Meeting of the Federal Open Market Committee

May 21, 1985

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, May 21, 1985, at 9:30 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Corrigan, Vice Chairman
Mr. Balles
Mr. Black
Mr. Forrestal
Mr. Gramley
Mr. Keehn
Mr. Martin
Mr. Partee
Mr. Rice
Ms. Seger
Mr. Wallich

Messrs. Boykin, Guffey, Mrs. Horn, and Mr. Morris, Alternate Members of the Federal Open Market Committee

Messrs. Boehne and Stern, Presidents of the Federal Reserve Banks of Philadelphia and Minneapolis, respectively

Mr. Axilrod, Staff Director and Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield, 1/ General Counsel
Mr. Truman, Economist (International)

Messrs. Bisignano, Broaddus, Kohn, Lindsey, Prell, Scheld, Siegman, and Ms. Tschinkel, Associate Economists

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

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1/ Entered the meeting after action to ratify transactions in domestic operations.

Mr. Coyne, Assistant to the Board of Governors
Mr. Roberts, Assistant to the Chairman, Board of Governors
Mr. Gemmill, Staff Adviser, Division of International Finance, Board of Governors
Mrs. Low, Open Market Secretariat Assistant, Board of Governors

Mr. Garbarini, First Vice President, Federal Reserve Bank of St. Louis

Mr. Fousek, Executive Vice President, Federal Reserve Bank of New York

Messrs. Balbach, J. Davis, T. Davis, Lang, and Syron, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Cleveland, Kansas City, Philadelphia, and Boston, respectively

Messrs. Pearce and Rolnick, Vice Presidents, Federal Reserve Banks of Dallas and Minneapolis, respectively

Mr. McCurdy, Research Officer, Federal Reserve Bank of New York

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CHAIRMAN VOLCKER. We have to approve the minutes.

MR. MARTIN. Move approval.

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN VOLCKER. Without objection. I have an extraordinary item this morning. We have had a request from the Chairman of the Council of Economic Advisers to receive the weekly report of the Manager for Foreign Operations and the weekly report of the Manager for Domestic Operations.

VICE CHAIRMAN CORRIGAN. Little does he know!

CHAIRMAN VOLCKER. I will say it is sent to the Treasury; it has always been sent to them, historically. The question is whether we can change this rule and send it to the Chairman of the Council of Economic Advisers under our rules of confidentiality. Does anyone have a strong opinion on this? Do we have to take a formal action? Does this have to appear in the record so we have to have a vote?

MR. BERNARD. No, I don't think so.

MR. PARTEE. There used to be projections in the New York report on domestic operations. I don't know; maybe they've been taken out. It was a source of leaks earlier. Peter, do you have any projections anymore in your report?

MR. STERNLIGHT. No, in the Manager's weekly report we do not include the projections in what has been going to the Treasury. I would think if you approve this, we'd send the same [to the Chairman of the Council].

MR. PARTEE. I remember we had problems with that some years ago.

CHAIRMAN VOLCKER. I don't know that we ever had a problem; I know we worried about it.

MR. PARTEE. Well, you know, it was distributed widely in the Treasury to something like 150 people some years ago.

MR. BLACK. 150?

MR. PARTEE. It was a big number!

MR. MARTIN. Mr. Sprinkel has not lobbied for this.

MR. PARTEE. I don't think they have 150 people anymore!

CHAIRMAN VOLCKER. Not hearing any objection--

MR. RICE. I have a question, though: Would this continue to be sent to the Chairman *ex officio* or is it specific to the present Chairman?

CHAIRMAN VOLCKER. I think once you begin this--. The problem is: I don't know whether any subsequent Chairman will be interested.

MR. GRAMLEY. I would be inclined to sunset the decision at the end of the present Chairman's term of office and, in effect, await a new request. The individual who first requests information like this may well understand the confidentiality with which to protect it. The next guy may not.

CHAIRMAN VOLCKER. It's worth reviewing.

MR. AXILROD. Mr. Chairman, if we do send it, I think probably we should add those few words to our present memorandum [on rules regarding confidentiality] because at the time of that GAO investigation, it was crucial whether the procedures we were following were consistent with the written documentation.

CHAIRMAN VOLCKER. I assume we are going to add it.

MR. AXILROD. Then there's the question of sunsetting it.

MR. BLACK. Can you take it out at the time you sunset it, Steve? That would be the only graceful way to do it.

MR. AXILROD. I guess we could.

VICE CHAIRMAN CORRIGAN. In the old days, the guy at the New York Fed who wrote the report could never read it.

CHAIRMAN VOLCKER. We can add "upon request".

MR. BALLES. Mr. Chairman, is there some sort of "need to know" test?

CHAIRMAN VOLCKER. It's not supposed to go to anyone else other than those who receive it. But--how many people here read this report?

[Secretary's note: Among those whose hands were raised, only Mr. Wallich spoke.]

MR. WALLICH. Well, not every report.

CHAIRMAN VOLCKER. I think I have the sense of the meeting. Mr. Cross.

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

CHAIRMAN VOLCKER. Comments? Questions?

MR. WALLICH. Sam, this kind of information, I think, is substantially ignored by the people who are working on the exercise of the G-10 Deputies--the reform of the monetary system. The discussion of intervention there continues exactly along the old lines of what was said at the time of the study--we can do a little but not much and so forth. But there was no sense from any of the central bankers or

Treasury people there of a cumulative deterioration of markets, which I take it to be the implication of what you say.

MR. CROSS. Well, certainly the complaints about market conditions have been much, much worse. And there's no doubt that the day-to-day volatility in the past two or three months has been far greater than in earlier periods. We've been hearing for a long time from the banks regarding their concern about the market's condition and we're beginning to hear more complaints from some of the corporate representatives at this point. That's a new element in this.

CHAIRMAN VOLCKER. Are the banks not making any money these days?

MR. CROSS. Generally speaking, most are making money on the exchange market, if you look at their quarterly reports. With some notable exceptions, they continue to make money.

VICE CHAIRMAN CORRIGAN. Though less so in the first quarter compared to last year.

MR. CROSS. Less so. It does vary; it moves up and down. But at least at the banks in New York that we keep an eye on, the number of quarters in which they had large losses was very few and that was only at a very few institutions.

VICE CHAIRMAN CORRIGAN. To me it's astonishing, given what has been going on in this market, that somebody hasn't taken one great big loss in foreign exchange operations. It's a miracle.

MR. GRAMLEY. Is it a miracle or have they hedged their positions sufficiently so that they get by?

VICE CHAIRMAN CORRIGAN. The logic of that can only take you so far. Somebody somewhere is absorbing the price risk associated with this volatility.

MR. CROSS. I think the banks are withdrawing more and more from the market, so they are protecting themselves by being much more unwilling to be market-makers except in limited conditions than they were before.

MR. MARTIN. Are they hedging or are they using some creative accounting?

MR. CROSS. No, they're just not doing business.

MR. MARTIN. No, I'm talking about the traders not the banks.

VICE CHAIRMAN CORRIGAN. Everybody can't be hedged; that's clear enough.

MR. CROSS. It is a matter of considerable concern. The volatility did increase considerably, of course, after the operations in late February. Now, that does not mean necessarily that people should be unhappy about the heavy intervention in late February. But there is a question of whether there should be some follow up to that kind of arrangement to provide for a little more structure in the

market and a little more effort to try and deal with this kind of very short-term variability.

CHAIRMAN VOLCKER. There's short-term variability, hourly variability, daily variability, and intra-daily variability.

MR. CROSS. What I've been talking about here was intra-day--the amount during one 24-hour day--which, as I say, now averages about 2 percent whereas in earlier periods it was much less.

CHAIRMAN VOLCKER. Well, in the absence of a constructive suggestion we'll turn to Mr. Sternlight.

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

CHAIRMAN VOLCKER. Discussion? If not, we'll ratify the transactions. Motion?

SPEAKER(?). So move.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection. Mr. Prell.

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

CHAIRMAN VOLCKER. When I listen to you, I wonder how you get all those projected GNP increases. Well, what comments are there? Mr. Black.

MR. BLACK. Mike, do you have the figures for gross domestic purchases and domestic final purchases for the first quarter as a percentage increase?

MR. PRELL. Yes, for brevity, I eliminated a sentence in which I was going to refer to gross domestic purchases.

MR. BLACK. Well, you alluded to it.

MR. PRELL. For the first quarter, it was 4 percent; and final sales to domestic purchasers was 3-1/2 percent.

MR. PARTEE. In both cases, it was down by 1/2 percentage point.

MR. PRELL. Yes, I believe so.

MR. BLACK. Down by 0.4 on the first one and 0.8 on the [second].

MR. PRELL. Ted tells me the 3-1/2 percent final sales to domestic purchasers is unchanged.

MR. GRAMLEY. But the reduction of 4 [tenths] is primarily, I think, a consequence of governmental purchases rather than private final purchases. That is, the private final purchases were actually revised up somewhat from what they had been. That part does not signify anything.

MR. BLACK. What were those figures, Lyle? Do you have them?

MR. GRAMLEY. The domestic final demand was revised down from 1673.2 to 1672.9 but the private component thereof was increased from 1362.6 to 1363.8. I don't have the growth rate, but it is a tiny little adjustment.

MR. PARTEE. Mike, I thought I heard you suggest that there would be less strength in state and local purchases looking ahead. That sort of surprises me; I had the impression that revenues were coming in very well and I assumed that expenditures in the state and local sector would rise with more prosperous times.

MR. PRELL. Well, it is certainly the case that their operating capital account budget surplus position has improved over the past year, and we think it will stay reasonably positive. Last year there was some spurt in construction outlays, but on the whole there was not a tremendous growth of state and local expenditures. The first quarter of this year doesn't look particularly strong. And while there is a lot of talk about a backlog of repair and renovation work that needs to be done, we just don't see the evidence of it. I think there is a great deal of caution on the part of many state and local government units about forging ahead with spending programs partly because, given taxpayer attitudes, they don't think they are going to be able to keep all those tax revenues that they got from increasing taxes in earlier years. Then there is the question of what will happen both with tax reform and federal spending. Both the House and Senate proposals spell the end of grants to state and local government revenue sharing by 1987. So, I think there is a good deal of caution being exercised.

MR. BOEHNE. Are we ready for comments or are we still in the question period?

CHAIRMAN VOLCKER. We're in the comment period.

MR. BOEHNE. Well, I have been out travelling around the District more than usual this spring and talking to lots of people in different kinds of businesses. It is a little hard to summarize the situation because there is such great variability among industries. In general, what I find is that people are saying: "Well, things aren't great, but they aren't terrible either." In my District there seems to be a changing economic mix more toward some of the faster growing sectors and away from the traditional manufacturing area. So, in general, I think the tone is probably a little better in my District than it might be in some others.

One thing that did strike me, as I was talking to lots of people, is that the expectations about the economic outlook seem to me in a rather precarious zone right now. Earlier, around the start of a recovery when expectations are generally for expansion, if you get a bearish statistic, it is greeted as an aberration and it doesn't really have very much effect on expectations. When you get into a recession it is just the other way around: Everyone thinks things are going downhill and if you get a bullish statistic, that is viewed as an aberration. With this kind of bombardment of mixed signals that we are getting, I think we are in a period where expectations could change rather rapidly. Right now I think the predominant view is

still that the economy is going to continue to expand; but there are just enough [negative] reports coming in, that people can shift over. It is almost like a teeter totter and the weight of opinion could shift more toward the down side. A story that somebody told me illustrates this. A person who runs a medium size capital goods firm, a family business, told me that while they still expect a good second half, what makes her nervous is that the salesmen, instead of buying cars and boats, are now buying CDs in insured institutions. And that gives her a great deal of pause about what might happen. So, I think we are in a gray area where these expectations could change rather rapidly.

