Meeting of the Federal Open Market Committee

December 21-22, 1981

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., starting on Monday, December 21, 1981, at 3:30 p.m. and continuing on Tuesday, December 22, 1981, at 9:30 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman
Mr. Boehne
Mr. Boykin
Mr. Corrigan 1/
Mr. Gramley
Mr. Keehn
Mr. Partee
Mr. Rice
Mr. Schultz
Mrs. Teeters
Mr. Wallich

Messrs. Balles, Black, Ford, and Winn, Alternate Members of the Federal Open Market Committee

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

Mr. Axilrod, Staff Director
Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Mannion, Assistant General Counsel 2/
Mr. Kichline, Economist

Messrs. R. Davis, Duprey, Mullineaux, Prell, Scheld, Truman, and Zeisel, Associate Economists

1/ Entered the meeting prior to the action to ratify System Open Market transactions in Government securities, agency obligations and bankers acceptances.

2/ Attended Tuesday session only.

Mr. Cross, Manager for Foreign Operations, System Open Market Account

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

Mr. Wallace, First Vice President, Federal Reserve Bank of Dallas

Mr. Coyne, Assistant to the Board of Governors
Messrs. Gemmill and Siegman, Associate Directors, Division of International Finance, Board of Governors
Mr. Lindsey, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Kohn, Deputy Associate Director, Division of Research and Statistics, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. J. Davis, T. Davis, Eisenmenger, Keran, Koch, and Parthemos, Senior Vice Presidents, Federal Reserve Banks of Cleveland, Kansas City, Boston, San Francisco, Atlanta, and Richmond, respectively

Messrs. Burger and Syron 1/, Vice Presidents, Federal Reserve Banks of St. Louis and Boston

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

Transcript of Federal Open Market Committee Meeting of
December 21-22, 1981

December 21--Afternoon Session

CHAIRMAN VOLCKER. We can come to order and approve the minutes.

MR. SCHULTZ. So moved.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. With a motion and a second we will approve the minutes, if there are no objections. Then we will have a report on foreign currency operations or the lack thereof.

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

CHAIRMAN VOLCKER. Any comments or questions?

MR. GUFFEY. I'd just like to ask this: You mentioned that we had authority to intervene. Authority from whom?

CHAIRMAN VOLCKER. What was the question?

MR. CROSS. The question was: From where did the authority come to intervene? The New York Federal Reserve Bank was instructed by the Chairman on the basis of discussions between the Treasury and the Federal Reserve.

MS. TEETERS. What were the terms that the Treasury agreed to for us to begin [intervening]?

CHAIRMAN VOLCKER. Well, we would have intervened if the [mark] had continued to weaken. I am sorry I missed whatever you said Sam, but we would [unintelligible]. After the Polish declaration of martial law, the mark was very weak and then it strengthened relative to [its level] in the Far East. We would have intervened if it had retreated rapidly again after having strengthened at around the 2.30 level or a little lower, [unintelligible].

MR. CROSS. The mark hit a peak in the Far Eastern trading of about 2.36-1/2 and the rates in terms of the other [currencies] were similar. But in terms of DM it went down to about 2.33 when Europe began its operations. Also, the Japanese intervened in their market. Then as the European markets opened there was intervention by the German authorities and also some profit-taking and the rate continued to come down to 2.30. And then in the middle of the morning here it was down to about 2.28. So, during the entire period when our markets were open, the rates were coming back into balance and the pressures were subsiding. But we had the authority to step in had the movement gone the other way and had it looked as though the rates were beginning to spurt back up with the dollar getting stronger and the mark and yen and other currencies weakening. But we did not use the authority.

MS. TEETERS. Did the Treasury say in any specific way what it considered a disorderly market? Did they say a certain percentage change or something like that would be--

VICE CHAIRMAN SOLOMON. Well, as Paul said, there was a feeling on that midmorning that if the mark reversed itself and the dollar weakened--the mark was up to about 2.29 or 2.30--then it might be appropriate [to intervene], depending on the conditions at that moment. But that was in the context of the reaction to the Polish move. I don't think that the Treasury or even you have a view as to what rate change [constitutes a disorderly market], devoid of the context in which the rate change comes about, unless maybe it comes about very abruptly.

CHAIRMAN VOLCKER. Where's the rate now?

MR. CROSS. 2.28.

CHAIRMAN VOLCKER. I still think that was fairly abrupt.

VICE CHAIRMAN SOLOMON. But we have had bigger moves than that.

MR. CROSS. The market has been quite unsettled all week. On Friday the rate in terms of DM again--I hate to keep talking about that one, but it is convenient--hit 2.30 in the European markets. It started at 2.27-1/2 on the previous trading day, went up to 2.30, and came back down to 2.27-1/2 during our trading day. Then after the money supply figures were announced, it went up to 2.28-1/4 roughly. So there was an awful lot of movement during many of these days.

CHAIRMAN VOLCKER. My sense is that this market has been a very poor market--let me put it that way--right through this period. Is that still correct?

MR. CROSS. That's correct. It has been a very thin market, particularly coming as it does near the end of the year when we are told that not only the banks but the corporations are interested in getting their books cleaned up and don't want to take new positions and so forth. There are not many operators out there making markets, so if anybody has something that he has to do in terms of business, it seems to move the rate by quite a substantial amount with a relatively small amount of activity. I would agree with you that the markets have been quite unsettled.

VICE CHAIRMAN SOLOMON. The markets attribute that to our policy of nonintervention. In fact, I gather at the Federal Advisory Council meeting you had in November that all the banks represented on that Council criticized the nonintervention policy. At least that is what Don Platten told me.

CHAIRMAN VOLCKER. I guess I said something. I forget exactly what they said.

MR. PARTEE. It wasn't that much.

MR. SCHULTZ. Yes, it wasn't severe criticism.

MR. TRUMAN. My memory is that he said there was disagreement among the banks. He presented a view which said that [the FAC members] suspect this [nonintervention policy] has something to do with [the market unsettlement] but there are banks that have other views. That is also my memory of the written report that they made to the Board at the time.

CHAIRMAN VOLCKER. But when we asked them, the Federal Advisory Committee members did say that banks not under the FAC might have other views. I guess that is the way it was. As I recall, that comment was in their written report but they weren't violent about it.

MR. SCHULTZ. As a matter of fact, they also said that there was some general agreement that intervention policy should be used sparingly or something like that. I didn't get the feeling that they had a strong position on that. That's my recollection. I didn't think it was a very vitriolic comment.

VICE CHAIRMAN SOLOMON. It is always interesting to hear two people report a conversation.

MR. PARTEE. That is what I was thinking. He thought he delivered a strong message and we didn't even hear it!

VICE CHAIRMAN SOLOMON. That is what he told us [in New York].

MR. SCHULTZ. Is my recollection wrong?

MR. PARTEE. I can hardly remember [what was said].

CHAIRMAN VOLCKER. Well, I'd forgotten it. But it did come up and I guess they did put in their written report a positive recommendation that we ought to intervene. They were not frothing at the mouth about it, but it was a positive recommendation. I asked whether that view was generally held and they said they thought it was by a lot people, but not everybody. And that was the extent of it.

MS. TEETERS. What I'm trying to find out is: Do we have some general guidelines from the Treasury as to when we intervene or don't intervene that you can speak to?

CHAIRMAN VOLCKER. I don't know what you mean by general guidelines. We always have this problem. There is nothing I can recite that is good in all seasons. We developed this interim guideline following the Polish [action], that if [the dollar] took a sudden jump up beyond where it was [against the mark], in essence we'd intervene. That was after the dollar had already gone up; it was already up about 4 percent from where it had been trading.

MR. WALLICH. At least it wasn't that an assassination attempt was needed to intervene.

CHAIRMAN VOLCKER. We're developing case studies. We intervene on assassinations and military takeovers!

MR. GRAMLEY. Or we stand ready to intervene.

CHAIRMAN VOLCKER. Well, actually what happened is that we were quite ready to intervene and at the time I thought it would probably be necessary. But in every one of these occasions recently the rate has reached its nadir in European trading rather than in the United States. So every time we've gotten geared up to do something, the rates have come off the peak or off the floor.

VICE CHAIRMAN SOLOMON. Well, people know what Beryl Sprinkel and Don Regan mean by a crisis and, therefore, they probably expect some intervention. That is obviously clear and, therefore, maybe that is one reason the rates are--

MS. TEETERS. Or the Germans do it ahead of us, or for us.

CHAIRMAN VOLCKER. Well, that is what has been happening.

MR. CROSS. Both the Germans and the Japanese intervened during this latest spate of activities.

VICE CHAIRMAN SOLOMON. The Japanese intervened very heavily.

CHAIRMAN VOLCKER. We reserve the right to intervene when we find it necessary. Sometimes our patience is more strained than at other times. We also want to cooperate if possible. And we have been cooperating, I guess. We have nothing to approve here. No recommendations?

MR. WINN. The other Polish problem is their debt. Do we have any feeling at all on when that will start to come to a head?

MR. CROSS. Well, I don't know when it is going to come to a head. The banks were supposed to enter into an agreement, a prior condition of which was that they should receive the arrears. But they didn't receive the interest in arrears. They received a telegram asking if they could make $350 million of loans available. The last we heard is that the banks were talking to each other about what to do. But there does not seem to be, at least among the people we talk to, any great disposition to provide more money to the Poles.

CHAIRMAN VOLCKER. The Poles [were given] a rather clear message just a couple days before martial law was imposed. They calculated that they owed about $350 million of interest. They did not have $350 million. So, [they were told] they could pay the interest for 3 or 6 months, and then the rest of the agreement could go into effect.

MR. CROSS. They requested what they called a bridge loan. Some of [the banks] thought it looked more like a pier than a bridge.

CHAIRMAN VOLCKER. I think that situation is very much up in the air. I find it a little difficult to see that anything is going to be done unless the Russians give them money to pay the debt and pay the interest between now and the end of the year. I don't think they will last.

MR. WINN. The end of the year is the due date, is it?

CHAIRMAN VOLCKER. Well, there was a date earlier in December, but now the end of the year is critical in that if [the lenders] don't get paid by the end of the year, then they will have to admit that the loan is in default--or at least that it is questionable--on the day that they have to make up their books for the end of the year and decide what to do about it.

MR. TRUMAN. Most of the interest started to be in arrears on March 26.

MR. CROSS. This covers three-fourths of the year. The banks and the Poles were supposed to meet on December 28, I think, to sign the agreement; and they wanted the payment cleaned up two weeks early, which was December 14, so they wouldn't sit down at a table and not be able to sign. But that day passed and the payments weren't made.

VICE CHAIRMAN SOLOMON. The banks had told their committees before the takeover that if the Poles did pay the interest, sympathetic consideration--that was the term they used--would be given to some new short-term trade credits of 60 to 90 days. Not all the banks would do that, but that was the language they agreed on if the Poles didn't default. And then everything got overtaken. Nothing probably would have happened anyway, but any chance of a solution being reached certainly got wiped out temporarily by that takeover. So, everybody is in disarray. I don't know how many banks are going to move to increase their loan loss write-offs. I checked around but nobody that I am aware of has done more than 50 percent as write-offs.

CHAIRMAN VOLCKER. I wasn't aware anybody had done that much.

VICE CHAIRMAN SOLOMON. A couple of banks said that they had increased their loan loss reserves by 50 percent of the Polish loans.

MR. WALLICH. They might have to proceed differently with respect to the 1981 maturities that should have been rescheduled but now have fallen through. They might have to write off 50 or even 100 percent. But most of it, of course, is into the future.

CHAIRMAN VOLCKER. Mr. Sternlight.

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

MR. STERNLIGHT. Mr. Chairman, if I may, I also have a recommendation to make: namely, that the leeway for changes in holdings in the System Account, which the Committee voted to enlarge to the $4 billion level, be left at that $4 billion level up to the time of the next meeting. Our projections make it look as though we might need to absorb something like $3 billion of reserves during January, essentially reversing much of that seasonal need that we met in the last several weeks. That concludes my remarks, Mr. Chairman.

CHAIRMAN VOLCKER. Any comments?

MS. TEETERS. You used up $3.8 billion of the $4 billion? Is that right, Peter?

MR. STERNLIGHT. Yes, and we may have done another $150 million today because we took some notes from one foreign account.

MS. TEETERS. Don't you feel you need a little more leeway on that? You are pretty short at this point, aren't you?

MR. STERNLIGHT. Well, the leeway needed to last only through today or tomorrow, so we were willing to run it right up to the line. After this meeting a new leeway is established. We may have a little more to add on an outright basis but as soon as we get into January we'll have to swing around the other way. It is to provide the leeway for a possibly large move in the other direction, a large absorption of reserves, that I think it might be useful to leave that limit at the $4 billion level.

MS. TEETERS. The $4 billion runs from when to when?

MR. STERNLIGHT. It would run, I believe, from the day after this meeting--that would be Wednesday--through February 2.

MS. TEETERS. So you get a new $4 billion starting tomorrow.

MR. STERNLIGHT. Yes.

MR. ALTMANN. It's $3 billion unless the Committee approves this.

MS. TEETERS. It's $3 billion. Oh, I see what you mean.

MR. BOEHNE. Is there any thought in the market that the strengthening in the money supply we've seen recently is due more to the economy perhaps being not as weak as we thought versus the Fed making an overt attempt to pump up the money supply? Is there any sense of that?

MR. STERNLIGHT. I think there's some puzzlement about the strength that market analysts have seen. I don't have any sense that they are associating it with the economy being stronger. Some of them see other special reasons; some have the same sort of temporary parking place idea that we've kicked around here.

MR. BOEHNE. A precautionary type--

MR. STERNLIGHT. A precautionary [move to] higher savings rates. There are varying estimates about the strength of the economy, but I haven't really gotten much sense of people relating the aggregates to that.

MR. BOEHNE. Well, it is a strange bulge for this part of a recession. It's out of character for this stage of a recession.

MR. ROOS. The Bluebook made reference to an anticipated reduction in the rate of money growth for the last part of December. Does that appear to be probable?

MR. STERNLIGHT. A lot of people in the market expect that also. Steve might want to comment on the particular Bluebook reference.

CHAIRMAN VOLCKER. We look forward to it with our usual conviction.

MR. AXILROD. Thank you, Mr. Chairman.

MR. ROOS. I didn't get an answer, Mr. Chairman.

CHAIRMAN VOLCKER. The answer is: Nobody knows.

MR. AXILROD. Two independent staffs within the Federal Reserve System are projecting a decline of varying magnitude. So, that might add a little to [one's conviction].

MR. STERNLIGHT. The New York staff has a little more of a drop.

MS. TEETERS. Have you both been wrong before?

MR. AXILROD and CHAIRMAN VOLCKER. Yes.

VICE CHAIRMAN SOLOMON. Maybe you can get a better answer if you ask why they are projecting that, Larry. At least when I've asked that specifically, the answer is: Because it has gone up so fast, it ought to slow down.

CHAIRMAN VOLCKER. Are there any other questions that can have equally enlightening answers? No other comments? We have a proposal on raising the [intermeeting] limit to $4 billion. Is that acceptable? Hearing no objections--

MS. TEETERS. Is it symmetrical, plus or minus?

CHAIRMAN VOLCKER. Yes. That is accepted. We need to ratify the operations. Without objection we will ratify the operations. On my agenda I have next the longer-run ranges for monetary aggregates and then the economic situation. It seems to me that it may be a little better to take up the economic situation first. If that seems more logical to other people, we will call upon you first, Mr. Kichline. Did I decide on the other order when we made up the agenda?

MR. KICHLINE. I was prepared, though. [Statement--see Appendix.] I might note that the CPI should be available tomorrow morning. And, unfortunately, new orders figures will be available tomorrow afternoon.

CHAIRMAN VOLCKER. I'm just looking at the Greenbook. It has national defense spending declining every quarter. Is that correct?

MR. KICHLINE. That's been corrected in the errata. I think we reversed the lines for that and the state and local sector. State and local spending was shown to be rising each and every quarter and that should be negative. Those lines, unfortunately, were reversed.

MS. TEETERS. But the state and local sector is approximately double the size or more of the defense sector, so those declines in state and local are quite substantial, of course, in real terms.

MR. KICHLINE. Yes, they are.

VICE CHAIRMAN SOLOMON. You said you assumed that retail sales would be going up somewhat nominally both this month and in

January. The executive of a leading national retail chain said to me that they think the reasonably satisfactory pre-Christmas sales are the last gasp and that there is going to be a major fall in retail sales in January. They had a poor October-November. Since then they've done reasonably well with all these sales; they ran a 12 percent increase in nominal terms. But they expect January to be extremely poor, for what it is worth. Generally speaking, the business CEOs I've been speaking with, as distinguished from the financial CEOs, are much gloomier and expect a greater-than-average recession and, some of them [are especially gloomy]. I'm not talking about the interest rate sensitive industries but, for example, car loadings on the railroads. The head of one of those railway outfits said that it was the worst he'd seen in--I forget the period of time--many, many years; it was worse than in the 1974-75 drop. There is a lot of gloom and doom in the business community, whereas I think in the financial community there is an assumption that the recession will be more or less an average one.

MR. SCHULTZ. I'd be interested to know what people are hearing about the labor situation. Jim puts together some tables on wage concessions, every week or so I guess, and they are lengthening. I was on the plane Friday with a fellow who recently retired as head of one of the major trucking companies, and he said that a lot of the Teamster locals are likely to go with just a cost of living increase because the competition is just tremendous and, indeed, a lot of unionized trucking companies look as if they are not going to make it. What kind of noises do you hear as you talk to CEOs?

MR. BOEHNE. I hear throughout my District a sense that labor negotiations are not going to be as tough--that there will be concessions and that there may even be some inroads into cost of living indices. But as far as the outlook goes, what I hear is that they think the unemployment rate is going to go higher than in the Greenbook forecast. I hear more and more stories of lay-offs; and it is that fear of lay-offs that I think is affecting the climate in which these wage negotiations are taking place. I share Tony's view that there seems to be more pessimism in the manufacturing area than in the retail and financial areas, but what I get is uncertainty. We are in the phase of the business cycle where there is a downward slide and nobody has a good feeling about whether that slide is going to accelerate or taper off. There is a feeling that the economy will recover in the middle of the year, but I would guess the sentiment is that the recession will be average to worse. And that, too, is contributing to a more favorable [climate for] wage negotiations.

MS. TEETERS. Are you going to report a lot of plant closings?

MR. BOEHNE. I wouldn't say a lot more than we are used to in my part of the country, but I am hearing of more cutbacks in the work force in the plants that are operating--not outright shutdowns but [reductions of] 450 here and 800 there. It is very common [to hear such reports] in talking to people and they are very common in the newspapers and radio reports. And it seems to be widespread; it is even happening in parts of our District where they usually don't feel recession as much. There is a part of Pennsylvania that is generally fairly insulated from that, and reports from there are about as pessimistic as elsewhere. So, it seems to be very widespread.

MR. PARTEE. Eastern Pennsylvania you mean?

MR. BOEHNE. There is an area around Lancaster and Harrisburg, the South Central area, where generally the unemployment rate is well under the national average. We have a director from Armstrong Cork in that area and he says that even Lancaster is feeling it this time around and they usually don't feel it.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. On the specific question--I'll comment [on my general views] later--I think there has been within the last 30 to 45 days a decided shift on the part of labor out our way. Their focus is now shifting from concentration on the financial aspects of the package to the job per se. For example, the UAW has indicated a willingness to reopen the auto workers contract; the Teamsters have reopened [their contract] and the trucking people that I talk to expect some significant concessions there. The UAW has specifically said they will reopen the Harvester contract; there they are going to try to get rid of the last increase that was given in October and there is going to be a discussion about the COLA increase coming up in the next couple of months as well as the pension increase that is scheduled for April. Harvester expects to get a hundred million dollars a year out of the renegotiation the union has authorized. I would echo Tony's comments; the industrial CEOs I have talked to are extremely gloomy and are expecting a very difficult 1982--a far deeper recession than most of the financial people I've talked to anticipate. Therefore, I think they are going to go into negotiations with a tougher attitude than they might have had six or eight months ago. I think there has been a big change on that front.

VICE CHAIRMAN SOLOMON. On the other hand, notwithstanding what I said earlier, I was talking with Citibank's board of directors last week and I went around the table and asked them what wage settlements each plant expected to make. I was surprised that every single man at that table who headed a large company said between 9 and 9-1/2 percent.

MR. WALLICH. Were they unionized?

VICE CHAIRMAN SOLOMON. Most of them were unionized. But when I asked them if they had any plants that were nonunion, because some of them were very [diversified], they said it didn't make that much difference in their company as a matter of policy. Quite a few said, however, that they expected some productivity increases and that the net increase in labor cost might come in around 7 percent.

MR. SCHULTZ. I have a comment on work rules. When John Sagan was here for the Conference of Chairmen, he indicated that at one Ford plant where they had 44 work rules they had gotten the number down to 6 or something like that. There were some major changes in the work rules which he thought was really significant. Are you hearing that kind of noise too?

MR. CORRIGAN. Yes. The scope of the cutbacks that General Motors announced on Friday for their white collar workers was rather astonishing. They are freezing pay, cutting back vacations from six weeks to two weeks, and putting in a major cost-sharing provision in their medical insurance programs--all three at once.

VICE CHAIRMAN SOLOMON. But where the threat is clearly coming from imports in addition to the depressed economy, they tell me management has a much stronger case in getting labor to--

MR. CORRIGAN. Well, obviously, in this case they chose to do the [cutbacks of] white collar workers with a view toward trying to influence the [labor union] negotiations. But doing that kind of thing for 150,000 white collar workers is a big, big bite.

VICE CHAIRMAN SOLOMON. But I think there is going to be a significant divergence in the wage settlement between manufacturing and service industries.

CHAIRMAN VOLCKER. I wonder whether this kind of thing is ever reflected in the statistics.

MR. GRAMLEY. Well, some of this is showing up now. There is much more improvement in manufacturing wage increases this year than anywhere else. That is where the big improvement has come; it's in the average hourly earnings index.

