TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

February 28, 1978

Prefatory Note

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

Staff Statements Appended to the Transcript

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

2/28/78

Meeting of Federal Open Market Committee

February 28, 1978

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, February 28, 1978, at 9:00 a.m.

PRESENT: Mr. Burns, Chairman
Mr. Volcker, Vice Chairman
Mr. Coldwell
Mr. Guffey
Mr. Jackson
Mr. Mayo
Mr. Morris
Mr. Partee
Mr. Roos
Mr. Wallich

Messrs. Balles, Baughman, Eastburn, and Winn, Alternate Members of the Federal Open Market Committee

Messrs. Black, Kimbrel, and Willes, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and Minneapolis, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. Axilrod, Economist

Messrs. Balbach, R. Davis, T. Davis, Eisenmenger, Kichline, Scheld, Truman, 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

Messrs. Coyne and Keir, Assistants to the Board of Governors
Mr. Wallace , Staff Director for Federal Reserve Bank Activities, Board of Governors
Mrs. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Boehne, J. Davis, and Parthemos, Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Cleveland, and Richmond, respectively

Mr. Brandt, Vice President, Federal Reserve Bank of Atlanta

Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis

Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York

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February 28, 1978

CHAIRMAN BURNS. Gentlemen, we will start our meeting. I am glad to see all of you once again but I had hoped, as I know all of you did, that this meeting would be chaired by Mr. Miller. He is testifying this morning and he has had his difficulties, but I am reasonably confident that they may be cleared up this morning. We all have our duty and we will perform it. It has been a somewhat difficult period for all of us and some mistakes have been made, and I'm responsible for two mistakes. Well, I don't know how many I'm responsible for, but I'm responsible at least for two that I can think of immediately involving this Committee. The first was to advise you not to take up the long-range targets at the January meeting. That was a mistake. The second was postponing our regular meeting a week. That was the second mistake. I think that, under the circumstances, these mistakes are understandable; I hope they are. Nevertheless, they were errors as things have turned out; they were hurried suggestions. From now on, no matter what happens, we will proceed according to our regular rules--not deviating to the left nor deviating to the right one inch. A motion to act on the minutes would now be in order.

MR. WALLICH. I move [that the minutes be] approved.

SPEAKER(?). Second.

CHAIRMAN BURNS. Approval has been moved and seconded. And I take it there is no difficulty. We had a report of the Examination of our System Open Market Account. Is there any desire for discussion of that report?

MR. COLDWELL. I move acceptance.

CHAIRMAN BURNS. Mr. Balles.

MR. BALLES. Just a comment, Mr. Chairman. I guess it's from the Board's annual report that the press picks up this news--that it looked like a $100 million loss last year in foreign exchange operations. When I had my staff look into this, it turns out that much of that goes back to the middle of 1971 or whatever, but we're still amortizing some of the losses from that point in the foreign exchange operations. I'm informed by my staff--and I checked here [at the Board]--that there's actually been a small profit in each of the last several years. The only reason I make this comment is that it might be a little misleading the way the thing is reported. Whatever the basic source of the information is, it leads to some misunderstanding among the public and the press. I don't know what if anything can be done about that, but I simply raise it as something that might be looked into a bit.

CHAIRMAN BURNS. Well, I don't know what we can do about the report, but this question will come up in Congressional hearings and then we ought to make not only the points that you have just made but the additional point that we held onto our gold, and that's why we got into this loss. Gold then was worth $35 an ounce and, if I remember the current quotation correctly it is something like $181.

MR. BALLES. Right.

CHAIRMAN BURNS. If you take that into account, as you should, and if profits in terms of inflated dollars mean anything, we've made an enormous profit.

MR. BALLES. Good point. It simply came to my attention because Table II of Bill Wallace's report had a line showing losses from foreign exchange in 1978, and I think the figure was close to $100 million.

CHAIRMAN BURNS. Yes, and I have seen figures of this sort cited by distinguished columnists.

MR. JACKSON. Governor Wallich covered that in his testimony recently, Mr. Chairman.

MR. WALLICH. I did refer to this when they complained about the heavy foreign [exchange] losses and I made the point that we retained gold.