On the inflation front, I just don't sense any great concern about inflation. Most people that I spoke to are talking about fairly moderate wage increases. They find it difficult to pass on price increases and they find that the prices from their suppliers are holding fairly steady. So, whatever the statistics coming in, I just don't find much out there on the inflation side. The influence of the international sector continues to strike me in a dramatic way. In the smallest of businesses and the smallest of towns one keeps hearing more about world markets and world trade. I have heard even more concern this spring about Korean imports than Japanese imports; that seems to be the new kind of enemy, if you want to look at it that way. More and more business people are expressing concern about competition from the Koreans.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. I would like to add some rail cars to the locomotive of expectations already alluded to. I am struck by the cumulative nature of the vulnerabilities of markets and of the financial side of the economy. Notice that in our first two reports this morning there were some comments on the variability in foreign exchange markets. Think of the junk bond phenomenon, which continues into this year. The SEC indicated that they are not disposed to intervene in the merger and acquisition surge. You are talking about $80 or $90 billion at an annual rate of equity retirement replaced by debt. In the commodity markets and the COMEX in New York, the three largest traders failed to meet a margin call one day, though it was only a temporary phenomenon. As for the LDC debt deterioration, we get reports out of Argentina on a series of private bank failures; the government steps in and this passes. Capital flight has resumed from the LDCs and various measures we're all familiar with are being implemented there. It is not all one-sided, of course. We have what sounds like favorable news out of Venezuela and the Philippines, but still there is the onus of this capital flight situation. Newspapers in the last few days have had the Coldwell Bankers survey, which talks about $25 billion plus of nonresidential construction coming on stream--80 percent above 1980. I think there is a kind of frenzy of office building and other kinds of activity. Sooner or later that is going to put pressure on major money funds around the country because tens of billions of dollars are coming in there, resulting in overbuilding. Multiple unit dwellings are hung on the revenue M bonds, industrial revenue bonds--techniques that are a tax phenomenon in part. Vacancies are accumulating there. As for government bond dealers, obviously, we know the work that has been done in that area by the New York Fed. But I wonder if we weren't so concerned with the cost and we weren't so concerned with the smooth running of this

enormous market, if maybe we might have come up with something a little less voluntary and more like the rulemaking being extended in the municipal securities market. But we have the vulnerabilities to contend with and who wants to take that chance? Ed Gray has talked about $100 billion in savings and loan assets in savings and loans that are essentially defunct. Well, that's $100 billion out of an industry that is 10 times that large that he has found; and I wonder what else is out there that could come around to haunt us.

The President is about to go on the road to present the so-called tax reform and simplification program. There is going to be a great deal of attention to top bracket rates and a capital gains treatment a little more favorable than the Treasury proposal. Is that going to add to a speculative bubble that seems to be occurring in market after market after market? Where can we find a financial market that doesn't have this feeling of a kind of froth in it right now? And how many of these things need to go down in one day, one week, or one month before we talk about expectations and attitudes? Government securities and mortgage-backed securities markets are enormous markets trading hundreds and hundreds of billions of dollars now. And one day, Ginnie Mae, Fannie Mae, or Freddie Mac may decide they are not going to settle. Well, all that [happened in the past] and there were negotiations and so forth and every one of these potential crises worked out fine. Everybody saluted and got in [line] and did what they had to do and it worked. But what are the dangers that we are facing here?

I am not so concerned about the tiny bit of evidence of price increase; I certainly am concerned about unemployment and the lack of employment growth and the 0.7 percent real growth figure that that implies. Think of the cumulative nature of financial vulnerabilities of the country right now. I think I voted for--maybe I even made the motion, I can't remember--the [recent] discount rate cut. I think we should have done that. But my goodness, let us be aware of what we do next in terms of this tremendous pervasive, ubiquitous, financial vulnerability that we have here. That is my cheerful message.

CHAIRMAN VOLCKER. I don't know whether [that means] we should tighten up or ease up.

MR. GRAMLEY. The remedy for that is good old-fashioned monetary discipline--make credit tight enough.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. Well, I do think we are in a period when the signals are decidedly mixed at best and are very conflicting. The good businesses are continuing to do pretty well and are continuing at a pretty good level; the automobile business is good even though it has leveled off a bit. Those in the industry do say that the dip in the early part of May should not be taken as a change in the trend. They view it rather as a comparative issue, given a very strong period the year before. Retail sales in our District, if you put March and April together and adjust for Easter, are really very strong; commercial building is particularly strong--indeed I think perhaps too strong; steel output is rising a bit; and the service sector is strong. But on the negative side, I think the news is very serious. The capital goods people are experiencing a slowdown this year as

compared to last year, and last year certainly was not very strong. One CEO I talked to who has a very heavy commitment to the capital goods sector said that his company had a really dreadful month in April and if they had another month or two like that, he would be very, very worried about the outlook.

The agricultural situation is deteriorating further. Land values are down. We had a good planting season this year and are considerably ahead of last year; some 83 percent of the farm planting is done. Therefore, over the long time between now and harvest the outlook is for higher levels of production, which will have a depressing effect on commodity prices. Anybody who has anything to do with the agricultural sector is having a very tough time. The implement people are operating their plants at about 30 percent of capacity and there is a significant number of plants that have just simply shut down. I commented last time that railroad shipping and car-loadings were down; we have had another period here in which the railroad shippings are down. There's an interesting import implication here that one man told me about. Whereas before they were shipping [unintelligible], now the parts are coming in in a finished state and are by and large being shipped by truck.

On the inflation front, I think the news is mixed. I agree with Mike that many of the positive factors may be behind us and that there are some very significant increases taking place in the services side, in pretty steep amounts. But more positively, I am impressed with the number of people I have talked to who are still renegotiating contracts for three years in the 3 to 4 percent area. And they are finding their union negotiators to be very, very flexible with regard to work rules. They are getting very significant productivity increases as a consequence of this. And the pricing out there is terribly competitive; the people I have talked to just simply can't get price increases through in a full sense. If there are any trends that are persistent in all this, I think one is that expectations are being revised downward. I haven't talked with anybody who is revising his expectations upward. No one that I talked with suggests that we are on the edge of a recession; nonetheless, they do think that the outlook for the rest of the year and next year is more modest.

I think that the most significant trend is this export-import problem and the dollar value. I have a couple of anecdotes. First, cement--and I have always had the feeling that cement was a commodity that was very, very transportation sensitive in that beyond 200 miles [shipments] fell off the edge of the table. Fifteen percent of the cement consumption this year is going to be from imports, which I find rather staggering. Also, we had our first meeting of our small business advisory council, a group that I would have thought would be absolutely insulated from this dollar problem. We had a representative from Indiana, and one from Iowa and both of them said that without a single doubt the most difficult problem they are having is the export-import problem--the value of the dollar. Their industries and businesses are being very hard hit by imports. As I look at it, I think this high value of the dollar is the most pervasive problem that we are dealing with. The economic news is pretty mixed and the inflation news is pretty mixed, and I think that we are probably in a period where it is awfully difficult to tell how the future is going to unfold.

CHAIRMAN VOLCKER. Mr. Forrestal.

MR. FORRESTAL. Well, Mr. Chairman, the conditions in our part of the country pretty much mirror what is going on in the rest of the country in terms of mixed signals. The service industry throughout the District seems to be doing pretty well. We have fairly good news with respect to construction, real estate, tourism and so on; but the bad news is related to the manufacturing sector and those sectors that are dependent on a lower dollar--particularly textiles, apparel, and agriculture to some extent. Energy is also a negative in the economy. With respect to the apparel industry, you might be interested in knowing that the protectionist sentiment is growing by leaps and bounds. Their latest slogan is "Take off your foreign clothes."

I am also concerned about the overbuilding, particularly in offices and multifamily structures, that seems to be going on in many cities in the Southeast. I think that is creating vacancy rates that are going to be unsustainable in the long run. So, as we look at what's going on in our District and around the country, I think we would now revise our forecast down somewhat. That seems to be the general sentiment of people that I talked to. Expectations are being cautiously revised downward. Like Si, I don't hear anybody talking about a recession; but on the other hand, I think there's a great deal of concern about where the economy may be going. On balance, we don't differ significantly from the projections in the Greenbook. If anything, our expectations in the near term may be a little lower than suggested in the Greenbook. Going out a little further, I think the reduction in the discount rate and other short-term interest rates might give a little push to the economy, but with a lag--later on in the year. So as I look out over the horizon, I think the risk is on the down side for the economy, and I think growth for the rest of the year is going to be just barely acceptable.

I would say one other thing about sentiments in the District, and that is that there is a great deal of concern now about the financial stability of the banking system. If you put together all of the various episodes that we have had, people are asking: Is this just the tip of the iceberg or is there more? With these government securities dealers, firms like E.F. Hutton and so on, the list goes on and on. While there may not be any direct relationships among all of these, the psychological atmosphere that is being created is one of mounting distrust in the financial system or concern about whether the stability of the system is what it should be. People are asking questions very strongly about that. In summary, Mr. Chairman, my view now--and I haven't had this view before--is that the economy is tottering a little and that our policy prescription needs to take that into account.

MR. GUFFEY. How do you respond to that question?

MR. FORRESTAL. Which question?

MR. GUFFEY. About the financial stability.

MR. FORRESTAL. Well, my stock answer, which I think is the correct one, is that the banking system is in good shape and that these are isolated incidents. I say that with my fingers crossed.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. Mr. Chairman, reverting for a moment to the similarities and dissimilarities of the Board staff's forecast to our staff's forecast: We have similar views on the outlook going through the fourth quarter of this year in a number of major areas including consumption, capital spending, government spending, and inventories. Where we differ, and where our staff turns out to be somewhat less optimistic than the Board's staff, is with respect to our expectation that imports will be up somewhat more because of the recent behavior of the dollar and that housing will be up somewhat less than the Board staff's projection because of the weakness in disposable income. So, even though our two forecasts tend to converge, ours is up a little from last month and the Board staff's outlook for real GNP has been revised downward this time from last month. We are still significantly lower for the year as a whole, showing a 2 percent real GNP gain, fourth quarter to fourth quarter, versus the Board staff's view of 2-1/2 percent. Whether it is 2 or 2-1/2 percent, it is still going to be a pretty weak year. I share the view that we are experiencing already--and are likely to see more of it as the year goes on--a pretty sluggish economy operating below its potential, in large part because of an enormous distortion and imbalance that has already been touched on, particularly relating to the impact of the huge federal deficit and the high dollar and the import surge that has resulted from all of that.

Like Si, we recently had our meeting of our council on small business and agriculture in response to your suggestion. We got a whole earful of bad news and I, too, was surprised by some of the anecdotes that we heard. For example, one of the small business firms represented was a very small manufacturer up in Oregon, which is outside the Portland metropolitan area. It turns out that they export a good deal of equipment all around the world; more than half of their business in fact is foreign. We really got some graphic illustrations of what the high dollar has done to this small little business. We found similar illustrations from other representatives of small concerns that were there. Contrary to conditions in your District, Si, or yours, Roger, where the family farm still predominates, as you know in the West it is the large scale farm that predominates. And even representatives of those agri-businesses were singing the blues and gave some pretty graphic illustrations of how bad business was, not just because of the high interest rates but also the strong dollar. Cotton is one of the major products of our agriculture in California and traditionally about 80 percent of it has been exported. You can imagine what the high dollar has done to cotton exports; that particular business is in big trouble.

Based on the latest information we have, nearly all of the nine states in our District experienced an increase in unemployment fractionally; and in the latest month for which we have data for total employment, it actually dropped a bit. Electronics, which had been one of our stronger growth industries for some years is now flat; manufacturing has been rather weak except for defense spending; and lumber is still a disaster. Aerospace is the one industry still going fairly strong. On balance, adding up all these strong and weak areas, it is clear that the weaknesses predominate and that we are seeing in the West what we are seeing in the national statistics: a pretty

sluggish performance. Therefore, when we get around to the policy discussion, that would be the reason I would like to err, if we are going to err at all, on the side of ease.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I have long since abandoned any hope that anybody can do very well in projecting the economic outlook over any extended period of time. I am particularly uncomfortable in trying to do that today because the signals are so mixed. But having said that, my guess would be that if the staff forecast is wrong, it may be a tad bit on the low side. As we see it, domestic demand is still pretty strong and the sharp growth in M1 back in the winter is likely to keep it fairly strong. The real question is: What's going to happen to imports? And I don't think we know the answer to that. I agree with the staff's assessment that the dollar probably has peaked and will continue on down. When that will be felt by some slowing in the rate of increase of imports, I don't know; it may be in 1986 as Mike suggested. We were thinking we probably would see some effects before then. In any event, we think that by the last half of this year GNP might be somewhere around the 3.3 percent growth that the staff is projecting for the last half of this year.

On the implicit assumption on velocity that the staff has made, if we had the kind of growth in M1 that they seem to be talking about--say, 6-1/2 percent from the fourth quarter of last year to the fourth quarter of this year--that implies a slight decline in M1 velocity. If we get a more rapid rate of growth in M1, that would of course mean more than that, and that would be very unusual for this stage of a business expansion. I certainly wouldn't say it can't happen, but I don't think it is very likely. So in short, I don't believe the general economic outlook provides any very compelling reasons at this point for any significant move toward ease. It is tempting to think in terms of ease, as we see all these worries that Pres has outlined. But to me at this point that really would exacerbate most of these problems. It was excessively easy policy, coupled with some other things, that I think created most of these in the past. To me it is time, even though the statistics seem to be flashing danger signals, to keep our eye on our long-run objective. I would try to keep the aggregates under control; specifically, I had in mind trying to get M1 back somewhere within these target bands that we set for ourselves.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. I want to applaud the Board for reducing the discount rate, although the timing I found a little surprising. But--

MR. GRAMLEY. You can't win!