CHAIRMAN VOLCKER. That is right. I don't see much in the nonmanufacturing area. I was talking to some bankers out in Chicago and they were all reporting that they have in their plans 11 percent or more for wage increases. I think they are a little behind the times, but so it is. Any other comment while we are on the subject? Let's remain on this subject for a moment. Does anybody else have anything?

SPEAKER(?). It's a form of rational expectations--that is, the expectation that your employer may go bankrupt.

CHAIRMAN VOLCKER. They wait for that expectation until he is practically on the edge. That is true.

MS. TEETERS. Actually, Frank, the capacity utilization in this [forecast] doesn't get down to where it was in 1974. It bottoms out at 73 percent and in 1974 it was 69 percent.

MR. MORRIS. I thought the chart in the Greenbook showed that we are already down to--

MR. SCHULTZ. No, I think Nancy's right.

MR. FORD. There is a revision that was passed out. Did you see this here?

MR. MORRIS. This is a revised one. It says capacity utilization, total manufacturing--

MR. SCHULTZ. That is for 1980, you see. Look back to the--

MR. MORRIS. All right. Okay.

CHAIRMAN VOLCKER. Any other comment on the wage cost/price situation?

MR. KEEHN. I think there have been some developments on the price side as well. There is the price cutting in retail; with Christmas sales it is hard to tell how it is going to work out but there are clearly some price cuts there. In the automotive industry it has been demonstrated that when the manufacturers go to rebates, etc., that kind of price [cutting] tends to bring higher levels of sales, and I think [price cutbacks] are beginning to [reach] back into the raw materials. There is a very big overhang internationally in aluminum ingots, for example; the book price, I think, is 74 cents a pound and the trades are taking place at about 49 cents a pound. So there's a very appreciable difference in some of the raw materials areas, which ultimately ought to show up. So I think there has been progress on that front as well.

CHAIRMAN VOLCKER. Are commodity prices still declining? I haven't looked at that for a couple of weeks.

MR. KICHLINE. Yes they are, but much less than they had been earlier.

MR. GRAMLEY. For raw industrial commodities, we are now back to something like [the level of] the middle of 1978.

MR. KICHLINE. Right.

MS. TEETERS. Jim, will the CPI pick up the pre-Christmas sales?

MR. [KICHLINE]?. This next one?

MS. TEETERS. Yes, the December CPI. Do they have a way of [measuring] the widespread sales that are taking place?

MR. KICHLINE. Well, they are supposed to take into account actual transactions prices, but there is a question as to how well they can do that. The report tomorrow is going to be for November, so in any event we wouldn't be picking up what is happening now until later in January.

CHAIRMAN VOLCKER. If that exhausts our wisdom on wages and prices, is there any other comment on the business outlook generally?

MR. WALLICH. In the midst of this gloom, there is one substantial difference and that is that a major tax cut is already on the books. I think this lends a certain support to the [expectation] not in the first quarter, but looking to the second and third quarters, that the economy is going to come--

VICE CHAIRMAN SOLOMON. Isn't there a law that when everybody expects an upturn--if it looks unanimous--it isn't going to happen?

MR. PARTEE. I have a few butterflies about it myself.

MR. CORRIGAN. In terms of the business picture, this is a bit of an outlier observation, but some of the business types that I have been talking to, in the Minneapolis area at least, clearly are already at the point where they are looking across the valley. Even from the nonfinancial types I don't get that sense of gloom that Mr. Solomon and Mr. Boehne are picking up. I think there is a recognition that we have had a very, very steep decline; but they are already clearly looking out to what they think is going to be a very strong second half of next year.

VICE CHAIRMAN SOLOMON. There is a widespread feeling among businessmen--they all volunteer it--that we have a dualistic economy: that people are lucky to be in the service sector because they aren't going to have it very tough. The head of IBM was telling me that business is absolutely booming. They make a distinction between wage increases in the service sector as against the manufacturing sector. It is the manufacturing people and the people who ship the bulky stuff who are talking about how serious they think the current situation is.

CHAIRMAN VOLCKER. What does Texas say, Mr. Boykin?

MR. BOYKIN. I reported at our last meeting that there seemed to be a slight slowdown in the energy area, particularly in drilling activity. I'm told now that that has reversed. There were two rigs in the pen last time but those are out. They tell me that has turned around a little, although they are expecting a bit of a slowdown in the rate of increase for 1982. In the manufacturing end, we really don't have all that much [change]; but in the semiconductor business, which is a large employer, they are taking an extended Christmas holiday. They are shutting down until January 11. The agricultural area, though, is an area of concern. As we know, the prices to the farmers are not good; the crops have been very good. We are told that our agricultural banks probably are going to have to carry over more farmers than they ever have. And they can probably carry them this year, but without some improvement there are going to be some very serious liquidation problems.

MR. SCHULTZ. Let me ask you a [question]. The loan/deposit ratios in agricultural banks, remember, had been pretty high in the spring of 1980, at about 68 percent nationally. When we looked at them here not too long ago, a couple months ago, they were down to 60 percent. Are your banks pretty much in that same situation--that their loan/deposit ratios are pretty good? Do they have plenty of room to make loans if they want to make them and carry them over?

MR. BOYKIN. Yes, they have the room. But the question is how comfortable they feel, even though they have the money, about how long can they stay with [agricultural borrowers] in the expectation of a repayment because of the price problem.

MR. SCHULTZ. What about the land prices? Again, looking at the places where most of the problem loans tend to be, people had gotten pretty extended on land. Are you beginning to see a break in your land prices?

MR. BOYKIN. I think so, a break in the sense that the sales of farm lands are going down. I have heard of a few instances of a little price concession, but there is not a lot moving right now.

CHAIRMAN VOLCKER. That is the story I hear when people from farm areas talk to me: that there isn't much movement in the price but there sure aren't any sales, and don't try that price too hard.

MR. KEEHN. In our District, when land that was valued at $3500 to $4000 an acre comes up for sale, the price goes down; and they pull it off the market at $2700 or $2800 an acre. The price just doesn't clear the market.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. Obviously, things are relatively slow in our District, but I think it is important to remember that part of it can be attributed to the rather abrupt drop in the rate of money growth during most of this year. As we look ahead into what next year will bring, especially the second half of next year, it is awfully important to keep in mind--unless I am the only one in this group who sees it this way--that the decisions we make this afternoon and tomorrow will have a direct bearing. They will have even a greater bearing than what recent conversations with people in business might indicate for the future. If we choose to set targets that imply a faster rate of money growth than we are presently experiencing, we are inevitably going to have a step-up in economic activity after a few months. So, what we do will have a direct bearing, at least as we look at it, rather than just psychological [effects on] decisions that businessmen might be making.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. There are more than the Polish loans out there that are in trouble. The insurance industry reports a considerable increase in the amount of problem loans. Our Canadian friends have come down and done a big real estate investment without taking out financing, so some of the office building complexes are in a peculiar status at the moment, and they may be coming on the market. My guess is that the building boom has about run its course--well, it may go another year--but that office space is starting to show up as a little on the heavy side across the country.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. On some of the points you have mentioned, in our end of the so-called Sun Belt things are not really all that sunny. Specifically, for example, on Nancy's point about the pre-sales in the retail area, we are definitely seeing a whole lot of that. We have 45 board members in our District and a number of them are retailers; they have been telling us that their sales are flat to down in real terms. They may have a nominal increase in dollar sales, but a lot of that is coming on white sales that were taking place in December and November instead of in January and later. So, they are a little depressed about that. The tenants in the large Atlanta malls are concerned about their inventories being high and are having to do heavy promotions to keep their sales up. On the employment side, we are seeing some rather heavy layoffs in the more industrialized areas of our District, particularly in the housing-related carpet industry. We produce half the carpets in the United States in northern Georgia and they have experienced a 50 percent drop in production in the last few months. So, we are seeing big problems there. Some of our major employers, like Fruehof in Florida and even Excel in Orlando and the Ford glass plant in Nashville, are all laying off big chunks of their labor force. In the service industries, which someone else asked about, we are finding some problems. Air Florida, one of the more robust regional airlines, has had a very heavy cutback on its employment, as some of you may have noticed in the newspapers. So, we are seeing pretty much across the board in both the service and the manufacturing industries that the recession is deepening throughout our area. In some of the [most depressed] parts, in Alabama in the industrialized areas, we have unemployment rates approaching 12 to 13 percent. They are a little [higher] than the northern version in Detroit and that area. So, we are seeing the recession come down in the Southeast pretty heavily.

CHAIRMAN VOLCKER. Refresh my memory, Mr. Kichline, if you can. In the 1974-75 recession did wage rate increases actually come down appreciably?

MR. KICHLINE. Immediately after, as I remember--in 1975 and 1976--there was a sharp break in wages, and prices also came down substantially.

CHAIRMAN VOLCKER. Well, I know prices did; I couldn't remember how much wages did.

MR. WALLICH. They never had risen that much. Inflation had not become imbedded in ways that--

CHAIRMAN VOLCKER. I understand that, too. I really don't know whether--

MR. GRAMLEY. When we removed the wage and price controls in the spring of 1974, what happened immediately thereafter was a catchup burst of wages. If you look at a chart on wage rates, they were rocketing upward and then the rate of increase came way, way down. But a very large part of that reduction in the rate of increase in wages was nothing more than a termination of the round of wage increases that ensued after the wage and price controls were removed. So, you can't look back at the 1974-75 experience.

CHAIRMAN VOLCKER. Wage and price controls were removed in the spring of--?

MR. GRAMLEY. April 1974.

MR. BOEHNE. There were a number of phases, I think. The final phase came off in 1974.

MR. PARTEE. There was a holdback on big companies that extended to the spring of 1974.

MR. GRAMLEY. As I remember, by about the third quarter of 1975 the annual rate of wage increase got up to around the 12 to 14 percent range. There was actually an acceleration of wage increases during the recession. It wasn't until afterwards, once the recession was over, that it began coming down; then we began to get the big downward adjustment in the rate of increases in wages.

MR. SCHULTZ. Do you have numbers down there, Mr. Kichline?

MR. KICHLINE. We have some numbers. Unfortunately, they are annual numbers. On an annual basis 1975 still showed an increase and 1976 is the big year where there is a break. I would agree with Governor Gramley that the whole period is confused; I think part of the controls were off in 1973, and in 1974 we began to see the acceleration of wages when we were in that recession.

CHAIRMAN VOLCKER. A bunch of the controls came off in early 1973; I remember that very well. I remember very well when I thought the great bulk of them were sneaking off in January of 1973.

MR. PARTEE. Employers with 5,000 or more--

MR. KICHLINE. It was continued on large firms as I remember.

CHAIRMAN VOLCKER. I don't even remember that. What were those annual numbers just for the heck of it?

MR. KICHLINE. In 1973 the average hourly earnings index had a 6.1 percent increase; in 1974, 8.0 percent; in 1975, 8.3 percent; and in 1976, 7.2 percent.

CHAIRMAN VOLCKER. So it was just a 1 percent decline even then?

MR. KICHLINE. Right.

CHAIRMAN VOLCKER. Then it went up again or held steady or--

MR. KICHLINE. It began edging up.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. It used to be that second perhaps only to Texas, the West was fairly recession proof, but that doesn't seem to be the case today. Looking around for some elements of strength, I have been hard pressed to put my finger on them. Alaska is the only one of our nine states that still seems to be adding to payrolls. Nonresidential construction, which has been very strong, is still above a year ago but the growth is definitely slowing. And across a wide range of areas there is developing weakness or a going downhill, even in the aerospace industry, on balance, strangely enough. Lockheed just announced getting out of the production of the 1011. They are hoping to pick up something in defense orders. The semiconductor high-tech business that had such a strong growth trend has turned sour. Some of the semi-conductor firms from Silicon Valley and elsewhere in the West are having extended shutdowns because of excessive inventories. Even Boeing, which has a huge share of the commercial airline market, is getting increasing numbers of cancellations. There is more competition from the Airbus, etc., and even though they are rolling out a couple of new models in the very near future--the 767 is about to come out and the 757 is expected a year later--their sales are definitely down and so is their employment. So, it is hard to see the bottom being reached in the near future. The trend is still downward across a pretty broad front.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. [I'd say] that, if anything, we are likely to go through a recession this time which is worse, or somewhat worse at least, than the average postwar decline. We are talking about something that is quite pervasive and quite deep. If memory serves me, the average postwar decline in real GNP is about 2-1/2 percent. What we are looking at is a forecast of about a 2 percent decline, which is a milder recession than the average in the postwar period. Now, recessions come in all different sizes, so this is still a classic recession; there's no question about that. But I have a hunch that if things work out differently--and they always work out somewhat differently than anybody expects--the area I worry about that happening in is business fixed investment. And I think Mr. Kichline is right that if we are in for a surprise there, it will be a surprise in which the drop in business fixed investment is significantly worse than the decline of about 4 percent we are now forecasting. I think businessmen are very, very pessimistic for a variety of reasons. One is that they look for a future of real interest rates that potentially will stay up at extremely high levels because of huge deficits in the federal budget. And they are pessimistic because they have been through a 2- to 3-year period in which each time the economy has gotten off the ground it has gotten slugged in the head again and gone right back down. They are pessimistic because they are looking at very, very low levels of capacity utilization. And they are pessimistic because in some areas of the country we have had such [economic] devastation. So, I think we are going to see a bigger drop in business-fixed investment than this [forecast]. We are likely to see a first quarter that looks very, very bad--considerably worse than what we are now forecasting--and it may stretch out into the second quarter before we begin seeing things turn up again.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I guess the tone of the conversation is getting a little too gloomy for me. I would remind you that we are having the largest tax cut in the postwar history of the country. That will be taking effect in stages over a period of time. Henry referred to the 10 percent cut next June 30. In addition, there is a sizable relaxation that occurs as of January 1, just a few days away, for a wide range of activities that well could have a little more oomph in them as a result of the change in tax treatment. I would point out that housing is very low. I suppose [starts] could drop from 800,000 to zero--well, to 500,000 or something like that--but the downside risk can't be very large at this level. Nor can domestic car sales go very much below the [recent pace of] 5 million for very long, given the fact that people still need cars in order to drive. And inventories of cars on the road are depreciating and the stock, as somebody said, is declining. Fred, I think you mentioned that a decline in the stock of cars is occurring. So, some of the areas that are customarily sources of weakness can't be that much of a source of weakness from this point on, in my view.

I'd rather agree with Lyle that there is some exposure in plant and equipment. We were talking about that this morning, and I would be inclined to think that there might be a little larger decline and perhaps a good deal larger decline than the staff has in its forecast. But again, for every inch that you give there, the less pressure there is on financial markets and money markets. And it seems to me that we can almost, with a little lag, get a substitution of housing for plant and equipment if in fact we get that much weakness in the system. Also, this Christmas of 1981 is not good but, on the other hand, it is not just abysmal. Let us not be too gloomy; we ought to get a recovery, I think, sometime in 1982.

CHAIRMAN VOLCKER. I don't want to [catch] you unawares, Mr. Truman, but it might be appropriate for you to say just a word about what is going on abroad.

MR. TRUMAN. Okay.

MR. SCHULTZ. To give you a little more time, would you like to have a filibuster?

MR. WALLICH. Do you need your pipe?

MR. SCHULTZ. You just let the cat out of the bag, Henry!

MR. TRUMAN. The picture is broadly similar to what we have seen here in the sense that the economies abroad have been growing, although it has been small positive growth. It has been quite modest on average over the last several quarters. There have been some signs of a bottoming out: There were increases in the United Kingdom after a very sharp decline; and the German GNP number that came in for the third quarter, just released today finally on a seasonally adjusted basis that one could understand, shows essentially zero growth rather than negative [as it was] in the second quarter. So, there are some signs of a bottoming out, though I think we have marked down the extent to which we see real positive growth in this quarter. We expect at best only a modest rate of acceleration in the course of 1982, reaching something on the order of 2-1/2 percent on average as I recall for the last half of 1982. That is hardly a very robust performance, when you factor in Japan, which in the past, even in the first oil-shock environment, has had a fairly good growth rate relative to the rest of us.

Generally speaking, unemployment is expected to continue to rise abroad; and there may be some improvement--maybe a percentage point or a little more--on the price side but not any rapid expansion. One place where we have seen some shift in policies, or at least in that direction relative to everybody else, is France, where a somewhat rapid pickup is expected in both prices and real growth. I might comment that Japan in particular seems to be a serious problem. They had about 4 percent growth this year, which looks good from our perspective, but even the official authorities are not looking for too much next year, which clearly is one of the things that is causing the problem on the external side, the current account side. They just have very weak domestic demands, and that combined with the decline in international commodity prices--imports are weighted in that direction --is part of the reason why the number on their current account position looks so astronomical. Although that might moderate somewhat, it is likely to stay up in that range unless Japan experiences a dramatic rebound, which no one at the moment is particularly projecting.

MS. TEETERS. Ted, has the British price situation improved very much?

MR. TRUMAN. It has not improved, particularly over the recent period. The CPI in the second half of the year has been running in the 11 to 12 percent range; it had come down to a plateau and backed up. It actually got down almost to 10 percent on a year-over-year basis and backed up a bit as the pound weakened in the summer. So they are about back to where they started when Mrs. Thatcher came into power.

MS. TEETERS. And they have had how many quarters of decline in real growth?

MR. TRUMAN. Oh, I don't know. It is something astronomical, off my chart here. I think it has been occurring since the end of 1979.

MR. PARTEE. Yes, something like that.

MR. SCHULTZ. Ted, why doesn't Japan stimulate [its economy]? They have their inflation rate down to around 4 percent, as I remember the figure, and the domestic economy is weak. The yen has been pretty strong. The current account surplus is just--. What is the reason they don't stimulate?

MR. TRUMAN. I think there are two major reasons. One is that they found themselves burned badly in the past by excessive stimulation, or they feel they have been burned badly. And they had two rounds of rapid inflation--less the second time but it still was worse than they expected--in the yen as you may recall in early 1980 when it went to 260 yen per dollar, which was as ridiculous a level in some sense as the level of the mark in August. And that was partly an inflation phenomenon. The second reason is just that they have this maybe well deserved fear of fiscal deficits, and the stimulus to domestic demand one might expect would come from the fiscal side. They have taken some cautious steps on the monetary side though in terms of the mix of policy, everything else being equal, that tends to be a little negative from external perspectives. But their fear is of their large budget deficit, which they see problems in financing; they continue to have troubles with banks in Japan in placing their longer-term debt. The banks have been gradually backing-off from this sort of short placement system that they have run for years and that has led to caution in fiscal policy. Now they have a new budget in the process of being formulated; and from the indications I've seen, it may be a little less contractionary than the rhetoric suggests. They are talking about expenditure increases in nominal terms on the order of 6 to 6-1/2 percent, which does show some slight positive increase in real terms. But the rhetoric is going to be in the direction of continued fiscal restraint.

CHAIRMAN VOLCKER. And they are very worried about their exchange rate. They figure they are in a "no-win" situation if they take a stimulative action, particularly in monetary policy. Their exchange rate will weaken and they already think it is too weak. That would get them in more trouble on exports, and they are already in a lot of trouble on exports. So how do they stimulate is the question, particularly when the budget deficit might--well, I don't know what it will do to the exchange rate. But they feel they can't do it on the budgetary side and they can't do it on the monetary side because of the exchange rate.

VICE CHAIRMAN SOLOMON. That is why when they implemented that 1 percent reduction of the discount rate last month they combined it with heavy intervention.

MR. ROOS. May I ask a question on the domestic end, of either Chuck or Jim Kichline? This next round of tax reductions, the ones that take effect in 1982, are those to a great extent offset by payroll tax increases?

MR. PARTEE. There is hardly any increase, is there Jim?

MR. KICHLINE. No, it is not very--

MR. ROOS. Is that possible on these?

MR. KICHLINE. No, it is very small. On January 1st of 1982 the tax rate increase is only one-tenth of 1 percent compared with the 1 percent that went into effect in January of 1981. And the wage base continues to rise; it goes up something like $3,000, I believe.

MR. ROOS. So it is not a cut?

MR. KICHLINE. No. In total the expected increase from payroll taxes next year is something like $5-1/2 billion. The second stage of the tax cut for individuals, when it goes into effect, is in the range of $33 to $35 billion.

MR. ROOS. Thank you.

MR. BOEHNE. What does bracket creep do next year?

MR. FORD. That eats up another part of the $33 billion you are talking about. You have $5 billion going for payroll taxes?

MR. KICHLINE. Right.

MR. FORD. The question is how much does bracket creep do?

MR. KICHLINE. Well, I haven't thought about that question, so I don't have the answer. I think it is a factor but not--

MR. SCHULTZ. I think Otto Eckstein is using a figure of around $15 billion or something like that.

MR. FORD. $15 billion? So it uses up a little more than half? In other words, is there a real reduction in the effective tax rates counting everything?

MR. KICHLINE. The effect is reduced by bracket creep, but there is a net stimulative effect, a substantial one. We also have low income growth next year and that will hold down the effect of bracket creep.

MR. GRAMLEY. The staff's full employment budget calculations show a switch of around $48 billion from the first half of '81 to the last half of '82, with most of it coming in the latter half of '82. And that is something like 1-1/2 percent of GNP. That is a pretty good kick from the fiscal side. And I think Chuck was right that it is something we need to keep in mind as a source of stimulus as the year goes on. I don't think we really are too far apart, Chuck; I do feel that the recession is going to end and we are going to have recovery.

MR. PARTEE. Well, I don't think we are either. We had such a series of extremely gloomy comments that I thought I ought to say something on the other side.

MR. GRAMLEY. Your point is very well taken.

MR. SCHULTZ. I think Mr. Boehne made the right comment. We are at that stage of the cycle when one thinks it could just go "whoosh" down. It doesn't do that, but it always looks terrible.

MR. BOEHNE. That is right. If you are at all pessimistic, this is the time when it comes out.

MR. SCHULTZ. Yes.

CHAIRMAN VOLCKER. Well, we have lots of uncertainties and concerns in the business outlook. And, I must say the mood in Europe is extremely gloomy--more gloomy than the actual trends justify, it seems to me, at the moment. But their unemployment is very high and they are very aware of that; it is phenomenally high given past records during the postwar period.

