TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

September 21, 1976

Prefatory Note

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

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

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

Staff Statements Appended to the Transcript

Mr. Sternlight, Deputy Manager for Domestic Operations

Content last modified 01/11/2011.

9/21/76

Meeting of Federal Open Market Committee

September 21, 1976

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, September 21, 1976, at 9:30 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Black
Mr. Coldwell
Mr. Gardner
Mr. Jackson
Mr. Kimbrel
Mr. Lilly
Mr. Wallich
Mr. Winn
Mr. Balles

Messrs. Baughman, Guffey, Mayo, and Morris, Alternate Members of the Federal Open Market Committee

Messrs. MacLaury, Eastburn, and Roos, Presidents of the Federal Reserve Banks of Minneapolis, Philadelphia, and St. Louis, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist (Domestic Finance)
Messrs. Brandt, Davis, Keran, Kichline, Parthemos, Reynolds, and Zeisel, Associate Economists

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

Mr. Coyne, Assistant to the Board of Governors
Mr. Keir, Assistant to the Board of Governors
Mr. Gemmill, Adviser, Division of International Finance, Board of Governors
Mrs. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Balbach, Boehne, Doll, Eisenmenger, and Scheld, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Philadelphia, Kansas City, Boston, and Chicago, respectively
Mr. Burns, Vice President, Federal Reserve Bank of Dallas
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis
Mr. Hall, Economist, Federal Reserve Bank of Cleveland
Mr. Hill, Senior Economist, Open Market Operations, Federal Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting of
September 21, 1976

CHAIRMAN BURNS. We can get our meeting under way if someone will be good enough to move approval of the minutes of the August meeting.

MR. COLDWELL. So moved.

CHAIRMAN BURNS. Motion made and seconded. I hear no objections. Let us turn therefore to Mr. Holmes's report on recent foreign developments.

MR. HOLMES. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN BURNS. Thank you, Mr. Holmes. Are there any questions? Very well, is there a motion to approve the transactions of the Foreign Desk?

SPEAKER(?). So moved.

CHAIRMAN BURNS. The motion is made, there is no objection. And the credit that we've extended to Mexico has recently been renegotiated in connection with a further commitment made by the U.S. Treasury. All this took place over a hectic weekend and was not concluded until early Monday morning. The foreign currency subcommittee acted in behalf of the full Committee; there was simply no physical opportunity to deliberate with this Committee. And when you get into one of these negotiations, there is really nothing to deliberate over until the very end because positions are not clearly defined or keep changing. That's the nature, I'm afraid, of the beast. Mr. Wallich will report on the outcome of these negotiations.

MR. WALLICH. Mr. Chairman, the Mexicans almost a month ago presented a pretty grim picture of their situation to the Treasury, with hints of the possibility of a moratorium on [payments on] their foreign debt. They've since moved in a much more constructive direction, made an agreement with the IMF, made an agreement with the Treasury and us, and set themselves on the policy course that hopefully will get them out of trouble over time--at any rate, avoid anything on the order of a moratorium.

So far, we've had a sharp devaluation of the Mexican peso, which brought back about a $190 million reflow. They then, however, raised the rate again in order to give their wage negotiations, which are critical, an assist; as a result, they lost more than they had taken in. This is an important feature of the situation. As soon as the wage negotiations are out of the way, then they will be free to let the rate find [a] better level again.

The agreement with the IMF is under the highest conditionality that the IMF has for the extended facility. They draw first their regular credit tranche, plus the so-called compensatory facility which has little conditionality; but nevertheless the conditionality relating to the whole agreement is intended to apply to this part also. Then [they] draw over three years on amounts of $235 million per year under the extended facility, giving them in the aggregate [an] amount well over $1 billion.

Now the Treasury and possibly the Federal Reserve engage in a pre-financing of some of these drawings. The first part, the credit tranche plus the compensatory facility, amount to $365 million. The Treasury has offered a pre-financing in which the Federal Reserve, in the manner in which I will explain, is a potential participant. The expectation is that the money from the IMF will come in around November 1. That would mean that the Mexicans get this money for a matter of 35 to 40 days, and the financing would be paid off from that IMF money. Further installments of pre-finance by the Treasury [would come] then in three annual installments during 1977. The Federal Reserve has nothing to do with that.

As regards our own participation, the arrangement is the following: the Mexicans are given [two] option[s]. [In the first,] they maintain their present swap position of $360 [million] until it's due on October 9, and [then they] pay us off. Steve Gardner and I have talked to them, and we have some impression that there is considerable goodwill. It was strengthened in later conversation, I guess today, that they will do everything possible to repay at that time.

Alternatively, [under option two] they would integrate up to one-half of the 360, that is 180, into the Treasury arrangement. That would mean that they have to prepay the swap and immediately redraw--it's the same swap but a separate drawing. They repay immediately, redraw, and the new drawing would be under the same conditions that apply to the Treasury [financing]. The advantage there from our point of view is that the Treasury has a firm takeout from the IMF for its pre-financing; if we could get into that, we [would] have the same takeout. The advantage to the Mexicans is that they keep that money a little longer instead of having to repay on October 9. They`d be repaying whenever the IMF money comes in, around November 1. So we think that we have at least [potentially] improved our position with respect to the swap. If the Mexicans take this option, then we have a takeout for one-half of the money, although it comes back three weeks later. If they don't take the option, well, then we are in the same position we were in to begin with, with this maturity coming up on October 9.

Now, one has to see that operation in proportion. The Mexicans have an enormous current account deficit, and merely to finance that deficit of about $3 billion a year they must be borrowing something like $250 million a month from the international capital market. In addition, of course, they have maturities, so they've got to refinance by additional borrowings. So they're in the world capital markets continuously. Our [part] of the Treasury's operation is financially rather small for them. It's crucial for them in the sense that they want to establish their credit, they want to show a solid position to their creditors. And one element of doing that is not to draw on this facility that the Treasury and the Fed are offering to repay the swap if they possibly can [avoid it], and to make their affairs look as normal as possible in these conditions.

Fundamentally, the devaluation has eased their position by laying the basis for the improvement of the balance of payments. Very much depends of course on the kind of policies they follow. There are some reasonable doubts about those policies because they involve an undertaking to avoid a decline in real wages. My impression is that that undertaking isn't being taken all that literally, and it would be very difficult to implement it.

The agreement with the IMF is such that the IMF appears to be fully satisfied and is prepared to give them this credit, which they can do only if they are satisfied with the program. They've also certified this to the Treasury, and you have a copy, I believe, of the letter from

[IMF Managing Director] Witteveen certifying this to the Treasury. There is another letter from the Mexican Secretary of the Treasury confirming the arrangement. We have to wait until October 9 to see whether the Mexicans pick up their option under the swap to go in on the undertaking with the Treasury.

CHAIRMAN BURNS. Thank you, Mr. Wallich. Are there any questions? Yes, Mr. MacLaury.

MR. MACLAURY. Can I ask Governor Wallich, is the certification of Witteveen in some sense [similar to] the indications of the [U.S.] Comptroller of the Currency as to the viability or solvency of banks? That's one question, and the second one is do we have any--

CHAIRMAN BURNS. You have an answer to that question. I don't think we ought to say one word about it. We all know what it means.

MR. MACLAURY. The other question was--maybe that will then rest as a rhetorical question--in our swap drawings, there's no question as to the fact that there will be no exchange losses to the Federal Reserve in the repayment of these drawings? No splitting of losses or anything?

MR. WALLICH. The latter is correct, and I would like to add that this certification of Witteveen does represent a carefully negotiated program. Now, I gather that the Chairman is somewhat skeptical of this program when you consider that the British are very much concerned about the political implications of getting that certification from Witteveen. I think one has to concede that there is some reality to that [concern].

Moreover, there is an opportunity to implement the conditionality. The money doesn't come all at once, they can't walk away with it, thumb their nose. It comes over three years, and any time they don't meet the stipulations, they don't get it. The ultimate test of this is that balance sheet numbers are specified on the balance sheet of the Bank of Mexico [unintelligible] unless the credit expands.

MR. MACLAURY. Is there any reluctance on the part of the capital markets to provide the funds that the Mexicans continue seeking?

MR. WALLICH. They say that [there is] not. They say that they recently received an offer of $1 billion--and the inclination was to say, "Why don't you grab that?"--which they turned down because it would have [involved] irregular procedures. They borrow in $1/4 billion lots and they want to go on doing that.

MR. PARDEE. I have a kind of answer to that question. We were talking to people in the market on that. As soon as they devalued, the Mexicans called a number of the U.S. banks to see if they could get additional credit lines and did obtain some credit lines with New York banks. Several of the people in New York say that the image of Mexico is somewhat tarnished [regarding] borrowings. So they may say they're getting a lot of money, but it's on the basis of a major effort they have made, and, as I say, this word "tarnished" has come up.

MR. JACKSON. Is it possible that this is the ultimate enforcer of their programs?

MR. WALLICH. Their inability to borrow in--

MR. JACKSON. The continuing monthly needs will be supplied only to the extent that they can qualify--

MR. WALLICH. That may very well be, because that's where the most [of the] money comes from.

CHAIRMAN BURNS. Of course, that carries with it the danger that, instead of adjusting their policies and moving in a constructive financial direction, they may declare a moratorium and continue to do business at home politically the way they have. So there is a lot of uncertainty in it.

MR. JACKSON. To declare a moratorium when you need $200 million a month additional?

CHAIRMAN BURNS. Well, I don't know the exact figures, but there is a repayments schedule, and then you don't need to repay and you don't need to pay interest on the outstanding bill, and you don't need to amortize or repay on the due date. How these figures come out, I don't know; they may come out exactly as I have suggested, maybe not.

Gentlemen, no action, as far as I can see, is required by the Committee. We have this renegotiation, and as a result of it we are no worse off, and we may be significantly better off. Any further question or comment?

All right, let's pass to the Manager's recommendations. Thank you, Mr. Wallich, for your report and for the fine job you and Mr. Gardner did on negotiating with the Mexicans.

MR. WALLICH. I think we could give credit also to the Treasury, which steered the Mexicans in a good direction.

CHAIRMAN BURNS. All right.

MR. HOLMES. Mr. Chairman, the Bank of England's two drawings of $100 million each under the swap will be up for their first renewal on September 23 and September 30. It had earlier been understood that the drawings would be renewable only until December 9, when the British had agreed to arrange borrowing from the IMF. It is my understanding that the Bank of England is determined to pay their drawings under the swap on time even though IMF money may not be available until later in the month. I therefore recommend renewal on the two swap drawings until December 9.

CHAIRMAN BURNS. Any questions? All right, I take it that the recommendation is approved. Anything else, Mr. Holmes?

MR. HOLMES. Mr. Chairman, turning to our Swiss franc indebtedness, last week in Basel we negotiated a plan with the Swiss National Bank for a possible refunding of our swap debt and a definite quarterly repayment schedule, which would settle the debt within three years.