CHAIRMAN BURNS. While we're on that subject, we sure are hoarding that gold as if it were there never to be used. Well, we may possibly have further comments on that when we come to item 3 on the agenda, and we'll be there soon.

MR. WALLICH. Mr. Chairman, may I make a comment in light of Mr. Balles's comment on the losses in the foreign currency transactions? I was going to bring it up [under agenda item 3] but it bears on the System portfolio. The System portfolio is enormously profitable and it is well managed, but there are computations you can make by which you can establish putative gains and losses that would have been realized in certain conditions if maybe sales had been made to realize them. Take our coupon portfolio of only between $60 and $70 billion. At the end of 1976 it had an unrealized capital gain on it of $2.1 billion; at the end of 1977, it had an unrealized loss on it of minus $1/2 billion. So it was a swing from an unrealized gain to an unrealized loss of approximately $2.6 billion, but it was not realized. That doesn't mean that we are not receiving an appropriate interest on the portfolio. But it is a very sizable loss [if one makes] another calculation, which is really an estimate and can be challenged in many ways.

CHAIRMAN BURNS. Well, the first figure could be challenged too, but go on.

MR. WALLICH. Well, you can say that the average maturity of the portfolio is on the order of 3 years. What has happened to a 3-year note in the market? It has gone down. If the portfolio were to consist all of 3-year notes, which of course it does not, we would have had a loss on the order of $4 billion from this. Again, as I say, this is a purely theoretical computation, but I mention this because I anticipate that it will be pointed out that there are losses on the foreign currency operations. And it needs to be remembered that in proper economics there are unrealized losses on the portfolio that are much larger.

CHAIRMAN BURNS. I hope that if and when or as this is debated in the Congress, this will never be pointed out because that would only add to the confusion. After all, we could, by pumping reserves into our commercial banks, add enormously to the security holdings of the System and run up our profits to--well, let me say to any conceivable figure.

Well, a motion to accept the examination report has been made. Is there any--

VICE CHAIRMAN VOLCKER. Let me just say for the record, Mr. Chairman, if I may, that there was a reference in the examination report to some custody control standards in the acceptance division, which is a fairly small part of the operation. There were some differences of opinion, if that's the right [term], about the standards that had been followed there for some years, and some changes are being made. I think it's incorrect to leave the suggestion that there was some sense of weakness, at least on our part. There may be a difference in the way this can be controlled, and changes are being made in response to the examination report. But there should not be any implication that something weakened during the year there. The procedures had been followed for many years. The new ones may or may not be better; they're different, anyway. I just didn't want to leave an implication that something had weakened during this period in that area.

CHAIRMAN BURNS. Was such an implication intended, Mr. Wallace?

MR. WALLACE. No, Mr. Chairman, it really wasn't. Conversations between our staff and members of the New York Bank staff indicate that changes are being made to correct the difficulties that we pointed out. I believe Miss Young from our staff, who did this examination, and Mr. Ozog at New York have worked out whatever these differences were. So I think Mr. Volcker's comment is correct.

CHAIRMAN BURNS. Thank you very much. Any other comment on the examination report? If not, a motion to accept the report was already [made]; if seconded we can move on.

MR. WALLICH. So moved.

CHAIRMAN BURNS. I think that it has been seconded. Again, [I hear] no objections, so we'll turn now to Mr. Pardee for his report on foreign currency operations.

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

CHAIRMAN BURNS. Thank you, Mr. Pardee. Are there any questions or comments?

MR. MORRIS. Mr. Chairman, this was the first time I was aware that the limitations we place on the Manager are limitations on gross transactions. It seems to me that the procedure has some question marks. The objective of the limitations is to assure the Committee that our net exposure will not exceed a given amount. And it seems to me that the limitations for the future ought to be placed in terms of a net change, not the gross transactions; they don't carry nearly the same meaning.

CHAIRMAN BURNS. I think that's a fair question. Mr. Wallich.

MR. WALLICH. We have [limitations on] both. The principal one that is stated in the Authorization, which is the basic document, is in terms of the net exposure. And the exposure limits were not overrun. [The Desk] was well within those. What was overrun was the [limit on] gross transactions. The reason for having that is not that it's more important than the overall exposure limit but that a lot of things can happen in an unchanging net exposure. For instance, you can go from plus to minus a billion in a day and it shows no change in the net exposure. You're still exposed a billion, only you switched the position the other way. And that was the reason why a gross transaction limit was [imposed]. That doesn't mean that it can't be lifted very easily, but this Committee should be aware of what's going on and the Subcommittee should be more aware.