MR. TRUMAN. That is right. They have already exceeded the 1974-75 peaks, partly with the help of the United Kingdom. But all the countries have generally higher [unemployment now].

CHAIRMAN VOLCKER. Yes, in many countries it is comparable to ours or even higher, which is very unusual just taking their raw figures. On the other hand, I have a feeling that there is more movement here on prices than there has been for years, literally, in terms of a change in trend. And that among other things could have favorable impacts on financial markets if anybody believed it. I don't think the financial markets believe it yet. I am not sure I believe it yet, but I must admit there is more gestation and more ferment and more talk about lower [wage] settlements than even that reduction in 1976 or whenever it was indicates. [The staff has] some fairly optimistic price figures in its forecast. We will see, but I am not sure they are out of sight. Let's go to your commentary, Mr. Axilrod.

MR. AXILROD. Thank you, Mr. Chairman.

CHAIRMAN VOLCKER. Let me say I don't anticipate getting down to anything very [specific] in the way of numbers on this particular longer-range exercise this afternoon or tomorrow. There may even be conceptual questions that people may want to raise about how to present these, and I say that without having thought through any change myself. So proceed, Mr. Axilrod.

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

CHAIRMAN VOLCKER. Let me just make a couple of comments. On the technical side, the possibility exists of some redefinition of M2. What sounds logical is putting in retail RPs, which would raise M2 some historically. If we take out institutional money market funds, it's practically a wash. That leaves us with some unknown amount of institutional money market funds in money market funds that are not labeled institutional and that we don't know how to break down. What to do with IRA/Keogh accounts, which might change appreciably next year, is a confused subject. I'll put it that way. It depends upon what one thinks M2 is measuring and what a transition of money into those accounts may mean. It might have been worth distributing, but I forgot about it, a little set of charts that Mr. Truman's people circulated this morning [at the Board meeting]. The charts were notable for showing that currently none of the main countries was near its monetary targets this year and that enormous discrepancies--larger than for the United States by a considerable margin--had developed between the different Ms. There were actual minus numbers for M1 in some cases with 12, 14, 15 percent increases in M2 or M3 as the case may be. The only country that showed a nice orderly pattern was the country which doesn't have monetary targets. That was Japan. I don't know what the lesson is to that. But it was an extremely erratic picture. It was poor--

VICE CHAIRMAN SOLOMON. But they don't have the innovation and the technology--

MR. TRUMAN. They had gradually declining interest rates; that is the thing that has helped.

CHAIRMAN VOLCKER. Oh, you wouldn't think some of these other countries did either. They have not had the swings in interest rates and they haven't had the swings in the economy, which may say something too. These other countries have had some technological innovation but the impression is that they haven't had as much as ours. But the discrepancies in the numbers were even larger than we had. It is a startling picture of the differences between the various [Ms] in those countries.

MR. TRUMAN. We could have copies of those charts circulated to the Committee tomorrow.

CHAIRMAN VOLCKER. Well, let's have a little discussion in the remaining time.

MS. TEETERS. I have a question. Given the tentative targets that we established in July, are the various growth rates for the Ms now consistent?

MR. AXILROD. Well, if our projections are right, we think M2 and M3 growth just at, or a shade below, the upper end of the ranges is consistent with growth of M1 at the midpoint. That means the margin of error on the up side [for M2 and M3] is above their ranges.

MS. TEETERS. Taking just the difference in the midpoints for this year, a midpoint on M1 of, say, 4 percent, given a 2-1/2 to 5-1/2 percent range, would imply 11 percent for M2 and 12-1/2 percent for M3?

MR. AXILROD. Yes, but our projection is for somewhat slower growth in nominal GNP over the year, which tends to hold that down.

MS. TEETERS. And then you have interest rates beginning to rise again in the latter half of the year. Won't that mean the same forces that were operating this year will tend to expand the rate of growth in the broader aggregates?

MR. AXILROD. Yes, to the degree that this year might have had an unusual amount of shift into money market funds [from] market instruments or back into depository institutions that would not otherwise have been there, we would have less of that in store next year. In any event, maybe somewhat optimistically, we worked our way down to a growth of just under 9 percent for M2 and M3, but it could very well be a little higher.

MR. WALLICH. But why is that?

MS. TEETERS. Essentially what you are saying is that we may get a rerun of this year with M1 growth toward the bottom end and M2 and M3 constantly on the--

MR. AXILROD. Well, I don't have a strong feeling that way, Governor Teeters. It is not too bad to think of the change in velocity of M2 as normally about zero, or not much change. That would give our present projection of M2 some credibility, and that is on average what happens. My instincts are not that we have severely underestimated it. But, obviously, there is not any room for error in that, particularly.

CHAIRMAN VOLCKER. Governor Schultz.

MR. SCHULTZ. Steve used the word credibility several times. I have been talking to market participants the last few weeks and that term keeps coming up in their discussions as well. In particular, just to give you three examples and names that might you remember: In talking with Paul Boltz, who used to be with us and now is at Continental, and George Henry who is now up on Wall Street, and John Phalen from the NYSE, I asked the question about credibility. They all said that the credibility of the Federal Reserve is much higher than it has ever been before. There is a cost to that, however. The cost is [related to] the second question I asked them: What do you think would happen to financial markets if we were to change course perceptibly? And they said they thought it would have enormous impact on the financial markets. So, I think we have a situation in which we have built up a lot of credibility, but the flip side of that is that we have painted ourselves into a corner in that if we don't stay pretty well on the course that we have generally outlined, it is going to have a rather substantial market impact.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. To pick up on what Fred said about credibility and going back to Steve's comments on it, we recently had our full academic conference with about 35 professors from all around the West who specialize in money, banking, and monetary policy research, etc. While there are all different points of view and schools represented, from various degrees of monetarists to Keynesians to a few supply siders, the one overwhelming conclusion that they arrived at when we solicited their advice on appropriate ranges for money growth in 1982 goes right to the credibility problem. It translated specifically into a recommendation from that group, for what it's worth, that it would be a serious blow to our long-term credibility if we didn't follow through with something like the provisional ranges we announced last July--that is, at least a fractional reduction as a part of a multi-year program to get the rate of money growth down and, hence, the rate of inflation. So, that came across loud and clear.

The other point I wanted to make, having supported Steve's view on the vital nature of the credibility problem, with your permission Steve, is to take a contrary view with respect to the 3-point range that we provisionally decided on for M1 in July for which you have again argued cogently here today. Looking back at the July minutes, just to refresh my own recollection, we considered three alternatives for M1. Two of them involved a 2-1/2-point spread between the upper and lower [ends]; the third one, which we adopted, had a 3-point spread. And for reasons that were set forth by Steve, it has been the usual Fed policy to widen the range of long-term targets when we perceive increased uncertainty in the economy. Now, that made sense as I thought about it under our former operating procedures, which had in effect tended to accommodate changes in money demand more or less automatically. In fact, I think the big problem in those days was that we accommodated too much, which is probably the main reason we changed the procedures. But with the new approach that has been in effect since the fall of 1979, and particularly with our record this year--and I might add that we got plaudits from this academic group for what we had done in 1981 [whereas] last year we had a lot of scar tissue as you might imagine and you have heard that yourself--we are doing a better job of keeping within our target ranges and that has [helped] the credibility problem. We don't automatically accommodate changes in money demand. I suspect most of us are uncertain about money demand in 1982. For example, our staff thinks, and I tend to share this view, that if anything there is likely to be a further downward shift in money demand in 1982. But that could be wrong. In the Bluebook Steve brought out the possibility that it could go the other way. And to allow for that possibility, since we really don't know which way it is going to go, I would argue that, if anything, we ought to go back to the 2-1/2-point spread for the following reasons: If money demand should shift downward, obviously the effective money supply is going to be greater than the actual observed money growth; on the other hand, even though I don't expect that this will happen, if the demand for money should shift upward, then the effective money demand of course will be less than observed money growth. Net, bottom line, if we are uncertain, as I am, about what might happen to money demand next year, I think we should narrow the range of possible effective money by narrowing the range of observed money growth, which is the only thing that we can control. So, at this moment, without hearing other views, I am leaning toward going back to that spread of 2-1/2 points that we had before.

VICE CHAIRMAN SOLOMON. Where would you cut the half point, from the top or the bottom?

MR. BALLES. Well, if I had to commit myself today, I'd go for 3 to 5-1/2 percent instead of 2-1/2 to 5-1/2 percent, but that is just provisional until we have had a lot more discussion.

MS. TEETERS. 3 to 5-1/2 is only 2 percentage points.

MR. PARTEE. No.

MR. BALLES. 3 to 5-1/2 is 2-1/2 points.

CHAIRMAN VOLCKER. With that I think we can agree. Governor Partee.

MR. PARTEE. One of my problems with talking about money demand is, as you say, that we don't know what it will be beforehand. I never know what it was afterwards! It seems to me that what we say was a change of money demand is just the residual that one can't explain. So I am a little reluctant to do a lot of changing on the basis of that, although I suppose one could say that this year there seems to have been a better economy until recently than one would have expected, given the very low money growth that we had in M1-B. I assume you are talking about M1-B.

MR. BALLES. Yes.

MR. PARTEE. When you are talking about money demand, you are not talking about the [broader measures]?

MR. BALLES. No, all my remarks were on M1-B at this point.

MR. PARTEE. On the technical side, I don't really understand M2 either, but one thing that has disturbed me about it is that it seems to me to be subject to the possibility of coming in higher as a result of the structural changes. Steve mentioned it. We have IRA and Keogh accounts, and nobody really knows how they are going to go over the next year. They involve a very long-term commitment of funds, but there is a very desirable tax effect from [getting into them]. I just don't know how it will go. In addition, we have the fact that people who are uncertain about the future at least now have the option of going to money market funds from the market itself. We have seen continued rapid growth in recent months in the money market funds, partly because of the uncertainty, and that could continue in the period ahead. But even more broadly, all of the efforts on the part of the government and the administration to stimulate savings could be successful. That is, we have IRA/Keoghs, the tax [cut], the all savers certificate, and the reduction in the maximum rate on earned income from 70 to 50 percent. And if [such saving] were to materialize, it seems to me it would tend to show up in the M2 number. Now, you have projected an increase in the personal saving rate for next year. You mentioned the decline in the increase in nominal GNP--there is an increase of 1/2 percentage point, I think--but there is also a 1/2 point increase in the saving rate projected from 1981 to 1982. So I wonder whether, in fact, we don't need in that broader aggregate to allow for the possibility at least that there is going to be a larger gross flow that makes up the picture of the new economy. Now, I don't think what I say applies to M1-B. There may be some downward drift in the demand function. But it is associated mainly with transactions except for very, very temporary periods such as right now when maybe NOW accounts have some extra money in them as a parking place. I am not saying anything about numbers because I think it is too early to do that, but as we look ahead I think we should take into account not only what Nancy said about a tendency to miss on the M1 versus M2 and M3, but also what the effect of a changing structure of the economy would be on the comparison between M1 and M2 and M3.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I am concerned about the assumptions the staff is making with respect to the NOW accounts in 1982 in that they assume that the adjustment is largely behind us. That goes against the experience of the NOW accounts in New England, where it took several years to make the adjustment fully. And it seems to me--

CHAIRMAN VOLCKER. That is an assumption the Committee made rather than the staff, if I may just put in a footnote.

MR. MORRIS. Well, if the Committee made it, I also question that. I would call the Committee's attention to the recent rate of growth in other checkable deposits. In November it was 46.2 percent. In the second week of December, when total M1-B was up $800 million, other checkable deposits were up $2.9 billion. To me, this does not lend a lot of credence to the idea that the adjustment is behind us. Apparently it still does to you, Steve?

MR. AXILROD. Well, yes. I think that particular [development] has another explanation. We are adjusting essentially for shifts out of existing demand deposits into NOW accounts because of the opening of NOW accounts. But the big increase in November and presumably in early December was also associated with the fact that savings deposits, which had been dropping at a 20 percent or more annual rate month-after-month, stopped dropping. And it is not implausible that this is an aspect of the same phenomenon. That is, for precautionary reasons or what have you, people have increased their saving rate as they did in the fourth quarter and some of that money has spilled over into what they think of as the safest form one can find that has a little interest paid on it. The turnaround in savings accounts and the increase in NOW accounts are--in my mind in any event--aspects of the same phenomenon. So I don't take that as evidence that the shift is not over. The only evidence we have that the shift is over, of course, is that the data we got on the number of NOW accounts--my memory may be off in terms of the exact numbers--was that they increased at something like a 67 percent annual rate through May. And the data we now have for May through November at banks, and I think also at other depository institutions but I am not sure about the latter, show an increase in the number of accounts at only about a 12 percent annual rate. So, there has been a marked, clear, and definite [deceleration]. While the increase for the year is about as we had projected in July, though much more than we projected in February, the bulk of it came early in the year. And then there was this marked slowing in the increase in the accounts. We can never say that some inflow isn't [going into] some account that it has taken a person a year to learn about. But given the publicity this past year and given these data, I feel that it is reasonable enough to say that the shift is over. The risk we are open to is the risk that interest rates may get a little lower than the staff is projecting and people may say: "Well, I'll just put my money in the NOW account, particularly if that interest rate is permitted to rise some, rather than the money market fund. It is insured as a NOW account; it is safe; and what do I care about 2 percentage points?" Then we would get a sharp rise. But I don't think there will be a shift.

CHAIRMAN VOLCKER. If that happens, then what? I am getting--

MR. AXILROD. I don't think that is a structural shift in the same sense that we were talking about this year. It's a shift, and you probably should accommodate it, but it is a different kind of shift.

MR. MORRIS. Well, there are two aspects that could get us in trouble. One is that it is entirely possible that we could get continued shifts out of savings accounts into NOW accounts. Certainly it would be at a slower rate, but it could be at a big enough rate to have a substantial impact on the rate of growth of the new M1 and perhaps lead us to set too low a target for M1. That is what I am concerned about for 1982.

MR. AXILROD. I wouldn't say that is not [possible]; it is, certainly.

MR. MORRIS(?). It is complicated also by people using their NOW account as a savings vehicle--that is, by adding savings to their transactions balances. This would again lead us to way overshooting our M1 targets.

MR. AXILROD. I think the latter, too, is also a real risk.

CHAIRMAN VOLCKER. That is right. There is a risk on that side. But what do you do about the risk that Visa, Master Charge, and a bunch of other money market fund people will introduce sweeping of demand accounts and NOW accounts into money market funds next year?

MS. TEETERS. That will only widen the spread between M1 and M2.

CHAIRMAN VOLCKER. It will widen the spread between M1 and M2, but--

MR. MORRIS. I think sooner or later we have to recognize that we can't measure transactions accounts anymore. We ought to start looking at other things. I think that is a clear message.

CHAIRMAN VOLCKER. Governor Gramley, I don't want to go on too long on this scene here.

MR. GRAMLEY. I just want to say a word about credibility and what it means in terms of selecting targets for next year. I think credibility is terribly important. I do think we have improved our credibility enormously but we ought to understand why and what that has to do with the selection of targets next year. We have gone through a two-year period in which the first year M1-B ran way over the target and the second year it ran way under the target. M2 ran over in both years. The fluctuations in the money stock have been greater since October of 1979 than they ever were before; so have the fluctuations in interest rates. And somehow we have come out ahead. I think the reason we have come out ahead is because in the pre-October 1979 period, whenever the System was faced with a choice of erring on the side of opting for a lower unemployment rate and more inflation or the reverse, it opted for the former; and in the post-October 1979 period, we have said we are going to opt to hold the line on prices and take a higher unemployment rate. That is basically what the markets are telling us. That is basically why we have had the improvement in confidence. We have run a much, much tighter policy.

So, what we ought to do is try to figure out what sorts of targets we need for 1982 to run the kind of monetary policy we think is sensible and worry less about the announcement effects or the reactions of the financial markets or the public. On M1-B, although Frank has a point that we need to worry about the possibility that demand for M1-B will run over a 5-1/2 percent upper end, I think the bigger likelihood is that we will have trouble holding M1 growth up to 2-1/2 percent because so many of these innovations, which have just gotten started, will continue. So, I would be prepared to live with the 2-1/2 to 5-1/2 percent range [adopted tentatively in July]. And if it runs below, I don't think that is going to hurt our credibility. On M2, though, so many things are happening that to hold to a 6 to 9 percent range runs the danger of having an M2 figure that is again way, way above the target. And I think we could raise that range to 7 to 10 percent or 6 to 10 percent or something like that without doing our credibility any damage at all.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. I share to a great extent what Lyle has just said. It seems to me that we would sharpen this discussion if we were able to agree upon and accept for ourselves certain basic targets related to those objectives that we really are charged with achieving. The two principal objectives we should have are to achieve certain targets of output growth as well as targets for the reduction of [inflation] and concurrently to consider what effect achieving those targets might have on the unemployment rate. Now, for what it is worth, [let me tell you what] our people projected [would happen] if we were to come down on a broad conceptual objective of maybe a 5 percent rate of growth for M1-B in 1982 and 1983--assuming just theoretically that that was achievable by us and assuming a moderate slowing in the growth of federal spending and the tax policy as presently enacted. They projected that fourth quarter of 1981 to fourth quarter 1982 nominal GNP would be something in the vicinity of 7-1/2 percent to 9 percent; real GNP would be 1 to 2 percent; prices as measured by the deflator would be 6-1/2 to 7 percent; and this would result in an unemployment rate of maybe 8-1/2 to 9 percent. And in 1983 if these assumptions were held to, we again would see growth of nominal GNP of 7-1/2 to 9-1/2 percent, with a bit higher real GNP of 2 to 3 percent, price [increases of] 5-1/2 to 6-1/2 percent--that is, a reduction of about another point--and unemployment still 8-1/2 to 9 percent. I don't know whether these objectives are what the Committee would opt for, but it seems to me that it is important, and should be important when we discuss this tomorrow, for us to try to agree on what we think are the tolerable ranges of output growth, what price objectives we would like to achieve, and what unemployment rate we would be willing to tolerate and then try to establish money growth rates that we think would achieve those objectives.

Probably some of you would part from the rationale that I am trying to present by saying that money growth does not have a precise effect or even a meaningful effect on output or on prices. I think what seems to be happening on prices is more than a reflection of the whims of the people who are negotiating wage settlements and that it really is a reflection of the reduction in money growth that we have achieved either purposely or otherwise. So, in thinking about these things, I believe we should try to define our objectives and then regardless of how we come toward those--whether it is through money growth control or interest rates--try to agree on what we think are the decisions that would lead to the output growth and price targets that we agree on and the unemployment consequences.

CHAIRMAN VOLCKER. I have three more names on my list. I will not accept any more. And if any of the three on the list--Messrs. Wallich, Solomon, and Black--wish to wait until tomorrow, that would be acceptable. If you have an urge to say something, Governor Wallich is first.

MR. WALLICH. I am perfectly willing to wait 'til tomorrow.

CHAIRMAN VOLCKER. Mr. Solomon, do you have an urge?

VICE CHAIRMAN SOLOMON. I just was going to ask you a question if you have the urge to answer. I can understand the case for not including retail RPs and I can understand the case for not including IRA and Keogh accounts [in M2]. I don't understand what the rationale would be, though, if I understood you right, for [not including] institutional money market funds.

CHAIRMAN VOLCKER. Because they are more like [components of] M3 than M2.

MR. AXILROD. The average size of those accounts is about $125,000. The average size of accounts of the others is between $12,000 and $16,000. So, there is a sharp distinction in the holder and it is our thought that the holders of the institutional funds would otherwise be putting their money in CDs or market instruments and not otherwise be putting their money in M2-type instruments.

CHAIRMAN VOLCKER. Mr. Black, do you want to--

MR. BLACK. No, I'll withdraw, Mr. Chairman, until tomorrow.

CHAIRMAN VOLCKER. Okay, we will meet again tomorrow at whatever time--

MR. ALTMANN. 9:30 a.m. tomorrow morning.

MR. PARTEE. Weather permitting.

[Meeting recessed]

December 22, 1981--Morning Session

CHAIRMAN VOLCKER. Well, I think we can proceed with the discussion of the longer-term ranges in a very tentative way. Governor Wallich, you were cut off before.

MR. WALLICH. Yes, I was. All I can think about as I look at what we are proposing to do [is whether we are] setting very tight targets. We are proposing to finance a 7 percent growth in nominal GNP, which is all inflation and has a little minus in real growth, with a 4 percent rise in M1-B, [using] the midpoint of the target. In other words, we are relying on a shift in the demand function for M1-B. We are also accepting some base drift that we are carrying over from 1981, which adds to the tightness. But the fact is that we have had base drift from time to time and sometimes in very durable form. And the reason that our policy in the mid-1970s, for instance, now looks so poor is not that the targets were not very tight; they looked extremely tight. But we got an amount of shift in the demand function that made them very loose. The growth of effective money was much higher than we realized. It was again much higher than we realized in 1981. We got a very large shift in the demand function, on the order of 6 percent, which meant that the very modest nominal GNP growth that we got was financeable.

So I would say that our main risk is really on the side of getting new additional shifts in the demand function. We have analyzed these and how they work. We have a theory that they come after peaks in interest rates. We can now foresee them institutionally, with the sweeps out of demand and NOW accounts into money market mutual funds. All that suggests that we are going to see, if anything, greater economies in M1 than we have seen in the past and that, therefore, the seemingly very tight targets ex post will not look nearly so tight. One can see the same thing if one looks simply at what is in M1. It does not contain that part of money market mutual funds that clearly serves as transactions balances today, which I think must be quite considerable. And it doesn't take account fully either of the liquidity enhancing effect of the existence of money market mutual funds that people can write one check a month on; that saves them half their normal bank balance in that they can replenish their bank balance in the middle of the month out of their money market mutual fund. So, again, I think one can see that in practice that makes the tight M1 target of 2-1/2 to 5-1/2 percent much less tight than it seems.