MR. MORRIS. I think [unintelligible] that the economy has performed in a much weaker fashion than I expected or than I think most of us expected a few months ago. I am finding in the comments of businessmen--right across the board regardless of the industry, again with the exception of the defense industry--that they all tell me that orders are coming in at lower rates than they had contemplated. And there is a very sobering mood developing. Another phenomenon--I don't know whether it is confined to the New England area and I would like

to hear some other comments on this--is that a lot of businessmen are telling me that they have been waiting for the dollar to go down so that they can begin competing in world markets again. They have about given up on that, so they are planning in a great many industries to expand their production facilities abroad. That is the only way that they can compete in world markets; they can't do it from a U.S. base. In the past few years, the decline in U.S. direct investment abroad has been an element of strength in the dollar. But if we see a pretty widespread movement to build new production capacity abroad, that could very well put downward pressure on the dollar at some point if the movement got very far. Has anybody else run into this phenomenon?

CHAIRMAN VOLCKER. I hear the threat all the time. Everybody I talk to--

MR. MORRIS. But they are beginning to plan to do it now. That's the difference.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. Well, Mr. Chairman, I think the major concern is whether the economy is going to rebound moderately in the second half as projected in the staff forecast or whether it is going to continue along the present sluggish path. Now, if one is convinced that the economy is going to perform along the lines of the forecast in the second half, I don't think we need to worry too much; the worry then would be about next year. While I think the staff forecast probably captures the most likely outcome, the factors supporting that outlook do not seem to me to be very strong. While we probably can expect continued strength from residential construction, the rate of growth in business fixed investment and consumption expenditures will be declining. Yet, the 3 to 3-1/2 percent growth that we look to depends on some moderate strength in both these categories. So, it is very hard to be confident that there is this basic strength in spending that's going to produce this outcome. With resource utilization significantly below capacity, with capacity utilization most recently falling--and even if it stabilizes from this point on, it will still be at a relatively low level--and with the outlook for unemployment not very reassuring in that it is not declining significantly, it seems to me that the economy is vulnerable on the down side. There seems to be very little risk of excessive growth in these circumstances. So, I would say that what we can reasonably expect is an economy that is, as Governor Martin put it, very vulnerable. It could go either way; I see no strong momentum in either direction.

I think the inflation outlook is moderate. Most of the recent influences on the inflation rate are probably temporary; I am not convinced that the recent spike in wage costs is more than temporary. I would say, therefore, that with the inflation outlook moderate we should not be satisfied with anything less than a 3 to 3-1/2 percent rate of growth in the second half. And I think we should make our policy judgments with that particular bias in mind. Thank you.

CHAIRMAN VOLCKER. Mr. Corrigan.

VICE CHAIRMAN CORRIGAN. Mr. Chairman, looking at the economy first and taking a little longer perspective on it, I think the

numbers would suggest that domestic final demand really has been performing more or less as expected for the third year of the recovery and maybe even a little better than expected. But the wild card, as has been amply reflected so far in the discussion, insofar as the GNP and production, etc., is the external side. Against that backdrop, I still lean to the view that for the balance of the year real GNP is likely to be growing in the 3 to 3-1/2 percent range. And I think that this recent rather pronounced decline in interest rates provides a little further measure of insurance in that direction. At the same time, that kind of forecast is one that assumes a much smaller drag coming from the external sector over the balance of the year. While economists seem pretty comfortable as a group with that, I will be darned if I can find a businessman--whether in small or large business--who agrees with that. I think that remains, therefore, the wild card.

I agree with those who say that the nonresidential sector--the construction sector in particular--looks very vulnerable at this point. On this question of financial shocks and disturbances, the point has to be made--whatever else one might want to say about them--that to the extent that they are being managed and contained, they are being managed and contained with a very high degree of government involvement. Whether it is front page news or not, that has been the case. Indeed, what I see almost daily is the situation where "free markets will take care of things" is a slogan only until people think they are on the hook. And then that slogan goes out the window in one heck of a hurry. I would like to say that I can see some reemergence of discipline growing out of this cumulation of problems, but I don't see it. The leaders in banking and investment banking institutions, foreign and domestic, have reached the point where I think they want discipline. But in a setting in which all of the institutional sand has been taken out of the wheels, they don't seem to know how to get it. I think that those vulnerabilities in that setting are something to be concerned about.

On the inflation side, I keep coming out on the side of being uneasy. I look at the numbers and I listen to what everybody says and I am tempted to reach the same conclusion that Governor Rice just stated: that these are all temporary things. But I can't quite get myself comfortable with that. Even if these things are temporary, the rate of inflation that we are seeing right now, against the backdrop of the exchange rate that we are seeing right now, still strikes me as high. I am concerned that if the inflation rate were to start to creep up from where it is now, even by a percentage point or so, and produce the situation in which we felt at some point we had to move against that, it would be a very, very difficult thing to engineer, to put it mildly. But more importantly, I think some of this financial market situation that we are seeing still reflects a kind of residual point of view that says somewhere down the road inflation is going to bail this situation out. So, I can't bring myself to be sanguine about the inflationary situation, even though I certainly don't think it is something that has to be the number one priority for policy. But I think it has to be watched very, very closely.

CHAIRMAN VOLCKER. Mr. Stern.

MR. STERN. First, in terms of our District economy, I would characterize that as simply more of the same. The split that we have

had, which may be most easily described as urban versus rural, persists. The economy in the urban areas--from the city of Rochester to Sioux Falls to Rapid City--continues to do reasonably well on balance; the economy in the rural areas is very difficult at best. And that has been the situation for quite some time.

On the national level, without wanting to belabor the obvious, the key word in my mind is uncertainty. As I look at the Greenbook forecast, my own view of the situation is that the economy is going to have to hustle just to get that 2.3 percent real growth in the second quarter, given the monthly trajectory in the first quarter. But having said that, I expect that the economy may do a little better than the Greenbook suggests in the second half of the year, largely because I think the interest sensitive sectors of the economy may do somewhat better. But I would re-emphasize the term uncertainty. I do not have a great deal of confidence in that particular scenario, although it is the one that, under the circumstances, I am inclined to go with.

We too have had our first meeting of our advisory council on small business and agriculture, and we included labor as well. Most of the news would have to be described as grim, particularly from the people associated with the agricultural sector. The focus of concern seems to have shifted a bit, however, in the last several months. The focus used to be on the producer--the farmer. I think now the focus is shifting to his or her lender, be it the Farm Credit System or the agricultural banks. There seems to be rather vague but mounting concern about the status of some of those lenders.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. The war between the forces of the budget and the trade balance seems to have moved increasingly in the direction of the trade balance prevailing, which pulls the economy down, over the stimulus that comes from the budget deficit. To some extent this will continue, as net exports are scheduled in our forecast to become increasingly negative for several more quarters. But my impression is that it is slowing down. On the other side, of course, if we succeed in bringing the budget deficit down, that expansionary force diminishes as it ought to. It seems to me that there is a sort of stand-off in the economy between these two forces. And they have very drastic repercussions on various sectors: farmers, some parts of heavy industry, and the import-competing sectors. So this is not a static situation; it is a situation full of great tension.

Given that there is a [pause], as it were, this may be the opportunity to do something that in the long run is very important: to try to reduce the structure of interest rates--not in the sense of stimulating the economy in trying to accomplish a short-run objective, but to bring interest rates down over time, as with inflation. If I thought that a reduction in interest rates now would have the effect simply of a brief stimulus, I would think that could be a great mistake.

Let me look for a moment at the mistakes that we might fall into. We have always leaned toward fine tuning. When the economy is going down, immediately one sees what one could do by monetary policy if one doesn't think too much about the long lags. Long lags have

been mentioned and I think they are important. What we do now in May may have effects early next year, at which time the problems we face may look quite different. There has been a proclivity at the Federal Reserve to push harder late in the cycle, perhaps because the cycle tends to peter out, the natural forces of expansion diminish. It's the nature of a business cycle. And one tries hard to postpone the evil day and push back the moment when the economy flattens out so that we do not have to go into recession. One stacks up problems, financial problems and economic problems, for the future; and instead of a mild growth recession, one may get a real recession a little later. So, I would not press very hard to keep the expansion alive if what it wants to do is to slow down. But that does not seem to me a very clear description of the present situation. It may be more of a lull before the current account ceases to drag it down while budget improvement and lower interest rates give a certain stimulation. Finally, as for the alternative of inflation and unemployment, I keep looking at that myself and I arrive at a somewhat different conclusion. I think that inflation is still much above where it ought to be. And I don't see it coming down other than in a recession, which we want to avoid. So we do have to do something to bring it down during a period of good activity. A 7.3 percent unemployment is not good and 2-1/2 percent growth also isn't very good. I would still pay a price to bring the inflation down. Thank you.

CHAIRMAN VOLCKER. What is that price?

MR. WALLICH. Well, 2-1/2 percent growth for a year and acceptance of 7.3 percent unemployment.

CHAIRMAN VOLCKER. I thought you indicated earlier that that wasn't going to bring it down, but I--

MR. WALLICH. Well, the inflation should come down; the unemployment and the growth rate will be less satisfactory under that [scenario].

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Mr. Chairman, I don't really have anything positive to bring to the table today. The situation in the Eleventh District pretty well mirrors what has been going on [in other Districts]. We obviously had a slowing in the first quarter of 1985. In the fourth quarter of 1984 we were pretty well paralleling the nation in terms of economic growth but our rate of increase has slipped below the pace of the nation in the first quarter, in part because of absolutely declining activity in energy, electronics, and construction. Reference already has been made to office building construction and that sort of thing. Of course, we have had an awful lot of construction in our area as I've reported in the past. The problems in Houston are very well known; they are not unforeseen problems; they have been trying to live with their problems for a couple of years. We are getting reports that now there is concern in Austin, which has been a very strong boom area; that seems to be slowing very significantly. As an example, based on a recent survey, we had about 18 million square feet of office space sitting empty in Dallas in March--a vacancy rate of a little over 21 percent. But on top of that in March we had another 25 million square feet of office space under construction. The conclusion of the survey was that we

are now approaching the end of a real estate cycle. I think I can accept that statement. Agriculture remains weak. Our preliminary indication on our latest survey of agricultural land prices actually showed a little increase in 1984 but the first quarter now is beginning to show a little decline. So, it looks as though those who said we are about a year to a year and a half behind the Midwest might be right.

Having said all that, I would also share the view expressed by a few others regarding a little concern about overreacting on the side of ease, despite all the gloomy reports. The uncertainty is very, very great and I still think it remains to be seen which way the economy is going to turn.

CHAIRMAN VOLCKER. Governor Seger.

MS. SEGER. I have been very impressed with the size of the downward revision in the official staff forecast since our Humphrey-Hawkins FOMC meeting in February. That shows a far more significant change than just the change from the March meeting to this meeting. I must say that I concur with those downward revisions because of the problems with the manufacturing sector of this country and the import competition. The fact that imports are hurting not just the auto industry and not just textiles but a broad spectrum of companies in many, many different industries really depresses me. Also, I see the kinds of people who are aware of this: individuals I would expect to be unsophisticated and not even know what exchange rates are. But they are tuned in to the super dollar; they also are tuned into why it's super; and they know that it is hitting them very directly. I think that we have not seen the full extent of this yet.

Also, I continue to be very concerned about the fragilities of the financial system. I got on this jag early; unfortunately, it has been going on since '81 and '82 and I don't see it getting better. I see it getting a lot worse because it is not just a couple of states that have had specific problems, namely local depressions; it is now a lot broader. Unlike Jerry, I don't think this is because free markets don't work. I think the problems with the financial system go back to poor public policy in the '70s: namely, a very inflationary policy that sent bad signals to financial institutions and participants in financial markets. Then when the gears were shifted and we went into a more moderate approach to public policy, i.e., fighting inflation and producing deflation in certain sectors of the economy, it was a real adjustment for those people to make. Also, I think we have to be candid and say we probably have not regulated them as well as we could have. Supervision has left a lot to be desired. That is the message that I think comes through from Ohio and Maryland. It isn't that free markets don't work but that the supervisor did a crummy job. I think further that if you really started to dig into the asset portfolios of many institutions that have not been looked at, you're going to find a lot of water in there to squeeze out. We haven't seen it all yet. And when that squeezing takes place, I think we are going to see many, many more insolvencies. I am not just talking about thrifts; I am talking about banks. This is, of course, a problem for those institutions themselves but I am more and more worried about how that will impact on consumer confidence in general and on business confidence--and particularly how it will impact on these little towns in rural areas. If you want to have some fun, go back and read about

the 1920s and the problems in the agricultural community in that decade and what that did not just to agriculture but to whole sections of the country when the problems with farms brought down farm banks and the result was tremendous local recessions or depressions. I think this is one thing we have to take very, very seriously.