The plan is subject to approval by the Swiss National Bank board and of course by this Committee.

The negotiations also cover the plan for Treasury repayment of their Swiss franc bonds concurrently over a three-year period, and the Treasury is in full agreement with the proposal. Total U.S. debt to the Swiss National Bank amounts to approximately 9.3 billion Swiss francs, or about $3.7 billion at current market rates. Of this total, 3.9 billion Swiss francs represents our swap debt. The Treasury has agreed to a somewhat faster paydown of our swap debt in the first year of the proposal, but final payments of both debts would come at the end of the three-year period.

As far as the [Federal Reserve] System is concerned, details are still to be worked out. The proposal could involve the series of Swiss franc drawings outside the regular swap network, with the proceeds used immediately to pay off debt outstanding since 1971 under the old line. Repayments would be made in scheduled quarterly installments. We would make every effort to buy Swiss francs in the market, conditions permitting, and on occasion to sell the Swiss National Bank other currencies that we have acquired and for which they have a need.

Finally, and this concession on the part of the Swiss is what will make the plan work, the Swiss have agreed to sell us directly at market rates against uncovered dollars any Swiss francs we need to enable us to meet our scheduled repayment obligations.

The loss-sharing agreement reached earlier this year will remain in force, and the Swiss have extended it to cover the Treasury as well. At current exchange rates, full repayment of our swap indebtedness will entail a loss of about $415 million, of which the Federal Reserve share would be $271 million. Losses would be taken only as quarterly payments are made and so would be spread out over a three-year period. Losses, of course, could either be more or less depending on market developments over the next three years, and I would certainly not by any means rule out the possibility that they could be less.

Mr. Chairman, I recommend that the Committee approve in principle the proposal outlined above and that we proceed to work out the details with the Treasury and the Swiss National Bank. In light of the fact that we do not have final Swiss agreement, I believe that final Committee action should await confirmation by the Chairman that such an agreement had been reached and details agreed on. That's all I have, Mr. Chairman.

CHAIRMAN BURNS. Well, first of all, I think you are to be congratulated on working out this agreement with the Swiss. The proposal that Mr. Holmes is making has been put before you in writing. You might read it, Mr. Broida, to make sure that we all know what it is.

MR. BROIDA. This is a proposed special authorization. It reads:

> The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to arrange for repayment of the System's outstanding swap commitments to the Swiss National Bank (concurrent with repayment by the U.S. Treasury of Treasury notes denominated in Swiss francs and held by the Swiss National Bank) within a three-year period by means of quarterly payments on a schedule that is mutually satisfactory to the Swiss National Bank, the U.S. Treasury, and the Federal Reserve. This authorization shall become effective upon final approval of technical details by the Chairman of the Federal Open Market Committee.

CHAIRMAN BURNS. Any questions or comments? Yes, Mr. Mayo.

MR. MAYO. Alan, is this schedule that we are talking about visualized as having some flexibility, or is it a fairly rigid schedule?

MR. HOLMES. I think it ought to--certainly we should have flexibility. But I do think we ought to set up a schedule for ourselves and really try to stick as closely to it as we possibly can. [If] overwhelming problems in the market or other places [develop], sure, I think we [would] have to reconsider. But I think there will be no problem in doing that with the Swiss National Bank.

MR. MAYO. I guess this is my question. The Swiss franc continues to be very strong, and this is a big chunk. I just feel a little uneasy, myself, [about] our ability to do it at, quote, "current market rates."

MR. HOLMES. Well, you know, we said that earlier this year. And the Swiss franc was at 2.60 [per dollar]. If we'd repaid then, our loss [would] be less than it is now. So I don't think we ought to take a risk [by hoping for] a favorable development in the exchange rate, but [instead] get started even though it does cost us money and even though, if we waited for three years, we might do it more cheaply. I think we ought to get going.

MR. MAYO. I fully subscribe to this. I just have the uneasiness going along with the subscription.

MR. PARDEE. The Treasury still has all that gold that the swaps were entered into to protect, so the loss that we have now is the value of gold--

CHAIRMAN BURNS. Well, this is a footnote. It's useful to remind ourselves of it. But less and less attention is being paid by the rest of the world to that footnote. We have to speak much more loudly even to be heard on this.

MR. WALLICH. Of course, to the extent that's there more risk in the later payments, we will have a little less risk by virtue of being able to pay about in proportion the first year, then of the second and third year, the Treasury taking the later installments in larger part.

CHAIRMAN BURNS. Well, whether that's good or bad, time will tell.

MR. COLDWELL. Mr. Chairman, I assume this special agreement means that the Treasury is not going to develop that commitment or semicommitment that we thought we had.

CHAIRMAN BURNS. I would accept the conclusion. I would not accept the language. The Treasury is unwilling to give up gold or SDRs.

MR. HOLMES. Mr. Chairman, I think the Treasury would be willing to take over our debt. I think they would agree to that. I think the Swiss would prefer to do it in the way we are suggesting here.

MR. COLDWELL. But my question is not that so much as it is in [regard to] the future. Are we now without any backup from the Treasury on future swap drawings?

MR. WALLICH. I would not think so. Our discussions were of the kind in which the Fowler letter was discussed. It was treated with some irritation, if I may say so, but not with total rejection.

CHAIRMAN BURNS. I would share Mr. Coldwell's skepticism. I think that the Fowler letter is unlikely to have much effect, if any, in the future.

MR. COLDWELL. In which case the net result of all this questioning is that we ought to plan our swap arrangements with the idea of no takeout.

CHAIRMAN BURNS. With the idea that there was still a Treasury [backup] in case there is a serious problem for us; I think the Treasury would take that into account. But I don't [think] we can count on getting gold or SDRs from the Treasury, and I think that's a realistic view. We can understand it.

MR. WALLICH. Mr. Chairman, that is a perfectly realistic view, but the alternative [was] having them take over our deficit, as Mr. Holmes said, and that was really the issue that one would discuss next time.

MR. HOLMES. I think another possibility might be discussed with the Treasury--I don't know how successfully--and that is an IMF drawing as takeout, because we certainly have had other countries do that. We at least ought to consider it with our Treasury.

MR. MACLAURY. But in a floating [exchange rate] world, really you have to ask yourself what takeout with gold or with an IMF drawing or anything else in some sense means. It seems to me that what we would be talking about now is, one, getting the debt off our books; but, second, the losses that we would incur as an institution in doing that. And if Henry and Alan are right, that the Treasury is prepared to take the debt off our hands at the rate at which it's on our books, then we have as much of a guarantee, it seems to me, for both things as we had with the Fowler letter--which strikes me as being pretty much a dead letter philosophically, and not just by virtue of the course of events in the meantime.

CHAIRMAN BURNS. Well, let me make two comments. First, yes, to be sure, we have a floating regime, and the role of gold is quite different. But it seemed to us for a time that we could more readily reach an agreement with the Swiss if some gold or SDRs were offered. That's point number 1. Point number 2, as far as the Treasury taking over any of our indebtedness to another central bank is concerned, I don't think that we ought to leave the matter having the Committee think that [this] is going to happen. It may or may not be going to happen. I don't know how to assess the probability. I doubt that anybody can at this time.

[MR. HOLMES or MR. PARDEE.] Mr. Chairman, at the Desk, I have been going under the assumption that we have no takeout and no assistance from the Treasury. That every operation has to be self-liquidating in the exchange market, and every swap line liquidated throughout the operations in this--

CHAIRMAN BURNS. I think you're proceeding on what I consider to be a very prudent course. I think that's the assumption that should be made. Any other question?

SPEAKER(?). I [noted] a technical detail that you mentioned first off, the [unintelligible] through their willingness to sell us [Swiss francs]

SPEAKER(?). Yes--

SPEAKER(?). This is the thing, the very thing that makes it work.

CHAIRMAN BURNS. Well, I'll tell you about technical details. I was shown a piece of paper this morning which I refused to put before the Committee because I didn't understand it myself. This, I understand.

SPEAKER(?). I consider that a little bit stronger than a technical detail.

CHAIRMAN BURNS. Well, that is really the heart of the agreement, not a technical detail.

SPEAKER(?). That wasn't mentioned as briefly at [unintelligible] I'm perfectly happy with this solution because I understand [unintelligible].

CHAIRMAN BURNS. Well, you have a proposal before you written out on the sheet of paper that Mr. Broida read. Is there a motion, or do we need more discussion of the proposal?

SPEAKER(?). Could I ask a question? I've seen this before. The word "concurrent" simply means, broadly, that [unintelligible] jointly with the Treasury but not does not specify any amounts?

MR. HOLMES. Not parallel but ending at the same time.

CHAIRMAN BURNS. All right, any other question or comments? If not, is there a motion to approve the special authorization?

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN BURNS. Motion has been cautiously made and cautiously seconded, and in view of the caution exercised, may we have a voice vote. All those [who] approve will kindly say aye.

[NOTE. Multiple responses: "Aye."]

CHAIRMAN BURNS. Any no's? All right, any other recommendation, Mr. Holmes?

MR. HOLMES. No.

CHAIRMAN BURNS. Are you going to be repaying the Belgians any money?

MR. HOLMES. Yes, there is a possibility at the end of this month. They have a large debt to pay to the Germans, and we might conceivably pay off the whole thing by the end of this month--I would say, though, at a very poor exchange rate, so we do want to see if we can improve that rate a little bit. We'll be working on that the next few days. It's uncertain right at this moment, but we will continue to make progress and maybe get rid of the whole thing.

CHAIRMAN BURNS. Well, I think this should be a happy day for us because we finally are in the process of getting rid of our indebtedness. Let's turn to the economic outlook. Mr. Zeisel, would you be good enough to report to the Committee?

MR. ZEISEL. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN BURNS. Thank you, Mr. Zeisel. This is the time for members of the Committee to express their views on the economic condition of the country and the outlook for our national economy. Mr. Eastburn will speak first.

MR. EASTBURN. Just one comment. As I've compared the quantitative information, such as that in the Greenbook, with qualitative comments being made by businessmen and others, I think there's a considerable difference. The qualitative information is more pessimistic than the other. I just wonder whether this is your experience too. Second, whether you see this as some kind of a forecast [with] less bullishness--

MR. ZEISEL. Well, the more negative qualitative reports that I've heard have been largely from the retail sales area, particularly from those chains that concentrate on nondurable goods. And they have every reason to feel somewhat depressed. The rate of growth in these sales has been very weak in recent months, but there has been a significant pickup there--and if things continue to rise as we expect they will, I think they will have a somewhat brighter outlook in the near future. They remain very cautious, obviously.

Otherwise I really haven't heard much that I would characterize as negative--rather, cautious [instead]--and I think this has probably been a very good thing. It's resulted in a very careful attitude toward inventory investment, which has kept things well in line there and I think keeps the economy in a position to move ahead as final demands increase, as I think they will. Are there any specific areas that you can put your finger on?

MR. EASTBURN. One of our directors in chemicals, for example, was discouraged about the current [unintelligible].