Now, I think the wide range that we are proposing is all right because there is so much uncertainty here that one cannot operate with a very tight target. We do have to realize that these tight targets probably condemn us to quick, short swings in business. If we follow a tight money supply track and stay on it, interest rates will move up and down sharply. We have not accepted the full decline in interest rates that would have come had we stayed exactly on M1-B, and we didn't because we knew that in 1980 when we came close to doing that we got a very sharp drop but then a very quick snapback. It didn't do us any good against inflation this time by not allowing quite [as] extreme a [shortfall from our] money supply target. Hopefully we will get a more lasting effect. We do need a period of slack in the economy if we want to wind out the inflation. Our problem is whether we are going to bounce back and forth going up and down to the very top peak of the ceiling and then to the floor as a result of these techniques; to the extent that we can avoid that, we clearly should.

Now, just a word about M2. M2 [growth] has usually been in line very roughly with [that of] nominal GNP. So I would view with alarm any increase in [the] M2 [range]. It is true that there are some practices [in train] that may make M2 rise abnormally, for instance the IRA and Keogh expansion that may be ahead. But broadly speaking, M2 tends to expand faster in contractions and expands more slowly than nominal GNP in expansions because of the way the fixed rate deposit interest rates compete with market instruments. So, we are going to go through eventually a period of expansion. I would think that would hold M2 down, and I don't see much harm in a relatively tight M2 ceiling. I think the removal of institutional money market mutual funds and addition of retail RPs would be a reasonable adjustment. We shouldn't be in the posture of never mending the structure of our aggregates. Thank you.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Well, I think the recession that we are in might well be more severe than a number of other people seem to believe. Nevertheless, there is a real limit as to what we can do in monetary policy to cushion the decline. We have tried a lot of times in the past to do this and we have gotten ourselves into a progressively more vexing web of problems in the process. Really, the difficulties that we will have for the next few months are foreordained, so to speak, and inflation is still the underlying problem that we have to deal with. So it seems to me that if we make any significant moves toward trying to accelerate the aggregates, we run a very high risk of reintensification of inflationary pressures and another debacle in the long-term bond markets. That would be very, very bad for some companies that need to tap that market fairly soon and [would lead], I believe, eventually to a deeper recession and more unemployment down the road than we otherwise would have.

But there are two issues that I do think deserve some special priorities that haven't been [addressed] in exactly this way by anyone. One is the issue of multiple targets; [the other is] the width of the target ranges. My feeling is that the combination of these multiple targets and wide target ranges quite legitimately raises doubts in the minds of quite a few of our critics about the seriousness of our efforts to control the rate of growth in the money supply. I continue to believe that M1 is the best of the aggregates to target on and I really would prefer to target on that one alone, although I realize I won't get you all to agree with that. Further, I would favor setting a relatively narrow range for M1 and then if we should find that there is a significant change in the demand for money and we can agree that that has in fact taken place--although I share Chuck's apprehensions about that--I think the best way to handle that is with an overt and publicly announced change in our targets. Now, I recognize that there are some technical problems in moving from an adjusted M1 range to an unadjusted range. It seems to me that this target problem is reasonably manageable. Actually M1-B looks as if it will grow about 4.7 percent from the fourth quarter of 1980 to the fourth quarter of 1981, and it seems to me that that should be about the upper limit for 1982. So, I am thinking in terms of something like 3 to 5 percent. But I would want to aim at the midpoint of that and make a determined effort to hit it. That midpoint, incidentally, is the same as the midpoint of the 2-1/2 to 5-1/2 percent range that we tentatively adopted in July.

CHAIRMAN VOLCKER. Mr. Rice.

MR. RICE. Mr. Chairman, I hope I'm in better voice this morning than I was yesterday. I would like to say a few words about credibility. I agree with most of the varying earlier comments on the importance of credibility. However, it seems to me that credibility has several dimensions--certainly more than one. Many people I have talked to feel that it was the high interest rate policy of the Federal Reserve that caused the current recession and they wonder what kind of institution this is that really wants to cause a recession. On unemployment there are some credibilities involved, too, except that it is negative credibility. In the long run, not necessarily in the short run, we have to take account of this negative credibility. I agree with a good part of Governor Gramley's observation that some part of the current credibility that we seem to be enjoying, especially from the investor community, is based on the perception that we are willing to accept very high rates of unemployment as a means of fighting inflation. However, over time we ought not leave the impression with the public that we are indifferent to high rates of unemployment. It seems to me possible over time to accommodate both the need to fight inflation, which is the primary objective, and to consider as well the effects of our policy on the economy.

As to the target ranges for the aggregates for 1982, Bob Black said much of what I wanted to say about that. In the period immediately ahead, i.e. 1982, we should in the process of maintaining our credibility try to ensure that we do not starve the economy for money and that there will be enough money around to provide for a recovery, which we need. Therefore, I would favor narrowing the target range for M1 somewhat. I would favor raising the lower limit of the range from 2-1/2 to 3 percent and keeping the upper limit at 5-1/2 percent. I think that was the proposal made by John Balles. That would tend to keep our performance closer to the target and reduce the possibility that there will be a repeat of this year's performance, where growth of M1 fell very, very short of the target range. If we set the lower limit higher, it would be more likely that the shortfall in money growth would not be substantial. So, I would propose a range of 3 to 5-1/2 percent; and 5-1/2 percent for the upper limit, of course, demonstrates that we are sticking with our policy of gradually reducing the rate of money growth. But increasing the lower band also will reduce the likelihood that we would starve the economy for money during the period immediately ahead. I would also say that we don't want to be too much influenced, in my judgment, by notions of growth in effective money. Particularly we should not be in a position of trying to place too much confidence in our ability to predict shifts in money demand. I think we should concentrate on the money growth that we can measure. With regard to M2, I would stick with the range of 6 to 9 percent that we had set earlier and hope that that range will turn out to be more consistent with the target we set for M1.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I think it is ironic that the Federal Reserve has switched to monetarism at the very time when our ability to measure the money supply has eroded dramatically and our ability to differentiate money from liquid assets is rapidly disappearing. And, therefore, the relationship between what we call money and nominal GNP, which is really what we are after, is becoming increasingly unstable. I think we've lucked out [this past] year. We have one target below [our objective] and a couple above and bank credit barely within. I hope we luck out this year, but I wouldn't know what set of numbers--

CHAIRMAN VOLCKER. By this year do you mean 1982?

MR. MORRIS. Yes, in 1982. I wouldn't know what set of numbers presented to the Committee would assure us that we will luck out in 1982. We are seeing very strange phenomena in both the numbers that we call money. We had something happen in November that I think has never happened before in a recession. We got a sharp deceleration in the economy accompanied by a sharp acceleration in our money measures. That has never happened before, at least to my knowledge.

CHAIRMAN VOLCKER. Let me linger on that point for a second. [Let me ask] our staff experts: Has it ever happened before? The same question has occurred to me. We only have a month and a half of experience--

MR. AXILROD. I have not made a thorough research of the past records. I would have to do that.

MR. MORRIS. Take all months where industrial production dropped by more than 2 percent.

MR. ROOS. I don't think any monetarist ever maintained that a 1- or 2-month trend, upward or downward, will have an effect on GNP.

MR. MORRIS. It is more than that, Larry. If you look at M1-B last year, its relationship to nominal GNP is not what one would have forecast at the beginning of the year by any model that I know of. And it seems to me that the situation is going to get more difficult in the future as banks begin sweeping consumer deposits into money market funds. So, it seems to me, Mr. Chairman, that the time is ripe to appoint a new committee on the directive. That committee should be charged with finding some target for monetary policy which is more stably related to GNP than the targets we are currently struggling with.

MR. GRAMLEY. And if they can't?

MR. MORRIS(?). Well, I don't think we ought to conclude at the outset that they can't.

MR. PARTEE. Maybe it's currency.

MR. MORRIS. It seems to me it could be currency or what is left of it.

MR. FORD. That is half of it.

MR. MORRIS. Currency has become very unstable.

MR. RICE. Do you think we have given monetarism a fair test?

MR. MORRIS. Well, I think we could have given it a much better test 50 years ago, or 30 years ago, than we can now. Monetarism does require that we are able to measure accurately the money supply. That is absolutely essential to the monetarist approach. And once you take the position that you can no longer differentiate money from liquid assets, you are in real trouble trying to pursue a monetarist course. Now, if we don't find an alternative, then we are suddenly going to shift back to targeting on interest rates. Looking at the short-term options the Committee has been presented with, I suspect very strongly that such a trend is already under way because of the fact that we had a shortfall in M1 in 1981, which we prized because it offset the overruns in the other aggregates. We have an extremely weak economy and for December through March we are presented in alternative B with a target of 2 percent for M1 and in alternative C with a target of zero. Now, it doesn't seem to me that either of those suggests any great determination to give a lot of priority to controlling M1. But there is something in the description of alternative B that makes sense to me. We used to call it around this table "maintaining prevailing money market conditions." It seems to me that it says the case for a 2 percent growth rate as in alternative B is that it would be associated with maintaining roughly the present level of interest rates for another month. Maybe I am reading more between the lines than Steve meant to write in there, but that--

MR. PARTEE. Well, he certainly wrote an analysis I am sure.

MR. MORRIS. But the less confidence we have in these numbers, the more we are going to drift back to controlling interest rates. And I would prefer that we find some other option.

MR. ROOS. May I ask Frank a question very quickly, Mr. Chairman? If we had a shortfall in M1-B this year and we have a weak economy, how does that add up to the conclusion that there is little relationship between the growth of M1-B and output? I think that strengthens the case for the fact that M1-B is a predictor of economic activity.

MR. MORRIS. Well, I would like to see the model that a year ago would have forecast the kind of nominal GNP growth we had in 1981 as being associated with the kind of M1-B growth we had.

CHAIRMAN VOLCKER. Which M1-B?

MR. ROOS. You are invited to St. Louis, my good friend!

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Mr. Chairman, given all that has been said here about the problems with M1-B, I would point out a little arithmetic exercise we did. I had my people go all the way back to October of 1979 and construct from the fourth quarter of 1979 the level of M1-B that we should have in the fourth quarter of this year assuming that we had achieved the midpoints of all the targets that the Committee has had for that whole period of almost 2-1/2 years.

CHAIRMAN VOLCKER. Are you are talking about the short-run targets or the long-run targets?

MR. CORRIGAN. No, the long-run targets.

MR. PARTEE. From the fourth quarter of 1979 to the fourth quarter of 1981?

MR. CORRIGAN. Right.

MR. PARTEE. Two years?

MR. CORRIGAN. Right.

MR. GRAMLEY. Shift-adjusted?

MR. CORRIGAN. Yes. Now, doing these numbers gets a little tricky, but let me just point out for the record that the target level of M1-B that comes out of that exercise is $429.2 billion. The actual level, leaving aside the last two weeks in December, is $428.6 billion, a whopping difference of $600 million. Perhaps things aren't quite as bad as we make them out to be.

MR. MORRIS. But do you believe in compensating errors as a basic--

MR. CORRIGAN. My own view, Frank, would be that the errors over the period haven't been all that big. There has been some luck and there have been some ups and downs, but when you look at the performance of policy over the whole period, I don't think it is all that bad. It could be better, but certainly it isn't something that one has to be ashamed of by any stretch of the imagination. That is where I start from. I am under no illusions, of course, that we can measure M1-B right now. I don't think we can. And I think these discussions about what model would say what really miss the point because in order to have a model you still have to plug in the money supply number to get the GNP out the other end. And quite apart from one's views about monetarism, models, or anything else, there is a legitimate question as to what to put in on the money assumptions.

My instinct, however, in thinking about the 1982 targets, is to leave them where they are. In the case of M1, I think the likelihood is great that we will continue to see strong forces working in the direction of a continuation of the so-called downward shift in the demand for M1-B. I don't see those forces lessening; as a matter of fact, if anything, I think they will remain as strong or maybe strengthen further. But even if that is the case, I still have some concern that later in the year the targets that we have for M1-B, even allowing for some further shift adjustment, could prove very difficult to hit if the economy were to pick up the way the staff is projecting, recognizing that there are an awful lot of private forecasts around that would place the economy stronger in the second half of the year than the staff has. So, my point here is that even under the best of circumstances those targets for narrow money, particularly as we get out in the year, will prove to be ambitious. And in fact it may be that the only way they will prove workable in that timeframe is in association with a price performance that is a little better perhaps than is currently being forecast. Incidentally, Jim, what was the CPI this morning?

MR. KICHLINE. It is up 0.5 [for November] compared to the 0.4 in October. Food prices rose 0.2, the same as in October. And housing performed very well; it was only up 0.4, and that reflects the sizable increase in the mortgage rate and a 3/4 percent decline in home prices. On average, it is a good report.

MR. CORRIGAN. Anyway, as I said, unless we get a little luckier on prices, I think those targets could be ambitious even allowing for demand shifts. On M2 I find myself attracted to Governor Partee's comments yesterday. I think there is a possibility that we could see some rebound in savings in the fundamental underlying sense next year. At least as far out as one can reasonably see, cash-type investments are probably going to continue to look pretty good. And I, at least, am inclined to the view that the IRA account could be a bigger factor than most of the discussion around the table has suggested so far. It is very attractive to begin with, but the fact that so many companies are going ahead with payroll deduction plans will make it such a simple thing and so attractive from an ease of transactions point of view that that could really generate some momentum in these accounts as the year unfolds. I must say I am perplexed as to what that means. I might even be prepared to make an argument that IRA accounts don't belong in M2 because they are a much more permanent type of savings than are the other [components of] M2. I get that feeling a little more so when I recognize that it is only the pure coincidence of who is managing an IRA account that is going to determine whether it ends up in the banking system or someplace else. The distinction is pretty arbitrary as to whether a particular IRA ends up as a component of M2 or in a money market instrument of some kind or another. And I would at least raise the question of whether they belong in M2 at all. But if we have them in M2, they alone could create some real problems in terms of the upper limit of the target for M2. That would lead me a bit in the direction that Governor Gramley suggested yesterday even though I am hesitant, to put it mildly, to change any of these targets, although they were only tentatively agreed upon by the Committee in July. That is it.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. With regard to M1-B, based on the results for this year as a whole and the expectations for next year, I fail to see any compelling reason to expand the width of the target range. And lacking any compelling reason to do it, in my view we would make a mistake to do that. Therefore, I would be in favor of keeping the spread at 2-1/2 percentage points as it is currently. Lending credence to the credibility theme that any change might be regarded as tinkering at this point, I would keep the spread at the same magnitude. But I would continue the program of restraint, which I think has been effectively established and, therefore, I would be in favor of moving the range down to, say, 3 to 5-1/2 percent.

With regard to M2, again given the results of this year--with growth running at or near the top of the range all year long--it seems to me that the relationship between M1-B and M2 this year has [not] been terribly tight. And because of the questions about what is likely to occur next year in the components of M2, which we have talked about a good deal, and the fact that we have established enough press regarding the "noise," if you will, in M2, I think this would be an appropriate time to make a change. Therefore, I would be in favor of maintaining the 3-point spread but moving the range up a bit to, say, 7 to 10 percent as a way of trying to get it back to a more comfortable level for an uncertain year.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. We have heard good reasons why a wider range in M1-B makes sense. There is uncertainty due to the innovation in technology impact, which is likely to continue. On balance, weighing the pros and cons, I would leave M1-B where it is. And I would leave M2 where it is rather than raise it if the Committee were to agree that we have to show a greater willingness to make a midyear adjustment if innovation in technology continues to bring about these shifts. It seems to me that there might be some advantage in terms of this famous or infamous credibility problem, in foreshadowing that adjustment in the policy record of this meeting or a subsequent meeting as well as in the Chairman's presentation in February. We can put everybody on notice and give it some concreteness and say it is not just a cop-out. We can point to the divergence between M1-B and M2 and say that if this divergence widened because of innovation in technology, then we would be prepared to make an adjustment in the targets at midyear. I think it would be a mistake for us to shrink from that. If I thought we were going to shrink from that, then I'd say we really should go with Lyle Gramley's suggestion and raise the M2 target. I should add, since I didn't make myself 100 percent clear yesterday, that I strongly support taking IRA and Keogh accounts out of M2. I guess they would go into M3; I am not quite sure whether they would go into M3 or into something else, maybe L.

CHAIRMAN VOLCKER. They may even vary L.

MR. CORRIGAN. That is right.

VICE CHAIRMAN SOLOMON. I still have some difficulty in understanding the rationale for excluding institutionally held, corporation held, money market balances in money market funds. The fact that they average $125,000 whereas the average household balance averages $12,000 is logical; one is a business and the other is a household. The motivation or the potential use of it as money--it is liquidity--is still the same. So I am not quite sure I understand fully why one can make that distinction or what the rationale is.

CHAIRMAN VOLCKER. Well, you are treading on delicate questions of what M2 and M3 mean anyway. But I think [unintelligible] the rationale [is that] M2 is more a household kind of liquid asset. And there is no difference between any institutional money market fund and [an institutional] CD, let's say, which is in M3 and not in M2. You'd certainly put it in M3.

VICE CHAIRMAN SOLOMON. But an institutional CD, even if negotiable, does have a fixed maturity. It's locked in for a period of time.

CHAIRMAN VOLCKER. Three months, four--

VICE CHAIRMAN SOLOMON. Whereas this money in the money market fund can move in 24 hours.

CHAIRMAN VOLCKER. But where does it move to? It moves to a CD or 20-day commercial paper.

VICE CHAIRMAN SOLOMON. Or it moves to a checking account to finance transactions.

CHAIRMAN VOLCKER. Conceivably, yes. Mr. Ford.

MR. FORD. Before I make my comments, I'd say on that last point that I have heard, but I haven't seen evidence, that a lot of smaller businesses tend to use these money market funds as a demand account. That reinforces Tony's point, I would think. I don't know how prevalent that is but certainly in the partnership areas a number of professionals tell me that they just use their Merrill Lynch account for all the bills of over $500 that they have to pay.

CHAIRMAN VOLCKER. Nobody knows. There is some of that, but I don't think they would tend to be the ones that label themselves institutional funds. These are the Merrill Lynch accounts or Fidelity accounts or whatever.

MR. FORD. Yes, maybe they are putting in the--

MS. TEETERS. We are going to undertake a special survey of the money market mutual funds at the beginning of next year, isn't that the timing, Steve?

MR. AXILROD. It might be a little later than that, but it will be early next year.

MS. TEETERS. And we'll try to find out what the transaction use is and what the turnover is on them.

MR. BALLES. Oh, good.

CHAIRMAN VOLCKER. We are not going to find out. We can try.

MS. TEETERS. We can try.

MR. FORD. Well, that then leads into another suggestion I have but first, with regard to M1-B, we feel we can be comfortable with the 2-1/2 to 5-1/2 percent tentative target we announced or with 2-1/2 to 5 percent, either one. I don't think the 1/2 point makes a big difference. I have some sympathy with what Si said, certainly, of not making the range too much wider. Dropping the NOW account adjustment seems to make lots of sense. So, we would say: Let's go from the end of year [and use] the last quarterly average as the base, as we normally do and as I think is recommended in the Bluebook, and go with perhaps the 2-1/2 to 5-1/2 percent range. But we are very concerned about the nature of the innovations that will be coming along, some of which we hope will be at least partly visible by the time of the next meeting. Nancy just mentioned that she thought we ought to do some more research on some of these things such as the

MMFs. I would suggest that we gear up either at the Washington level and/or at some of the Reserve Banks to get on top of the IRA developments, because the potential there is tremendous. If you take the number of American households and even if you assume that only 10 percent of them go into a $2,000 IRA, it comes to something on the order of just under $15 billion that could be moved around. And if you assume it is 20 percent or--

MR. PARTEE. I just figured 10 million accounts at $2,000 is $20 billion.

MR. FORD. Yes. Okay, there you go.

MR. AXILROD. For sure, President Ford, we are going to be developing and suggesting a data system to capture the flows as much as possible.

MR. FORD. Right, [that needs to be done] early on. I would say even before that if there is any way to find out intentions--that might be too romantic for research--it would be interesting to find out not just how many households but obviously the source [of the funds]. If people shift out of NOWs, obviously that is one thing; if they shift among M-2 type assets, then it is less scary. I'd be curious to know whether people are just going to take a large percentage of the funds out of their NOW accounts or whether they will shift out of other M2 assets or whether the funds will come from things outside of M2, all of which have very different implications. I'd just encourage everybody, especially our Washington leadership, to look at the early returns on IRAs.

MR. PARTEE. Or [it could] raise the saving rate.

MR. CORRIGAN. That is right.

MR. PARTEE. It could.

MR. CORRIGAN. That is what the payroll deduction could do.

MR. FORD. While we are at it, if we could find out anything about these sweep accounts, they, too, as a financial innovation have tremendous potential for bombing us on M1-B. So we should take a look at whether among some of the major institutions there really will be an outbreak of virulent competition in that area, which could further put us in the box of having undershoots on the M1-B target and possibly overshoots on M2. What concerns me most is the fact that all year long--while Jerry's calculation was a very elegant one and speaks well for how we actually came out on M1-B--I've had the feeling that we were undershooting one target and overshooting the other. And for the next year we ought to try to figure out a way, if we can, to get out of that box so that we are not always damned on the one side for being too tight and damned on the other side for being too loose.

CHAIRMAN VOLCKER. How do you suggest we do that?

MR. FORD. Well, if the research supports it and if the early returns on IRAs give any evidence that we should expect M2 to get looser and wider, I'm leaning to the view that we ought to consider just biting the bullet and raising the upper end of that target while doing other things to indicate that it is consistent with a lower or tighter target on M1-B. For example, we might choose a base that involves a little less drift--take the year-end M1-B figure if it happens to be lower than the quarterly average. Or if there is some other way we could start from a lower point, keep it down at 5-1/2 percent and do something which in combination says we are anticipating that M1-B already is going to be overshooting, so we are tightening up in that area and we think financial innovations really are going to make M2 behave in a way that suggests we can anticipate a higher upper end if the research supports it. That is why I hope we [won't] wait until--

CHAIRMAN VOLCKER. Well, I interjected my question because I am not sure the research supports anything. And I am not sure we will have the research that is going to support anything. The nature of the problem is that we don't know.