Finally, I just want to mention that I talked to three of the highest level economists in the auto industry and I'll just relay to you a couple comments from them because I think they are rather interesting. In general, their sales forecasts are below what we are talking about. One is using 10.5 million units or possibly slightly above that as total new car deliveries for calendar year 1985. Some of the sales that used to be in the form of autos are now going to be for small trucks, so there might be a little more in there; they think truck sales will be about 4.5 million. The big point this fellow made was that it takes a lot more marketing money to move cars. In other words, consumers are not coming in and beating the doors down to buy; they are having to be dragged in to purchase. Interest rate incentives are being used very heavily. The customers are interest rate sensitive, and the special promotional rates of 8.5 to 8.8 percent for slow moving cars have worked to move those specific cars. Auto makers are putting those incentives on some other cars--small cars--because they want to help their "cafe" ratings with the U.S. government. The penalties are going to be severe if they don't average out okay for this year, so they want to move more of these fuel economy cars to help that. Another chief economist is talking about 10.6 million deliveries for the year and truck deliveries of 4.4 million. But again, he mentioned this interest rate incentive to move new cars. It is substantial. He said that the going regular rate for new car loans would be about 14.5 percent and they are using 8.8 percent on selected lines. The third fellow says that the market at the moment is the strongest in this recovery if you just look at sales volume, year-to-date. According to his numbers they are coming out with 10.9 million [currently] but for the whole year he still thinks deliveries will be down somewhere around 10.6 to 10.7 million. And they're having to buy the business. He said the incentives provided on some of the big car purchases are $2,000. He also mentioned the competition from imports, such as Mercedes Benz, on the big car lines, and he brought up the matter of the strong dollar. In his view, we have not seen the full impact of the rise in the dollar in lower auto prices and, therefore, they have a lot of room to cut prices if they want to go after sales because this has just been going into their pockets in the form of profits. If they really wanted to go after sales more aggressively, he thinks they could. Anyway, [these economists] are not complacent about the economy as a whole and they see a slowdown being something that would cool off their numbers still more.

MR. GARBARINI. Since my District is contiguous in small part to Mr. Boykin's, I'm glad that they have found they are at the end of the building cycle. We have had space for lease in three of our offices for some time and have found that the overbuilding in those areas was recognized, at least by us, somewhat earlier. Our discussions with business folks in our District reinforce some of the comments Jerry made about their lack of optimism and what Frank said about firms giving some serious consideration to moving manufacturing facilities. However, I would say that in such discussions in the past

generally those folks were the most pessimistic right before things got a little better.

The lack of any what might be called "meaningful" growth in the first half wasn't too much of a surprise to us and was fairly consistent with the projections that we had made. As I recall, at the February meeting--and you testified about the central tendency [of forecasts] expressed around this table--we were somewhat of an outlier both on real output and inflation. On real output we were 1/2 to 3/4 of a point [lower] and on the inflation side about 3/4 to 1 percentage point higher. For the second half, even though there is that lack of optimism in the business community in our District, and in spite of the mitigating factors such as the strength in the dollar, I believe that the stimulation that we gave to the economy in the last half of 1984 and the first half of this year and the impetus of current rates and promise of a reduction in the budget deficit could give us stronger growth, perhaps even above that 3 percent plus level. I would echo Bob Black's and Governor Wallich's comments that at this point in time surely we are looking at uncertainty but not a disaster, and that keeping our eyes on our long-term goals is certainly appropriate.

MR. GUFFEY. Let me focus just briefly on the Tenth District economy. The major sectors in that economy are agriculture, energy--which includes both petroleum and mining [unintelligible]--aircraft, auto, and high-tech, including semiconductors. In that array, only one is doing very well and that's the automobile industry. The remainder are all in a depressed state. In agriculture the situation is basically the same that has been well publicized and that we've talked about around the table. I would note that, based on the results of a quarterly survey just completed, the land values in the Tenth District--that would be dry land, irrigated, and pasture land--are down another 6 percent from the end of 1984. In the aggregate for the District as a whole, land values are down 38 percent from the high of 1981. Now, that means that in some of those states it's down 30 percent, depending upon the kind of agricultural land, and in some states it's down 40 to 45 percent; on average, it is down 38 percent. But the important fact, I think, is that land continues to drop in value, showing a 6 percent decline from the end of 1984.

Energy, both the petroleum and mining, is just rocking along with no great hope of any resurgence in the period ahead. Aircraft manufacturers just can't sell commercial or private aircraft overseas as a result of the dollar. And with high interest rates and the uncertainty about what the future state of the tax law will be, corporations are just laying back in the woods and not committing themselves to aircraft. As a result the industry is struggling. The auto industry in the District, which is a very big employer and a big component of the economy, is going full out and that's the real positive aspect. In the high-tech area, which is in Kansas City, essentially, and in New Mexico and the eastern range of the Rockies, we find that the competition from overseas together with the [strength of the] dollar [has put] the semiconductor part of that industry at great risk. As a matter of fact, we had the second closing of a high-tech firm in Colorado this past week. They just are not able to compete with the overseas markets.

Having said all that, I would like to turn momentarily to the national economy. I take some encouragement from the comments that have come from around the table. There is very little concern about a recession. That is to say, the staff's forecast of 2 to 3 percent growth for the year as a whole suggests that we will be in the positive figures and perhaps not working against the high unemployment rate. Nonetheless, there is no concern about recession, and I find that true in talking to people in the Tenth District; recession is not on their minds. Our staff, looking at the outlook for the period ahead, would forecast just a bit more expansion in the second and third quarters than the Board staff's forecast, but on balance we would come out for the year as a whole about where the Board staff comes out, with slightly more growth in the latter part of the year because of the interest rate action that was taken most recently. There are two parts to that expectation of a bit more expansion than in the Board staff's forecast: one would be inventories in the second quarter and the other would be domestic consumption remaining very strong through the second and third quarters. My own view, however, would be a bit more optimistic than the Board's staff or even my own staff. Given the money growth in late 1984 and the early part of this year, I think the chances are that we will see some real strength beginning to emerge in the third quarter and maybe on through the remainder of 1985.

Having said all that, I also have met with the small business and agricultural group as well as people around the District and, clearly, the focus in their minds is the strength of the U.S. dollar. That touches each of the areas that I mentioned that the Tenth District is involved in. It is becoming very [apparent] that they tie in the federal budget deficit with the dollar and they see that as their enemy at the moment. The most recent decrease in the interest rates is looked upon very favorably, and I should think the reduction of the discount rate will fall in that category. I would just note, if I heard the Vice Chairman right that he could not [identify] any financial markets that didn't have froth in them, that I can tell you that the agricultural financial markets don't have froth in them.

CHAIRMAN VOLCKER. No new froth.

MR. GRAMLEY. Well, we are hearing a lot of gloomy reports today and that's understandable. There is a lot to be gloomy about. When that sort of thing happens I think it's worthwhile at least to remind ourselves that there are some positive signs developing. Housing has been moving up for four or five months now. I agree with Jerry that we have had enough reduction in interest rates, given the lag in the way they affect spending and credit sensitive sectors of the economy, that we should expect to see some results from that as time goes on. I would regard auto sales as a positive; they may go down but they certainly have been quite strong recently. Consumers remain quite confident. And I take some comfort in the fact that, although investment spending intentions for 1985 are a lot more subdued than they were at this time last year, we don't seem to have seen any further deterioration from the fall to the spring. That rather surprises me, but maybe it will turn out that that won't hold up. We should remind ourselves also, I think, that periods of slowdown during an economic expansion are the rule, not the exception. If I remember my business cycle history correctly, Wesley Mitchell and Arthur Burns used to talk about a mid-cycle retardation, which

occurred about 3/4ths of the time. The problem is that we don't know whether we are in the 3/4ths now or in the 1/4th. I am not a wild optimist by any means. I agree with the staff's forecast that we will have some pickup in economic activity. I have a hard time assessing whether the risks are a little on the minus or the plus side, but I think I would assign a probability of .001 to an outcome of more growth over the next year than I would be comfortable living with.

Now, I would like to put that in a longer-run context. I think we ought to take into account the fact that what we are looking at now is an economy that is being severely depressed by competition from the international side. It's a consequence of a horrendous increase in the value of the dollar and the dollar is eventually going to decline. When? I don't know whether it is going to be next week or next month or next year; but when the dollar goes back down, we could find the economy as severely stimulated as it is now being depressed. And if that occurs in the context of a federal structural budget deficit that is still rising, we are in big trouble. That may not happen, but I think one has to remember that the problem we may be worried about on average over the next three years is not too little growth but too much, and not too little demand, but too much. We need to keep that in mind as we think about the course of monetary policy under present circumstances.

MR. PARTEE. Well, Lyle said a good deal of what I was going to say. This has been such a gloomy go-around today that I thought maybe I couldn't even survive it! I didn't get any sense as I was listening to everybody that in the first four months of the year nonfarm payrolls rose by more than 1 million workers. That's a tremendous rate of addition to our employment.

CHAIRMAN VOLCKER. Want to be gloomy? Look at how lousy that means productivity grew.

MR. PARTEE. Well, we don't even measure productivity in services or trade and, of course, that is where the employment gains were. They weren't in manufacturing. I think that we tend to be bemused by manufacturing, because historically it was the cyclically volatile sector and historically where we thought we got our oomph. And, of course, we are not getting any now with the import competition. I agree with Lyle that that is a temporary phenomenon, although temporary in terms of years, perhaps, rather than months. But we really have had a very buoyant domestic economy in my view, with the strength being sapped by the import competition. And I think we ought to keep that in context.

Now, I'm as concerned as anyone here--even Pres--about the condition of the financial markets. I think that they are in terrible shape. In fact, I can't even bring myself anymore, Bob, to say what you say about the banking [system]. I don't know that it is sound or that banks are in good condition. I am very much taken by the fact that we are 2-1/2 years into the recovery and that we are still talking about all of these problems. We have a thousand problem banks, [the ones rated] fours and fives. We have failures moving along and we are 2-1/2 years into the recovery. What happens come a recession--which will come? I don't know. There may be no way out of this box. But I do believe that the worst conceivable thing that could happen--the thing I have nightmares about--is a situation that

brings about the necessity of a substantial increase in interest rates. By substantial I don't mean a point; I mean a substantial increase in interest rates because of, let's say, a very sharp drop in the dollar or a sudden strengthening in the economy because of less import competition or an inflation rate that accelerates. I remind all of you that all the research shows that inflation starts with prices, not wages. And then when prices move up, wages follow. They will do it this time too--that is, if we have another rise in prices. But an increase of 3 or 4 percentage points in interest rates would absolutely sink most of our financial institutions--certainly most of our thrifts and a good many of our other financial institutions. So, I think the big thing to guard against is getting ourselves into a situation where perforce we have to tolerate or accept, and maybe even encourage, a substantial increase in interest rates six months from now, a year from now, or a year and a half from now, as the case may be.

So, I find myself a little timid on this business of stimulating the economy at this point through monetary expansion. Some fluctuation in rates is all right, certainly. One has to recognize that we are not anywhere close to our potential, that we very easily could accommodate in the near term more growth than is forecast, and that we may not have as much growth as is being forecast, because quarter after quarter we have had shortfalls in our projections. But I wouldn't want to do that in any kind of gung ho way because I think that would raise the odds that a subsequent sizable fall in the dollar and a subsequent increase in observed prices would bring higher rates that would give us really serious financial troubles in our system. So, I come out on the side of caution and moderation in what we do today.

CHAIRMAN VOLCKER. Mr. Axilrod, why don't you pronounce an invocation.

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

[Coffee break]

CHAIRMAN VOLCKER. Let me just make a couple of very brief comments. In terms of the business situation and outlook, I myself would be quite surprised if we have seen the end of the import penetration at anything like the current exchange rate. I think that process is maybe not in midstream--it's beyond the midstream--but we are not to the other shore by a long shot in my own appraisal. Mr. Morris expressed a bit of surprise at the timing of the discount rate change. I am not quite sure what you had in mind. You may have had in mind the timing relative to this meeting.

MR. MORRIS. Yes.

CHAIRMAN VOLCKER. That was a factor that we considered and we thought on balance that it was better to get it out of the way before the meeting--kind of as a benchmark--rather than leaving some question as to how it would fit in connection with open market operations. I would simply say that I did not have in mind that we would be reversing direction of that action by tightening up on open market operations. With that much preliminary, who would like to comment?

MR. MORRIS. We have observed in Boston that the only thing in the economy that is very strong is M1. I have distributed to all of you a chart that I thought was rather interesting entitled "Super NOW Account Yields." In the last six months more than a third of the growth of M1 has been in Super NOW accounts.

CHAIRMAN VOLCKER. In Super NOWs as opposed to NOW accounts?