CHAIRMAN BURNS. Mr. Coldwell.

MR. COLDWELL. I think there was another reason too, if I recall correctly, for the establishment of the gross limits--to achieve some balance in the Desk's operations in foreign currency transactions. [The goal was] that we not be intervening constantly in the market, but intervene with a balanced approach without heavy, massive intervention. A net limit, as you pointed out, would perhaps reveal nothing.

CHAIRMAN BURNS. Mr. Jackson.

MR. JACKSON. To what extent do you try to unwind our position in periods of relative calm?

MR. PARDEE. I'm sorry, but we haven't had a period of relative calm in which we could really begin to unwind our positions.

MR. JACKSON. I misunderstood. I thought you said there was relative calm for an extended period of--

MR. PARDEE. That's right, but it was a very, very tenuous one. During that period, as I say, the same issues that everybody else was worried about were still there. And if we were seen as a buyer of [marks] in that period, we could have had a bigger problem on our hands. We had discussions on several occasions with the Bundesbank on the possibility of their picking up some marks for us and on a couple of days we might have ended up with some if the market had turned in our favor. We also carry at this stage a rather substantial accounting loss on the operations we have engaged in up to this point; and when the turn comes, we should be in a position to take a profit. I'm rather reluctant to start unwinding this early, both because of the sensitivities of the market and this profitability question in the back of my mind.

MR. JACKSON. Do you perceive our function to be to make a profit [and not] a loss or to counter a disorderly market?

MR. PARTEE. The first function is related to the conditions of the marketplace. And, as I say, we did discuss actively with the Bundesbank this [issue of] when they might pick up some marks for us but the conditions were not right. The second consideration--I'll say it because it was discussed earlier on--is this question of relative profits and losses. But that is not the first objective.

VICE CHAIRMAN VOLCKER. As of noon, or whenever it was on Friday, we had picked up quite a few marks. The market was having a rally. Unfortunately, the market turned again during the afternoon, but that was the specific instance when you got up to $85 million, I think.

MR. PARDEE. The two-way approach does provide us with marks. And once the market turns in our favor, then we will be net buyers of marks without the market necessarily paying much attention to it. But if we go into the market flat out and simply start buying ourselves marks, it would be a matter of a day or two before they'll say, "Aha! The Federal Reserve is covering its debt; that means the upside risk of the dollar is limited." Already the operation with the Bundesbank, which has a serious liquidity problem as a result of the international [situation] in reabsorbing some of that, is seen in the market as putting a damper on the dollar rate. It's a very sensitive situation.

CHAIRMAN BURNS. Mr. Partee, please.

MR. PARTEE. Well, I think there are two questions here and they're really aspects of the same question. The one that was raised by Frank Morris about the Desk exceeding its limit is whether there needs to be an intra-day limit on gross transactions. I think perhaps there does, but I do think as a matter of strategy it is desirable sometimes to show your presence and then to offset it later in the day. And I believe that is exactly what happened on Friday. You had a large gross but the net wasn't very big for the day. You apparently sold in the morning and bought in the afternoon and largely offset [the sale]. And I think that kind of thing is to be encouraged where it can be, particularly with the market as volatile as it is between Europe and New York. As the day progresses, that offsetting of gross sales--to the extent it can be accommodated--I think is desirable; it reduces the net exposure on the day. Then extending that thought to Governor Jackson's [question], I think over time you also want to be looking for opportunities where you can reduce the net exposure position. I'm sympathetic, I believe, with the idea of relenting on the daily gross limit but I don't think I would do away with it entirely because I imagine we could get very, very large gross figures. We might even have a very large gross figure that you expect to offset later in the day and you can't offset it. So it can lead in a way to an exposure that's unanticipated. But given the kind of markets we have, I think a $100 million limit on gross [transactions] is probably too low.