MR. FORD. We can't know, but don't you think we can learn a little about IRAs because by the middle of February we will--

CHAIRMAN VOLCKER. We can learn a little something, [but] experience not only here but internationally suggests that we are not very good at predicting this [kind of development].

MR. FORD. Then maybe we have to go to Mr. Morris' idea that we look at some other things, although my thrust in the research would probably be different than his. I'd say, if we are going to reexamine what we shoot for, that we ought to pull out the monetary base and total reserves as possibilities, along with whatever [measures] he has in mind, although those two present difficulties that everybody here has commented on at one time or another. Where we are presently structured, as I see it, is that we are making ourselves subject to the same problems we had this year. And I would be inclined not to give up so easily, Paul, on being able to find out something about the trend in financial innovation. You may well end up being right, but I would want to come down on the research to see if we can find out something about IRAs and sweep accounts at least.

MR. SCHULTZ. Some information on the payroll plans probably would be the best indicator that we could get, if there is a way to find that out relatively soon. I think that would give us some real indication.

MR. FORD. I don't know about the public sector, but our own benefits people are putting it into our plan to make it easy, in line with the comment that Jerry made.

SPEAKER(?). Yes, we are proposing to do that.

MR. FORD. It may be that if all other government agencies are going to do that, we might have a big chunk [of employers doing that]. I don't know.

MR. PARTEE. I don't think so.

MR. FORD. Maybe we ought to do a little survey of major employers or something like that.

MR. RICE. But we don't know what the [employee] reception would be.

MR. BLACK. We don't know when it would [go into effect] either, do we?

MR. RICE. Yes and no.

MR. BLACK. It won't be until April or May sometime.

CHAIRMAN VOLCKER. We won't know where the money comes from.

MR. CORRIGAN. This really gets murky because people can [wait to put in the] money all the way out until April of 1983.

MR. BLACK. That's right.

MR. FORD. Yes.

MR. CORRIGAN. They can put it in [then] and get the tax deduction for 1982.

MR. BLACK. I bet a lot of people will borrow money in April of 1983.

CHAIRMAN VOLCKER. Well, I don't think it is useful to speculate on this at great length at this point. Are you finished, Mr. Ford?

MR. FORD. Yes, I'm sorry. I just hope you are not right about it, Paul; you might well be right. But I would hate to give up so easily on saying we can't foresee innovation in the financial markets.

MR. RICE. I don't think we ought to give up on the principle of how to treat these various [monetary measures]. We ought to decide where they ought to be.

CHAIRMAN VOLCKER. I agree with that and I agree we ought to do all we can to understand what is going on. Mrs. Teeters.

MR. PARTEE. I wonder where the thrift plan is in these Ms?

MR. RICE. It is harder to understand what is going on.

CHAIRMAN VOLCKER. Mrs. Teeters.

MS. TEETERS. I simply want to support maintaining the M1-B target. I have a lot of sympathy with what Frank has said. I think we do need to see whether we can find something else. It may be in between the two ways that we operate but I am not satisfied with what we have. I am really very concerned about the M2 target because we had a 7 percentage point gap between the growth of M1-B shift-adjusted and M2. We got ourselves into this situation where we are below one [target] and at or above the other. I would guess that the midpoint of M2 that is consistent with the midpoint of M1-B at 4 percent is 9 percent so that we are going to find that we will do again what we did last year. If we hit the 4 percent midpoint of the M1-B target, we will hit M2 at 9 percent or above. So it seems to me this is a perfect time to adjust it. We have a history of a 7-point gap. If we aim for a midpoint of 9 percent or thereabouts for M2, that is only a 5-point differential instead of 7, so we are not repeating completely what we did last year. And we'd have a better chance, I think, of staying within the targets and not agonizing all year long about which one is the most important and which one is going over. So, I would associate myself with those who would accept the existing M1-B target, increase the M2 target, and remove the IRAs and Keoghs [from M2]. We don't have a record of changing in midstream, Tony. We have never changed a target.

MR. PARTEE. Never?

MS. TEETERS. We never have, from the time we [established the tentative ranges] on down.

VICE CHAIRMAN SOLOMON. That's because we are always afraid our credibility will be injured if we change. But if we foreshadow it--put people on notice that we have a very clear, honest case on innovation in technology--and everybody is aware of it, we can begin to educate people more and make it easier for us.

MS. TEETERS. Yes, but then when we get down to doing it, we always say we won't do it.

MR. WALLICH. Or we make another shift adjustment.

MS. TEETERS. We'd rather overshoot than change the target. That is why establishing them in July a year ahead of time is such a mistake. We have no idea what the next year is going to be like. And this is not a very good forecast. As of the fourth quarter of this year, we will be exactly where we were in the fourth quarter of 1979. And if the forecast is accurate for next year, in the fourth quarter of 1982 we will be exactly where we were in the first quarter of 1981. That is really a galloping economy over two years!

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. I would like to join the chorus of those who are calling for a re-examination of these measurements because I think we are just playing mumbo-jumbo with the numbers game now. I think we can do a better job of providing measurements of what money is all about. And until we do that, Fed targets don't make much sense to me because we just explain them away by all these deviations. In Columbus, for example, our money market fund clearings have gone from 25,000 a day to 115,000; that gives you some idea of the kind of activity that is going on in that area. This is the Merrill Lynch clearing setup. And here is a backward way of getting into that measurement.

CHAIRMAN VOLCKER. That is the number of checks or--?

MR. WINN. On the money market funds.

MR. PARTEE. It certainly is the most active.

MR. WINN. I think we have to get on with the measurements. [As for] Frank's point on seeking other measurements, unless we have some measure of the reserve base or something else, we don't really have reserveable assets involved in the money concept. I just think we must get on with an attempt to remeasure some of these magnitudes. They may not be very accurate, but they are a lot better than reaching in the dark for some numbers that really don't mean anything. And then if we don't hit them, we explain it away because of all these deviations. In view of that uncertainty, I would prefer to stay right where we are with these targets but to get on with the recalculation of some of these numbers. Unless we do that, we won't have any way of establishing a reserve basis for these items. We are playing more and more an inequitable game in terms of those who participate in the conventional forms. It just behooves us to get on with the problem of measurements. I don't think we have any real basis for our shift adjustment; it [involves] numbers that we had some time ago but I don't think those are accurate. I urge that we get on with the problem of a re-examination of these targets.

CHAIRMAN VOLCKER. Well, instead of urging, I would suggest that if you have some practical way of going about this, reduce that to a piece of paper and tell us.

MR. WINN. Yes, I will make an effort.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Back to the credibility problem: In terms of the long-term ranges, it seems to me that the tentative ranges that we have published and that have been discussed and seem to be understood on the outside probably should not be changed at this point simply because I don't think we know enough to improve that in any way. I am not saying they are the best; I doubt that we know what is the best right now. But M1-B and M2 at least as of midyear seemed to be giving more consistency in terms of a relationship. Whether that will hold up remains to be seen. I think we should hold to [seeking] a gradual reduction [of these ranges] over time; it's a perception that I still think is very important, particularly to those who are less sophisticated, and we should hold to that. What is actually going to happen with regard to the innovation that is coming is mere speculation on our part, as we can tell from going around the table here. And I agree very much with Tony Solomon that the time to make an adjustment is when we have some pretty firm facts or a basis for doing it and doing it in a supportable way rather than by conjecture. The idea of giving the first signal that this will be rethought has a lot of appeal to me. I don't think the fact that we have never made a midyear shift should [mean] that we never would, if the facts are there and a change is supportable. So, I would be inclined to stay where we said tentatively we were going to be and let events unfold; and I'd be ready to make adjustments or changes in definitions, or whatever will be necessary, but based on more knowledge than we have now.

MS. TEETERS. It is not just a midyear shift; it is a mid-18 month shift or any shift in announced ranges. We just don't do it.

MR. BOYKIN. Well, whether we do it at midyear or do it before then or after, it seems to me that it would be incumbent upon the Committee to reach a judgment and make a determination when the facts support it, whatever point in time that is.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. I have just a couple of comments, Paul. I share Frank's frustration on knowing what money is these days. He proposed a new Committee on the directive. A couple of months ago I think I spoiled Steve's whole day by suggesting that maybe first and foremost we needed a major restudy of the monetary aggregates. And that is why I was so glad to hear Governor Teeters say that we are going to do something about money market funds early in the year. Could I ask a little more about that? For example, Steve, we know that some of the investment houses are arbitrarily adding to observed M1-B either 10 percent or 20 percent of money market funds on the assumption that some of these must be transactions balances. I would like to ask the question whether our look-see is really going to zero in on what percentage of these [funds] are turning over at the rate of normal transactions balances. I think we really need that kind of study before we need a Committee on the directive, Frank.

MR. AXILROD. That is our hope. In response to a Board discussion, we are in the initial stages of outlining a one-time survey; whether it will be a sample or complete [coverage] we are not certain yet. For the money market funds, we have attempted to determine in more detail than we now have the various characteristics of the account: the ownership, size, turnover, and other [characteristics] we may think of. We would expect to have a draft of the survey in a few weeks to bring before the Board. That is the stage where we are now and we hope to have it in the field relatively promptly. Whether it could be done and accomplished before the February meeting, I don't know; that seems like a very tight schedule, but we are trying to [meet it].

MS. TEETERS. Steve, I am fascinated by Willis' observation. Can we get at some of this from the clearings [data]?

CHAIRMAN VOLCKER. Well, we have data on some of this and we have done some analysis, good or bad, that takes as its point of departure how many checks, the value of checks written, or the value of turnover and says: If that is representative of a transactions account and has a normal turnover of an individual's checking account, x amount of the money market funds are like M1. And it came out to about a little less than 2 percent the last time we--

MR. KOHN. It was 4 percent, Mr. Chairman.

CHAIRMAN VOLCKER. Well, 4 percent of the money market funds, but adding 2 percent or a little less than 2 percent or a little less than 1 percent is a very [unintelligible]. There are all kinds of questions that can be raised about the methodology. There is some turnover to savings accounts that we don't put in at all; there is some turnover to CDs that we don't count at all. On the other hand, it makes no allowance for the fact that if somebody owns a money market fund, even if he doesn't write any checks on it or doesn't take the money out except rarely, the fact that he has it and knows he can write a check on it induces him to hold a lower cash balance than he would otherwise keep. Now, how do we measure that? I think it is basically immeasurable, and it is undoubtedly there. We have a spectrum of assets and we are trying to draw an arbitrary line through it and say this much is M1 and that much is M2 or M3; in fact the arbitrary line doesn't mean anything because it's a spectrum. I understand the frustration. We ought to know all that we can know about it; but in fact we are dealing with a spectrum and there isn't any answer. Nothing is going to fall neatly into what is M1 and M2 and M3. We'd have a little trouble if we sat around this table trying to rationalize the distinction between M2 and M3 and M3 and L. Any sense that after that discussion we're going to get a clean, conceptual difference between these Ms I'm afraid is an illusion.

MS. TEETERS. But the troublesome thing about the money market mutual funds is that the data we're getting on low turnover and all the rest goes against what all of us hear that people are using these funds as checking accounts. My own sample indicated that 99 percent were using them as checking accounts.

MR. CORRIGAN. Well, that's the problem with turnover. One of the ways that people use the money market mutual funds is that they write a check at the end of the month against them and put it in their checking account and then write 20 checks against the one check. And if you just measure turnover, you get one check.

CHAIRMAN VOLCKER. But it's a big check in that case. The only explanation I have for the phenomenon that I think you correctly observed is that it is a mixture. A large portion of that is basically savings or investment in the broader sense. Some fraction of it is transactions accounts. That is the nature of it. M1 is only $400 billion and M3 is $2 trillion or whatever it is. And money market funds are an indistinguishable blend of the two.

MS. TEETERS. Then what do we do when everything becomes money market funds?

CHAIRMAN VOLCKER. Precisely, we don't know. I am saying that I think it's a little difficult, however much study we give this, to say we're going to come up with a number that says this portion of it is M1 and this portion of it is M2 because it doesn't come that way. It doesn't come in that kind of package.

MR. WALLICH. It doesn't have to come into the money market fund. Merrill Lynch lets you draw checks against your securities and puts the money into a bank account that has a money market fund associated with it; that fund is up to $12 billion now. You can draw a check for fifteen cents.

CHAIRMAN VOLCKER. Well, I am not arguing at all over this; obviously, we should get as much information about this phenomenon as we can. I just think people are suggesting more than is practically feasible to say that we are going to have some great study and somehow the numbers are going to come fluttering down and on this half of the table they are going to be M1 and on the other half they are going to be M2.

MR. PARTEE. I couldn't agree more, Paul. It is very analogous to our difficulty in dealing with savings accounts over time. Savings accounts have more turnover than money market funds and yet we never put any portion of savings accounts in M1. Indeed, we didn't even blink an eye when [depository institutions] went from interest figured on the minimum balance to interest from day of deposit to day of withdrawal, which was a big change in savings accounts. We never did a thing about it. I don't think we have ever handled the notion of savings accounts at all well in research that I can recall, extending back into the 1950s, in terms of what to do with savings accounts and how to treat their "moneyness" in looking at monetary expansion. So, I think it is not really the turnover but [their use as a] backup that's terribly important. The difference between a money market fund which you can have immediate access to and an IRA account which you can't draw on until you're 59-1/2 years old is really phenomenal, and yet they are both in M2.

CHAIRMAN VOLCKER. Well, let me just inject a thought on IRAs. Conceptually, the argument is very strong, as I see it, to take those out of M2 on liquidity grounds. But suppose we went ahead and did that. What we don't know is how much money is going into IRA accounts that otherwise would have been in M2 or is already in M2, so we'd get an artificial deflation of M2 in an attempt to improve the figure. In some long run sense it probably would be an improved figure, but it is not going to help us in 1982 in understanding M2, I suspect.

MR. WALLICH. You'd turn it into another M1-A.

MR. CORRIGAN. You'd have a shift-adjusted M2.

VICE CHAIRMAN SOLOMON. That's inherent in almost anything we look at. Where's the money coming from, right?

CHAIRMAN VOLCKER. Right.

VICE CHAIRMAN SOLOMON. It can't stop us from--

CHAIRMAN VOLCKER. But this is a reflection of a change in law. It's like the M1 adjustment problem.

VICE CHAIRMAN SOLOMON. It's so clearly understandable by everybody that there's a rationale for taking it out.

CHAIRMAN VOLCKER. I'm not arguing against taking it out. I'm just arguing against the notion that it will give us a clean analytically nice figure when we take it out.

MR. BALLES. Mr. Chairman, one more observation: I'd just like to remind you that back in the mid-1970s we had one of the several Committees on the directive--some of us at this table served on it--chaired first by Bob Holland and later by Chuck Partee. We took a long, hard look at optimal control, working on the ultimate variables and not using money as the intermediate target. And the net of that was a dry hole. It just didn't prove to be doable in practice. So, despite all of our frustrations about what money is, how it behaves, and what should be in M1 and M2, it is still the only game in town as far as I am concerned. Some of the academics--and it is a real minority--are urging us to target on real interest rates or to target on nominal GNP. They get little, if any, support from their peers. That came out loud and clear in this recent academic conference that I mentioned yesterday. Despite the frustrations about the money supply--will the real money supply please stand up!--I think it's the only hope we have.

CHAIRMAN VOLCKER. With that comforting thought, Mr. Boehne.

MR. BOEHNE. Taking into account all this frustration, uncertainty, and credibility, which I don't think I can add to after this dinstinguished discussion, we still have to set some targets for next year. I think John is right that we still have to deal with these. I come down for lowering the M1 range to 2-1/2 to 5-1/2 percent, which is what we tentatively agreed on in July. And I am sympathetic to the notion of raising M2. It does seem to me that we ought to make these as consistent as we can. I don't think it adds to or subtracts from our credibility if we make an adjustment in M2 to make it consistent with M1. So, I would favor such an adjustment.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, just so we have everything in front of us, I also would like to point out that there is the problem of choosing the base in doing next year's targeting. We've rather easily slipped over the fact that there was a considerable shortfall in M1-B this year. In fact, Jerry had an interesting explanation for it--and I think it's something we ought to work on--that involves a 2-year look at the expansion of M1-B. But there are a good many people who have been greatly afflicted by high interest rates and poor business and bankruptcy who won't quite understand why it is that we just disregard the shortfall entirely and go on and assign the same old lower growth rate to M1 in the year to come. I think it is a very serious problem that we have to deal with in explaining, if that is what we want to do, why it is what we want to do. Most people would say we ought to add our shortfall in 1981 into the 1982 expectations.

VICE CHAIRMAN SOLOMON. But last year didn't you accept the base drift in M1?

MR. PARTEE. Yes, but it didn't involve bankruptcy the way it does now. I am talking about builders and realtors and people like that who just aren't going to understand it and quite a few Congressmen who already have begun to focus on this issue in looking at 1982.

MR. WINN. Chuck, what do you do with M2, then?

MR. PARTEE. Well, I think most people would regard M2 as a very much lesser target of policy. That hasn't been the emphasis at all, for a very good reason in my view. Of course, we differ on that, but it is a problem we have to take into account now. It happens to be most pointed in this particular Bluebook because in this Bluebook we have the sense--and it was referred to earlier, I think, by Frank in a somewhat negative way--that we have a year in which we've fallen progressively short in M1-B and we finally got 2 or 3 months that are up. October was a normative or maybe a slightly more than normative month; November was a little strong; and December is another sort of normative month. But choosing the fourth quarter as the base means that December is above the fourth-quarter average so that when we ask "How are we going to be on track for the first quarter?" we get very low money rate objectives, and everyone notices that. [Growth] is only 1/2 or 2 percent, depending on which alternative one takes; the fact is that it is very hard to explain. We are still below target and now we are talking about getting down to the new target in this very meeting, in the second part of this meeting that we are going to have. It seems to me that's a very [unintelligible] representation of the problem we have.

MR. ROOS. Chuck, doesn't the law say that we have to use the fourth quarter as a [base]?

MR. PARTEE. No, the law doesn't say that. It says the year.

CHAIRMAN VOLCKER. I would observe in this connection that I like to look at a somewhat longer perspective than these fourth-quarter [measures]. This doesn't deal with the short-run problem of what to do when we have a sudden increase such as we have now. We end up with a high December and all the rest. But on an annual basis the table on page 6 [of the Bluebook] in a sense is another way of looking at what Jerry Corrigan was looking at; it overlaps, anyway. If you look at these annual [growth rates] year over year, which are the number 2 figures here, [for M1-B] it's 8.2 percent in '78, down slightly in '79, down more in '80, and down more in '81. It's a fairly smooth pattern, though you can argue that it's too much, too little, or whatever. But it doesn't give that extreme movement we get with the fourth quarter figures because that reflects the obvious; in fact we started high this year and ended up low [given] the declining trend during the year. Last year we did the opposite. When you average through the 12 months you get a reasonably smooth pattern.

MR. PARTEE. Well, if we wanted to take that 4-1/2 percent [year-over-year growth] for '81 and have, say, 4 percent for '82 for the annual average, I think we'd find that the quarterly growth rate would have to be quite a bit more than that.

CHAIRMAN VOLCKER. Steve has done that calculation. If I understand it correctly, if we stayed exactly on the target quarter by quarter at the 4 percent midpoint of this tentative range, the annual average also comes out to 4 percent.

MR. AXILROD. Yes, it's tricky because that's the actual M1 not shift-adjusted over last year's regular M1, so it works out fortuitously that way.

CHAIRMAN VOLCKER. But what's the meaning of that? It comes out considerably higher if you measure the actual M1 in '82 over the shift-adjusted in '81.

MR. AXILROD. No, in '81 the year over year not shift-adjusted so-called M1 grew [6.9] percent, so we would get that going down to 4.0 percent. And the shift-adjusted M1 grew 4-1/2 percent, and we get that going down to 4.0 percent. So we really are getting a year-over-year drop.

MR. PARTEE. I see.

CHAIRMAN VOLCKER. I'm not sure I fully understand how we come out on the number 2 basis but any way we do it I take it that if we stayed on path, we'd come out with another drop year over year on this tentative target.

MR. AXILROD. If it was exactly a 4 percent increase month by month after the first quarter, with a little slower growth in the first quarter, it would come out at 4 percent on this measure.

MR. GRAMLEY. I wonder if anybody has noticed how beautifully we have come out by way of the performance of nominal GNP in terms of deceleration. Page I-V in the Greenbook shows the fourth-quarter changes. Starting from 1979 it shows 9.9 to 9.4 to 9.1 to 8.6 percent. Now, that is about as good a target for nominal GNP as one can possibly imagine--fortuitous, but very well balanced.

CHAIRMAN VOLCKER. Where am I here? Has everybody said all they want to say on this particular subject? I am not sure I heard an enormous range of opinion on the targets themselves. There is some disagreement about what to do with M2. I have a great deal of sympathy with the subject that Frank particularly emphasized and others have too. I must say I have a great deal of sympathy with the frustrations in defining the numbers and knowing what they mean. I don't extend my sympathy to a great antipathy about or not worrying about interest rates. I think that is the obvious modification that one might introduce into our procedures in the absence of some magical other statistic. I think we have had a problem with interest rates. If anything, we probably should have paid more attention to them rather than less, I'd say. That's a personal reaction anyway. It certainly is not driving me back to being more precise about numbers that I don't understand.

Let me give you the nature of the problem that I see in M1. I think some day, conceptually, if we didn't have any statistical problems, this demand shift that we keep talking about might go in reverse. If people had more confidence in the currency and lower interest rates and we got interest rates paid on transactions accounts that would be by regulation or in practice much closer to market rates, we might find some day that we had to have a decidedly faster growth of M1 relative to nominal increases in GNP or other magnitudes. I don't think we are there yet. But some day that is going to happen. Apart from that, what do we say about M1 next year? I could see it repeating [this year's experience] as some people have said, but it could go either way so far as I know, for purely institutional reasons. If interest rates continue to decline, if the economy were somewhat on the soft, depressed side, if the ceiling rates go up on transaction-type accounts, we might get a big expansion in M1 relative to what we otherwise would contemplate or relative to past patterns because of money flows, particularly into NOW accounts, that otherwise might have been lodged elsewhere. [That assumes] we don't get the aggressive competition from money market funds, we have a [markedly upward sloping] yield curve, and short-term rates are getting down toward what institutions can pay. On the other hand, if interest rates remain relatively high, which might occur with a fairly strong economy relative to projections, we could get a great spread of sweeps into money market fund accounts, with practically every bank in the country offering that service. M1 could get very depressed relative to other economic magnitudes. I don't know which way it will go.