CHAIRMAN BURNS. All right. Thank you, Mr. Eastburn. Mr. Kimbrel, please.

MR. KIMBREL. Mr. Chairman, I'm concerned how staunchly Mr. Zeisel [would] support the prices [projection]--5 to 5-1/2 [unintelligible] I guess is limited only by food and energy. If these wage rates should start picking up and if these industrial price hikes stand, I wonder how strongly he feels that [unintelligible] these numbers look pretty good at 5 to 5-1/2.

MR. ZEISEL. I think they are fairly reasonable. For the near term, it appears that food prices are likely to continue to be rather moderate and in fact possibly to continue down somewhat. The outlook for meat prices looks pretty good. This may mean somewhat larger rises in 1977, but it is hard to project the food area that far ahead.

As far as other sectors are concerned, in terms of cost, our productivity performance has been really quite good. The rate of increase in productivity over the last half year has been in the 5-1/2 percent range, and unit labor costs have been between 3 and 3-1/2 percent, which has been moderate, certainly, [relative to] performance of the last couple of years and I think does not suggest undue pressure on prices. The key--we anticipate continued good gains in productivity, obviously not as strong as we've had, but we do think that this will be a factor limiting the increase of prices.

The area, of course, that disturbs us is energy prices. They have been rising very rapidly, but we think that this period of rebound--after all, there was a decline in energy prices, and this is a period of adjustment upward, and that appears to be coming to an end, and we see fairly moderate increases in energy prices ahead.

CHAIRMAN BURNS. Are you taking into account what OPEC is likely to do in December?

MR. ZEISEL. We have built in a one dollar increase per barrel of oil, Mr. Chairman. It's certainly possible, and we are considering the likelihood of a dollar and a half increase in oil prices.

CHAIRMAN BURNS. Intelligence reports are very strong on this issue, suggesting a 10 to 15 percent rise.

MR. ZEISEL. A 15 percent increase rather than a 10 percent increase, by our calculations, would affect the consumer price index by only 1/10 of 1 percent. It would not be a major factor. If things get no worse than that, I would hold with our forecast for energy prices. Over the next few months, I think some of the pressures on gasoline will be diminishing. We have passed through the period of greatest demand this summer, and in fact there have been a few indications of price reductions in gasoline. I think we will see at least some easing of prices after September. I think, overall, given perspectives that we have now, it seems to us that the 5 to 5-1/2 percent range is a reasonable one.

MR. COLDWELL. Jerry, does your forecast of only 1/10 percent of CPI just look at the direct impact of the price changes in gasoline or is that filtering back to the prices elsewhere in the economy?

CHAIRMAN BURNS. Including the outside economy.

MR. ZEISEL. My impression is that it's a total effect.

MR. COLDWELL. I have a hard time believing--

MR. ZEISEL. Well, the difference between 10 and 15--excuse me, I didn't quite understand. The effect of a 15 percent increase would be something in the neighborhood of about 3/10.

MR. COLDWELL. I hope you're right.

CHAIRMAN BURNS. Don't make this calculation available to OPEC. Thank you, Mr. Kimbrel. Mr. Winn now, please.

MR. WINN. In the housing area, Mr. Chairman, I think we would make a mistake not factoring in the home remodeling and renovation expenditures. In '73, I understand, single homes were running around $47 billion and home remodeling was about 18. Apparently they're estimating on a single home now 43 or something like that and estimating remodeling would be 30 some odd, which is a very big factor. And I understand that the changes in FHA requirements on the [unintelligible]. I understand that this reduces the interest cost about 2 percentage points, and that makes a difference in terms of multifamily dwellings because interest is such a large cost in their construction, and some people [unintelligible] get 7 to 7-1/2 percent money.

CHAIRMAN BURNS. This is under the Tandem plan?

MR. WINN. Yes, this is going to make a difference to multifamily construction. The second comment I would make would be [that the] machine tool business has shown the same lag [unintelligible] in construction as the energy area. This has been very weak. They're projecting a 10 percent price increase, with only about a 6 percent increase in cost, which makes their margins a lot better. Business had dropped off for about two months prior to the trade show in Chicago last week, and they were expecting that to be a big turn, and it happens to be in that area.

MR. ZEISEL. Well, the machine tool series has begun to rise and shows a significantly more rapid increase--of course, as you know, it's quite a small proportion of the total, between 1 and 2 percent of purchases of nonelectrical machinery. You're perfectly right on the repairs and additions, and we have built in a very strong rate of increase. We have been aware that this has been a strong element of support for activity.

CHAIRMAN BURNS. I thank you, Mr. Winn. Mr. Black, please.

MR. BLACK. Mr. Zeisel, looking at these two green tables, the first one in the Greenbook, I'm struck by the capacity utilization projections you have made [and] the pretty rapid increase in industrial production related to the relatively slow growth in manufacturing employment. I was wondering if you've made any explicit projections in the way of behavior of unit labor costs.

MR. ZEISEL. Yes, we have such projections for the total nonfarm economy, not for manufacturing. However, there are implicit productivity projections for manufacturing. For the nonfarm economy, our projections of productivity call for a much more moderate rate of increase than we have had. As I indicated, the rate of increase in the first half of this year shows 5-1/2 percent. We expect it to drop down to 3 percent or a slightly under 3 percent range for the remainder of the projection period. This would be slightly above the long-term trend. And we feel [we are being] consistent with a rate of growth of real output in the roughly 5 to a little above 5 percent range.

In terms of unit labor costs, they have been running slightly over 3 percent. That's a function of the very rapid productivity gains which are typical in the early stages of recovery. The unit labor costs will be edging up a bit. As I remembered them, they are in the slightly above 4 percent range.

MR. BLACK. By the end of '77?

MR. ZEISEL. They are in the middle-4 range at the end of '77--about 4-1/2 percent for the second half of 1977 for unit labor costs. This is in conjunction with a productivity increase of about 2.8, 2.9, and compensation increases during that period of about 7-1/2 percent.

CHAIRMAN BURNS. All right, thank you, Mr. Black. Mr. Morris, please.

MR. MORRIS. Mr. Chairman, I agree with the staff's economic projections. I do have a question, however, and that is, it seems to me that this Committee over the next couple of years will need all of the intelligence it can get on the question of price expectations. And in this regard I want to ask the staff whether it thought it would be useful to include in the Greenbook a section analyzing what's going on in the futures markets for basic commodities, both food and nonfood. And also whether it would be useful to analyze whether we could get any kind of intelligence of note through analyzing what's going on in this new Treasury bill futures market.

CHAIRMAN BURNS. I would think that while what you suggest is useful, we might supplement it and perhaps even learn more by having Mr. Mayo do a special exercise for us, the way he did earlier on another problem on capacity, and canvas our directors on their price expectations. Mr. Zeisel, please.

MR. ZEISEL. Well, we would be delighted to. We do keep an eye on these prices, of course. I'd be delighted to prepare some analysis, although it tends, as you know, to be a fairly volatile kind of area, and it's a little difficult to interpret short-term movements. But we'll take this under consideration, review the numbers, and see whether we can make something meaningful out of this and provide such an analysis.

MR. AXILROD. On the Treasury bill futures, President Morris, we've been keeping track of that market as its volume has grown. In the early days, it was a very limited market, and we can report [on it] when it's of interest. My impression most recently is that it's not telling us anything very different than reading [forward] rates out of the government securities market proper. We have been keeping rather close track on it. And to the extent it can reveal differences or trends, we will report back.

CHAIRMAN BURNS. Well, would you expect any differences?

MR. AXILROD. I wouldn't really expect any differences.

CHAIRMAN BURNS. Theoretically they should be identical because they are the same phenomenon.

MR. AXILROD. Theoretically they should be identical. Sometimes there have been some differences recently--

CHAIRMAN BURNS. Well--which would suggest that the participants in the two markets are not quite the same--they think a little differently. But such a difference is not likely to persist very long.

MR. AXILROD. As the volume has grown and familiarity with the market has grown, these differences [unintelligible] have tended to dissipate.

CHAIRMAN BURNS. All right, thank you, Mr. Morris. Mr. Baughman, please.

MR. BAUGHMAN. Mr. Chairman, I question first the different signals from the household survey and the nonfarm payroll employment data on employment last month--will you draw any particular significance from that in terms of trend of employment, or not?

MR. ZEISEL. Well, I'm afraid we can't. I wish I could put my finger on which of the two series I believe [for] last month, but I can't. I'd say the problem has always been that, for any given month, there may be a difference in the way the two series behave. And the thing to do is to watch them over a several-month period.

The thing that gives me a little bit of confidence about what the payroll series is signaling is the fact that there were two months in a row of fairly good gains in nonfarm payroll employment, accumulating to half a million, and that's a rather impressive number. We'll just have to wait and see. I think that, over a longer period, the two series do tend to follow pretty much the same paths. They both slowed down considerably after the spring. As you remember, the household series rose quite strongly the previous month while the payroll series rose this month--I think at the moment I'm willing to at least accept the fact that the payroll series suggests that employers are adding to their staffs.

MR. BAUGHMAN. I could make a couple of comments, Mr. Chairman, with respect to the local impact of the devaluation of the peso. I may say that the action which has been taken--and I didn't find it reported in the *Wall Street Journal* this morning, but I assume it will be recorded very soon--will be very welcome news soon along the border. We had been receiving a fair number of telephone calls, primarily from banks on the U.S. side of the border, indicating something like this was very much needed, because there was a rising feeling of uncertainty, particularly on the part of Mexican nationals of significant wealth. Of course, as you know, runs on banks were developing, and some banks were having to close early because they ran out of currency. And in our own shop, we saw return flow for a few days, but then it turned right around, and we're now shipping sizable volumes again to Mexico as they undertake to respond to that sort of development.

We've had some reports from business firms of cancellation of orders for capital goods as a result of the reduced purchasing power of the peso. Of course, the merchants along the border who were serving a sizable Mexican trade [have seen] their sales drop very sharply, and presumably they are looking at a very awkward inventory situation. It's interesting that some of them have apparently chosen to run ads in Mexican papers in which they offered higher-than-market prices for pesos rather than reductions in prices of merchandise as a merchandising device.

We have reports that Mexican officials have closed some Mexican businesses that did not take their advice to resist temptations to mark up prices of merchandise. We don't have any indication as to whether that is widespread at all. We do have reports from U.S. bankers of quite a bit of what you might call suitcase money moving across [the border] and opening accounts in U.S. banks, apparently in response to a rumor that deposit accounts in Mexico might well be frozen and the border closed to movements of currency. But, again, announcement of the actions taken yesterday I believe would bring substantial stability to that situation.

CHAIRMAN BURNS. Those are very interesting comments. Thank you, Mr. Baughman. Mr. Wallich, please.

MR. WALLICH. Looking at investment expenditures as they are projected, would you say they are more or less on track given the determinants as we know them and as we evaluate them? Or are they significantly under what we would expect them to be at given capacity, given the rate of growth of the economy, given the financial availability, profits, and so forth?

