there's a strong advantage to it.

MR. COLDWELL. An overriding political reason.

CHAIRMAN MILLER. I'm not understanding. Phil, you have confused me. You said you didn't see a reason not to do it becaue it didn't cost us anything. And now you're saying you are opposed to it.

MR. COLDWELL. No. What I said, Mr. Chairman, was that I agree it doesn't cost us anything. But I think it has to be demonstrated that there's an overriding political gain to be achieved by this. I would oppose it otherwise.

CHAIRMAN MILLER. Scott, did you have anything that you wanted to ask?

MR. PARDEE. No, I'm just wondering [how] we would come out on it and what somebody will say to the Mexicans that will--

CHAIRMAN MILLER. We haven't come out yet.

VICE CHAIRMAN VOLCKER. I'm not sure I'd use the word "overriding" but I certainly agree that there's no point in making a gesture unless somebody knows we are making a gesture.

MR. PARTEE. Use the word "advantage."

MR. PARDEE. My problem on this is that there may be an advantage in our relations directly with the Bank of Mexico. There's a concern that they have and that we have on the financial side. There are a lot of political deals being struck on oil, on emigration, and so forth. [Say] all of a sudden the State Department on our side and whoever it is on the Mexican side come to some agreement and then the Federal Reserve and the Bank of Mexico [are given] some sort of order: Okay, you fellows, to finish whatever discussion has been going on, here's your part of it. If we separate this discussion on the swap increase to some degree--and it is costless if they're not going to draw--then we've got a better line of communication directly with the Bank of Mexico. Again, if we let them down gently, like saying at the end of the year or at some appropriate time we select we will talk about increasing the line, at least we have the good communications with the Bank of Mexico--and with the least cost, if you want to consider it that way. It's a hard one to handle.

MR. COLDWELL. The bottom line, Mr. Chairman, is that I think I'd insist on the Treasury joining us.

MR. BAUGHMAN. I assume it's irrelevant, Mr. Chairman, that they have recently been [picking] up a fair amount of [large denomination] bills from the El Paso branch.

MR. RICE. Mr. Chairman, if we are going to go for letting them down easy or if we put conditions on it by working for the Treasury's participation, I think we lose whatever advantage might be gained in doing it. So I think we either do it in a way that seems obviously forthcoming and cooperative or we don't do it.

CHAIRMAN MILLER. Maybe I misunderstood or maybe it has been misstated. I did not view this as a political issue. I viewed this as [a means of] improving relations with the United States on the initiative of the [Mexican central] bank. I have never heard from the State Department or anyone else on the subject. [Bank of Mexico officials] approached me directly. They came in to see me and said we need to build our relations with your country and make them stronger. We are a central bank, we'd like to [request an increase in our swap line]. That was the proposition. And the advantage was not that they wanted to use the money, but they wanted to demonstrate that we are working closely together. I don't know. As I say, I don't have any particularly strong feelings on this.

MR. ROOS. Let's have our December meeting in Acapulco!

CHAIRMAN MILLER. Pardon me? Oh, you want to go down and negotiate in Acapulco you say? Oh, shucks. Well, I'll take this under advisement. They don't need to know immediately. Maybe if I get any thoughts from the counsel you have given, we'll come back with a particular suggestion--either that we have a timetable or a different approach or something.

Now we must do something very important, which is to confirm that we are going to meet again on August 14 here and by phone in the interim should the need arise. Is there any other business? Thank you very much. Lunch will be served.

END OF MEETING