We all want to be very precise about the money supply target and that's fine. The effectiveness of that target may be more altered by a decision that we have to make as to whether we are going to permit sweeping of accounts or not than by the decision we make as to where to put the precise target. We have to face that decision, which will be a very difficult one. But I think we probably will have quite a different situation if there is no sweeping than if this [practice] catches on like wildfire. There was something in the paper this morning about the Fidelity fund being all set up to do this with a large group of Midwestern banks. I don't know what the implications of that will be but I suspect things will be different whether it's permitted to take place or not to take place. I have a rather strong bias under these circumstances not to be more precise than we really can be in setting the targets and not to put all the weight on one monetary aggregate either because I find it very useful to look at more than one, whatever we say about the targets, in trying to understand what is going on in these very complex and difficult circumstances in which we live.

On the substantive side, where I think greater problems lie, we may have an insoluble problem. It is not impossible and may even be likely, apart from the short-run question, that we will have the immediate problem of a recession and not want to aggravate that and want to facilitate recovery and all the rest. In that process, I don't think we can forget about what happens when the economy turns around and begins to rise again. If it does, we will just run into another blank wall on sharply rising interest rates--with precipitous increases in money market rates and long-term rates, not just reflecting what is going on but in anticipation of budgetary deficits and economic recovery and restrictive monetary policy--and I'm not sure we will have served the country well. We have to think a bit about strategies to minimize that possibility; we can't eliminate it. The reason the problem may be insoluble is that the only way we are really going to deal with this, I suspect, apart from the budgetary consideration, is to convince people that we have a hold on inflation and have created a climate in which interest rates, particularly long-term rates, will tend to go down. But how do we create that climate and that expectation without in some sense risking being overly tight in the short run? And because people are so skeptical about whether that is going to happen, the long-term rates won't come down fast enough to facilitate the recovery we want. To what degree can we overcome that by being "easier" in terms of the money supply? Maybe that will scare people even more and work against the objective of creating a climate in which interest rates aren't going to bounce up again as soon as the economy turns around. I am not entirely discouraged about this because I think, particularly starting where we are with interest rates so high, there is a possibility that confidence will return more rapidly than we could imagine now. So we could get a situation where the economy could turn around consistent with declines in interest rates, if we can get the economy turned around at all. But I think that is the chance we have to play for.

Well, I don't know that we are going to be all that far apart in the mechanics. On this question that Governor Partee raised, we could broaden that a little as to whether there is any better way of presenting our targets. How we deal with base drift is one aspect of that. I don't have any brilliant suggestions but it may be worth a little further thought. We have to deal with this immediate problem in setting the short-run target. I don't know that we can go any further on the discussion of the long run. This has been useful in some ways. We will obviously return to it and will have to resolve it in early February. Why don't you present the short-term issues, Steve, and then we'll have a coffee break.

MR. AXILROD. If I might take a minute before I do that, I did look up the answer to the question that President Morris raised of whether we have ever had rapid growth in M1, such as the 4-1/2 percent rate of growth we are having in the fourth quarter, with a marked deceleration of the economy, where it is going down as it is this quarter at a 5-1/2 percent rate. There are a surprising number of quarters of negative growth in the economy and positive growth in money--I am talking about on a quarterly average basis. There were even quarters where we had a deceleration and then an acceleration of money, surprisingly enough. For example, in the second quarter of 1979 real GNP was [minus] 1-3/4 percent after being plus [3.9] percent in the first quarter, and money growth went from 5-1/2 in the first quarter to 10 percent in the second quarter. Similarly, in the the first quarter of '74 real GNP had dropped at around a 4 percent annual rate after rising at a 3-1/4 percent rate in the fourth quarter of '73, and money growth accelerated from 4.8 to 6.7 percent. So it is not an extremely infrequent occurrence that something like that happens and, of course, we are aiming at it this time.

MR. WALLICH. Money is supposed to lead the economy with a long and variable lag.

MR. AXILROD. This is only quarter to quarter. I didn't trace out the averages. I was just responding to the question.

MR. MORRIS. The examples you gave were all relatively recent.

MR. AXILROD. But it's even the case going back.

MR. ROOS. I wonder, Steve, if you compared the quarterly rate of money growth to the trend rate, if there is any instance where we had two quarters of M1-B growth falling below the trend rate where we haven't had a significant downturn in economic activity.

MR. AXILROD. Well, that is a different question. I was just responding to the question that President Morris raised of whether within a quarter we had had this kind of movement. Our observation is that it's not as rare as one might have thought it would be.

Mr. Chairman, we designed the short-run alternatives on the basis of the tentative range of 2-1/2 to 5-1/2 percent that the Committee had set for M1-B and on the basis of the Committee's previous practice of, in effect, shifting the base to the actual level of money. Alternative A was designed to hit the upper end of that 2-1/2 to 5-1/2 percent range, alternative C to hit the lower end, and alternative B to be in between by March. It is a fairly mechanical setting of the ranges. Thus, from the fourth-quarter average that we suggested as a base, the growth rate for alternative A is 5-1/2 percent, the upper end of the range. That [took account of] how the Committee has set short-run ranges before. Our thought was that December as a base is somewhat unstable because we don't know the number yet. If it did come out as we are projecting, the implied growth rates are so low that they raise the possibility of being subject to some misinterpretation when put out in the directive. An alternative way of doing it would be to make the base November, which the Committee has done before, and the growth rates for alternatives A, B, and C would be about 0.3 lower. That is, the 5-1/2 percent with November as a base would be 5.2 percent to hit the upper end of the range; and that 0.3 would extend across all of the other alternatives. That, as I say, the Committee has done one time before.

MR. CORRIGAN. That would be November-to-March then, Steve?

MR. AXILROD. Yes. With regard to the implications of these alternatives for credit markets (and assuming less of a demand shift, so to speak, than took place in 1981) our analysis suggested that the odds were--unless the economy was considerably weaker than is being projected--that there would be not much room for further interest rate declines under either alternatives B or C, which call for really quite modest growth in money consistent with the Committee's long-run range. Under alternative A it looked to us as if there was more of a possibility for declines in interest rates given the GNP projection. So, in a sense, one way of putting it is that the Committee's choice would be to set a target depending on how it tends to lean in its attitude toward credit markets at this time, before the recovery has started. To the degree that the Committee wishes to give a little impetus to easing in credit markets in order to encourage the recovery, that tends to argue, of course, for the more liberal [fourth quarter to March] alternative within the Committee's range. To the degree that the Committee would want to leave more room for expansion later and believes the recovery has enough momentum and can turn around on its own, that tends to argue for an alternative of lower growth, leaving a little more room later to finance the expansion as it develops.

I should mention one other point, Mr. Chairman, with regard to the borrowing assumption. We have assumed borrowing in alternative B of around $450 million, which is a little higher than we have actually attained in recent weeks. Again, to the degree that the Committee wants to lean toward a little easing in credit markets in setting its monetary target, consideration could be given to lowering that more toward the levels of borrowing that are suggested for alternative A, which would be around $250 million. That leaves a range, obviously, in between.

CHAIRMAN VOLCKER. Let me make a couple of quick comments just in terms of presentation. I am not crazy about that first alternative in the Bluebook, [shifting the base] from a quarterly average to a monthly number. That looks a little awkward to me and I recoil a bit. I don't like the December-to-March approach particularly because we don't yet know December. It seems to me we have done that before and then gotten mixed up by the fact that December, or whatever the last month in the quarter was, didn't come in the way we expected. This leaves me thinking that maybe the November-to-March method of looking at it is the most fruitful. This is just arithmetic in presentation.

On the substance, I find myself thinking these numbers mean something quite different if in fact we continue to get sizable growth because NOW accounts are bulging--and we don't quite know why but it may be [related to] this interpretation of a temporary parking place--than if NOW accounts are not bulging the way they have been in the last few weeks. I guess that's all I have in the way of preliminary comments. Why don't we have coffee.

[Coffee break]

CHAIRMAN VOLCKER. Let me make one other comment just to set the stage for what we're talking about and to give us a due sense of humility. If I recall the discussion correctly at the last meeting, I don't think anybody around the table--I certainly speak for myself--had any conviction that, almost regardless of what we did, we were going to have high money supply figures in the period from the last meeting to this meeting. Everybody was worried that whatever number we put down we might fall way short even if interest rates declined. Instead, we had interest rates tending to be under a little more pressure in the money market and the money supply figures moving significantly in excess of the target we put down. I don't think that is a tragedy. I am just saying that is an indication of the [limited] degree of precision that we have in setting the target for a one-month period; whatever effects there will be on the money supply in the next month are probably already [determined] in the market, rather than by what we do today. But we are setting a money supply target here for a quarter. Let's proceed with the discussion. Is there a general agreement that we ought to use November as a presentational base?

SEVERAL. Yes.

CHAIRMAN VOLCKER. It may just make it a bit less confusing if we--

MR. MORRIS. Paul, how would that influence the money growth numbers?

CHAIRMAN VOLCKER. Well, it's just what Steve said. If you're looking at the fourth quarter-to-March numbers, take off 0.3 to get the equivalent number on M1. I don't know what it does--

VICE CHAIRMAN SOLOMON. On M2 the numbers are 9.8, 8.9, and 8.1 percent.

CHAIRMAN VOLCKER. Those are the equivalent numbers?

VICE CHAIRMAN SOLOMON. Those are the equivalent numbers according to our calculations.

CHAIRMAN VOLCKER. Let me just write those down.

MR. BALLES. Say them again.

VICE CHAIRMAN SOLOMON. Taking the November base to March, for alternative A M2 is 9.8 percent, alternative B is 8.9 percent, and alternative C is 8.1 percent.

MR. BALLES. How about M1?

VICE CHAIRMAN SOLOMON. M1, as Steve said, is 5.2, 3.7, and 2.2 percent.

MR. BALLES. Right.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. What I would recommend, Mr. Chairman, is taking the November base and liberalizing alternative B somewhat by rounding up the 3.7 to 4 percent. I'd start with around $350 million of initial borrowing and lower the fed funds rate range by 1 point, which would bring it down to 10 to 14 percent or we could use 10 to 15 percent if we want to go back to the 5-point spread.

MR. PARTEE. Tony, the 4 percent is the quarterly average? Is that what you're explaining?

CHAIRMAN VOLCKER. No, it's November to March.

VICE CHAIRMAN SOLOMON. Which is a liberalization of "B."

MR. FORD. You're saying make the fed funds range 10 to 15 percent, Tony?

VICE CHAIRMAN SOLOMON. Yes.

CHAIRMAN VOLCKER. Or 10 to 14 percent.

VICE CHAIRMAN SOLOMON. Either 10 to 14 or 10 to 15 percent, I don't care. There's some advantage in changing that range from time to time whether it's 4 points or 5 points. I don't feel strongly about that. But I do think the lower end of it ought to be lowered by 1 point and that the initial borrowing ought to be around $350 million.

MR. MORRIS. Sounds like a Solomonic judgment!

MR. SCHULTZ. I'll vote for that.

MR. PARTEE. What was your M2 number?

VICE CHAIRMAN SOLOMON. Well, the M2 number then becomes around 9 percent. It's 8.9 percent technically, but if we round up the 3.7 on M1-B to 4 percent then it would be shading M2 to a little more than 9 percent.

CHAIRMAN VOLCKER. Mr. Gramley.

MR. GRAMLEY. I'd like to say first that I don't think anything we do here today is going to help this recession come to an end soon. It's going to run its course for a while. I do believe that if we are not careful in the selection of where we go, we could draw out the recession and make it longer. Therefore, I want to avoid any alternative that would result in rising interest rates at this stage. I think that would be a grave mistake. What we ought to be aiming for is to set the stage for a recovery later this spring but one of moderate dimensions. We ought to be very careful to avoid the kind of problems we got into in 1980. I'm cognizant of the enormous uncertainties we face in interpreting the monetary aggregates, not only in the long run because of these tremendous innovational changes but also the point you made earlier, Mr. Chairman, that we have something going on here in the OCD area that we ought to be awfully careful with. I would opt for alternative B. I could live with a somewhat lower borrowing level, but $450 million or $400 to $450 million is acceptable. I would say, however, that in addition to adopting the specs of "B" for growth rates of M1 and M2 we ought to be willing to live with a larger increase in M1-B if it results from the kind of increase in OCDs we've been seeing recently, which we have a reasonable basis for interpreting. This parking of funds while there is uncertainty is clear.

CHAIRMAN VOLCKER. Just as a matter of clarification, when you say "B," are you willing to accept something like Mr. Solomon's [numbers]?

MR. GRAMLEY. Yes, that's all right; I would go with that.

MR. WALLICH. You know that when we set something and accept a higher amount that it has the effect, really, of pegging the funds rate. Is that what you want?

MR. GRAMLEY. I tried not to use--

MR. PARTEE. He doesn't want interest rates to go up.

VICE CHAIRMAN SOLOMON. Well, I think there's a difference of view among the technical people as to whether initial borrowing of $350 million means a lower rate or the same rate as we've been seeing lately. Borrowings have been running on average less than the $450 million. We might ask both Steve and Peter to comment on what they think the implications are.

MR. AXILROD. We've assumed in the Bluebook that if the path were $450 million and it was successfully hit, probably there would be some little upward tick in the funds rate, but maybe not a lot. I would assume that $350 million at a minimum would probably avoid that; whether that would cause the funds rate to drop initially, I feel more agnostic about.

MR. STERNLIGHT. I wouldn't disagree with that. I would tend to think of something like $250 million of borrowing as perhaps likely to keep the funds rate just around the discount rate, $350 million maybe 1/4 percentage point over it, and $450 million a little more--maybe 1/2 point--over it.

MS. TEETERS. To what extent does the discount rate act as a floor?

MR. STERNLIGHT. The discount rate becomes a kind of anchor around which the funds rate clusters once there's enough borrowing to make that discount rate meaningful. If there's so little borrowing that a great majority of banks hardly ever [come to] the discount window, then the discount rate isn't too meaningful and we fall into this zone of indeterminacy. I don't know whether it's $200 or $250 million or what, but once there's something like that level of borrowing then there will be enough borrowing so that the discount window is a meaningful alternative that a number of banks want to avoid; they will be willing to pay the rate in the funds market rather than come to the window. And the more of that borrowing gap there is, the more demand for funds there will be by banks that want to stay away from the window; so, they'd be willing to pay up a little higher in order to stay away [from the window].

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I find very little to disagree with in either Lyle's or Tony's statement, and since it sounds a little poetic I'll say that I'll just go with the wisdom of Solomon.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. I want everybody to know that I am the one who first said that I don't think anybody here is wise enough to determine interest rates except Solomon! I, too, tend to agree with him. This is getting to be easy except that I'd like to reinforce one point he made and that relates to the fed funds rate range. If I read the Greenbook forecast correctly, the staff is saying that in the first quarter of next year we're going to have a negative GNP of 2.2 percent, a GNP deflator of under 7 percent, and unemployment approaching 9 percent. And with a GNP deflator that low, other price indexes are probably going to be down. We're talking about real interest rates on average in those three alternatives of 5 percent on "A," 6 percent on "B," and 7 percent on "C." I think we should at least allow the possibility of seeing [real] interest rates get into the single digit range at the nadir of this deep recession. So, I'd argue for "B" with a wider fed funds range, maybe going from [a lower limit of] 9 percent and centering on the present rate, which I understand is just over 12 percent.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. I am comfortable with Mr. Solomon's variation of "B," although I'd like to think of the initial borrowing as more like $400 million or maybe a bit higher rather than the $350 million that Tony suggested just because I'd still like to leave a little room down the road. But, basically, I'd go along with something like Mr. Solomon's suggestion.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I have no difficulty with the funds range that you specified Tony, of 10 to 14 percent. We're right about at the midpoint of it now and that assumes that it might drift a little lower but not very much, at least initially. I don't know but I think either $350 or $400 million on borrowing would be all right. I'd certainly accept the $350 million. I do think that your objectives for M1 and M2 are pretty stingy. Page 2 of the Bluebook shows a September-to-Decebér increase in M1-B shift-adjusted of 6.3 percent. Now, that has benefitted some from the shift adjustment; that is, I don't have an M1 figure here. But if it weren't shift-adjusted, it would be somewhat higher than that--7-1/2 percent or something like that.

CHAIRMAN VOLCKER. What are you looking at?

MR. PARTEE. I am looking at page 2; I can't work with these alternatives which don't have the correct figures on that. So I am trying to look at what experience has been recently as against what we're plotting for the period ahead. It shows an increase from September to December--but if anything December is raising it just a little--and that goes into our numbers that we're calculating looking ahead as maybe something like 7-1/2 percent in M1 as newly defined and 12-1/2 percent in M2. You are cutting those to 4 and 9 percent. That's a pretty sharp cut in the growth rate compared with what we have been experiencing recently. And I think that's too abrupt. I would prefer an M1 of 5 percent and an M2 of 10 percent as a center point for November to March. I don't think anybody would be surprised at that or regard it as being unduly expansive; in fact they might regard it as being pretty restrictive compared with recent experience and [given] the shortfall we've had.

MR. BOEHNE. What was your M1, Chuck?

MR. PARTEE. Five. I am just picking it almost out of the air but a 5 percent M1 seems to me like a normative M1; and if we took 5 percent and 10 percent for the two numbers, that's really quite a bit less [growth] than we've had recently in both M1 and M2.

MS. TEETERS. Well, if we have a big December; this is a November-to-March number.

MR. PARTEE. That will mean even less in the course [of the 4-month period]; and we'll review it again in early February. The other thing I'd just comment on is that I don't know what to make of those NOW accounts. I'm inclined to think it is an error in the seasonal adjustment but I am not sure. It could be that there is a big build-up in precautionary balances in NOW accounts, as the staff says, and that might well continue right on through the winter if that is the case.

VICE CHAIRMAN SOLOMON. Well, it might be temporary parking for Christmas.

MR. PARTEE. Well, that's right. And that is why I think [the explanation] may be the seasonal. The seasonal doesn't have the advantage of knowing what those household accounts have done in past years.

MR. SCHULTZ. Or a temporary parking for IRA-Keoghs.

MR. PARTEE. Or just temporary parking because people are scared they may lose their jobs.

MR. BLACK. That is right.

MR. PARTEE. You know, it makes a difference. I think Lyle is right that we want to watch that carefully to see whether [NOW accounts] continue to be the source of strength in M1 and regard that a little differently than if it is in corporate balances or in traditional demand accounts where one might think that a build-up would be a predecessor, as Larry likes to say, to an expansion in activity, which also could be the case. We might be right on the edge of a recovery in the economy and not know it. But it is just not clear to me which is the case. Nevertheless, my basic point is that 4 and 9 percent are so far below what we recently have had that they are too low to shoot for, and I would rather have 5 and 10 percent but with your parameters on the funds rate and initial borrowings, Tony.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. I'd prefer something between "A" and "B," and I can't get excited whether it's Tony's or Chuck's [formulation]. I do have stronger feelings about the funds range; I think it ought to be 10 to 14 percent. I would look with considerable disfavor if the funds rate rose; I could accept some decline. And somewhere between the $350 and $400 million range on borrowings makes sense.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. Generally I come out in favor of "B+," about halfway between those two revised numbers, starting with November [as the base]. I share the concern that Lyle and some others have expressed that this recession might be worse than the staff is now forecasting. If there is an error, it is likely to be on the side of the recession being deeper through the first quarter than both our staff and the Board's staff have suggested. And for that reason I would agree with Bill Ford on the federal funds rate range. I'd prefer to see the bottom of it as low as 9 percent, and I would not like to see us strongly resist the decline in interest rates that would accompany a really soft economy. So I'd accept either 9 to 14 or 9 to 15 percent on the funds rate range. And as far as the borrowing assumption is concerned, $350 to $400 million would be okay with me.

CHAIRMAN VOLCKER. Mr. Wallich.

MR. WALLICH. Well, I find myself leaning toward the easy side this time because what we have done is to avoid following the aggregates as far as we might; had we done so, interest rates would be a lot lower. Not having done that, I think we ought to give the economy a chance to recover at this interest rate level and try to string that [level] out as long as it will last, giving [firms] a chance to issue more bonds and so on. I would not welcome a further drop unless the economy weakens substantially because that would simply be what I think has been the error that we have avoided in the first place. But we have to compensate somewhat for not having let rates drop that far by now smoothing them out for the future. So, I would go with the higher aggregate [growth rates] proposed--that is M1 at 5 percent and M2 at 10 percent, a low borrowing assumption of $250 or $300 million, and a funds rate range of 10 to 14 percent. I wouldn't see any advantage in letting fed funds get into the single-digit range; I'd try to hold it here for a while if circumstances permit. There is a cost to this; later in the year we may have to accept higher interest rates to stick by our overall targets. That cost I think we have to be prepared to pay.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. I'd be comfortable with Mr. Solomon's proposal for both M1 and M2, given the current state of the economy, with the thought that a little reduction in the fed funds rate might provide some encouragement. I'd be in favor of a $350 to $400 million borrowing range and a federal funds target range of 10 to 14 percent.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. I'd be comfortable with Mr. Solomon's proposal with one exception. It is maybe a fence-riding caveat. I am concerned about interest rates rising and, to ensure against that, I would like to suggest that we adopt the modified "B" as Tony has suggested, with $400 million borrowing but by the same token have an understanding that if money in January begins to come in a bit stronger than projected, there wouldn't be any overt action taken that would result in higher interest rates until we got to [M1 growth] at about the "A" level. In other words, we'd have a range, if you will, of 4 to 5 percent M1 growth under that kind of proposal before the Desk would alter the path that was set based upon a November base. Also I'd favor a federal funds range of 10 to 14 percent, which provides a bit of insurance that we would have a consultation if the funds rate begins to rise early in the period.