MR. MORRIS. Ten billion dollars out of the $26 billion growth in M1 has been in Super NOW accounts. In the prior 6 months, instead of growing at a $10 billion rate, they grew at less than $2 billion. I think the answer to why M1 exhibited slow growth in the middle of the year and very rapid growth in recent months is shown on this chart. The interest rates on Super NOWs as administered by the banks tend to be rather sluggish relative to market rates. When rates went up sharply in the spring and summer, the opportunity cost of holding Super NOWs relative to money market mutual funds rose substantially, so we had a very slow rate of growth in Super NOWs. As the opportunity cost dropped--there's now only a one percent differential and I suspect in the weeks ahead it may drop below the one percent level--you would expect people to--

CHAIRMAN VOLCKER. Before you say that, let me just ask: A one percent differential between what and what? That's not what it looks like.

MR. MORRIS. The difference between the [yields on] money market mutual funds and the Super NOW accounts is about 1 percentage point. In the original that bottom chart was colored; the differential was about 1 percentage point as of April. I suspect now it is probably down lower than that. As the opportunity cost changes I think you would expect that the public's willingness to hold Super NOWs relative to money market funds would change; and it changes in precisely the direction that you would expect. So, I think this explains a part of the acceleration in M1 growth--not all of it, but a part of it. It also raises again the question that I have been raising for several years: If a large, and the fastest growing, component of M1 is paying a rate very close to the money market mutual funds rate, should you expect the aggregate that contains that rapidly growing component to behave the same way as it has in the past? Quite clearly, it seems to me, the new M1 is going to be more interest sensitive than the old M1 as long as the stickiness of the Super NOW account rate persists; and the relationship between the new M1 and the nominal GNP is going to be as unpredictable as it has been during the past few years.

CHAIRMAN VOLCKER. It all sounds very plausible to me. I asked a similar question to the staff recently and they told me there was nothing to it, so I will let them respond. I may have misinterpreted their answer.

MR. AXILROD. I think what you're observing is the interest sensitivity of M1. This is why the models have been predicting large growth in M1. This was somewhat of a phenomenon in earlier periods. Part of the growth of the Super NOWs, of course, is related to the switching out of NOWs when the minimum went down from $2500 to $1000 at the beginning of this year. But if you go back for six months, there has been a $10 or $11 billion increase in regular NOW accounts,

including Super NOWs, so that they have been--as they have been in the past--a large part of the increase in M1. That is the reason we have been contending that M1 cannot have the same degree of weight it had in 1979-1982. There are a lot of reasons for that, but one is that one cannot be certain how M1 velocity is going to behave under different circumstances. I think President Morris rightly points out that the interest sensitivity has increased with the Super NOWs and NOWs in M1 and the sluggish behavior of their rates was indeed quite a phenomenon in 1982 and early 1983. But after a while we are not sure what is going to happen to that interest sensitivity. If the institutions begin moving their rates with the market rates, then to a degree that interest sensitivity will diminish. Our own uncertainty in that respect is one of the reasons that we are a little reluctant to advocate M1 strongly at this point. We just haven't had experience in varying kinds of circumstances as we go through all of these transitions.

MR. MORRIS. But it does suggest to me that with rates coming down and the differential narrowing, if anything, we could very well see sustained strong growth in M1.

CHAIRMAN VOLCKER. Well, what I asked you, [Mr. Axilrod], explicitly the other day was: Does it look different if you look at the old M1 and M1A? You told me no, but this would seem to imply that it should look different.

MR. AXILROD. Well, on other figures they don't behave differently--the velocity behavior and the growth rates behave very similarly. Give me a second and I can round those figures up here.

VICE CHAIRMAN CORRIGAN. While Mr. Axilrod is looking, I will give you a sample of one.

MR. AXILROD. In the first quarter, growth in M1 was 10-1/2 percent and growth in the old M1A was 6.8 percent. In the second quarter, growth in M1--this is with certain assumptions--would be around 6.7 percent and M1A would be 5.3 percent. If you look back since 1981--omit the year 1981--in 1982, 1983, and 1984 growth in M1A was running anywhere from 1-1/2 to 5 percentage points below growth in M1. So the relationships that have emerged in the first and second quarters are not that different. The velocity of M1A declined 0.3 of a percent in the first quarter when velocity of M1 declined about 0.4; in the second quarter the velocity of old M1A was about unchanged, or down a little now given our revisions, and it was down 0.2 percent on old M1. So they are behaving roughly the same. But the greater growth in M1 relative to M1A is a function of the greater growth in the NOW account component. But the structural relationship--

CHAIRMAN VOLCKER. What were the fourth-quarter figures?

MR. AXILROD. Fourth quarter of 1984? M1 grew 3.2 percent and M1A 1.4 percent; the velocity [growth rate] was around 3-3/4 percent for M1 and 5-1/2 percent for M1A. M1A has had a steadily higher velocity [growth] for several years now. The reason is that NOW accounts have low velocity [growth].

MR. GRAMLEY. There is another way you can get basically the same conclusion. One of my favorite ways--nobody else likes it but

me, I guess--is to look at those old money demand functions and ask: What would money have done if the relationship between GNP and interest rates and the growth of money had been what it used to be? If you do that, you find that over the past year the predicted growth of M1 on those old money demand models was 6.9 percent compared with an actual of 6.2 percent; for the past two quarters predicted growth was 7.0 percent compared with an actual of 6.8 percent. I think the really big question is not so much whether money is behaving in a peculiar way relative to what might have happened in the past if old money demand models prevailed, but rather whether money growth has the same kind of meaning when you have an exchange rate that is way, way out of line. We used to think that money was related to aggregate demand not to output. That in itself makes a difference. But maybe even the relationship between money growth and aggregate demand is not the same in a world of wildly volatile and fluctuating exchange rates.

CHAIRMAN VOLCKER. That's another thing you can look at--that this money growth may not look all that odd compared to demand. [Unintelligible] 4 percent in the first quarter.

MR. AXILROD. Mr. Chairman, I did ask some people to run some--Mr. Garbarini will excuse the words "simple-type"--simple-type St. Louis model predictions from M1. That had been something we tested back in 1982-1983 to see if there indeed had been some sort of demand shift. In that period, M1 had been predicting a lot higher nominal GNP than actually developed. We were in a discussion with monetarists [unintelligible] would be needing, and indeed the nominal GNP came in lower than the monetarist-type models would predict. M1A in those days was not predicting so badly for 1983. Now, simple predictions on M1 underpredicted in the first half of 1984 and overpredicted in the second half. Looking into 1985, they would predict in the first quarter a 9-1/2 percent nominal GNP, which is almost 3 points or so higher than we got; and they are predicting double-digit nominal GNP, of course, in the second and third quarters. The old M1A is also predicting nominal GNP higher than our staff is predicting, although not as high as the M1. So, if the nominal GNP comes out about as our staff predicts, it looks as if we are going to see a pattern somewhat similar to what happened in 1983 in terms of these predictions.

CHAIRMAN VOLCKER. Well, what I conclude from all this discussion is that we better have a little more orderly analysis of this before the next meeting when we have to look at those [long-run] targets.

MR. AXILROD. We will provide some.

MR. MORRIS. It does suggest that if M1 keeps rising very rapidly between now and July that we might have to rebase it for 1985.

CHAIRMAN VOLCKER. I think we can face that issue then. Meanwhile, who would like to make a suggestion? In the absence of any other suggestions, I will make a suggestion: Keep the reserve pressures about where they are.

VICE CHAIRMAN CORRIGAN. As long as we know where they are. I will make a suggestion which really does involve keeping reserve pressures about where they are. In terms of the monetary aggregate

specifications, I can easily live with those specified in alternative B. I personally would shade the borrowings level a bit higher than the staff's suggestion of $300 to $350 million. This is really splitting [hairs], but I would rather see it $350 to $375 million because I think that is compatible with existing money market conditions, as I understand them.

MR. PARTEE. Now, what are you doing with the thrift [borrowings]? Is that--

VICE CHAIRMAN CORRIGAN. The thrifts are out as described by Mr. Axilrod in his [briefing] a few minutes ago.

MR. PARTEE. Totally out, Steve?

MR. AXILROD. Well, that's what I was assuming.

MR. PARTEE. You regard them as a functional equivalent of extended credit?

MR. AXILROD. The Ohio thrifts are on extended credit and the bulk of those in the Richmond District are on extended credit at the moment. Some additional ones may be put on.

MR. PARTEE. Oh, is that right?

MR. BLACK. We would be glad to put them all in there, if you will take it out of that figure, because it is like extended credit on those that [unintelligible] for a short time; [the institutions are] not feeling the adjustment pressure that is ordinarily felt in adjustment credit.

CHAIRMAN VOLCKER. I would think you could [unintelligible] out of extended credit as you do out of adjustment credit.

MR. BLACK. The rate is higher.

CHAIRMAN VOLCKER. Those institutions are under some pressure.

VICE CHAIRMAN CORRIGAN. Again, I would take alternative B with borrowings of $350 to $375 million. We have this awkward problem of having set monetary growth paths for the quarter in March that, especially in the case of M2 and M3, just are now so far out of line with what we were talking about then that I think we have to consider --although no one likes it--finessing the language of the directive to acknowledge that situation at least as it pertains to M2 and M3. I think M1 we can finesse without any great problems. That's about where I am.

MR. PARTEE. You are prepared to accept those low M2 and M3 numbers, though?

VICE CHAIRMAN CORRIGAN. Yes.

MR. PARTEE. You don't think that there is any information content in them?

VICE CHAIRMAN CORRIGAN. I do not.

MR. MARTIN. Picking up on Governor Rice's comments with regard to the economy growing under its potential, I would certainly subscribe to that comment. I don't know whether it's 3 or 3-1/2 percent or more, but certainly [2.7] percent and a range of 2 to 2-1/2 percent are under potential. It seems to me, though, that that question is properly addressed in the July review rather than in this short-run situation we face. Secondly, I would like to address the suggestion that M1 be brought down to the band--I think it was the band, not the cone. I won't get too methodical with you here. It seems to me that the growth in GNP right now is too low, and that there is a downside risk. The 7.3 percent potential growth rate [for M1] that Steve mentioned earlier--if that is the case for the year--I don't find all that disturbing, considering the discussions that we have had with regard to V1. It seems to me that in the usual model it would take a federal funds rate--what would it be: 8-1/2 or 9 cent?--to bring M1 down within that band. And it seems to me that that is not called for under these circumstances.

As far as alternatives are concerned, the point I was trying to make by reviewing the horror stories that unfortunately are real and not in the movies anymore is that I think we made the correct move in reducing the discount rate but that there is enough speculative fever out there that if we were observed doing anything further in the direction of ease, we would run a risk that I don't believe is necessary of aiding and abetting that fever. So it seems to me that this is a wonderful time for the Chairman--as only the Chairman can do--to make that representation that we are central bankers and we are concerned with orderly markets and inflation and we are going to hold the line, as it were. That gets me certainly to voting for alternative B as the closest thing to the status quo I can read out of today's confusing events and the description thereof. If the market expects a nudge further in the direction of ease, our failure to satisfy that expectation might be the best thing we could do right now, when I feel there is so much potential panic out there. As far as the borrowing is concerned, I go along with Jerry's suggestion of $350-$375 million, partly because I cannot understand how the thrifts' borrowing [fits], and secondly because I don't know how much borrowing will occur as unfortunate events unfold and how that will affect the borrowing level. It seems to me that results in a federal funds rate, perhaps as was indicated, between 7-1/2 and 8 percent; and I think that is appropriate in terms of market pressures and the discount rate reduction.

MR. BLACK. Mr. Chairman, my wife tells me I'm hard to please and if she were here today she would say that my actions would prove that because I don't like any of the alternatives. I am mindful of the risks involved in this, but all of these alternatives would put us above the upper band and also above the upper cone for M1. And I just don't think anything would be gained by pushing M1 above the long-run target range; on the contrary, I think we have a lot to lose. The financial market participants are well aware of these parallel bands and if they see us running short-run targets above those bands, I think they are going to question our anti-inflationary resolve. Therefore, I couldn't accept anything above 5-1/2 percent, which would put us about at the top of the band. Actually I prefer 5 percent, which would give us a little breathing room. I don't know what kind

of federal funds rate it would take to do that--it might take a little bit of an uptick from where we are now--maybe where we were right before the discount rate was cut. But if that had to be, I would rather see that than encounter the kind of scenario that Chuck outlined earlier, where later we find that we were wrong and have to push it up still more. And if an increase is necessary, I think that might be some indication that the economy is really stronger than the Greenbook suggests.