CHAIRMAN BURNS. Before you answer that, I would like to refine the question. The question may be interpreted in terms of levels--actual and prospective business capital expenditures--or the question may be interpreted in terms of recent and prospective rates of change in capital expenditures. And the two answers are going to be very different. You will have to refine the question before you answer it, or possibly answer both. The question on both interpretations.

MR. ZEISEL. Well, as you know, the rate of growth has been a laggard series or area in the recovery, but it's beginning to move in a pattern that seems more sensible. And the rate of increase in business fixed investment in real terms was about 8 percent last quarter; we expect it to be rising from here, if we're right, into the 12 to 14 percent rate range, which would be, again, a reasonable rate of increase, although coming rather late in the recovery.

The other dimension, which is the level of investments, of course is another matter. In real terms, investment has not recovered. It remains well below earlier rates, and in that sense we can consider this to be a sector which is still depressed in a sense. "Depressed" may be a strong word, but still relatively low compared to what it should be in terms of the contributions to building capital stock.

CHAIRMAN BURNS. All right, thank you, Mr. Wallich. Mr. Balles, please.

MR. BALLES. Mr. Chairman, I'd like to make several comments and then ask a question about the economic outlook that was presented by the staff. Generally speaking, I can accept that outlook as being certainly a reasonable and plausible one, but I would also have to add that, in my opinion, it probably has more downside risk now than we've seen in recent months, and for several reasons.

First of all, you mentioned, Mr. Zeisel, with regard to the outlook as you briefed us on it, that there were two principal risks--an extended auto strike and a renewal of stronger inflationary pressures. Well, with regard to that first point, I think it's quite possible that even if the strike is short, it could certainly change the quarter-by-quarter pattern of the output of the economy. I've asked my staff to do a little looking back into the record. In 1970, which was the last strike we had, it lasted 70 days. That was the strike against GM, and it had a very noticeable effect of cutting real output by an estimated 3-1/2 to 4 percent at an annual rate between the second and the fourth quarters of 1970.

Now, how deeply this Ford strike is going to cut into the output of goods and services obviously is going to depend on the length. My staff took a look at the 1967 Ford strike, lasting 49 days, and that took nearly 2 percentage points off the growth rate of real output in the affected quarters. It's our best guess that a short strike, let's say two to three weeks, would probably have the effect of reducing real GNP [growth] by about 1 percentage point at the most, but if the thing went on for, say, six or seven weeks, it could reduce real output [growth] in the fourth quarter by 2 to 2-1/2 percentage points.

Now the only good news, I suppose, in this look at the record is that most of the real output lost during the strike seems to be made up in the quarter following the end of the strike, but even if that's true, and if the strike, contrary to my hopes, should last longer than a couple of weeks, we could have a pretty soft tone, I would think, in the economy during the first quarter [of 1977], or the fourth quarter of this year, even though we might see a strong bounceback in the first quarter.

So one of the questions, I guess, that I would like to put to you if you've had a chance to look into this is, what duration of strike would you consider to be of sufficient magnitude to have a significant effect on the tone of the economy?

I'll let you think about that for a minute while I go on with the second comment, and that's the outlook for inflation. I must say that most of our industrial directors at the San Francisco Bank and its Branches continue to be skeptical of the outlook for inflation as you have outlined it--and with which my staff is in essential agreement.

Whether [the directors] will be right or whether the research staff will be right remains to be determined, but at least as far as the psychology and the expectations in a number of segments of industry [are concerned], they expect the cost-push pressures to be stronger and the price increases to be more widespread than our research staffs are inclined to believe will be the case. And if nothing else, it indicates a frame of mind in a number of segments of industry that is going to affect their actual decisionmaking processes, I think, whether it's going to be on the inventory front or on the capital front.

So much for my comments, Mr. Chairman, and if Mr. Zeisel has any answer to the question I pose on how long an auto strike would be serious enough, say, to cause us to bend in our policy, I'd like to hear this response.

CHAIRMAN BURNS. I'm going to give Mr. Zeisel a little more time to think over that question while I comment on your first question. Exactly 20 years ago I made a rather extensive study, a very careful statistical study of the effects of major or long strikes on the economy, and I took the strikes in the railroad industry, in the coal industry, and in the steel industry for this purpose. These are industries [in which] the effects may be reasonably expected to be nationwide.

I don't recall precisely the period of the strike that I took for the purpose of my analysis, but I'm quite--it was longer than a month. And the result was that, when you examine charts drawn to a liberal scale, unless you knew the precise time when a strike occurred in any one of these industries, you have [unintelligible] great difficulty determining that from the chart.

MR. MORRIS. The 1959 steel strike must have been such an exception.

CHAIRMAN BURNS. Well, I made this study in 1956, 20 years ago, and I have not studied it since, and maybe conditions are different, but I went back a good many years, and I thought it would be of interest on this occasion.

While you live through one of these strikes, you go through all kinds of anxieties. But they don't last more than a month or two, and the effects are rather minimal and more in men's minds than in reality. That was the conclusion I drew at that time, and I have no doubt that it was a correct conclusion at that time. About the past 20 years, I'm not going to comment. I haven't studied the question. Mr. Zeisel, you've had time to reflect now and--

MR. ZEISEL. I was listening to you, Mr. Chairman. And may I add my visceral, if nothing else, reaction [regarding] the last 20 years to your earlier analysis--I agree with you completely. I can't recall a strike that we didn't overestimate the impact of. Even that steel strike, we thought the world was coming to an end and it really quite didn't.

But that's sort of a general statement. In specific terms, it seems to us that a strike of something over a month would be necessary before you really felt any significant impact. The response to a Ford strike and a GM strike seems to be very different. Obviously, there is the tremendous difference in the volume of production and impact, but beyond that, in our analysis of the past several strikes, the spillover, that is the demand for other model cars, seemed to be quite large during the Ford strike, and in effect the total loss in consumer sales tends to be relatively small.

CHAIRMAN BURNS. Well, there's that, and there's also the effect on the used car market--

MR. ZEISEL. Right.

CHAIRMAN BURNS. --and that, in turn, with the run-up in prices on used cars when the strike is over, there would be a rebound in purchases of the new cars. Because the differential, you see, has become adverse.

MR. ZEISEL. For the 1967 Ford strike, which was for nine weeks, our estimate was that the actual loss in sales--that is, the loss forever--was really quite small. There were two kinds of offsets. One was a shift to other models, the second was purchasing later. And our calculation was that the loss was only in the neighborhood of, oh, possibly half a million units in total during the entire period.

There are a couple of factors operating to moderate the early effects of the strike. Producers of component parts and materials continue manufacturing on the assumption that Ford, when it starts up again, is going to be running flat out to make up. Number 1. Number 2, Ford this time had a much longer lead time in anticipating the likelihood of a strike than they did last time. Last time, I think, they were told the day before the strike that they were going to be hit. This time they've had enough time to build up stock, and our estimates are that there is a fairly good stock of cars in dealers' hands at this point.

As far as supplier industries are concerned, rubber, at least, is likely not to be affected very strongly by the strike because they're in a period of recovery from their own strike and are building inventories and would be operating at virtually full capacity under any circumstances at the present time.

To be specific about how long the strike may be before it really has a significant effect, our estimate is that certainly a one-month strike would hardly be felt because the first two weeks are at the end of this quarter and rather minimal. The last two weeks of the strike would be in the fourth quarter and would be offset by activity in the remainder of the quarter. We would think that something beyond six weeks would begin to have a significant effect.

MR. BALLES. Thank you.

CHAIRMAN BURNS. Now, I think that perhaps the time has come to introduce a strong optimistic note into our deliberations, and since no one else is supplying it, I'd like to comment on the economy as I see it.

We were concerned for a time about sluggishness in retail trade. We've learned that figures for earlier months had been underestimated. In August, if our statistics can be believed, we had a very strong rise, an increase of well over 2 percent, and more significant, the increase was widespread. General merchandise sales rose by well over 3 percent; furniture and appliances by 3 percent; apparel, after rising sharply in July, rose a little under 1 percent; and so on. And the reports for the month of September so far are quite favorable.

As for business capital spending, I see rapid increases in the making in view of reports on new orders for business capital goods, on construction contracts for commercial and industrial buildings, and on new capital appropriations for manufacturing firms. The picture on housing could be better, of course, but there is a slow upward trend, and the figures for August for starts and permits are, I think, clearly reassuring.

On the inventory side, I think businessmen are behaving in a cautious and admirable way. They're monitoring their inventories and recently, retailers, wholesalers have adjusted their inventories significantly. There are no excesses of any significance that I'm aware of, and the expansion is proceeding in quite orderly fashion.

Now, the reports on activity are reasonably satisfactory. The industrial production index for July has been revised upward; for August it's the same as for July. In view of our recent record over the past year in estimating industrial production, the chances are that we're continuing to underestimate industrial production.

The report on employment in the more reliable establishment series was quite favorable. As for the flow of incomes, you read reports about the retardation in the month of August in personal income. Well, in the first place, you had a very sharp rise in July, reflecting Social

Security benefits. And secondly, the report is for total personal income, and the significant part is nonfarm personal income because the farm component is sheer conjecture. It's an artificial figure. And [nonfarm personal income] shows a rate of increase of 8 percent rather than the 5 percent which has been so widely reported in the press.

As far as business income--specifically, corporate profits--is concerned, well, there again, I don't think the reports in the press are very revealing. You lump a lot of things into these reports, including profits of the Federal Reserve--which have been quite sluggish, and we don't regret that. But domestic industries are doing quite well. And look at manufacturing, the critical industry of the economy. Look at the evolution of profits [after] allowing for inventory valuation adjustment. Starting with the second quarter of '75, $43 billion annual rate, $57 billion, $55 billion, $61 billion, $66 billion. Now, between the first and second quarters you have a 5.2 [percent] increase on a base of 61, which is an enormous increase.

Now, the picture looks very healthy to me, [but] I have been skeptical on the inflation side. I've been skeptical about our staff projections. Our staff has stuck with a figure of 5 to 5-1/2 percent, and I've stuck with a figure of 6 to 7 percent, and I continue to think that our staff is underestimating what is likely to happen on the price front.

MR. BALLES. Mr. Chairman, you have made me feel better already. There's one observation I'd like to make about this long list of favorable factors. I'm not sure how favorably we ought to interpret the good indications of a coming upturn in capital spending, and perhaps the staff has some input on this.

What I have in mind is that I keep hearing, again from our directors in industry, that a substantial fraction of this increase in capital spending is not productive in the old fashioned sense in that it's aimed at complying with environmental requirements. Whether it's the scrubbers for the utilities or whether it's cleaning up the pulp in paper mills, they are spending tremendous sums of money to comply with environmental requirements. Now this will mean dollars pumped into the economy, but it might not mean the usual increases in potential for a rise in output per man-hour that we've seen associated in the past with the rise in capital spending.