CHAIRMAN VOLCKER. Governor Teeters.

MS. TEETERS. Well, I can endorse Tony's suggestion, which was modified by Roger, Chuck, and others. If you look at it visually, we need something more than 4 percent [M1 growth] to come in on target. So, if we take Roger's suggestion of 4 percent for M1 and use 9 percent for M2, a funds range of 10 to 14 percent, and borrowing of $350 million with the understanding that if M1 growth begins to go up we won't try to restrain it if it means a rise in interest rates, that would be a perfectly acceptable decision for me.

CHAIRMAN VOLCKER. I am not quite sure about one comment you made. What you are suggesting is low relative to the targets, as I understand this, because if you are talking about next year's target, it is right on it.

MS. TEETERS. No, I am talking about Chuck's point that by going from November to March we have a December which is probably going to be above November and we have a high first month in there so we may need a little leeway to accommodate for the fact that December is coming in above the November level.

MR. PARTEE. If you look specifically at the staff's numbers on page 12 for M1 under alternative B, which is about what Tony had in mind, that calls for a December of 8 percent and then a January and February of 2.2 percent in each month.

CHAIRMAN VOLCKER. Yes. Well, that's reflected in the second part of page 11.

VICE CHAIRMAN SOLOMON. I should say that New York, for what it's worth, has a lower projection for December.

MR. PARTEE. Well, it is very hard to know what December will be. There is some exposure here to having to seek quite low numbers.

MS. TEETERS. If we need a little leeway, we could have a conference.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. As a means of achieving growth in M1 next year of 5 percent, for the reasons I attempted to enunciate yesterday, I would favor the alternative A choice. I wouldn't jump off the bridge if you adopted Tony Solomon's "B+;" I would be happier on Christmas Eve if we did widen that funds range a little, maybe to 9 to 14 percent or something like that. A $350 to $400 million borrowing assumption would be consistent with this, I think.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. Mr. Chairman, I would want to rush to support Governor Wallich's proposal while I can, for the reasons given by Governor Partee.

MR. PARTEE. It seldom happens!

CHAIRMAN VOLCKER. It depends.

MR. PARTEE. I want to be associated with those remarks and I'd like to join Governor Wallich, too.

MR. RICE. I would say 5 percent for M1 and 10 percent for M2, borrowing of, say, $350 million, and on the funds range 10 to 14 percent.

MR. FORD. I didn't hear that. Could somebody repeat it?

MR. RICE. I said borrowing at $350 million and a funds range of 10 to 14. Did you hear what I said about M1 and M2?

MR. FORD. Yes.

CHAIRMAN VOLCKER. We have no more volunteers. Mr. Winn.

MR. WINN. I would take to heart your caution that we better look down the road in terms of the short-term target as well as just the immediate problem. And I would go along with the 4 and 9 percent on the aggregates because they're in line with our longer-range targets. [For the funds range] 10 to 14 percent is fine. On the other hand, if the aggregates should come in stronger, a little increase in the rates, not a major one, would not bother me as a warning in terms of what lies ahead. So, I would not be upset, if the aggregates were strong, to see a little firming in rates as a warning to what the fall may hold for us.

CHAIRMAN VOLCKER. We have a few precincts that haven't been heard from.

MR. SCHULTZ. Well, I'll do it quickly. The $350 million and the 10 to 14 percent I think are fine. I prefer 4 and 9 percent [for the aggregates] because I don't believe we're going to have a great deal of problem with that. My feeling is that there's a risk in the economy that tends to be on the down side and I just don't understand the OCDs. I don't know, but my gut feeling is that [the recession] is not going to continue forever, so I don't feel that we are going to have much of a problem. On the other hand, if we do have some problem, I wouldn't mind seeing us have a little leeway on the up side there. I am perfectly willing to tolerate a little stronger growth depending upon what happens in the economy and what happens to interest rates.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. I'm trying to remember the numbers Tony gave originally. I don't think I got them down right.

VICE CHAIRMAN SOLOMON. You want all the decimals?

MR. BOYKIN. No.

CHAIRMAN VOLCKER. [For M1 and M2] 4 and 9 percent and 10 to 14 [for the funds range].

MR. BOYKIN. Okay. That's what I wanted to be sure of. Yes, I would find that acceptable.

CHAIRMAN VOLCKER. This is for November to March, right?

MR. BOYKIN. Yes, I would find that acceptable.

CHAIRMAN VOLCKER. Mr. Morris and Mr. Black haven't been heard from. No, I have Mr. Morris and Mr. Black down.

MR. BLACK. I've said something but apparently it didn't--

CHAIRMAN VOLCKER. I'm ahead of the Secretary. I guess everybody has been heard from. We obviously don't have any very big differences here. Where has borrowing been in the last three weeks?

MR. AXILROD. I'll give you the precise numbers in just a second. It has been running about $340 million this week so far and that would be about the average. For the week of the 16th it was $268 million; for the 9th, $493 million; for the 2nd, $192 million; and before that, $214 million. [For that period] we were expecting borrowing of $400 million or higher.

MR. GRAMLEY. Wasn't this partly a consequence of very little demand for excess reserves?

MR. AXILROD. Well, initially. But excess reserves were revised upward successively as the weeks passed. They ran a little low in two out of the first three weeks and were very high in one of them, so they averaged [close to expectations] in the first three weeks and then were very low last week. Last week [excess] was negative; I don't how it's coming out this week. It didn't turn out to be nearly as low as it looked at the beginning because we got "as-of" adjustments subsequently.

CHAIRMAN VOLCKER. I only have some very limited substantive comments to add to what has been said. A premise of a lot of the comments was that nobody's dying to see interest rates rise at this point. And there's a certain sense that people would feel a little more comfortable with a decline, I suppose, if I can summarize the atmosphere. In that connection a number of people commented that they are not going to be upset by a slightly higher growth rate in the aggregates. Nobody mentioned the opposite, which I would now mention. If interest rates really softened, I wouldn't be all that disturbed about some shortfall from any of these numbers we are talking about if, and I emphasize this, interest rates were declining in any very pronounced way during this particular period.

MS. TEETERS. What if the decline in the real economy in the first quarter continues at the rate in the fourth quarter? [Interest rates] undoubtedly would be softer.

CHAIRMAN VOLCKER. Well, it didn't happen in the last part of November and December. I just don't know. It depends upon that funny demand for money that we can't fully explain in the very short run. I would agree with you that it is not likely [to continue] over a longer period of time, but I don't know what is going to happen in the very short run.

I wonder whether [my summary] is consistent in substance with what everybody in varying degrees seems to be saying. Well, let me approach the funds rate first, where there isn't much disagreement. I would think 10 to 14 percent makes a lot of sense just in terms of the form. We're about in the middle of that now range and it allows [a decline of] 2 percentage point or slightly more in the federal funds rate. I don't say that with any feeling that 10 percent ought to be an absolute floor in any sense; it hasn't been in the past and this seems a logical range to put down. Almost everybody has said that with some exceptions. I guess everybody on the Committee has said that. I have no problem with that. I wonder a little whether the borrowing level that people were talking about isn't a little high in terms of the balance of risks and possibilities here. I'd be a little more comfortable with, let's say, a $300 million number than the $350 or $350 to $400 million that people mentioned, considering where we are now and considering this average pattern in the past, in order to provide a little more assurance that rates are not going to rise even if these numbers come in more or less as projected. So, I would raise that question.

We have a clear majority for around 4 and 9 percent [for M1 and M2] on a November-to-March basis. In any event, I think that would be interpreted, if that's where we alight, as our not being unduly concerned by a somewhat higher number than that. If we put down a higher number, I'd feel more strongly that if it came in lower and interest rates were declining appreciably, we shouldn't push any harder than necessary just to hit the 5 and 10 percent numbers. But the 4 and 9 percent numbers suit me all right with the understanding that we're not going to be very upset by some overrun and starting with a slightly lower borrowing number than the weight of opinion has suggested here. I'm just a little worried about that borrowing number being a bit too high. And I think we do [need to] interpret these numbers--I don't know how to put that in the directive--somehow in the light of what is going on in NOW accounts, if we can make any sense of it, as opposed to a general increase.

MR. PARTEE. We have been carrying 7 percent for months as our objective on M1-B.

MS. TEETERS. You feel so sure on this.

MR. PARTEE. Yes, there's some room to bring it down.

MR. SCHULTZ. That [depends on] the initial borrowing number. What happens initially with that borrowing?

MR. AXILROD. Well, I don't think much.

CHAIRMAN VOLCKER. I don't think anything much would happen.

MR. AXILROD. I think the funds rate would stay somewhat above the discount rate at that level of borrowing. When borrowing in the first two weeks of this intermeeting period was around $200 million, the funds rate was a little below the then discount rate. And in the next week borrowing was $493 million, followed by $268 million and thus far this week $330 million or so, and the funds rate has been about 1/2 point above the discount rate. So, it's probably a little above--

CHAIRMAN VOLCKER. This is obviously a fine judgment, but I'd worry a little about forcing the funds rate on the high side of where it has been or maybe even a little higher than where it has been, as opposed to making sure it doesn't rise in the very short run. I'm not even sure $300 million makes that [certain], but it's just a question of where we want to take the risks. My feel for the situation is that it is more consistent with the comments I hear around the table about not wanting an increase in the funds rate right out of the box or not even wanting it if money growth gets a little higher.

MR. CORRIGAN. So 4 and 9 percent would be the numbers in the directive?

CHAIRMAN VOLCKER. Well, in that interpretation, I think we'd say something in the directive--I haven't got any wording--

MR. BOEHNE. Or somewhat higher?

CHAIRMAN VOLCKER. I don't think I want to bias it to that extent but [I'd include] some language that this takes careful interpretation of the NOW account situation. Maybe that's hard to do; I haven't worked out any language. But whatever the directive says, that is what we mean.

MS. TEETERS. We could do it by saying "around" 4 and 9 percent and let that--

CHAIRMAN VOLCKER. Yes, having "around" is fine with me and taking account of or analyzing the figures in light of the fact that these are not shift-adjusted and have a big NOW account component. That's not good language, but that's--

MR. BLACK. And praying a lot!

CHAIRMAN VOLCKER. On the other hand, if we went with a slightly higher number, I'd also put in the directive that this is taking account of the fact--and we can do it this way too--that we are not using a shift-adjusted number and that the discrepancy has been quite large recently and we assume it's going to continue to be sizable. So, theoretically, we can do it either way. It will be hard to get that language in there but [we need] some allusion to the problem that we're moving from a shift-adjusted number. We have had a long [explanation in] parentheses in the directive that we were talking about a shift-adjusted number; now I think we need a long [one in] parentheses that we're not.

MR. CORRIGAN. Is that an illusion or elusion?

MR. PARTEE. It made a three point difference in November.

MR. SCHULTZ. From a perception point of view, I think we're a little better off with 4 and 9 percent and tolerating somewhat higher growth than with 5 and 10 percent, tolerating somewhat lower.

MR. PARTEE. From the perception of whom? From the financial markets or the people who are unemployed?

MR. SCHULTZ. Well, I don't want to get into that one! I have some rather strong feelings about the fact that the critical thing we have to do is to find a way to get long-term interest rates down. So when we target on that sort of thing, the perception of what we do has considerable importance since expectations are so much [a factor] in those long-term rates. But I don't want to get off on a diatribe on that issue.

CHAIRMAN VOLCKER. I'm a little bothered by the 5 and 10--more by the 10 than the 5--which is above our long-range target and, unlike M1, coming off a high number not a low number.

MR. BLACK. True.

MS. TEETERS. What do we have for the long-term range?

MR. PARTEE. But what is going to bring down M2 growth in the period?

CHAIRMAN VOLCKER. Well, I was just going to ask. What, if anything, is your estimate of M2 based upon here, Mr. Axilrod? What is the estimate for December?

MR. AXILROD. Well, for December, the M2 growth estimate is rather high, given [the data] we now have. In the last week growth of money market funds was a little slower. That's not much to base [your decision] upon. But [flows into money funds] have usually slowed down, with a lag, following a period of declining market rates.

CHAIRMAN VOLCKER. And there is a chance that money market funds will really slow down now, because the money market certificate rate is at--and in the next couple of weeks may even be above--the money market fund rate for the first in a long time.

MR. CORRIGAN. That's not going to help M2, though.

MR. PARTEE. Won't that shift into another component of M2?

CHAIRMAN VOLCKER. Well, maybe.

MR. AXILROD. We really have not allowed for the savings accounts to show the same kind of strength, so to speak, that they've shown. If they showed that kind of strength, it would spill over also into NOW accounts, I think. We haven't allowed for that continuing. Those are the two principal factors.

MR. PARTEE. You have a December estimate of 12.6 percent in the Bluebook?

MR. AXILROD. That's right, and a very marked slowing in January.

MR. PARTEE. You have it dropping to 7.3 percent in January. I don't quite see what is going to bring about that slowing from 12 to 7 percent, if we don't really care what the figures are.

MR. AXILROD. Well, those are the two factors, Governor Partee. The only thing I could offer is to look at October, which was 8 percent.

CHAIRMAN VOLCKER. I didn't realize the December estimate was quite that high.

MR. PARTEE. That's the trouble, you see; that really pinches it.

VICE CHAIRMAN SOLOMON. Assuming you go ahead with one or more of these three conceptual changes in the definition of M2, that would be effective at the beginning of January or what?

CHAIRMAN VOLCKER. Well, we can make the two we're talking about effective right away, I guess, because we have the numbers. I don't think we have the numbers for--

MR. AXILROD. Well, we were assuming that at the beginning of January we would switch over to M1 as is and do away with M1-A and M1-B. But we had hoped to make the other changes effective in February when we've [typically] done the seasonals and the benchmarking and do it all at once. Because there are other--

VICE CHAIRMAN SOLOMON. And making it retroactive?

CHAIRMAN VOLCKER. Can you even do the IRA/Keoghs in February?

MR. AXILROD. That I don't know. That depends.

CHAIRMAN VOLCKER. You raised another question, now that I think of it.

MR. AXILROD. No, I was thinking of the other ones.

CHAIRMAN VOLCKER. We have a period here, [November to March], which encompasses a period of time when we used M1 shift-adjusted, and there is quite a difference. What are we talking about here? A shift-adjusted figure for one month and a--

MR. AXILROD. Well, I was assuming you'd start in January with regular M1.

CHAIRMAN VOLCKER. Yes, but what is this number we put down--the 4 or 5 percent or whatever?

MR. AXILROD. M1.

MR. BLACK. It's M1.

CHAIRMAN VOLCKER. For December too?

MR. AXILROD. Well, you're comparing it with old M1-B, which is in effect M1. That's right. M1-B not shift-adjusted is M1.

MR. FORD. That's right.

CHAIRMAN VOLCKER. Well, the only difference is what might happen in December. How much difference is that?

MR. AXILROD. Well, there's roughly a 12--

VICE CHAIRMAN SOLOMON. We have to be consistent. If the base is going to be M1-B unadjusted, then December has to be treated that way.

MR. AXILROD. You take off from the regular M1-B series.

MR. SCHULTZ. Isn't it wonderful to be able to deal in such precision?

MR. BLACK. That's why we all--

MR. AXILROD. Well, that number we know. It's the shift-adjusted number that's a little doubtful.

MR. PARTEE. Yes, it's really M1 that's 8 percent.

MR. AXILROD. That's right.

MR. PARTEE. And then it has to drop to 2 percent.

MR. AXILROD. Well, it rose from 3 percent to 11 percent in one month.

MR. PARTEE. I know.

MR. GRAMLEY. As long as we have this around 4 percent, I'd--

MR. SCHULTZ. Yes, that may be the more critical point. "Around" means anything from 0 to 10.

CHAIRMAN VOLCKER. Well, let me take this in an orderly way. The funds rate range is 10 to 14 percent; it was at least among the members of the Committee. I'm not sure there was any disagreement with that. That is where we are on the funds rate, I think. The borrowing really is the only operating decision we're making today. I gave you a little case for $300 million. The great majority was for $350 to $400 million.

MS. TEETERS. I can buy $300 million.

MR. RICE. Me too.

VICE CHAIRMAN SOLOMON. If $300 million is going to produce what Steve thinks it will produce--namely, [a fed funds rate] a shade over the 12 percent discount rate--then I'd go with that. That's basically what I was targeting for when I said $350 million. So it doesn't bother me if--

MR. BOEHNE. That's the way I feel about it too.

MR. SCHULTZ. If it doesn't work out that way, we'll kill the messenger! I was going to say put it in--

MR. BOEHNE. If it doesn't work out that way, raise the borrowings.

CHAIRMAN VOLCKER. Well, I think that's the way it will work out. I wouldn't die if the federal funds rate was 11-7/8 percent or even 11-3/4 percent. We're at $300 million on the borrowing?

MR. WALLICH. Suits me.

CHAIRMAN VOLCKER. All right, Now we'll talk about the cosmetics.

MR. SCHULTZ. You're being a little too frank!

CHAIRMAN VOLCKER. The range here is not huge. We can cut through it all if you want and say 4-1/2 and 9-1/2 percent.

MR. SCHULTZ. Oh, I think that gives a feeling of greater precision [than is warranted]; really that's nitpicking it.

MR. WALLICH. Well, there were some who wanted to accept an overshoot.

CHAIRMAN VOLCKER. We've often used "1/2" and we're--

MR. SCHULTZ. I know, but--

VICE CHAIRMAN SOLOMON. Not that often, it seems to me, in the time I've been on [the Committee]. It certainly makes us look a little sillier when we miss by a big amount if we put our targets in terms of halves.

CHAIRMAN VOLCKER. I think we have a long record of putting them in terms of halves, in my memory, but I--

MR. CORRIGAN. And missing them by a large amount

MR. SCHULTZ. I'd rather go with either 4 or 5 with some appropriate language than with 4-1/2. I continue to prefer 4 and 9.

MR. PARTEE. How about both: "about 4 to 5 percent" and "about 9 to 10 percent"?

MR. AXILROD. I think the Committee once did have [something like] that in the directive, too, for some reason.

VICE CHAIRMAN SOLOMON. I don't see how we can target over 9 percent unless we more or less agree that we are going to raise [the long-run target for] M2.

MR. FORD. That is exactly what was going through my mind.

MR. PARTEE. Well, I am going to vote to raise [the target for] M2 at the next meeting. We are starting in 1982.

CHAIRMAN VOLCKER. Your mind is supposed to be open for a while. It is supposed to be open for [unintelligible] too.

MR. SCHULTZ. There are some who would feel strongly--

MR. CORRIGAN. I like "about 4 and 9."

MR. PARTEE. Get it down.

MR. SCHULTZ. Me too.

CHAIRMAN VOLCKER. It's all right with me. But in any case we have an understanding that if it goes a little higher than that, we will not be too bothered.

MR. WALLICH. I would prefer 5 and 10 percent with no such understanding, even though it may produce what I don't want--a rise in interest rates. I think it is just bad in principle that we have fallen into implicitly targeting the funds rate only.

MR. PARTEE. That's a very bad principle but I thought we had gotten away from that.

MR. WALLICH. We've done that repeatedly.

MR. SCHULTZ. We're going to have to get Henry a red suit and a beard here! I sense a conversion in process here.

VICE CHAIRMAN SOLOMON. 1982 brings a new Henry Wallich.

MR. WALLICH. I'm just being consistent. I didn't want to let [rates] drop too far; I don't want them to rise too fast.

VICE CHAIRMAN SOLOMON. I agree.

CHAIRMAN VOLCKER. I don't know how to interpret that comment but.... The only reason I hesitate a little on the 5 and 10 percent is that the 10 looks a little high to me, just visually. I think that is what we are talking about here.

MR. RICE. Well, Mr. Chairman, you said it was cosmetic, so 4 and 9 percent with the appropriate language would--

MR. GRAMLEY. An alternative is 5 and 9 percent with an understanding that we may get even more than that.

MR. PARTEE. I would be happier with 5 and 9.

MS. TEETERS. They're not consistent.

SPEAKER(?). We aren't compromising.

MR. GRAMLEY. I think Chuck's point is very well taken. We're looking at a growth rate of M1-B shift-adjusted in our thinking whereas we are now targeting on non shift-adjusted. The difference was 3 percentage points. That is quite--

CHAIRMAN VOLCKER. Right at the moment.

MR. GRAMLEY. It was 11.1 versus 8.8 percent in the month of November, and that is a huge difference.

CHAIRMAN VOLCKER. Yes, and [consider] the problem we've got if that reverses itself. We don't know what is going on here. Suppose that suddenly reverses itself in January.

We'll just try to arrive at the greatest consensus here. If I get preferences, I'll know the answer. Who prefers 4 and 9?

MS. TEETERS. Wait a minute. What are our chances of hitting 9 percent on M2 if we have 5 percent on M1?

MR. AXILROD. Well, I think these are very small differences, Governor Teeters, given our track record in predicting these relationships. I don't think it is a matter of strong significance for the Committee, actually.

CHAIRMAN VOLCKER. These differences are small. What we're assuming is that we're going to continue to have a pretty big discrepancy if we shift adjust it, which we're not going to do anymore. I think what we're saying with the 5 percent is that it [involves] an assumption in substance that there is a lot of NOW account [growth] in this.

MR. BOEHNE. One possible way to break this is to say: "seeks behavior of reserve aggregates consistent with growth of M1 and M2 in a range of about 4 to 5 percent and 9 to 10 percent." It gives both numbers and has a range and has "about."

MR. CORRIGAN. We still have to draw the path, which makes a difference.

MR. BOEHNE. Draw the path somewhere in between [that range for M1].

MR. PARTEE. Yes, put it at 4-1/2. That is a way of doing 4-1/2 percent.

MR. BOEHNE. Without being too precise.

CHAIRMAN VOLCKER. We can do that. The only drawback I see is that in some ways one could argue that it sounds more precise--that somehow we're willing to tolerate 4 to 5 percent but we'd get very upset if it's outside. But I don't know that that's such a big deal.