CHAIRMAN BURNS. Well, I think this is a fair question, but one that I think we can postpone until the next meeting when I believe the rules under which we operate are to be reexamined by the Committee. In the meantime, I think we ought to have some discussion, perhaps some studies by our staff and by some interested members of the Committee. Perhaps before this meeting is over, we shall want to formalize that. Any other question or comments on foreign currency operations or the dollar problem as it now exists? Very well, if not, a motion to ratify the transactions since the previous meeting would be in order.

MR. MAYO. So moved.

MR. PARTEE. Seconded.

CHAIRMAN BURNS. A motion to ratify has been made and seconded. I hear no objections. We will pass on to Mr. Holmes's recommendations.

MR. HOLMES. Mr. Chairman, in March the System has 17 swap drawings, totaling $541 million, maturing. It seems unlikely, although it's not completely inconceivable, that we will be able to acquire that amount in the market. I recommend that the Committee approve the rollover of these swaps on maturity for 3 months. In all cases, these are first renewals; they've only been outstanding for 3 months.

CHAIRMAN BURNS. The recommendation is clear. Is it acceptable to the Committee?

MR. MAYO. I don't believe we have an alternative.

MR. PARTEE. We could just pay it back.

MR. MAYO. Take it out of your left pocket!

CHAIRMAN BURNS. Any objections to Mr. Holmes's recommendation? I hear none. I take it that it is acceptable to the Committee. Any other recommendations?

MR. HOLMES. Well, Mr. Chairman, in April we have a little different situation. We have six swaps totaling about $136 million that will mature. As they mature, they will have been outstanding for 6 months--the maximum called for in our swap arrangement without a special agreement between the Bundesbank and ourselves. I really think it is premature to make a recommendation concerning these drawings at the present time, but I would like to have preliminary discussions with the Bundesbank, which they are also very anxious to have, either at the Basle meeting in March or slightly before that. While I have no recommendations, I think it might be worthwhile to point out to the Committee the options it has before these swaps mature. First, they could be repaid. If we are lucky, we can buy the German marks in the market, conditions permitting, or directly from the Bundesbank. This is one very clear option.

CHAIRMAN BURNS. In the latter case, we need not be lucky; we just do it.

MR. HOLMES. That's right. I should point out, however, that from an immediate profit and loss point of view, for those people who are interested in that, these swaps are the most expensive drawings that the System could repay. This arises obviously from the fact that the drawings were made at rates of about 43-1/2 to 44 [cents] per mark, compared with a rate on our last drawing of about 49-1/2 [cents] per mark, representing the 13 percent appreciation of the mark since last October. Now, I remain confident, along with Scott and I think many others, about the chances of [eventually] unwinding the swaps at a profit or at least without a loss. In fact, the dollar would only have to regain about half of its losses against the D-mark since last October to reach the break-even point. And I think that's obtainable. Consequently, I personally would not be overly concerned about showing a loss on the repayment of any individual drawing. I think we should, however, consider whether it would be preferable to pay down other drawings, minimizing our losses and the Bundesbank's losses. We have other drawings at different rates that we could pay down, perhaps even showing a bit of profit. I think that's something we ought to consider and I have no recommendation at this time.

MR. PARTEE. But what difference does it make, Alan? If we take a loss on this one, we get a profit on something else.

MR. HOLMES. That's right in the long run; but in the short run we show a big loss. That doesn't bother me, but I just want to point out that if we repay those we maximize our book losses.

CHAIRMAN BURNS. You say you maximize them. You say that there are many who agree with your judgment [about the dollar]. I'm sure that is right, but there are many more, judging from the behavior of the market, who seem to disagree with your judgment. I think it is that kind of a question.

MR. HOLMES. That's right. I think we ought to consider it and I have no recommendation right now. We can wait until we get closer to the [time the drawings mature] for a firm recommendation.

CHAIRMAN BURNS. Also bearing in mind that profit and loss, while a significant consideration, may well be swamped by other factors such as the extent of our exposure as far as members of the Congress and perhaps the market both are concerned.

MR. HOLMES. Mr. Chairman, another option that the Committee has is that we could request the Bundesbank to routinely roll over the maturing swaps for 3 additional months with a possibility of another renewal. In many ways, this is the very simplest approach that we might follow. It would not, for example, raise the issue of our 50-50 loss-sharing arrangement with the Germans as a request by us to the Bundesbank for a direct sale of German marks might do. Again, this is something to be explored. I have no recommendation. I want to point out that this is another option that the Committee has.