On this matter of not changing policy: If the Committee does adopt alternative B, as I suppose it will, I think most people would regard that as a clear easing of the short-run policy stance that we adopted at the March meeting. Now, there is nothing in the directive language to indicate that any easing has occurred but we have taken a small step in that way. And in particular the term "maintain" in the first sentence of alternative B would be somewhat confusing. I recognize the system we use and that the term "degree of reserve pressures" refers to the level of borrowing. But I don't think that the outside world looks at it quite that narrowly, so they might not understand it. So, I think that's at least a question we ought to address if we go with "B" as I would guess the Committee probably is going to do.

MR. RICE. I would just like to respond very briefly to some of the observations that have been made. First, if I thought we were facing an inflation rate of 5 percent, I certainly would be much more concerned and that would be reflected in my view of appropriate policy in that I'd probably want to be more restrictive. I don't think we are. Secondly, if I thought we could get the inflation rate down under 2 percent by keeping the economy growing at 2 percent and the unemployment rate at 7.3 percent, I would be willing to do that too. I would be willing to pay that price, but I don't think we can get inflation down below 2 percent by holding the economy down at such a low rate of growth. I don't see any beneficial effects to be achieved from such a slow stagnating rate of growth and that is why I said that we ought not to be satisfied with anything less than 3 to 3-1/2 percent. Having said that, I would favor alternative B with a tilt toward "A." By that I mean that I would be willing to relax borrowing a little below Jerry's recommendation and more in accord with the borrowing that we would expect to be compatible with alternative B--in the $300 to $350 million range.

MR. KEEHN. Well, I do think we are probably at a time where maintaining the existing degree of reserve pressure is appropriate. I am a little unclear as to whether that is "B" or "C" at this point. I am a bit uncertain about the thrift aspect of the borrowing level, so I think I would favor alternative B. If I were going to vary from that, I would have a slight tendency toward "C," which maybe suggests raising the borrowing level a bit from the earlier recommendations to the area of $400 million. That seems to me probably about where we are, adjusting for the thrift borrowing.

MR. GRAMLEY. Well, I earlier indicated that I think we have to be thinking about where we are going over the longer run in deciding on policy today. By that I mean that I don't think we ought to dump in reserves in buckets. We shouldn't act panicky. We shouldn't let rates drop a ton. We should be ready to take back whatever additional stimulus we put in now, if it turns out that the

economy gets a bit more robust as the year goes along than we now are forecasting. I do think that what we need to worry about most with respect to M1 is not so much how fast it is presently growing, but whether or not there is going to be an impression out there that the Fed is throwing in the towel on inflation. If that impression were widespread, I would be deeply concerned. I don't sense that now and I do want to make sure that we don't give that impression. But I am perfectly happy to go along with the specifications of "B" and the borrowing range specified by Jerry of $350 to $375 million.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. Just a word on this matter of M1 showing growth above the band: I think we're all aware of the fact that there has been a change in the pattern of velocity here, probably stemming from deregulation and what that has done to the interest elasticity of the demand for money. In any event, our staff felt at the time of our February meeting, and still feels now, that we're likely to see a decline in V1 of approximately 1 percentage point for 1985 as a whole. So that influences my view of what the appropriate growth rate of M1 is. Because of that decline in velocity that seems to be going on, I'm not concerned that we are courting inflation or a reigniting of inflation in the near term.

With respect to the specifications, I would be in favor of the federal funds rate associated with alternative B of about 7-3/4 percent and borrowing in the neighborhood of $300 to $350 million. The San Francisco money model, given those and other inputs, would expect the growth rate of M1 to be more like that shown in alternative A. If it were 7 percent or a bit higher, that would be all right with me in view of the losses in the economy and the view I expressed earlier today about tilting in the direction of ease until we get some better balance back in the economy. So, as I mentioned, I would favor alternative B.

CHAIRMAN VOLCKER. Mr. Forrestal.

MR. FORRESTAL. Given the sluggishness of the economy and the fact that inflation is at a moderate rate and the dollar--in spite of its recent declines--is still at high levels, I think the Committee should appropriately confirm or ratify the accommodative stance that has been taken over the last couple of weeks. I'm not particularly disturbed about M1 being over its band at the present time, given the relative weakness of the broader aggregates and what I sense is going to be a continued weakness in the second quarter. So I would think, Mr. Chairman, that we ought to maintain the current reserve pressures, if "pressures" if the right word to use at this point. I would opt for alternative B with the borrowing specification given in the Bluebook which would translate in my mind to a federal funds rate of about 7-3/4 or 7-1/2 percent.

CHAIRMAN VOLCKER. Mr. Stern.

MR. STERN. Well, Mr. Chairman, I generally would support alternative B. I must admit to being a little concerned about selecting a target that leaves M1 above its channel. But it seems to me that at this point in time that is a relatively low-cost insurance policy, if you will, that may at the margin help economic performance.

That seems appropriate to me under the circumstances and, therefore, I don't have any problems with the general specifications of B. I don't have a conviction on the borrowing level, in part because of some of the noise that's affecting those numbers. But it seems to me that maybe a borrowing target centering on $350 million would be appropriate under the circumstances.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I think last week was an historic week in the evolution of the thinking of the Federal Reserve. On Thursday we announced a $2-1/2 billion rise in M1 and on Friday we announced a discount rate cut, which shows that we're really learning from experience.

MR. PARTEE. Or that we didn't know what the money supply was.

MR. MORRIS. As I read the numbers, it's clear to me that the U.S. economy--and I think the world economy--needs a lower level of interest rates in the United States to the extent that that can be produced without jeopardizing our determination to control inflation. It seems to me, therefore, that it's appropriate for us to probe a little on interest rates. I'm not completely persuaded that what has happened already will be enough. But I think we ought to sit back and assess things before we move any further. So, I would support "B" with Jerry Corrigan's $350-$375 million on borrowing.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. I favor alternative B, but I think we ought to recognize that alternative B in the context of a 7-1/2 percent discount rate is an easier policy than in the context of an 8 percent discount rate. I think it's technically correct to say that we're maintaining the same policy. But for the world at large that's only going to be a technicality. I would think we would be better off in the wording to use the words "maintain the existing degree of pressure on reserve positions" but that we might add the phrase "in the context of the recent decline in the discount rate." Otherwise, I think we're going to let something that is technically correct in a very narrow sense lead us into a communication problem. The other point is that the M1 specification of 6-3/4 percent strikes me as being overly precise; perhaps we ought to round that to something that looks a little more even, like 7 percent.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I have some sympathy with Bob Black's position. It makes me uneasy to be running above track on M1. There's no magic in it, of course. But we specified it and it is a relatively high number historically. We're at the time in the cycle when it's conceivable that we're seeing weaknesses here and there that could do the kind of thing that would lead people to say, as they do about the '70s, that we acted in an inflationary manner. It is a sensitive time to overrun the objectives that we have set before. I am impressed, however, by the fact that the M1 target ranges were set in the context of a higher interest rate structure than we now have. And interest rates, as Frank has pointed out, do now very much affect

the behavior of M1. So, that may be somewhat of a temporary explanation at least. I think we need to review this all quite thoroughly for the next meeting, including what NOW accounts are doing, particularly Super NOWs. You remember when the minimums were reduced on all of them in January that we said we were going to watch carefully to see what happened. I'm not sure that we have watched that carefully since then, having decided that nothing was going to happen. So that all ought to be reviewed. I'm also impressed by the extreme weakness in M2 and M3. I've asked about that several times and I'm always told that it's a technical thing that will soon reverse itself. But, in fact, if you look at the family of aggregates--and you remember that the Committee has a family of aggregates so that it won't be misled by some exotic movement in one of them--we're in pretty good shape. M2 and M3 have declined down not only within the parallel lines but are now within the cones. And seeing that gives me a little more comfort. So, I would accept alternative B. And if I were going to err, I'd err on the side of tightness rather than ease.

MR. MORRIS. I just wonder whether the weakness in M2 and M3 is--and we saw this at the same time last year--an IRA account phenomenon.

MR. PARTEE. Well, it could be that. It could be the Treasury refund situation and the big Treasury balance. I think we just have to look at it.

MR. MORRIS. Well, as I recall, didn't we have a similar kind of weakness last spring, Steve?

MR. AXILROD. Not that dramatic. If you put in all of the IRA increase seasonally unadjusted, that would add 4 percentage points to the growth rate. And assuming that our seasonal on the nontransactions component--

CHAIRMAN VOLCKER. 4 percentage points for one month?

MR. AXILROD. Yes, at an annual rate, for one month. If you assume that our seasonal on the nontransactions component caught at least half of that--which strikes me as a reasonable assumption--you'd add a couple of points, which would leave growth still very weak. You'd need other explanations.

CHAIRMAN VOLCKER. These M2 and M3 numbers are quite low however you look at them. If they were really that low for the quarter, I'd worry a bit. It allows much room for increases. Mrs. Horn.

MS. HORN. Mr. Chairman, I'd like to show some progress in moving the monetary aggregates--M1 in particular--toward where we want to be at year-end. Because of the uncertainties in the economy and the uncertainties with respect to velocity, where I personally would like to come out at year-end is in the top part of the ranges, particularly for M1. I'm not in favor of bringing it back too fast for a number of reasons, including the uncertainties. But I'm also not sure it's the appropriate time to be active on the other side either. So, I would favor alternative C, but I would favor changing the borrowing number upward slowly as things develop.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I would favor the aggregates specifications of alternative B. It doesn't bother me greatly that we are at, or near, or above the top of the parallel line [for M1], given the weakness we've had. I think it's an appropriate response, with the velocity [growth] being negative for what would appear to be two quarters. But what I am bothered about is the borrowing level suggested in the Bluebook: the $300 to $350 million range, which will achieve a 7-3/4 percent federal funds rate. If I'm correct in my thinking about that, if we maintain the same pressures on reserves that we've had in the past and have dropped the discount rate 1/2 percentage point, then that would suggest that in order to get a funds rate of 7-3/4 percent we would need to have the same borrowing level that we had before we dropped the discount rate. And if I understand the numbers right, that level is closer to $400 million than it is to $300 to $350 million. I think borrowing averaged $380 million over the intermeeting period. The point that I'd like to make is that $300 to $350 million seems a little low and I would be a little more cautious so as to get to the 7-3/4 percent over time. As a result, I would opt for a borrowing level of $375 to $425 million with a target, obviously, of $400 million starting out. And I should think that if we're looking ultimately to move to 7-3/4 percent that we can do it gradually.

The other point that I would make, and I've made it before, is that seasonal borrowings are now running about $170 million, which is half of the $300 to $350 million, and they will continue to build over the upcoming intermeeting period. Therefore, with a $300-$350 million borrowing objective, we're really getting very close to turning loose and actually pegging the federal funds rate, which I would oppose. Therefore, I would accept "B" and recommend a borrowing range of $375 to $425 million, centering on $400 million for the start of the intermeeting period.

CHAIRMAN VOLCKER. Ms. Seger.

MS. SEGER. As I reviewed the table here and the charts on the various monetary aggregates, it seemed to me that what I saw for M2 and M3 was, as Chuck said, that as of April we were already not only within the parallel lines but within the cones. Also, as I look at where the various alternatives A, B, and C are plotted for the end of the quarter, they are not really that far apart. They are within the cones at that point. For M1 I see that as of April we're a touch above but with each alternative--A, B, or C--we are going to be above the parallel line. So if we're concerned about how the financial market participants would view this, I don't see that it makes more than about a nickel's worth of difference. I don't think that they just look at M1 to begin with; and secondly, I don't think that they would be that sensitive to these short-range positions we are taking. So I guess I could practically roll the dice here and say that if everyone is going with alternative B, I certainly can. But I hope if there is a way to lean that we would lean toward alternative A rather than toward tightening, particularly because I think we have to be very careful about what our actions do to the fed funds rate and what message that sends to market participants about what we did today. In terms of the borrowing target, frankly, I'm so confused about how the thrift numbers come in here that I really don't know exactly what

number to pick up. But I think I would rather have it lower than higher, which is a very vague way to put it.

CHAIRMAN VOLCKER. Mr. Garbarini.

MR. GARBARINI. Mr. Chairman, I strongly endorse your recommendation that monetary policy be consistent with what we've been doing recently. I'm concerned that, while monetary policy might work with lags, monetary messages work somewhat quicker. And it seems to me that anything other than "C" gives a message of a move toward ease. If we had to go with "B," I'd agree with Roger that at least we should increase the borrowing level.

MR. PARTEE. I wonder, Paul, whether the staff has any view on this seasonal borrowing point that Roger made. I had sort of forgotten about the fact that it would be moving up--I presume significantly--in weeks to come.

MR. AXILROD. Well, it may. It looks like it would tend to rise a little in May naturally, although in 1984 the spread between the funds rate and the discount rate was about the same as in April--maybe a tad higher. It looks to me at least that if the spread between the funds rate and the discount rate is unchanged, that it probably would be running, say, $30 or $40 million or so or maybe a little more above what is "normal" for seasonal borrowing given this spread and this time of year. So, implicitly, the $350 million was allowing for that. And that probably would give you a funds rate of 7-3/4 percent shaded on the down side I would guess rather than shaded above. I don't know if Mr. Sternlight agrees or disagrees with that.