VICE CHAIRMAN SOLOMON. In New York the market participants seeing "around 4 to 5 percent" will tend to assume that the "around" refers to the area between 4 and 5 percent. And it gets us a little less precision if we just say "around 4" or "around 5."

CHAIRMAN VOLCKER. Well, I don't know; that really doesn't sound too bad to me. But I think a disadvantage of saying "around 4 to 5 percent" is--

MR. BLACK. Well, M1 for last year is estimated to come out at 4.7 percent, and some little downward movement looks a little better cosmetically. I think the 4 percent is a little better than 5 percent and I am forced to settle on it for that reason. But I wouldn't be disturbed if it hit 5 percent.

CHAIRMAN VOLCKER. Well, whatever we decide upon, we have to say here someplace in the directive or elsewhere that we have this problem with the fact that we think December is coming in high. So whatever number we have here is in a sense not as high for January, February, and March as it appears on the face of it because we think we're operating off a high December number. I think that ought to be clarified somehow in the record. Mr. Axilrod is trying to fiddle around with this language and it is so obscure that I don't understand what it means.

MR. SCHULTZ. That is the best kind!

VICE CHAIRMAN SOLOMON. Would you like to read it?

CHAIRMAN VOLCKER. "Taking account of the significance of shifts as they may develop between NOW and similar accounts and other assets..."

MR. PARTEE. NOW and similar accounts?

MR. BLACK. And other unknown phenomena!

MR. BALLES. UFOs!

MR. BOEHNE. No, UMOs: unidentified monetary objects!

VICE CHAIRMAN SOLOMON. That's not obscure, that's just--

CHAIRMAN VOLCKER. My quick reaction is that we're not going to be able to do it in a parenthetic sentence. We've got to write another sentence in there after the one that talks about "seeks behavior" etc. Then we could say: "In reaching this decision the Committee recognized that the target had to be evaluated in the light of the fact that shift adjustment was no longer being made and that the performance of the aggregates would have to evaluated in the light of NOW accounts, which have been exceptionally large recently," or some such thing.

MR. AXILROD. I was trying, Mr. Chairman, to make that apply also to M2 to allow for savings deposits which have been very strong as well. And we're not predicting any strength here.

CHAIRMAN VOLCKER. Let's decide upon what we want to say first before we decide upon what, in effect, the footnote says. How does the around 4 to 5 percent and around 9 to 10 percent strike you?

MR. SCHULTZ. I'm less happy with it than I am with a precise number.

MS. TEETERS. You want 4.7 percent?

MR. SCHULTZ. No, I want a [single] digit.

MR. BALLES. Well, there is virtue in the Chairman's proposal. We've missed every short-term path this year by a considerable margin and I don't know why we should insist on misplaced precision when we will be lucky to come even close to the intermeeting path, if the past record is any indication.

MR. SCHULTZ. The problem with it is that I think Tony is right. The Fed watchers will misinterpret if given any opportunity to do so. And I think it gives them a greater opportunity to misinterpret if we say "around 4 to 5 percent" in that they will in fact look at that as a range in which we're trying to operate, with a degree of precision that we don't have.

CHAIRMAN VOLCKER. Well, that's what I thought in a way, too. But when I think about it more, I am not sure what your objection is to "around 4 to 5." Is it in substance that it is too high?

MR. SCHULTZ. No, my objection to it is that I prefer 4 and 9 percent and a willingness to tolerate somewhat higher growth. It is easier to draw the path and I just think it works better than your--

CHAIRMAN VOLCKER. Well, clearly, we'd draw the path at 4-1/2 percent if we had "around 4 to 5 percent" initially.

MR. SCHULTZ. I still prefer 4 and 9.

MR. PARTEE. This would be published when, Murray, February 5th?

MR. ALTMANN. February 5th.

MR. PARTEE. And when do you [testify], do you know?

MS. TEETERS. Probably February 20th with Proxmire.

MR. CORRIGAN. I have a preference for 4 and 9 percent, but not on the cosmetics. It is a small distinction but I still think the economy will turn around, and I would like to have the leeway down the road rather than now. But the initial borrowing of $300 million is fine with me.

CHAIRMAN VOLCKER. Well, how do we reconcile this small difference? After listening to all of this, how many still prefer 4 and 9? How many prefer around 4 to 5 and around 9 to 10? We haven't seen all the hands up.

MR. PARTEE. You haven't asked about who would prefer 5 and 10.

MR. ROOS. You wanted just voting members?

CHAIRMAN VOLCKER. Yes, just voting members at this point. That leaves two with a preference for 5 to 10, I assume.

MR. RICE. I have a preference. I didn't know how you were going--

MR. PARTEE. And I thought you were going to say "prefer" and "live with."

CHAIRMAN VOLCKER. Well, all right. [Our preferences] are almost symmetrical. It sounds to me as if everybody ought to be able to live with the "around 4 to 5."

MS. TEETERS. And the 9 to 10?

CHAIRMAN VOLCKER. And 9 to 10.

MR. WALLICH. It is the principle of it that bothers me.

CHAIRMAN VOLCKER. What is the principle?

MR. WALLICH. That we're now beginning to fudge the difference between 4 and 5 by saying "around." The next time it will be around 4 to 6 and then around 4 to 7.

MR. FORD. Suddenly, it becomes our long-term forecast.

MR. WALLICH. It becomes increasingly realistic.

MR. BLACK. I think Henry has detected a trend.

MR. ROOS. Anything that is a departure from customary terminology leads market people to read things into it, I think.

CHAIRMAN VOLCKER. Have we ever given a range before?

MR. AXILROD. I know we did once before.

MR. PARTEE. Yes, I am pretty sure we did.

MR. AXILROD. I am not sure if it was for both M1 and M2. It certainly was on M1.

MR. CORRIGAN. In this particular case we can probably get away with it a little more easily simply because of this problem of going from shift-adjusted to non shift-adjusted. I hadn't thought of that. That really does make a difference in terms of our transition.

MR. SCHULTZ. Well, I just expressed my preference, but I'm not going to fall on my sword about this.

CHAIRMAN VOLCKER. How many can live with the 4 to 5 and 9 to 10 [formulation]?

MS. TEETERS. Do you want a show of hands?

VICE CHAIRMAN SOLOMON. Again, I just want to say that if we do 9 to 10 percent, then that does imply very strongly a case--and I think the markets will definitely read it that way--that we're going to come out in February with a revised figure that is somewhat higher than 9 percent on M2.

MR. GRAMLEY. I don't think that interpretation is necessary any more than it meant we were going to revise the targets on M1-B when we put a number like 7 percent for M1-B shift-adjusted during the summer or early fall.

CHAIRMAN VOLCKER. When I say this, somehow we are going to get in here that we think the December number is going to be higher than either of these numbers.

VICE CHAIRMAN SOLOMON. We don't want to say that specifically. Suppose we're wrong?

CHAIRMAN VOLCKER. I don't think we can be wrong. Well, we could be wrong, but it would take a very sharp drop in both of them to come in below 4 to 5 percent on M1. It's now estimated at 8.8 percent, I think.

MR. AXILROD. Yes. The policy record in that light, Mr. Chairman, with regard to M2--

CHAIRMAN VOLCKER. Anything is possible. I wouldn't promise you that it couldn't come in within that range but it would take a very sharp drop in the last two weeks of December.

MR. AXILROD. With regard to M2--and also M1, more tentatively--the policy record [for the November meeting] clearly indicates that the Committee expected a slower growth rate in the course of the quarter. That is, the 9 to 10 is really consistent--it wouldn't be that specific with something like 7 to 8 percent [for M1-B].

CHAIRMAN VOLCKER. This figure is between alternatives A and B; what does that imply for quarterly growth rates?

MR. AXILROD. For M1 it would be somewhere between 4-1/2 and 5-3/4 percent on a quarterly average basis, and for M2 somewhere between 9-3/4 and 10-1/2 percent. They are fairly high.

CHAIRMAN VOLCKER. Just taking the midpoint, the growth rates are a little over 5 percent and around 10 percent on a quarterly average basis, which is the nearest thing to a long-term target. Whatever we put down will be high in relation to the long-term targets interpreted on a quarter-to-quarter basis.

MR. AXILROD. Yes, the monthly growth rates are slow.

MR. BOYKIN. [If we say] 4 to 5 percent and 9 to 10 percent, I have a little problem with the understanding that we are not going to be that concerned if it comes out higher. That is a bit of a difficult bridge for me to get across because I would find acceptable the 4 and 9 percent with the understanding that you talked about earlier but I am a little uncomfortable with it. So, to go to 4 to 5 and 9 to 10 makes me even more uncomfortable.

MR. GUFFEY. Just to follow on that, Bob, I would prefer that the Desk, without regard to how it comes out in the directive, start targeting with 4 percent rather than 4 to 5 percent.

CHAIRMAN VOLCKER. You know, we are now talking about very small differences here. I am inclined to think that we are best off with the 4 to 5 and 9 to 10 [formulation]. Whether we set that path at 4 or 4-1/2 percent is going to make what--a $50 million difference by 3 or 4 weeks from now?

MR. AXILROD. Something like that. [No], by March it is that big, so it is less [for the next few weeks].

VICE CHAIRMAN SOLOMON. My concern is not with the substance. We all know the difference is very small. My concern is that I think we are loosing a certain sense of respect because of how outside people see these things. They see an overrun in M2. They see us targeting 9 to 10 percent, which is over our preliminary M2 target. It seems to me that there will be an immediate feeling in the market--I don't see how we could avoid that--that we probably will move the M2 target up in February and there will be talk about some easing. If we are willing to do that, all right; but I don't see how we can avoid that impression. If we had had a shortfall in M2, sure, we could get away with 9 to 10 percent. I don't see how we can escape that market reaction; if that market reaction doesn't bother you, all right, but--

CHAIRMAN VOLCKER. But there will be an explanation in there that we were high in December, which encompasses this period.

MR. GRAMLEY. Well, we could say that the growth rates implied for January and February, given the present estimates, would be below 9 percent. I really think we can handle that.

CHAIRMAN VOLCKER. I think we can find a handle on that, too, Lyle.

MR. BALLES. Tony, the present directive calls for M2 at an annual rate of around 11 percent. So what is different about this?

VICE CHAIRMAN SOLOMON. You are talking about the short term.

MR. BALLES. Yes.

MR. PARTEE. Well, we are talking about the short term here. The M2 growth rate was 16 percent for the month of November. And how are we going to bring it down?

CHAIRMAN VOLCKER. Well, let's go ahead with the 4 to 5 and 9 to 10 and see what comes up. Before we vote, there is this question [of the precise language to use]. I am afraid we are not going to be able to draft this very well sitting here. I may exceed the limits of your confidence and trust, but if you would delegate to me in consultation with the staff the task of putting another sentence in the directive, I would be pleased to undertake that responsibility. It would say we are moving from a shift-adjusted number to a non shift-adjusted number and M1 growth running a little high in December because of this NOW account bulge. We would get a little flavor of that in another sentence in the directive.

MR. SCHULTZ. I have great confidence that between you and Mr. Axilrod you can make it properly obscure!

MR. BOEHNE. I second that vote of confidence.

MR. GRAMLEY. You are full of Christmas spirit!

CHAIRMAN VOLCKER. I think the alternative is putting it in the policy record, which the staff will do anyway in other language.. This would be in the directive. Is that agreeable? With that understanding, let us vote.

MR. ALTMANN.

Chairman Volcker	Yes
Vice Chairman Solomon	No
President Boehne	Yes
President Boykin	No
President Corrigan	Yes
Governor Gramley	Yes
President Keehn	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Schultz	Yes
Governor Teeters	Yes
Governor Wallich	Yes

CHAIRMAN VOLCKER. Okay.

MR. BALLES. Now that this has been decided, I wonder if I can return for just a second to your comments a while ago that I found very interesting, to put it mildly, that once we had decided that the only real operational decision this time was the borrowing assumption, we could now deal with the cosmetics. That brings to my mind the question: Why don't we in the Bluebook, Steve, have some more analysis on this borrowing assumption that goes with the various alternatives and its implications? This is a very key part of what we decide at a meeting. And I, for one, would like to see some text, analysis, and recommendations. Is there some reason that it is not desirable or what?

MR. AXILROD. Well, we could certainly expand on it.

CHAIRMAN VOLCKER. Let me just interpret my comment. I do not interpret my comment as meaning at all that these aggregate figures are not important. The problem I talked about is that within a 1-month perspective what we do operationally to affect our reaching those targets is to set the path. It doesn't mean that these other numbers are not very important in a longer-term perspective. But the connection in any 1-month or 6-week period between meetings is very loose. It does in an operational sense come down to setting that reserve path--to state it more accurately--rather than the borrowing assumption. The borrowing assumption is part of it. It does not mean that we are operating on the basis of ignoring these numbers. But the numbers are cosmetic. They are not cosmetic at all in a longer perspective. I just want that clarification in the record.

MR. BALLES. Even if you had not made that comment, I was still going to bring this point up. There is a hidden variable running around loose here on these borrowing assumptions.

CHAIRMAN VOLCKER. No, the point is still--

MR. BALLES. And I would very strongly urge that we get something on it in the text in the Bluebook, unless I am missing some reason why they don't do it.

CHAIRMAN VOLCKER. Well, it is in the Bluebook, isn't it? I thought you were raising a question of whether it should be in the directive.

MR. AXILROD. Maybe I could explain, President Balles. We could develop it further, of course. But one of the things that came out of that study we did last year was that in terms of analysis and achievement of targets, the best kind of borrowing assumption to assume at the beginning of our path is the borrowing assumption that seemed to be consistent with the interest rates that come out of the money supply target. So, generally what we try to put down is what the Committee in reaching its decision may wish to use as an initial borrowing figure. Heaven alone knows what the final borrowing will be because that depends on how the money supply actually behaves. Presumably what the Committee makes its decision on, in some sense, is first whether it believes those relationships, and second, how it might wish to tilt, if it wishes to tilt, the initial starting point. But after the initial starting point, this borrowing is pretty well dominated by what happens to the money supply.

MR. WALLICH. But the borrowing assumption is generally viewed by people who look at these things at all as a proxy for the funds rate. So, if we put this into the directive, it will be interpreted as having taken a step in the direction of at least initially targeting on the funds rate. Now, it is true that borrowing shifts thereafter; but quite often we take steps to prevent that, like forgiving low volumes of borrowing or redistributing borrowing over a period of weeks. These are all ways of focusing more fully on the funds rate than a pure money supply target.

MR. BALLES. Henry, I was never suggesting that we ought to put the borrowing assumption in the published directive as part of the specifications. I was urging that there be more analysis and sets of assumptions about different borrowing levels as part of [the Bluebook] for the benefit of the decisionmakers.

MR. WALLICH. Well, that would reassure me. The second thing that would reassure me is if we left the borrowing more fully to find its own level during the period.

MR. PARTEE. We have to start someplace, though, Henry.

MR. WALLICH. Oh yes, we need a starting point.

MR. PARTEE. That is all we are talking about.

CHAIRMAN VOLCKER. If I understand what you are saying--I don't know what you have in mind in substance--in principle I think what you are saying is fine. Whatever analysis we need we should have in there. Maybe you should talk to Steve a bit more concretely about what you might have in mind. I thought he did put in what he thought was consistent with these numbers. The Committee has modified it a little today and on other days, on the basis of where we wanted to take the risk, so to speak. But why don't you talk to Steve about putting something in.

The Secretary raises the question of whether we are going to have a Monday afternoon session at the next meeting. Normally we would in the light of the fact that we have to settle on the long-range targets. So, I think you ought to assume that.

MR. PARTEE. There will be a longer projection [horizon], too, won't there? You will have to give us some look at 1983?

MR. AXILROD. We also plan to have alternative strategies, if the Committee wishes, as we have put it at other times, on implications for phasing down or staying the same.

CHAIRMAN VOLCKER. The other item that we have is the release of the memoranda of discussion for early '76. Maybe you ought to describe this situation, Mr. Altmann.

MR. ALTMANN. Well, as we said in the memo to you, these memoranda for the first three meetings of 1976 are described as unofficial because they have never been presented to the Committee for review or acceptance as we did in the old days. We were under a court order to accede to requests for the segregable factual portions of the memoranda and the Committee made the decision in May of 1976 to discontinue the memoranda of discussion after the memorandum for March. Those three memoranda were not presented because the drafting of them was given a low priority and they were not completed until some years later and by then the composition of the Committee had changed. That is essentially the issue. They could be withheld as being unofficial documents. They could be withheld, I suppose, even if they were regarded as official memoranda.

There is one other issue that I brought to the attention of the Chairman because I thought he should be aware of it before we put these out. At both the February and March meetings there was an executive session which concerned the Merrill case--that is, the suit under the Freedom of Information Act. And at the February meeting there was a report by the General Counsel on the oral decision that had been handed down by the District Court at that time, which was against the Committee, on release of the directive immediately and on release of the segregable facts in the memoranda of discussion. At the February meeting the Committee agreed to the appointment of a subcommittee to consider what to do with the memoranda of discussion in light of this court decision, which was obviously troublesome in many ways. At the March meeting, which was after the written decision of the court, the General Counsel again reviewed the options and the

Committee agreed to appeal the decision on the directive, but not on the memoranda of discussion. As you all probably know, that case went to the Supreme Court and back to the District Court, and the District Court ruled in June of this year that the Committee or the Board did not have to release the directive immediately. That was not appealed, so that is a dead issue at this point. But this would probably be the first time that the System has acknowledged the link between the Merrill case and the discontinuance of the memoranda of discussion. I think everyone connected with the case assumed that was the fact. And in testimony before Congressional committees starting in 1977 with Chairman Burns on new legislation to require some detailed minutes, it was said that the Board would go along with that legislation provided there was an explicit relief from the requirements of the Freedom of Information Act. Later testimony of Governor Coldwell and then Vice Chairman Schultz made the same points. I think it was generally assumed that there was a link between the Merrill case and the discontinuation.

CHAIRMAN VOLCKER. You said something that confused me a bit, if I understood you. I thought we were releasing these minutes in the past as entirely a voluntary act.

MR. ALTMANN. Well, it began as a voluntary act and continued to be so in the sense that the court order only required that we provide the segregable portions of the memoranda that were factual. We would have had to provide that on request. But we continued to publish the entire memoranda with only those deletions made in accordance with our guidelines.

CHAIRMAN VOLCKER. Yes, but on this segregable facts issue, there was a case about that. The only reason we haven't released the segregable facts is that nobody has asked?

MR. ALTMANN. I think that is the case. Mr. Mannion may have another--

MR. PARTEE. Did you ever see that draft with the segregable facts?

CHAIRMAN VOLCKER. Yes, I remember that discussion, but I thought the whole thing was dropped.

MS. TEETERS. But we have only released these with a 5-year delay, is that correct?

MR. ALTMANN. That is correct. I should have stated at the outset that in releasing these memoranda for early 1976 we would be following the schedule that we had followed for a number of years. The only thing about them that is different is that they are "unofficial."

CHAIRMAN VOLCKER. I thought the only issue here was basically that we are releasing them now, though it is questionable whether we have to. But if we release them now, we have continued the practice we had in the past. Nobody can raise any question of our holding back something that we have. On the other hand, if we release them, it calls attention to the fact that we no longer [prepare] these documents. And it may engender some discussion instead of letting the sleeping dogs lie. What do you have to say?

MR. MANNION. Everyone realizes that we don't prepare the memoranda of discussion any longer. If you are ever challenged, you always would have to release segregable facts; those are not subject to any privilege under the Freedom of Information Act. What the Committee has been doing on this 5-year delay basis is releasing the entire memorandum of discussion for each meeting except for certain items that may relate to a foreign country or central bank or some concern of the Treasury Department.

CHAIRMAN VOLCKER. And that has been entirely voluntary?

MR. MANNION. That is correct, Mr. Chairman.

CHAIRMAN VOLCKER. The question before us is: Do we persist in our entirely voluntary policy, recognizing these three haven't been checked the way the others have been checked by individual members of the Committee? And we will just say that these three months are all we have. Or do we forget about it on the basis that nobody has asked and who cares? I don't have a strong feeling one way or the other, but I don't think this will attract much attention. Is Mr. Coyne here? We put these out without an announcement as I recall.

MR. ALTMANN. We have not put out an--

MR. COYNE. I think they will go completely unnoticed. I would bet that you would not get one request.

CHAIRMAN VOLCKER. Hoping that Mr. Coyne is correct, I have no trouble myself in putting these out with a notice that they haven't been checked the way the others have but this completes [the release of] what we have and is in accordance with [past practice].

MR. COYNE. Even when we have announced--

CHAIRMAN VOLCKER. There is this discussion of the Merrill case in them, but that doesn't bother me much.

MR. BALLES. Can you possibly remember what you said back in 1976? I couldn't.

MR. MORRIS. I am the only one here who was at those meetings and I couldn't.

MR. FORD. Nobody can spot something he wishes he never said?

MR. MORRIS. That is a long time to remember what we said.

MR. PARTEE. Well, I was there, too, and--

MR. GRAMLEY. It is better not to start down that route because if we do, then we do have to stamp them as official.

SPEAKER(?). Yes.

MR. GRAMLEY. Put them out now and if [no member of the Committee] has looked at them, they are purely staff documents. I think we are safer that way than to start trying to hunt down those people who might remember.

MR. ALTMANN. We have a prefatory note which states the situation in terms of their being called "unofficial" because they were prepared after a time lag and had not gone through the [usual review] procedure.

CHAIRMAN VOLCKER. Well, if there is no objection or no contrary concern, we will just put them out as quietly as possible, which has been the case.

MR. ALTMANN. We don't issue a press release on this.

CHAIRMAN VOLCKER. While we are making them available, we are not announcing that they are available, if I understand this correctly. That means if somebody asks, he gets it. If nobody asks, I guess nothing will ever happen. With that understanding we shall proceed. I believe that is all the business we have. Do we have lunch out there?

MR. ALTMANN. Yes, lunch is available in the anteroom for Governors and Presidents and those who have been invited to stay.

END OF MEETING