CHAIRMAN BURNS. You mean go beyond a 6-month period or 9-month period?

MR. HOLMES. That's right. It is provided for by mutual agreement between two parties in our swap agreement. But it takes a special agreement to do that. Another possibility, and it's only a possibility, is that other sources of D-marks might become available to the System--should, for example, the Treasury decide to sell SDRs, borrow foreign currency, or draw on the IMF. Now, this is not [beyond] the realm of possibility, but it's a very remote possibility--though one that may be available to us before the problem arises. I think there is another approach the System could take. That is, we could request a special swap facility of a longer maturity--say, two years--with prepayment options, of course. Such an arrangement would be roughly similar to our special Swiss franc arrangement and could be useful if in early April concern about the System's acquisition of German marks to repay the swaps or fear that the System is running out of D-mark resources are putting great pressures on the market. That's something you can't judge now but that's another possibility. I think there are a number of possibilities and the final choice can only reflect market conditions as they exist in early April in light of whatever actions, if any, may be undertaken by the Administration or the Treasury in the international area.

MR. COLDWELL. If I hear you right, Alan, you are talking about doing some of this negotiation in what--March or April?

MR. HOLMES. I would like to have preliminary talks with the Bundesbank and be clear about exactly how they feel. They know the same possibilities that I listed here. But I would like to be able to feel free to talk to them quite frankly about the possibilities and get their thinking on this. They're anxious to do that.

MR. WALLICH. I think we have to bear in mind that the Bundesbank has some particular interest in this matter. One is their concern about the expansion of their monetary base and their money supply, which would be triggered if we were to repay by drawing on the Bundesbank. The second concern they have is that they are uneasy about the 50-50 [loss-sharing], which suggests that we should not do something that provides an opportunity for re-raising that issue. I think those are the two principal concerns that might come up.

MR. PARTEE. Would the latter come up, particularly with this 2-year thing?

MR. HOLMES. It could; it could indeed. That's why I think preliminary negotiations or talk about this would be useful.

MR. JACKSON. May I ask a factual question?

CHAIRMAN BURNS. Please.

MR. JACKSON. As you acquire marks in your day-to-day trading, are they put into the System's account or are they used to repay [swaps]?

MR. HOLMES. Well, they would go into the System account until we accumulate enough to make a decent repayment. We wouldn't do that with every million that we buy.

MR. JACKSON. What would you consider a decent repayment?

MR. HOLMES. $10 or $20 million. It can be very flexible.

MR. JACKSON. Which priced drawing would you apply the proceeds to when you make such a repayment?

MR. HOLMES. Well, I think that's what you have to decide. Do you pay off using a first-in/first-out approach? Or do you try to pick one where the rate is comparable to what you paid?

MR. [PARDEE]. In the past we have done both, but we mainly look to the earliest maturities if we don't face this problem with the second renewal. Usually, in the cycles that we get into, those are also the most expensive swaps, so we do take our losses early in the repayment cycle and the profits later on. But following the normal approach, if we were to acquire marks over the next couple of weeks, we would repay first those swaps that are coming up in April and take the substantial losses, reducing our average rate as time goes on. We also have--

MR. JACKSON. This is a policy question that should be addressed as we [review] these issues at the next meeting, so that we will know what the policy of the Committee is toward the swap agreement.

MR. [PARDEE]. We also have a substantial negotiation with the Treasury because they are in debt, too. And sometimes we have to make accommodations for our part in the operation.

CHAIRMAN BURNS. Also, I don't think that this is a policy we could arrive at unilaterally. The Germans will have their views as well as the Treasury and I do think we have to leave considerable room for flexibility to those who operate the Desk in dealing with that issue.

Let me return if I may to the question we considered previously on net versus gross exposure, or possibly retaining both but changing the limits perhaps along the lines that Mr. Partee had in mind. I think this should be examined not only by the staff but also by a subcommittee of this family. I'm going to ask Mr. Wallich to serve as Chairman of such a subcommittee and include on it Governor Coldwell, Mr. Volcker, and Mr. Black. And that subcommittee could also consider the question of the repayment and what recommendation if any to make to this Committee. But I don't think we would want to lay down a rigid policy; others are involved, as I noted. Yes.