MR. STERNLIGHT. No, I'd agree with that--shaded to the down side.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. I would find alternative B acceptable. In my view the borrowing assumption as a minimum should be $350 to $375 million. I would not go below that.

CHAIRMAN VOLCKER. Governor Wallich hasn't been heard from.

MR. WALLICH. Well, as I said before, the chief monetary objective that I envisage is to overcome the stickiness of the long-term rate and to bring about more reasonable real long-term rates. This can be done by steepening the yield curve--that is pulling the short-term rate down--provided that it doesn't lead to an excessive acceleration of M1 or the other aggregates. Fortunately, that seems to be what is happening now, so our range of maneuver is very limited. We have already reduced the funds rate, the short-term end of the yield spectrum. And I think we've probably done as much as we dare right now. One has to observe what the market does. If the market accepts it and brings down the long-term end so that the yield curve doesn't steepen, well, then one has made a step forward and one shouldn't take any risks of the market rejecting the maneuver. In practical terms I'm concerned also by how quickly one moves from the cone to the band. The main virtue of the band that I see is that it seems to give us in writing a lot of leeway; it doesn't matter whether the money supply overshoots quite sharply in the short run; we don't

have to bring it back immediately. But other than that, the band is not a good guide. It's the cone that is the right guide. So given the constraints, I can go with "B" and I can go with $350-$375 million on the borrowing and a funds rate to match, which would be 7-3/4 percent or a little more perhaps.

VICE CHAIRMAN CORRIGAN. I'd just make one quick technical comment on M2. In March and especially in April there has been a very substantial runoff of RPs, which we think is associated with the anomaly of the Treasury balance and the refund problem. That itself is a major factor in terms of abnormally slow growth of M2 in this period.

MR. PARTEE. Yes, I think that's right. But I'm hearing also that April was the lowest M2 growth since 1970. That goes back a long way. It may be strictly technical, but it gives me pause so long as I see it there.

VICE CHAIRMAN CORRIGAN. I agree. But the runoff of RPs, Peter, was how much in April?

MR. STERNLIGHT. I think that was the main factor in the weakness in M2 but I don't know how many percentage points.

VICE CHAIRMAN CORRIGAN. It was big dollars.

MR. PARTEE. One of the things is that thrifts are getting to be a part of these numbers and we know that FCA is still in trouble. And as a matter of fact the whole savings and loan industry seems to be much less aggressive in terms of expansion--I guess because of the Home Loan Bank Board rule on incremental net capital. So I'm wondering whether there might be something more there.

CHAIRMAN VOLCKER. It may well be. It's probably unduly optimistic to think that they decided not to make so many bad loans.

MR. PARTEE. No, they're going to make as many bad loans but they're going to make fewer good ones!

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. Mr. Chairman, there seems to be some misunderstanding as to what the level of borrowing is that we set forth with respect to the different alternatives, especially with "B." I would ask Steve--and I think the rest of you might be interested in the answer--whether, as I understood it, the level of borrowing he was talking about in the Bluebook assumed that all the so-called special situation borrowing with respect to thrifts would be treated as other extended credit. So, that is not as fluky a number or as unpredictable a number as it might otherwise be. That is the understanding, is it not?

MR. AXILROD. Well, that's how we wrote the Bluebook. I think what's unpredictable, essentially, is the relationship [of borrowing] to the funds rate. There has been a lot of looseness in that relationship. And I don't think any of us can guarantee any particular funds rate for any particular level of borrowing. We can guarantee sort of an area, but not any particular level.

MR. GUFFEY. As a follow-up on that: Your $380 million borrowing level that you averaged out over the period excluded everything, right?

MR. AXILROD. I excluded it. That's right; I took out all of the special situation borrowing.

CHAIRMAN VOLCKER. Which is clearly wrong at the extreme, it seems to me.

MR. PARTEE. Yes.

MR. AXILROD. In the same sense that it was wrong to take out all the borrowing by Continental last summer. Some fraction probably should have been left in there; I assume that some of it was not extended credit.

CHAIRMAN VOLCKER. Small or large. Well, there's no great desire to change things aggressively. That is a point with which I agree, but let me just make a couple of supplementary comments. I don't know where we are on the economy; it's not looking very good. I do know the exchange rate is awfully high and I surely wouldn't want to push it higher. I would rather do the reverse. I don't know what is going on with M1 or M2 or M3. I know they are giving out different signals, but I don't feel very religious about M1 at this point. If the economy shows further signs of softening and the dollar is going higher and financial strains in a number of directions continue or get aggravated, as they well might, I think we're running some financial [risks] in the financial system, clearly. There are financial strains across a large part of the structure of the American manufacturing industry at least. One is partly related to the other. And I think we have to maintain some flexibility on the easier side, although I wouldn't [move in that direction] right now. I think that's a much more likely hypothesis than the opposite, although I don't mind maintaining flexibility on the opposite side either. This alternative B/alternative C business never appears in anything [we publish]; maybe we ought to look at the [draft] directive language, which I don't like much in the sense that it doesn't change anything from last time. There have been a number of comments that we ought to mention the discount rate someplace. I think that would be wise. Let's put something in the first sentence there. I'm not quite sure why we would say "uncertainties in the business outlook." It seems to me what we ought to be saying is "relatively slow growth."

VICE CHAIRMAN CORRIGAN. We can't really say "taking account of progress against inflation" anymore either.

CHAIRMAN VOLCKER. That's long term. Another thing on the inflation front, as we said in our announcement [about the discount rate], is that the commodity prices are just continuing to fall. The averages for the most part, except for the very low level at the bottom of the recession, are as low as they have been in two years and the level is about where it was in '79 or '80.

MR. MARTIN. Yes.

CHAIRMAN VOLCKER. That is a real reduction in commodity prices of 30 or 40 percent, I suppose. And it's just about across the board: in agricultural prices, industrial, mining--

VICE CHAIRMAN CORRIGAN. That's another reason why it's disturbing that the general price level is rising as much as it is.

CHAIRMAN VOLCKER. Well, it's rising and it's mainly in the prices of services. But there has been a little bulge in gasoline prices recently, which we may have for another month in the statistics, but that seems to be over in the commodities prices.

VICE CHAIRMAN CORRIGAN. Car prices.

CHAIRMAN VOLCKER. Car prices went down last month.

VICE CHAIRMAN CORRIGAN. In the latest consumer [price report]? I haven't seen that.

MR. MARTIN. The Japanese premium ought to start coming in.

CHAIRMAN VOLCKER. Well, I just read it. Used car prices were down slightly and the new car prices were unchanged. It's a rare thing for used car prices to come down.

MR. PARTEE. It's all those trade-ins, with this high level of new sales.

CHAIRMAN VOLCKER. Well, the easy thing to do, and maybe it's sufficient, is just to mention in the first sentence that the discount rate went down.

MR. PARTEE. Well, there are three items mentioned--

CHAIRMAN VOLCKER. Let me suggest something radical: take out all this business about progress against inflation, uncertainties, and the exchange value of the dollar.

MR. PARTEE. Yes, they really are all very difficult.

CHAIRMAN VOLCKER. Say: "In the implementation of policy for the immediate future, against the background of the recent decline in the discount rate." We mentioned all these things [in our announcement of the discount rate action.] Put a footnote on it that says "See the statement on the--"

MR. PARTEE. Well, these are mentioned elsewhere too I think. This is just somewhat--okay.

VICE CHAIRMAN CORRIGAN. I think that's a good idea.

CHAIRMAN VOLCKER. "In the implementation of policy for the immediate future and against the background of the recent reduction in the discount rate"--is it worth mentioning market rates in there?

SPEAKER(?). You don't need it.

CHAIRMAN VOLCKER. I guess we say "The Committee seeks to maintain the existing--." Does it sound a little more accurate to say "The Committee seeks to maintain the range--"?

MR. BALLES. How about "the recent"?

CHAIRMAN VOLCKER. "The recent"? Borrowing is going to be very high this week isn't it? How about "in the period"?

MR. AXILROD. Well, yes, with this particular week's situation.

CHAIRMAN VOLCKER. [Mr. Axilrod,] you had a rather selective recitation, I think, of the average borrowing.

MR. AXILROD. No, no. It's going to be high with the--

MR. STERNLIGHT. Just yesterday there were--

MR. AXILROD. It was high with all the thrifts in. They are not all in extended credit yet. So we're running high with them in.

MR. STERNLIGHT. That would only take out about $200 million in the period average. I would say that what we'll publish this week will be high because most of them are in.

CHAIRMAN VOLCKER. It's going to be high without all the thrifts, isn't it?

MR. AXILROD. Well, I calculated that average--

MR. STERNLIGHT. My feeling is that without thrifts this period's average will be at something like $600 million.

SPEAKER(?). We could still get some borrowing in New York today.

MR. AXILROD. For the period, but the week will be a little high.

MR. PARTEE. Did you say $600 million without the thrifts?

MS. SEGER. Yes, that's high.

CHAIRMAN VOLCKER. I guess "recent" is better than "existing" in that connection. When I say it, it doesn't sound very good; but I guess "recent" is better than "existing."

MR. AXILROD. Maybe you could say "prevailed over recent weeks" or something.

CHAIRMAN VOLCKER. "In most recent weeks."

MR. PARTEE. "Selected recent weeks"!

MR. BOEHNE. "As interpreted in recent weeks"?

CHAIRMAN VOLCKER. I don't know. The more we try to explain it the more difficulty we get in. "The Committee seeks to maintain about the same degree of pressure on bank reserve positions." Let's go on to the next sentence, having resolved that one. I think this bracketed suggestion may be better; what do you think? M2 and M3 are awfully low looking.

MR. MARTIN. 4 percent and 5-1/4 percent.

CHAIRMAN VOLCKER. Just put it in there baldly. Look at the alternative: "This action is expected to be consistent with growth in M1 at an annual rate of around--." We can say "6 percent or a little higher."

MR. MARTIN. It's likely to be 6-1/2 percent.

CHAIRMAN VOLCKER. Well, but those differences are so fine. I don't mean to sound--

MR. PARTEE. That's a two-month rate for the two of them?

CHAIRMAN VOLCKER. No. The way this is written the M1 is a three-month rate.

MR. MARTIN. March to June.

MR. PARTEE. Yes, but the other two are two-month rates.

CHAIRMAN VOLCKER. Yes, that's right.

MR. PARTEE. Well, I guess that's 6-1/2 to 7-1/2 percent.

MR. BOEHNE. We could put M1 on a 6 to 7 percent basis and keep the timeframe the same for all the aggregates. It's a little peculiar, isn't it, to have one aggregate over one time period and the other two over different periods? If we said 6 to 7 percent, it's much--

CHAIRMAN VOLCKER. Well, everything is a little peculiar because they are not ordinarily that far off.

MR. BOEHNE. 6 to 7 percent kind of gets them all. But if we use April to June--

MR. KEEHN. But is 6 to 7 percent consistent with "maintain the existing"? It seems to me that that doesn't line up.

MR. MARTIN. It does April to June.

MR. GUFFEY. April to June it does.

CHAIRMAN VOLCKER. I hate to put two-month growth rates in there, but we could do that--roughly 6 to 7 percent--for all of them for April to June.

MR. MARTIN. It gives us a little more flexibility.

CHAIRMAN VOLCKER. M3 is actually higher than that I think.

MR. AXILROD. Another alternative, Mr. Chairman, would be to use the three months for M2 and M3 and maybe lower the number a little from the 7 to 8 percent or lower it a lot and indicate the possibility that it might be more because of the shortfall in the--

CHAIRMAN VOLCKER. I suppose we could just say something more vague such as "expected to be consistent with growth of M1 at an annual rate of around 6 percent or a little higher, while M2 and M3 would be expected to increase at a slower rate of speed than implied earlier, due to the sluggish growth in the--"

MR. AXILROD. That would do it. That would be in the spirit of the last--

VICE CHAIRMAN CORRIGAN. I think the neatest thing to do is to say April to June rates of 6 to 7 percent for all of them and just wink at that 7-1/2 percent on M3.

SPEAKER(?). Yes, I think that--

MR. BALLES. Even better might be to say 6 to 7 percent for M1 and M2 April to June and 7 to 8 percent for M3.

CHAIRMAN VOLCKER. My only trouble with that is that I don't like two-month growth rates and if M2 and M3 turned out to have a little bulge on the other side--well within what we thought earlier--it wouldn't bother me. But I don't know that it makes a lot of difference.

MR. AXILROD. You could say "M2 and M3 may grow slower than the 7 to 8 percent rates expected earlier because of..." to allow for that possibility.