CHAIRMAN BURNS. Well, you're quite right. As far as the effect on production, employment, and the short run is concerned, it's immaterial whether you spend money to improve your technology or spend money to build new plant for environmental or safety reasons. But the effects on productivity are very different for the two. Now, we do have figures on that, and there is enormous variation among industries on that. Do you have the figures in mind, the proportion of total capital expenditure that is accounted for by so-called antipollution or safety requirements?

MR. ZEISEL. In very general magnitudes, it tends to be extremely high in basic-commodity-producing industries.

CHAIRMAN BURNS. Paper, steel, very high--

MR. ZEISEL. About 20 percent in those.

CHAIRMAN BURNS. That's exactly the figure I had in mind, around 20 percent.

MR. ZEISEL. For all the industries as a whole, I think it's closer to 5, in that general magnitude, if I remember correctly.

MR. BLACK. Mr. Chairman, I share your assessment on the outlook in capital expenditures, but more observation might be helpful. In talking to our directors, we have a great deal of trouble convincing them that this is coming because they don't see it in place. And I think the basic difference is they don't see the plants yet, and the thing we're looking at are the leading indicators, which suggest they will be forthcoming. So any survey of businessmen as to what they see, I think, will reflect what our directors see rather than the point you expressed. We can't seem to get that difference across to our directors.

CHAIRMAN BURNS. Well, it's always been that way. Businessmen have always lagged in their recognition. You know, I don't hold out very much praise for the performance of economists, but economists have a far better record in recognizing changes than businessmen, and businessmen have a far better record in recognizing changes than does the consuming public. There are these lags in perception that have been characteristic for a very many years.

MR. BLACK. We have the same problem on the matter of wage settlements. We discovered that our directors really think of increases in productivity as implying that the average worker is working harder, and they don't see this, and they don't realize that you can [get] gains in productivity from a larger input in capital goods. So your survey, as you suggested, is likely to suggest more inflation. In fact, we really--

CHAIRMAN BURNS. I think businessmen will exaggerate just as they think economists are likely to understate. But you know, to come back for a moment to the Ford strike, at the present time what concerns me most about the Ford strike is the possibility of a whopping wage settlement rather than the effects on economic activity. Yes, Mr. Coldwell, please.

MR. COLDWELL. Mr. Chairman, I didn't put my rose-colored glasses on, but I don't have a whole lot of problem with some of your comment about the future. I guess my principal problem is timing more than perspective on the direction of the economy. I've been doing a little bit of traveling around in the past couple of weeks, and I don't find a tone of expectation [in] which businessmen and others are looking for the kind of movement that you're talking about. I recognize the lag which most businessmen have. [Unintelligible] statistical items that you mentioned with the exception of unemployment. It certainly seems to portray a stronger economy in the future. And I guess the question is, How long do we have to wait for this happy future to come about?

CHAIRMAN BURNS. You know, part of the problem is statistical reporting in our press and even on the part of our staffs. Now you take what I've said about corporate profits and what I've said about personal income--I dug it out for myself, you see. Our staffs continue to think in terms of broad aggregates, and they do not disaggregate sufficiently. Well, that's the tendency, I think, of economists.

You know, 40 years [ago], if you wanted to judge the economy, you had to dig down into details because aggregates were not available. Now statisticians manufacture figures, and we look at the aggregates, and, well, I do that myself. I rarely look to disaggregate, but I did a little more preparing for this meeting than I normally do. We look at aggregates and they don't always tell the story.

A profit picture looks very different if you look at aggregates than if you break the figures down and take out--well, look, you know perfectly well that profits of the Federal Reserve shouldn't be looked at. You know perfectly well that profits of our banking firms are down, you see. Take that out. Profits from outside activities, well, that has a bearing. But the domestic economy, and then you take the most significant part, which is manufacturing, moreover, the profits of manufacturing--I didn't go into that; [profits] have been concentrated [there]. That is, the great improvement has been in the durable goods sector. And I think that is quite significant. And in the nondurable goods sector, the profits recently have been flat, reflecting the flat activity in that sector of the economy.

And I think what we read in our newspapers about the economy is inadequate. Based on global figures. Anyone else like to speak on the economy? Well, if not, Mr. Broida informs me that coffee is ready for us, and we'll have to take a short break.

[Coffee break]

MR. AXILROD. [Secretary's note: This statement was not found in Committee records.]

CHAIRMAN BURNS. Thank you, Mr. Axilrod. Any questions to Mr. Axilrod? If not--oh yes, Governor Wallich.

MR. WALLICH. Mr. Chairman, I was interested in the comment on the slowing in growth of velocity. This is a particularly good test because interest rates have been relatively stable. Do you see the prospective ability of velocity to increase as interest rates rise [as being] more limited than it would have been last year?

MR. AXILROD. We would expect that this 2 percent figure is lower than we are going to have in the future. We would expect that, as economic activity picks up, interest rates will rise, and people will economize more on money, and velocity will increase. And we're projecting [that] an increase in velocity through mid-1977 in V1 [velocity of M1] will be on the order of 4-1/2 to 4-3/4 percent--which is somewhat more rapid than in the second year of expansion in most of the previous cycles.

CHAIRMAN BURNS. Any other questions? Yes, Mr. Winn.

MR. WINN. When you look back over history you can almost prove anything you want, but [what] you're struck [by] in the last five years, except for '72, is the first half's behavior versus the second. But bear in mind, most of these dates--you go back and look at the estimates, and we start out the month, estimates are high, and we tail off each time. Is there a feeling that that's going to change?

MR. AXILROD. Start out the month?

MR. WINN. You know, if we go back to the middle of the previous month and look at our estimates of what's going to happen in the next month.

CHAIRMAN BURNS. Of what variable?

MR. WINN. Well, of M1.

MR. AXILROD. Well, I don't, I'm not aware of successive lowerings of rates. My memory of it is that we miss on one side and we miss on the other side but I'm not aware of a steady--

MR. WINN. In the second half?

MR. AXILROD. Second half of the calendar, you mean? Oh, well, that's right. We have examined our seasonals back and forth over several years, and that persists and so--

CHAIRMAN BURNS. Wait, wait, I'm not following this. What persists?

MR. AXILROD. Well, I think President Winn is referring to the second half of the calendar year having a slower growth rate, and we have not been able to find that our seasonal factors are causing that result. We have examined it several times with the help of academic experts and run many different seasonal adjustment programs--30 was the last count--of which we made 10 available to the Committee, and virtually all come in with that result. So something else is causing that, like policy changes coincidentally around that period.

CHAIRMAN BURNS. I haven't been aware of that. I'd like to look into that with you, Mr. Axilrod. I didn't know about this repetitive intra-year fluctuation. Any comment on Mr. Winn's problem or any other? Mr. Baughman.

MR. BAUGHMAN. To Mr. Axilrod. Would you feel any better in the current situation if you saw a little more evidence of price flexibility on savings and small CD accounts?

MR. AXILROD. Well, I don't know that I'd feel particularly better, President Baughman. I believe that if inflows persist at this rate into those institutions and if loan demand [remains weak]--the thrift institutions have fairly high mortgage demand, but at banks, loan demands remain weak--and inflows persist very strong, I believe they will have to be under considerable pressure either to adjust their advertising or their rates because they are not going to get sufficient yield. That would imply some downdrift in Treasury yields, and they will be rather unprotected in terms of earnings. I believe that's the economics of it. But in terms of other factors, I have no comment.

CHAIRMAN BURNS. We want to thank Mr. Baughman and Mr. Axilrod. If there aren't any further questions, let's turn to our deliberation on monetary policy. In the interest of giving the members of the Committee a target to shoot at, by way of either favorable comment or complete demolition, let me suggest some policy miracle targets for the September-October period.

I am inclined to think that, [with] the economy behaving as it has; the economic prospects being what they appear to be; the monetary aggregates behaving like they have; interest rates, most important of all, adjusting downward--I think in good measure because of increasing confidence and the fact that we have been standing still on the federal funds rate, I am inclined to think we ought to remain pretty much where we are for the next month, and I would suggest that we set a target range of 4 to 8 for M1, of 7-1/2 to 11-1/2 for M2, and stay pretty much where we are with the federal funds rate. Who'd like to speak first? Mr. Coldwell.

MR. COLDWELL. Mr. Chairman, I don't have a whole lot of problems in the [unintelligible] question. I guess my principal question is one of flexibility. I like to cover my bets, frankly, and that to me means we permit more flexibility in our approach to this matter rather than the kind of rigidity in funds rate approach that we have had. I don't have problems with the range you suggested on the monetary aggregates, I think [unintelligible] range of 4-1/2 to 5-1/2--

CHAIRMAN BURNS. I'm sorry, I think I misspoke on monetary. I have various jottings and I looked at the wrong one. Let me repeat the ranges that I had in mind: 4 to 8 for M1, and 8 to 12 for M2. I think I said 7-1/2 to 11-1/2; that was last month's target range. I'm sorry, Phil.

MR. COLDWELL. Well, it was a 1/2 point [unintelligible] I didn't read you that closely. What I'm really aiming toward is letting the market have a little more freedom to move [within] the interest rate picture. If the market believed, in its wisdom, that a slightly lower funds rate could be accommodated, then I'm perfectly willing to accommodate it, provided our aggregates are moving within the bands set. If the bands were 4 to 8 for M1; 8 to 12,I don't care, somewhere in that neighborhood, for M2--I've given you a suggested alternative which tries to portray this flexibility that I'm trying to allow here.

And I think the flexibility could go either way if [the aggregates] show any kind of marked movement. But I think it would require that we look with a little more grace upon the idea of the market leading us somewhere, permitting the market to lead up or down within the range of the federal funds rate we establish. It means utilizing the full range for the aggregates before the Desk seeks to guide this federal funds rate, providing the rate's moving at orderly pace. I would not like to see anything over a 5-1/2 to 5-3/4 [upper bound] for the funds rate before the end of the next period unless we got some pretty violent moves in the aggregates. On the other hand, I wouldn't much want to see it below 4-1/4 to 4-1/2, certainly if the thing is going violently in the other direction. I really would rather keep about where we are, with perhaps a little shading toward the soft side if the market thinks that desirable.

I guess my underlying rationale for all of this is that I'm just not all that certain, and I'm a little bit perturbed about the idea that fiscal policy may come along [with] more stimulant injections at a time when I think we're fading out [of the] time in the cycle when such things are appropriate. So I guess I'm pleading for a little flexibility here but basically staying [in] the same general frame we're in.

CHAIRMAN BURNS. Thank you, Mr. Coldwell. Mr. Kimbrel, please.

MR. KIMBREL. Mr. Chairman, I think we accept the feeling that there may very well be a temporary lull--but temporary, really. And we share many of the optimistic observations you named earlier. We would be somewhat reluctant to engage in any obvious easing at this particular time, fearful that, with everything else, the market could misinterpret [it]--that we were unduly concerned about the present state and were moving at this juncture to accommodate that, [which is] more than we really feel. With no apparent end to the federal deficit--and, like you, my question earlier certainly indicated that I have some difficulty with prices over the next five to six quarters with over a 5 to 5-1/2 percent increase.