VICE CHAIRMAN VOLCKER. Just a comment on this loss question. I think this certainly should be secondary to [the Desk's] objectives. But my recollection is that whatever we do with the German swap is going to be swamped by the continuing repayment on the Swiss swap. So, for any relevant reporting period, we are going to show a loss whatever we do and, therefore, it's not going to appear as something special in terms of the overall reporting result.

CHAIRMAN BURNS. Did you comment on the Swiss transactions in the past month?

MR. PARDEE. I just mentioned them; I didn't go into a description. If you wish, I can describe the reasons behind them.

CHAIRMAN BURNS. Some criticism has been made of our being involved in the Swiss transactions. What was your defense for it?

MR. PARDEE. Well, the thing is that we have operated exclusively in German marks since 1975, but that's not the only currency that is the source of the disorder or unsettlement in the exchange market. Occasionally the Swiss franc clearly is. This very morning we have a higher Swiss franc, which tends to be pulling up a number of other currencies. And I had to discuss with people at the Desk whether we should today consider operating in Swiss francs. Our view is that when the Swiss franc is the source of the unsettlement, then we should consider intervention in Swiss francs to see if by calming that market we can calm the broader markets for the dollar. But I know what the criticism is and I feel it very strongly myself. We got into a very deep hole in Swiss francs. It's not that important a currency in the broad spectrum of international financial relations and I have been very sparing in use of this agreement that we had with the Swiss National Bank--to the extent that at the outset when we decided to go into the market, I negotiated with the Swiss National Bank that half of our operation in New York would be for our account and half for theirs. Now, the agreement is that the first $25 million that we do in New York is theirs. And from there on, we might consider whether we would intervene or not. So, on that basis, I have limited our intervention to $69 million. We have made a gesture in the Swiss franc market. On the days that we have operated, we have been reasonably effective. But we cannot get ourselves into a stampede in that particular currency, given this loss problem on our earlier debt. I would also [note that] there are times when there is a technical case and a philosophical case for intervening in other currencies. But we have avoided that because of the broader policy consideration on maintaining this operation strictly in marks, with occasional operations in Swiss francs, when I think it is absolutely defensible to the Committee and to the world at large.

CHAIRMAN BURNS. You say "absolutely defensible to the Committee." You are engaging in a bit of rhetoric now.

MR. PARDEE. Well, I'm hopeful it is defensible to the Committee. I have not heard any direct criticism and I'm willing to hear it.

CHAIRMAN BURNS. Have you heard criticism from the Treasury?

MR. PARDEE. They have agreed at a policy level, but they have warned us to be light-fingered. And I have been.

MR. MAYO. Is there any intervention by the Bundesbank in Swiss francs? Is that a fair question?

MR. PARDEE. They don't.

MR. MAYO. They don't?

MR. PARDEE. They do very closely coordinate their operations. They're on the phone back and forth most of the day.

MR. HOLMES. Mr. Chairman, may I say what Scott was saying just a trifle differently? It seems to me that there are times when intervention in the Swiss franc--if that's the problem in the market and that's pushing the market--makes some sense as long as it's limited. And since it's a small market, it usually can be quite limited. And if you can have even more of an impact on the D-mark--which is being pulled up by the Swiss franc--with a lesser amount of intervention using the Swiss franc, I think that is reasonable in the overall market context in which we operate.

MR. WALLICH. There are two considerations I would like to put forth, Mr. Chairman. One is that when one is trying to defend a world currency like the dollar, one ought to think of doing it in not just one other currency like the D-mark but to broaden it. After all, the Germans deal in dollars, and that means they're dealing with the biggest thing there is. But if we deal only in D-marks, we're trying to pull our currency up or keep it from becoming disorderly in just one direction and all the burden is put on that one currency. So there is quite a case for [operating in other currencies]. Second, we have told the market that we have $20 billion worth of swap lines and that has been frequently cited as an indication of the magnitude of our resources. I'm a bit surprised that nobody has ever said, "Which of these currencies would you really be prepared to sell in the market in maintaining the dollar orderly?" And, of course, the answer is very few.