CHAIRMAN VOLCKER. I don't mind that. Let me try something like that. The alternative, I guess, is giving a two-month growth rate but say "expected to be consistent with growth of M1 at an annual rate of around 6 percent or a little higher, while M2 and M3 are expected to grow more slowly over the quarter than anticipated earlier in the light of the--." One of them was actually minus wasn't it?

MR. AXILROD. Yes, "in light of that--"

SPEAKER(?). "April performance."

SPEAKER(?). "In light of April."

MR. PARTEE. "The sluggish April performance."

MR. AXILROD. "The sluggish April."

CHAIRMAN VOLCKER. "Their sluggish April performance" or "their weakness" maybe.

MR. GRAMLEY. If we separate M1 and M2 and M3, does that perhaps convey the notion that only M1 is the target now and that for M2 and M3 we have expectations but not targets?

MR. PARTEE. You used the word "expected" in both cases didn't you, Paul?

CHAIRMAN VOLCKER. The way this would read is: "This action is expected to be consistent with growth in M1 at an annual rate of around 6 percent or a little higher while M2 and M3 are expected to grow more slowly over the quarter than anticipated earlier in the light of their weakness in April". The advantage of this is that it has M1 a tad higher than what we said we envisaged before and it's immediately balanced by saying M2 and M3 are considerably lower. The alternative is just using the two-month growth rates. Or we can do what we have here. Which do you prefer? I guess I slightly prefer this.

VICE CHAIRMAN CORRIGAN. It's fine with me.

MR. PARTEE. Me too.

MR. MARTIN. I prefer your recent language.

CHAIRMAN VOLCKER. Well, let's assume that for the moment. [The next sentence is]: "Somewhat lesser reserve restraint--"

MR. MARTIN. "Would be acceptable."

CHAIRMAN VOLCKER. I'm perfectly happy to have it "would" in the first part and "might" in the second part.

MR. PARTEE. That's a shift.

MR. MARTIN. [Unintelligible].

MR. WALLICH. [Unintelligible.]

MR. PARTEE. That's noticeable.

MR. WALLICH. Yes.

CHAIRMAN VOLCKER. Under a magnifying glass!

MR. PARTEE. Well, that's where [markets] put the directive language.

CHAIRMAN VOLCKER. This isn't going to come out until two months from now.

MR. PARTEE. I think they have to be "woulds" in both cases or "mights" in both cases; I don't care which it is.

SPEAKER(?) Well, in both cases it ought to be "might" so that we don't get trapped.

MR. PARTEE. I can go with "might."

MR. MARTIN. I'd prefer "would/might."

MR. PARTEE. [Unintelligible] you'd prefer "woulds."

CHAIRMAN VOLCKER. That's what I prefer too, but what do you all want to do? It doesn't make that much difference.

MR. PARTEE. "Might" and "would."

MR. BLACK. No, I prefer "would/would;" I always prefer that so that we don't make a mistake.

CHAIRMAN VOLCKER. How many members of the Committee prefer "might/would"? The alternative is going to be "might/might."

MR. MARTIN. What happened to "would/might"?

CHAIRMAN VOLCKER. That's right: "would/might." Did I say it wrong?

MR. MARTIN. Yes sir.

CHAIRMAN VOLCKER. I thought that's what I gave first. Who prefers "would/might"? Wait a minute; let me see. How many "might/mights" do we have? Five. Somebody didn't vote.

SPEAKER(?). Probably you.

CHAIRMAN VOLCKER. I picked the "would/might."

MR. RICE. He counted himself.

MR. BLACK. "Would/mights." That sounds infectious!

MR. PARTEE. You wouldn't mind some company.

CHAIRMAN VOLCKER. I count one vote [more] for "would/might" at this point.

MR. BOEHNE. We can have a softball game: the Mights and the Woulds!

MR. BLACK. That's what it sounds like!

CHAIRMAN VOLCKER. What's this federal funds rate range? We have it at 6 to 10 percent and that still seems to be ample to cover all contingencies.

MR. MARTIN. In "B" it's 5-1/2 to 9 percent.

CHAIRMAN VOLCKER. Well, where do you want the federal funds rate? I don't think it's worth changing to get it to 5-1/2--

MS. SEGER. Zero to 12 percent.

MR. BLACK. 6 to 10-1/2 percent.

CHAIRMAN VOLCKER. Well, we're left with this borrowing figure. The center point seems to be $350 million.

MR. MARTIN. And all the thrift borrowing out.

CHAIRMAN VOLCKER. Well, all the emergency thrift borrowing.

SPEAKER(?). Only emergency thrift borrowing.

MR. AXILROD. The bulk of it is now extended credit and perhaps more of it will be. But I would say that Mr. Sternlight has made a mental adjustment even for some of it that might not yet be classified as extended credit, at least recently.

MR. STERNLIGHT. It would still be around $100 million now [unintelligible] extended credit when we make some allowance--

MR. MARTIN. [Unintelligible] adjustments.

MR. PARTEE. Now we're talking!

VICE CHAIRMAN CORRIGAN. I don't like to get in a position of splitting hairs about this borrowing. But it seems to me that $350 million taken by itself is kind of a threshold because if it goes down and stays down at $350 million or falls below that, there is a real danger: I think we'd find ourselves again in a situation where it would start pushing on the current level of the discount rate. And at this juncture, I at least would not want us to fall into a situation where the behavior of the federal funds rate starts to give rise to market expectations of a further discount rate reduction. I had mentioned $350 to $375 million, but I think the $350 million number at this point is more than symbolically significant because I think it does get you into that range where I would start to get very uncomfortable.

MR. PARTEE. Why don't we make it $350 to $400 million and allow some discretion to be exercised here? I think we all expressed the view that we didn't want it to threaten the discount rate.

CHAIRMAN VOLCKER. Whether the discount rate is threatened or not will depend upon what goes on in the economy or the exchange rate, I suspect.

VICE CHAIRMAN CORRIGAN. But that would take place in the normal course [of events], and I wouldn't want to kind of fall into that independent of the economy.

MR. BALLES. I'd be concerned, Mr. Chairman, about moving up to $400 million. I'm afraid that might push the funds rate up. I would not like to see that happen.

MR. PARTEE. Well, that's why it is discretionary.

CHAIRMAN VOLCKER. Leaving a little margin here is fine, obviously. We can leave a little margin by saying $325 to $375 million.

MR. RICE. I would support that.

CHAIRMAN VOLCKER. I think nobody is talking about trying to force the federal funds rate down at this point below where it would naturally lie, which is a little above the discount rate.

MR. GRAMLEY. I would feel much more comfortable if we stayed above $350 million. I like Jerry's formulation of $350 to $375 million. It just seems to me that if the funds rate gets down below the 7-3/4 percent range, then it raises questions again about whether or not we're going to have another cut in the discount rate. We've sent some very strong signals to the markets with this cut in the discount rate. And I really wouldn't want to send any more messages like that.

CHAIRMAN VOLCKER. I don't know whether we sent a very strong message; they were anticipating it for two weeks before it happened.

MR. GRAMLEY. Well, given what's happened to market interest rates and stock prices, it seems to me that the markets weren't expecting it all that confidently.

CHAIRMAN VOLCKER. The bond market was down 1/2 of a point this morning; I don't know where it is now.

MR. PARTEE. 20 points in the stock market yesterday.

MR. BOEHNE. Well, it sent a signal to the market that they think that at this meeting we are really going to go toward ease. That's one of the things I think it conveyed to the markets.

MR. AXILROD. As a technical point, Mr. Chairman--

CHAIRMAN VOLCKER. What did the stock market do this morning?

MR. AXILROD. Well, the first half-hour it was down 2 points, [so] it may be down [now]. I might mention a technical point: If, because of a wire failure, a large bank borrows $1-1/2 billion or something like that on a Friday--which often happens to us--the level of borrowing can easily be $600 to $700 million with money market conditions very little different from a borrowing level of $300 to $350 million. So there has to be--I hope--some sense from the Committee that there can be wide swings here in borrowing.

CHAIRMAN VOLCKER. I think we've learned that from experience.

MR. MARTIN. $325 to $375 million.

MR. GUFFEY. Mr. Chairman, the target that I think you're looking at is $350 to $375 million. If I understand, that would result in the federal funds rate quite likely moving to the 7-3/4 percent area immediately. Is that a correct interpretation?

CHAIRMAN VOLCKER. Well, you ask this question every time, Roger, and I'm not a prophet.

MR. GUFFEY. I understand that.

CHAIRMAN VOLCKER. I would assume it's somewhere in that neighborhood, give or take 50 basis points.

MR. GUFFEY. Well, if there's 50 basis points down to 7-1/4 percent then I would oppose it, obviously. I understand you're not a

prophet; but I think the staff's projection suggests that it will be moving immediately to 7-3/4 percent as a result of the discount rate cut with a $350 million borrowing level.

MR. AXILROD. Yes. There may be slight differences in judgment among the staff here. I had $300 to $350 million; there are other people, and I think Mr. Sternlight is one, who would say $350 million or maybe a shade above for that. I don't know how one could possibly be certain on this.

MR. PARTEE. That certainly does seem to suggest $325 to $375 million then, doesn't it? It encompasses both views.

MR. GRAMLEY. But it really suggests that we ought to have an agreed upon target for the federal funds rate. I would think that's--

MR. MARTIN. Oh, shame on you, Governor Gramley!

MR. GRAMLEY. Not a written one. Let Steve translate that to whatever borrowing level is appropriate.

MR. AXILROD. The stock market, Mr. Chairman, is unchanged at 1:00 p.m.

MR. PARTEE. And that means it kept all its gain.

SPEAKER(?). So it is pretty good.

CHAIRMAN VOLCKER. Well, I don't know that we need to linger over this point forever. I assume we will start--and probably miss it by $100 million plus or minus--somewhere around $350 million or slightly above with a bit of flexibility on either side.

MR. GRAMLEY. What was that again?

CHAIRMAN VOLCKER. We start at $350 or a little above and have some flexibility either way as we move along.

MR. RICE. I don't see how anybody could have a problem with that.

CHAIRMAN VOLCKER. How do you want to express that noble thought?

MR. RICE. Just the way you did it.

CHAIRMAN VOLCKER. Just say $350 for the moment with an understanding that there's a little flexibility. All right.

MR. BERNARD. Did you settle the [language] for this earlier part?

CHAIRMAN VOLCKER. I think so. We more or less settled it but various people are unhappy. It reads: "In the implementation of policy for the immediate future, and against the background of the recent reduction in the discount rate, the Committee seeks to maintain about the same degree of pressure on bank reserve positions. This action is expected to be consistent with growth in M1 at an annual

rate of around 6 percent or a little higher during the period from March to June, while M2 and M3 are expected to grow more slowly over the quarter than anticipated earlier in the light of their weakness in April. Somewhat lesser reserve restraint would be acceptable in the event of substantially slower growth of the monetary aggregates while somewhat greater restraint might be acceptable in the event of substantially higher growth." All the rest of it is the same with 6 to 10 percent [for the funds rate range].

VICE CHAIRMAN CORRIGAN. We ended up with "would" and "might" on the second page?

CHAIRMAN VOLCKER. By one vote as I understood it, with one person not voting.

MR. PARTEE. Where you said that there would be less growth than earlier anticipated for M2 and M3, don't you think we ought to put in the percentages earlier anticipated? There's no base there unless somebody goes back and looks at--

SPEAKER(?). Yes, that's right.

CHAIRMAN VOLCKER. Whatever they were. What were they?

MR. AXILROD. 7 to 8 percent.

CHAIRMAN VOLCKER. For both?

MR. AXILROD. It was 7 percent for M2 and 8 percent for M3.

CHAIRMAN VOLCKER. Add "the 7 to 8 percent range anticipated earlier." Would you want to say "grow significantly more slowly"? It was 7 to 8 percent for both?

MR. AXILROD. No; it was 7 percent for M2 and 8 percent for M3. And more slowly--

CHAIRMAN VOLCKER. So it should say the "7 and 8 percent anticipated, respectively."

MR. AXILROD. "Anticipated for M2 and M3, respectively."

MR. BERNARD. "Anticipated earlier for M2 and M3, respectively."

MR. PARTEE. I would just say "less rapidly" instead of "substantially less rapidly" because, as you say, if we should happen to get a snap-back, it would be acceptable.

CHAIRMAN VOLCKER. Okay. Well, if that's all right and nobody wants to raise any further points, [we can vote].

MR. BERNARD.

Chairman Volcker	Yes
Vice Chairman Corrigan	Yes
President Balles	Yes
President Black	No
President Forrestal	Yes

Governor Gramley	Yes
President Keehn	Yes
Governor Martin	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Seger	Yes
Governor Wallich	Yes

CHAIRMAN VOLCKER. Okay.

END OF MEETING