I guess that if we could maintain something of a steady posture, I have the feeling that businessmen themselves would be encouraged to make some forward commitment. Though I, too, would favor [remaining] very close to exactly where we are at the present time, I do feel some concern, that if we stay at this specific spot very long, particularly with interest rates and federal funds rates, that when we do move, there is going to be an overreactive reading of our move at that time. So I would hope that we maintain a steady posture but not unreasonably long.

I guess I should not pass this way without hoping that, some time--and not too far away--it would be convenient to consider some adjustment in reserve requirements. Announcing maybe that this is not intended as an easing move but with idea of encouraging bankers to not give difficult lending terms and to consider some [unintelligible] more aggressive practices and, not the least, to reduce inequities with nonmember banks.

CHAIRMAN BURNS. Thank you, Mr. Kimbrel. Mr. Eastburn now, please.

MR. EASTBURN. Mr. Chairman, I would be happy with prescriptions appropriate in the current situation of the [unintelligible] be able to see the funds rate maintained about right where it is. I do think that we are confronting an issue in the future where we are going to have to have more flexibility. I think in a longer-run proposition we should be using the aggregates directive rather than the money market directive, and I would hope that we could come to address this issue in a special session as soon as it could be worked out.

CHAIRMAN BURNS. Thank you, Mr. Eastburn. Mr. Black, may we hear from you?

MR. BLACK. Mr. Chairman, I find myself in somewhat of a dilemma on the policy question today. I come out almost precisely where you do. The healthy economic trend seems to be in prospect, and I think we made definite headway [unintelligible] with the twin problems of inflation and inflationary expectations. At the same time, after a year and a half of recovery, we’ve got substantial unused resources, [with] the unemployment rate moving in the wrong direction for three successive months. This being the case, I certainly welcome the recent action on the prime rate, and I would like to see mortgage rates come down more than they have.

But at the same time I am quite concerned over this rapid expansion in the savings deposits at banks and other financial institutions. I believe M2 has been growing much too rapidly lately, and I certainly [do not] want to risk any further acceleration of this by pushing down the federal funds rate. And I think we ought to bear in mind that there have been a number of institutional changes recently that have made the savings deposits more like time deposits. I would suggest that we begin to weight M2 a little more heavily than M1 instead of weighting [them] exactly the same, as we have done in the past.

At the same time, I wouldn’t want to raise the federal funds rate now, and I couldn’t go along with the wording of alternative C, although I do like the specifications for M2 that are embodied in alternative C, so I come out about where most of the others had in holding the money market conditions about where they are. And I think the 5 to 5-1/2 [percent federal funds rate] as specified would be about right, although I confess to having a bias in favor of a wider range and more flexibility. But for the time being, I would be prepared to endorse the money market directive.

CHAIRMAN BURNS. Thank you, Mr. Black. Mr. Jackson.

MR. JACKSON. Mr. Chairman, I feel that it is appropriate to maintain about our same posture. I do think that in view of the announcements expected this week, we may get a market reaction on the reverse side.

CHAIRMAN BURNS. You mean the announcement concerning money growth?

MR. JACKSON. Right. And to that extent I think we may get a slight change between our posture and the market's posture, which may take a little while to work out. For that reason, I would be inclined to favor the narrow rather than the broader approach to the federal funds rate and a money market directive. And I do think, in view of the strong growth in savings, that in the first part of September, the 9 to 13 range is probably the more likely consequence of this type of interest rate posture that we have, although I don't know that I feel we need argue about 8 to 12 or 9 to 13 percent. The consequences of [unintelligible] worth arguing about, but I think those are possibly the likely consequences.

CHAIRMAN BURNS. Thank you, Mr. Jackson. Who would like to speak now? Yes, Mr. MacLaury.

MR. MACLAURY. First of all, Mr. Chairman, could I get a clarification of your proposal on the funds rate range? I'm confused as to whether you're speaking of a 4-3/4 to 5-3/4 range as proposed in the Bluebook or 5 to 5-1/2 as was mentioned by someone else here. I think they're both centered on the 5-1/4, but I'm not sure which you were proposing in terms of the width.

CHAIRMAN BURNS. Well, I spoke a little vaguely on that. I would prefer the present range.

MR. MACLAURY. The narrower range.

CHAIRMAN BURNS. The narrower one, yes.

MR. MACLAURY. Well, in that context, if I may carry on. I certainly agree with your optimism about the economic outlook. I guess I am closer to the staff on its inflation outlook, and we will see where that comes out next year. The M ranges that you proposed are fine, I think. If I understood Phil's suggestion, I would not wish to disregard the whole range of 4 to 8 on the Ms or whatever else is consistent and let the funds rate in effect be led by the market. I think we have more or less agreed to a system of operation of linking movements of the aggregates to our funds rate, and until we have this debate that I also hope we have soon on our procedures, that we would not change that markedly. On the funds range, in the meantime, I think that my feeling is that we are in a less sensitive position and that we ought to, in my view, go back to a wider range of 4-3/4 to 5-3/4, centered on the 5-1/4.

CHAIRMAN BURNS. Thank you, Mr. MacLaury. Mr. Balles now, please.

MR. BALLES. I'm sorry, Mr. Chairman, did you call on me?

CHAIRMAN BURNS. Yes, please.

MR. BALLES. The noise outside--I couldn't hear. Well, I think at a time like this, while I share the hopes of the economy coming up out of this lull, and without wanting to be a Cassandra, I guess I'm a little more dubious than some around the table as to when we'll see this renewed strength. And where this comes out on the bottom line is sort of a visceral feeling about it--if anything, err on the side of ease.

The markets have been softening in terms of interest rates. I was glad to see this latest decline in the prime rate. I think in view of what I consider to be a little bit of uncertainty in the outlook, including, among other things, how long this auto strike will last and a few other things, I would be tempted to follow the strategy now, [given] the uncertainties around the real sector of the economy, to aim for a steady hand on the growth of the aggregates. As opposed to the situation earlier this year, when, because of the changing demand function for money, the disturbances seemed to be in the financial sector, it was more appropriate to call for a steady hand on interest rates. I think perhaps the reverse may be true now.

So, net net, I could accept the specifications on M1 and M2 that you mentioned, but if anything, I would like to see, irrespective of what range we set for the federal funds rate--whether it's 4-3/4 to 5-3/4, which would be my preference, or whether it's 5 to 5-1/2, both centered on 5-1/4--a willingness of the Desk to lean in the direction of letting that rate move down a bit in order to make sure that we continue to get the minimum growth in M1 that we've targeted.

CHAIRMAN BURNS. Thank you, Mr. Balles. Mr. Wallich now.

MR. WALLICH. Mr. Chairman, we've had a remarkable degree of stability both in interest rates and rate of growth in the aggregates. And that tempts one to want to perpetuate it. The easiest way of doing that is fixing a narrow funds range, but I think we would do that at some cost. Later, things may change. By that time the market may have thought that when things are good then everything is very stable. We ought to keep the market accustomed to some degree of variability. For that reason I would go with a wider funds rate. I think 4-3/4 [to] 5-3/4 would be right.

The aggregates as you specified them, I think, are good. It's probably desirable to put a slightly lower ceiling on the expansion of M2 before there is a reaction in the funds rate because M2 is now moving at a rate substantially faster than M1. The gap is unusual, and even though this may mean mostly a negation and not really the creation of additional liquidity, nevertheless it's a little excessive, and so I would agree with you on 8 to 12 as a substitute for 9 to 13.

CHAIRMAN BURNS. Thank you, Mr. Wallich. Mr. Mayo, may we hear from you?

MR. MAYO. I agree, too, Mr. Chairman, on the wider federal funds range--4-3/4 to 5-3/4 I think is quite appropriate and it doesn't box us in quite as much as the 5 to 5-1/2 would seem to, at least in the public gaze. I don't see any real difference in the effect of one versus the other on the way the Manager would operate, but he may wish to comment on that.

As far as M1 is concerned, 4 to 8 is fine. I had initially written down on my note sheet, Mr. Chairman, 7-1/2 to 11-1/2 on M2, which was the figure that you started with and then changed to 8 to 12. I certainly have no reason to differ from the 8 to 12. I share the point, though, that Governor Wallich made on our M2 range. I do feel fairly strongly that it shouldn't be as high as 9 to 13.

On the reserve requirement point, in case all the members of the [Federal Reserve] Board aren't familiar with it, the Conference of Presidents meeting in Chicago last week adopted a recommendation to the Board with regard to reserve requirements. It went along the lines that we could see merit in some announced plan late this year, perhaps the last six or seven weeks of the year, as to our intention to reduce reserve requirements, perhaps over some sort of a scheduled plan starting with some reduction before the end of calendar 1976. Seasonally, even though the seasonal may not be very great this year, there still would be some reason to provide reserves in this way. And, indeed, we feel further steps could be taken, even when the seasonal is more neutral, because of our ability to offset the effects in open market transactions.

CHAIRMAN BURNS. Thank you, Mr. Mayo. Mr. Volcker now, please.

VICE CHAIRMAN VOLCKER. My substantial feelings about the situation have been pretty well expressed by Mr. Balles, I think, and his repeated allusion to erring on the side of ease, if we make any change at all. I don't feel any strong need for changing interest rates, and the kind of bands that you proposed for the aggregates are all right with me.

My concern--to express it opposite, I guess, to the way Mr. Balles did--would be increasing the federal funds rate very readily, and that's what bothers me about a range of the federal funds rate from 4-3/4 to 5-3/4. I really don't look at moving down in the same way I would look at moving up at this stage of the game, given the degree of sluggishness there has been in the economy. How to handle that problem within the framework of the mode of operation that we have isn't quite clear to me. I'm inclined to say we ought to have a range of 4-3/4 to 5-1/2 without moving the rate right now--not moving it at all unless we began moving outside these aggregate ranges. But whether that kind of asymmetrical approach makes sense to other people--[it's] not quite rational, I don't think, but it expresses my feeling about where we should be with the aggregates.

CHAIRMAN BURNS. We haven't done this frequently. We've done it before, and I don't think--it may or may not be desirable--but I don't see any irrationality in it.

VICE CHAIRMAN VOLCKER. Well, I will leave that as a rational proposal and I--

CHAIRMAN BURNS. Everything you say, Paul, by the nature of things, is rational.

VICE CHAIRMAN VOLCKER. Well, I'm not sure about that.

MR. MAYO. Mr. Chairman, I intended to pursue with Alan on the question, would he operate any differently [unintelligible] 5 to 5-1/2 versus 4-3/4 to 5-3/4?

MR. HOLMES. Not unless instructed by the Committee to [move] very rapidly if the aggregates were moving to either end of the range. But you would move further with that range if the aggregates were moving either way. Unless the Committee wants a different set of instructions.

CHAIRMAN BURNS. All right, thank you Mr. Volcker, Mr. Holmes. Mr. Gardner now.

MR. GARDNER. I think Paul has rationality and merit in his asymmetrical approach to the funds rate. I am, perhaps from my antecedents, very impressed with the curious behavior of bank lending in this period of recovery. You've got a sharp divergence, and not only that, but we're in a season now where bank lending should pick up, and we don't have any evidence of it picking up. And the economic analysis that we've had today, I generally concur with it. But a slight slowing in the recovery process or at least more moderate economic growth leads me to think that we should, in due course, perhaps at future meetings, consider looking at the aggregates as President Eastburn has suggested, instead of a money market directive.

And I'd like to comment on the proposals that Bob Mayo made and, I guess, Ernie or Willis. You know the bank reserve picture is such that it seems to me we would want to defer looking at changes in bank reserves and pressure on the banks--far from it. Banks have very, very weak and placid loan demands, and this is a curious fact, with all the other elements in the economy proceeding to the tune of a different drum, I guess. Even the commercial paper market--if you put that together with bank lending, it doesn't impress me as being characteristic of the season or the period of a recovery.

I think, therefore, that I can associate myself very clearly with alternative B and those ranges. I would also opt for the bulge in the lower end [of the federal funds rate] as Paul has suggested, and I would also urge you to put the reserve question aside at this meeting.

CHAIRMAN BURNS. Well, that's not a matter for this Committee to act on, [not] in the power of the Committee. I suspect that the Bank Presidents who are speaking on this issue have in mind the [Federal Reserve System] membership problem at least as much as the problem of monetary policy.

MR. MACLAURY. Exactly. Very much so. Much more so.

MR. BALLES. Yes, that is our emphasis, Mr. Chairman, and we feel that this is one of the few areas where there is any discretion left on the part of the Federal Reserve System without legislative changes.

CHAIRMAN BURNS. Well, I think that what our Bank Presidents have to say on the subject, and they're close to the firing line--closer certainly than we are at the Board--deserves respect on the part of the Board and will receive it.

SPEAKER(?). Could I ask a question? Did I understand you, Steve, to be agreeing to Governor Coldwell's proposition?

MR. GARDNER. I don't know whether I want to state the case quite as specifically as Phil has. I sort of like the language in both the single aggregate proposal [unintelligible] alternative B. The market is proceeding pretty well.

SPEAKER(?). When you talk about Paul's proposal, what do you mean?

MR. GARDNER. Paul's was his federal funds rate proposal.

CHAIRMAN BURNS. I think that what Mr. Gardner was seeking to convey is general acceptance of the range and the asymmetry that Mr. Volcker had suggested. That was my interpretation. Is that correct?

VICE CHAIRMAN VOLCKER. I'm not sure I fully appreciate all the implications of what Governor Coldwell was saying. At times he seemed to be saying things that I agreed with, and at times he seemed symmetrical and certainly with larger federal funds movements in fact than I think we want to see at this point.

CHAIRMAN BURNS. All right, who would like to speak next, please. Yes, Mr. Morris.

MR. MORRIS. Mr. Chairman, I would like to support the asymmetrical funds range here. I think the evidence does suggest that we are getting a reacceleration in the economy, but it seems to me it would be prudent to give the Manager a little more room to lower the funds rate in the event that the evidence coming in tends to suggest that this reacceleration is in fact not occurring. But with the understanding that he would not move to the midpoint of this asymmetric range but could use it in the event that the aggregates come in weaker than were expected.

CHAIRMAN BURNS. Thank you, Mr. Morris. Anyone else? Mr. Baughman.

MR. BAUGHMAN. Mr. Chairman, just to express the view that I agree with the suggestions that it might be appropriate to see a little more flexibility of our operation. I would hope that it would tend to reduce the indication that we're supporting those elements in the markets which are resisting the tendency for rates to move down. It seems to me that the situation is one which would look better if we saw a little more downward flexibility in the private part of this market currently.

It seems to me also that within our frame of operation, the best way to get a little more flexibility is to go the route of the aggregate directive. I guess that's not necessary, but as we operate, it seems to me even more like [unintelligible]. As to the specific figures given, I have no objection.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Who would like to speak next? Who having already spoken would like to speak again?

MR. BLACK. That's a dangerous precedent, Mr. Chairman.

CHAIRMAN BURNS. Mr. Wallich.

MR. WALLICH. I just want to say I think the asymmetry proposal with the instruction to stay near the present level unless there are extreme movements is a good one.

MR. MAYO. I would agree with that.

CHAIRMAN BURNS. Gentlemen, I want to make a proposal as follows. Now (1) that we adopt the aggregates directive; (2) that we adopt an M1 target range of 4 to 8; an M2 range of 8 to 12; and a federal funds rate range of 4-3/4 to 5-1/2 with the understanding that the Desk will operate on an asymmetrical principle. As far as I can judge, that comes close to expressing a broad consensus of the Committee.

MR. BALLES. Mr. Chairman, I didn't catch that final key phrase, where you said with the understanding that the Desk would what?

CHAIRMAN BURNS. Would observe the asymmetrical principle as previously described by Mr. Volcker.

MR. BALLES. Fine.

MR. MAYO. Mr. Chairman, I'm not sure I understand the reason for moving back to the aggregates directive as against money market.

CHAIRMAN BURNS. Well, there are two reasons in my own mind. One is, I don't like to see us repeating in successive meetings a money market directive. The Committee had reached a decision to proceed normally on a monetary aggregate directive. I don't want to see us drift into [regular use of a money market directive]. Now the Committee, as it reconsiders its policy, may possibly prefer a money market directive as a broad rule. I doubt if the Committee will reach that decision. I would oppose it. It's possible, but if we do it, let's do it deliberately and not drift into it, so that is one reason for my suggestion.

Another reason is that we're broadening the federal funds rate range a little, and that too, I think, justifies a shift to a monetary aggregate directive. But all this is at the pleasure of the Committee. Now I think that Governor Coldwell's suggestion deserves an explicit vote, and members of the Committee who are inclined to support Governor Coldwell's suggestion on the directive would kindly indicate that.

MR. BLACK. Could we have that read?

CHAIRMAN BURNS. The directive would read as follows: "The Committee seeks a reasonably accommodative posture regarding bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing within the bands of expectation." Well, there is no general support for that directive, as far as I can judge.

I think what is perhaps most uncertain about my suggestion or vote is what I've said about the federal funds rate. And let's have a show of hands on the part of members of the Committee whether my suggestion, first, that the range be 4-3/4 to 5-1/2, and second, that the asymmetrical principle be expected by the Desk, whether that suggestion is generally acceptable. Let's have a show of hands.

MR. BROIDA. Ten, Mr. Chairman. It's unanimous.

CHAIRMAN BURNS. Well, do we want more discussion before the vote? Mr. Black.

MR. BLACK. Is there an understanding that we would weigh M1 and M2 on an equal basis?

CHAIRMAN BURNS. Yes, I did not say that, and that is the principle on which we've proceeded in recent meetings, and I have tacitly assumed that, but that should be explicit.

MR. BLACK. Well, I can foresee a case where M1 might not grow very rapidly, which might lead you to lower the federal funds rate, and at the same time M2 might be growing quite rapidly.

CHAIRMAN BURNS. Well, then, one would offset the other if that happened.

MR. BLACK. I guess that my feelings about M2 having grown too rapidly, I [would] feel a little concerned about moving down [just] because M1 didn't come in a little more.

CHAIRMAN BURNS. What would you suggest, that we give more weight to M2?

MR. BLACK. That's my feeling, but there doesn't seem to be any feeling on the part of others that M2 ought to be weighted a little more heavily.

CHAIRMAN BURNS. Would the Committee be inclined to give M2 a larger weight?

VICE CHAIRMAN VOLCKER. No.

CHAIRMAN BURNS. Well, there does not seem to be any broad sentiment in favor of that, so we'll stay with the general principle of giving approximately equal weight, with emphasis on "approximately" as well as "equal."

MR. COLDWELL. May I have just a bit of clarification, Mr. Chairman, on this asymmetric principle? If I understand, what the Desk would do is stay at 5-1/4 unless things start moving toward the upper or lower parts of their bands. And all this asymmetrical principle does is hold the wider range on the bottom side within which the Desk may operate.

CHAIRMAN BURNS. Pretty much, pretty much.

MR. HOLMES. That's the way I would interpret it.

CHAIRMAN BURNS. If there are no additional comments or questions, and apparently that is our situation now, let's vote, and would you be good enough to call the role.

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Mr. Balles	Yes
Mr. Black	Yes
Mr. Coldwell	Yes
Mr. Gardner	Yes
Mr. Jackson	Yes

Mr. Kimbrel	Yes
Mr. Lilly	Yes
Mr. Wallich	Yes
Mr. Winn	Yes

It's unanimous, Mr. Chairman.

CHAIRMAN BURNS. All right, we have a Partee and a Holmes-Axilrod memorandum. And Mr. Axilrod, would you be good enough to summarize the results of your deliberation--you might want to call it a study. And then your recommendation to the Committee.

MR. AXILROD. Essentially, Mr. Chairman, we considered four problems with regard to the instant reporting of Desk transactions through Telerate. Remembering, of course, that Telerate is not the only mechanisms at work in the market--the Dow-Jones wire [gives] reports [of] transactions--it's simply that Telerate reports them more promptly and, of course, often before they're consummated. I mean, they report when the Desk enters the market. On analysis, we determined that there was no way--

CHAIRMAN BURNS. Excuse me. Please continue--I'm familiar with your memorandum. I have some notes on it, but I don't seem to have a copy. Ignore my absence.

MR. AXILROD. We did not believe that there was any effective way that the Desk transactions could be kept secret, so to speak, for the reasons outlined in the memorandum. So we believe that we have to live with the publicity under current circumstances.

Secondly, we considered whether that publicity in any way made the FOMC's posture--that minutes, the policy record, should not be released except with a 35-day lag--whether it made that posture untenable. We concluded that it did not because what the Telerate system is telling the market is what our objective is now, or permitting the market to infer what our objective is now, today, for the federal funds rate, whereas the policy record gives rather more revealing information, [which is] what our objective might likely be two or three weeks from now. And if you're going to make money, that's where the money is to be made, in forecasting where the Fed's going to be in the future. Of course, that's where the most risk is also, but that is the information that market sophisticates, people with financial resources, can use to greatest advantage. That is also the type of information that would most complicate our operations.

So, from two points of view, it does not seem to us that there's any argument that can be made to release the policy record immediately after the Committee meeting, to release the specs immediately after the Committee meeting. So we don't believe the Telerate system invalidates the current Committee's argument to preserve the specs for 35 days.

We also considered two other possibilities, given the fact that we didn't believe that secrecy could be preserved. And one was, could somewhat more fluctuation in the federal funds rate be permitted within a day or within a week. We were not addressing ourselves to the width of the range but simply the question of widening the intervention points so that the market would have a more difficult time in gauging where the Desk is and thus would have a more difficult time in gauging changes in the Desk's own objectives. On balance, we felt there was little advantage to that, that the market would simply look at wider intervention points and that the federal funds rate itself might move more promptly to these wider intervention points once the dealers in federal funds began to learn the method of the Desk operation. So we did not think, on balance, that that would reduce market sensitivity to changes in our operations.

Secondly, we considered whether it might not be desirable to publish information at the end of the day on Desk transactions, that is, the amount the Desk did in a particular area, and no other information. This way, everyone would be on the same footing. On balance, we believe that there, too, the disadvantages would outweigh the advantages. It might give rise to a number of questions that we did not want to publicize at that time with regard to the purpose and reason and to a number of misunderstandings in the process.

So, in sum, we believe that there are no changes that appear to be required in Desk operations or in Committee procedures, given this system. I think, Mr. Chairman, that Mr. Holmes might wish to add a comment or two on the specifics from the Desk point of view.

MR. HOLMES. Well, Mr. Chairman, I really have very little to add to what Steve said. We do live in a goldfish bowl, unfortunately, but that's a fact of life. Telerate is not the only mechanism, as Steve said, that transmits information that we're in the market. When we come [into the market], in every dealer house, lights go on and bells flash, and people or salesmen are on the phone to their customers. So this is something we have to live with. Telerate perhaps reaches a slightly larger audience. They've been quite accurate in reporting our individual operations. They can give no information when we're operating for the System account or on how much we're doing, because the street never really knows that.

On balance, it seems to me that, while it may be annoying to have everything laid out on a little machine 20 seconds after you go into the market, I think it's something that we can afford to live with without any serious damage to our operations.

CHAIRMAN BURNS. I couldn't find my notes, but recollecting as best I can, I had questions. On page 8, the memorandum reads: "If the Desk simply permitted the funds rate to move in, for example, a 1/2 percent band around its objective before intervening, rather than a 1/4 percent band, the market would probably behave a little differently." Well, I don't question the judgment--I don't know enough to question the judgment--but it is a judgment, it's not a statement of fact. What harm would there be in the experiment to see, well, so we're [unintelligible]. If it turns differently, there might be an advantage.

MR. HOLMES. Mr. Chairman, I think Steve and I both thought that this is something that we expect the Committee to be discussing when they have a special meeting on procedures. And it really oughtn't get too much mixed up in something on the Telerate machine itself, but I think it--

CHAIRMAN BURNS. Yes, I think that's fair. Well, let's hold that as a subject for discussion. And another question that occurred to me is, on your page 9 you say, "While no formal System announcement is now being made on daily Desk operations, the Public Information Department has, upon inquiry, confirmed reports of Desk activity in the market of the type recorded by Telerate." Well, if you do that in response to an inquiry, then you're supplying an answer to some individuals. Then why not make it public to all [unintelligible]?

MR. HOLMES. Mr. Chairman, I must say that demand for this sort of confirmation of what people hear in the street or what they see on Telerate has not been very great, and this is a rare occasion that someone will call and say, "Are you buying coupons?"

CHAIRMAN BURNS. Well, but if you tell some people what you're doing, you ought to tell all alike. That's the way it struck me upon reading it.

VICE CHAIRMAN VOLCKER. Or you can go the other [way] and say why confirm it at all.

CHAIRMAN BURNS. Well, we might--

VICE CHAIRMAN VOLCKER. I was surprised to hear we did this, as a matter of fact.

MR. HOLMES. I see very little harm in doing it. As I say, the demand is not great. I mean, we don't do this at the Desk.

CHAIRMAN BURNS. I'm not thinking of harm here, except harm to our public image. I'm not thinking of harm to markets, but I would feel very uncomfortable if the statement like this were in the public arena and we'd be charged so quickly on Capitol Hill with making information available to some market participants and not to others. I'm thinking solely of that. It's not a good posture for us to be in, and we certainly ought to do the one or the other, I'm inclined to think. You talk to no one, or talk to all of them.

VICE CHAIRMAN VOLCKER. Well, this does say they respond to news media, which I assume means it can be published for all.

CHAIRMAN BURNS. Well, that's a little different, and some get it faster than others. I feel uncomfortable, I just feel so uncomfortable reading that.

VICE CHAIRMAN VOLCKER. Well, I don't really know why we do it at all.

MR. HOLMES. I see no harm in changing that policy.

CHAIRMAN BURNS. Well, I think this, too, ought to be discussed rather fully. We need not--in fact, any decision we reach today would be a hurried decision, and I don't think we ought to decide today, but let's think about that when we have our special meeting. Any other question? Those were the two that I recall occurred to me. Yes, Mr. Eastburn.

MR. EASTBURN. May I follow up that point briefly? I think it would be helpful to have a little bit more on costs and benefits of publishing daily what the Desk did.

CHAIRMAN BURNS. Daily, or maybe weekly.

MR. EASTBURN. All right, or whatever the period is. If you go on the assumption that services of this kind continue, I think maybe rather than trying to stop the tide, say that we don't want to add to concentration on short-term developments in the present--the market would do it anyhow. Then, it seems to me, the thrust turns into a question that you raised, Mr. Chairman, that is, what is our public posture with respect to information we have.

MR, GARDNER. Alan, the way this is written, it says the Desk "has"--upon inquiry. I hope you don't respond to one inquiry and not to another.

MR. HOLMES. Oh no.

MR, GARDNER. You really mean "does," I hope.

MR. HOLMES. No, it's the Public Information Department, not the Desk. We do not talk to the press.

CHAIRMAN BURNS. Well, that's exactly the same.

MR. HOLMES. But it's the same--

MR.GARDNER. But the point is, if you get an inquiry, you treat all inquiries the same way.

MR. HOLMES. Absolutely.

MR. WALLICH. I find very intriguing the suggestion that there'd be a full listing of all operations. Now, the idea is stated here, and then it is rejected, and I wonder how strongly the authors feel about this rejection. I could see that very considerable benefits in terms of public posture would come from it--we tell everything. At the same time, we don't tell very much that isn't on Telerate, as far as I can see.

CHAIRMAN BURNS. Wouldn't we put Telerate out of business?

MR. WALLICH. They have so many other pieces of information, Mr. Chairman--

CHAIRMAN BURNS. I'm not shedding tears.

MR. STERNLIGHT. It's a timing factor.

MR. WALLICH. --exchange rates, which makes it a very attractive thing to acquire for other reasons.

MR. AXILROD. Governor Wallich, the disadvantage that we saw--it would add one piece of information to Telerate; it would give the amount, probably. "The System today bought $200 million of Treasury coupon issues" period, that's what we contemplated.

CHAIRMAN BURNS. Let me ask this. This wasn't clear to me. When the System buys or sells on its own account, we don't answer that question through the Public Information office, and Telerate, they don't publish it.

MR. AXILROD. They indicate that the System is buying, but they don't know the amount.

CHAIRMAN BURNS. They don't know--but otherwise they do know the amount.

MR. AXILROD. For customer accounts of the Desk, yes.

MR. HOLMES. For the customer accounts. Mr. Chairman, when we're operating for the System account, we don't want to announce an amount in advance because part of what we do may depend on what sort of response we get to our operations.

CHAIRMAN BURNS. But they do know that we're operating. Well now, wait a minute now. They know that we're operating from the dealers, right?

MR. HOLMES. Yes.

CHAIRMAN BURNS. And if they know from the dealers that we're in the market, do they not also learn from the dealers how much we're buying or selling?

MR. HOLMES. Sometimes they make rather accurate guesses, sometimes the guesses are very wrong, because not all dealers want to give everybody else a list of what they had done with the Desk in a given operation.

CHAIRMAN BURNS. But the dealers will invariably or almost invariably indicate our presence in the market on the buying or selling side.

MR. HOLMES. Yes.

MR. WINN. Mr. Chairman, if I were the publisher of *Penthouse* magazine or any other mischievous person, and I know that a gadget was used by the System, and then I learned from an unhappy Telerate salesman or a dealer that it was withdrawn as a means of furthering the alleged secrecy of what we're doing--I think we're sticking our neck out a mile, if after something is in place, we pull back on it. I may see it totally wrong, but I think--

CHAIRMAN BURNS. But we may want to go the other way.

MR. WINN. Well, that's correct. I think this is one of those little cute situations that could be magnified to make us look sort of bad by someone who wants to make us look bad.

MR. AXILROD. Mr. Chairman, I was trying to respond to Governor Wallich's question of the disadvantages we saw to the proposal of announcing the amounts that we do. The disadvantage we saw, Governor Wallich, was not that the announcement itself, per se, would be harmful, but that questions would arise in people's minds. It may be difficult to stop with the announcement, but we would begin to be compelled just to explain why--

CHAIRMAN BURNS. I don't see why. Why would you be compelled? If you have a policy of not explaining, of releasing figures without explanation--as a matter of fact, for years

I've been a proponent of statistical releases by government that carry no explanation because I've seen too often that the explanations are self-serving.

MR. AXILROD. I believe, Mr. Chairman, you could hold the line. There wouldn't be a problem on that, but then the other risk would be, you would get considerable misinterpretation of your motives in the market afterwards.

CHAIRMAN BURNS. Well, there's no shortage of that now.

MR. WALLICH. I think it would be a very nice posture to be able to say we publish all we do in the market every day, and then there remains only one little bit that we don't publish, which is where we want to be at the end of the market by our decision [unintelligible].

CHAIRMAN BURNS. Oh no, we have daily figures on the money supply we don't publish. If you were to build a publication route, I'd want to have this--the staff, first, and then this Committee, consider very carefully whether we publish daily information or, let us say, weekly information.

MR. AXILROD. The Committee does understand, Mr. Chairman, that we do publish weekly.

CHAIRMAN BURNS. Because, after all, you know--

VICE CHAIRMAN VOLCKER. We publish weekly.

MR. AXILROD. We do publish weekly through our [unintelligible].

CHAIRMAN BURNS. Overall.

MR. AXILROD. Right, the net change during the week is discernable.

CHAIRMAN BURNS. Well, that's correct.

VICE CHAIRMAN VOLCKER. I must say, Mr. Chairman, I find their argument in this particular point somewhat more persuasive than you do. Maybe I'm more conscious of the frailties of human beings in responding to the pressures that I suspect would arise.

But I mainly wanted to say, I found these couple of paragraphs that you referred to, beginning at the bottom of 7 and 8 and going to the top of 9, interesting and to the point in the light of discussion we should be having, and have repeatedly referred to here, about our operating techniques. I think there are some problems that we've all been restive about, but they're not very easy to handle, as this suggests, in my opinion, and this does raise some points that we have to consider carefully.

CHAIRMAN BURNS. Well, gentlemen, I have to leave. I don't know whether the Committee wants to deliberate further or not. If there were such a thing as a movement to adjourn, would it receive your consent? Well, let's suppose there is a motion to adjourn.

SPEAKER(?). So moved.

CHAIRMAN BURNS. All right.

END OF MEETING