CHAIRMAN BURNS. I hope you wouldn't give that answer too quickly.

MR. WALLICH. Oh no, I never would because that would have the obvious effect of making it seem that our resources are much less.

CHAIRMAN BURNS. Or that the whole swap network is a charade.

MR. WALLICH. I think we do need to think of broadening the scope [of our operations]. At the same time, I'd like to suggest that we think again about the scale of operations. We went into this enterprise of raising the scale of intervention, as we had some new reasons--the President's statement, the Treasury coming into the arrangement--to think that there might be strength for the dollar. These were special occasions which justified a somewhat stronger effort. But I think those special occasions have passed now and we ought to think whether we ought not revert to the earlier scale of operations, which was substantially smaller--always, of course, bearing in mind that the scale of intervention has to be commensurate with the scale of disorder. If the market gets very disorderly, there's got to be more. But in relation to a given degree of disorder, I think we ought to reduce our scale of operations.

MR. COLDWELL. Mr. Chairman, I agree with much of what Henry was saying about reducing the scale of operations, but something he said bothers me considerably and it's something about which I wanted to check with the Desk. At least publicly we have been saying that we are intervening to counter disorderly conditions. And yet we are using the Swiss franc, in effect as Henry has been saying--obliquely anyway--as a means of achieving a higher dollar rate.

MR. WALLICH. I did refer to disorder.

MR. COLDWELL. But is there a conflict here between using another currency as opposed to intervening only in disorderly [conditions]?

MR. HOLMES. Well, if that other currency is a source of disorder or rapid movement in rate, which is one measure of disorder, then I think it is justified to use that currency--if [the disorder] is localized in that area.

MR. PARDEE. Since 1973 we have operated in five different currencies--the German mark, Swiss franc, Belgian franc, Dutch guilder, and French franc--under conditions in which those markets were particularly disorderly. This is the one occasion where we have limited ourselves strictly to the mark and the Swiss franc. The question of having a rate objective is a delicate one. The market thinks and wants us to have a rate objective quite often. As I mentioned, the market is pushing us to these benchmark numbers, but we are trying desperately to adhere to the floating rate principle of not having a rate objective and avoiding the kind of box that other central banks have moved into when they were actively intervening. The Bank of England did, as does the Bank of Japan regularly. They tend to fix on a rate--peg a rate and then have to back away. And that's when your scale of operations has to grow very big and then you have to have a disorderly retreat. Well, we have had to retreat but we tried to limit the disorder in those periods of retreat. It's a difficult gap to fill, but I think our main emphasis is avoiding pegging the rate.

MR. PARTEE. Would you or Alan like to comment on the scale of operations point that Henry made? Would you say that the scale of operations has increased over time relative to the scale of disorder?

MR. HOLMES. I think they have been [comparable].

CHAIRMAN BURNS. We will [get] absolutely nowhere, because nobody knows what disorder means, including those who operate the Desk. Yes, we're using words to justify what we're doing. Actually we're in there under the umbrella of disorder, though there is a thought in the minds of practically all concerned to stop or check the deterioration in the value of the dollar in the foreign exchange markets. We might just as well speak very honestly and openly in this room. If we don't do that, we're in trouble. Gentlemen, I don't like the language of disorder; there is an element of disingenuousness about it--not intended, but I believe it's there. Having said that, and if you still want to pursue this question--

MR. PARTEE. Well, I question that, Mr. Chairman. Do you [at the Desk] think that you're defending, say, 2.04 more strongly than you defended 2.07? I put it in your terms, I think.

MR. HOLMES. I'll say "no" to that right now, Chuck.

MR. PARTEE. The reason I asked the question was that I didn't have the same impression that Henry had. It was, as Scott said, a very quiet period for the most part since the last meeting and it was only with this new wave of selling of the dollar that our operations have picked up again. So I was a little surprised at your comment, Henry.

MR. WALLICH. Well, I have some data here, though they are approximate only. They show that in January the Treasury and the System in combined operations, both averaged on the days on which we did operate--there were 10 days--something close to $90 million. In February we've operated on a fewer number of days, so far, and we had $70 million on average per day.

VICE CHAIRMAN VOLCKER. This is on the days we operated?

MR. WALLICH. On the days we operated. This is well above the amounts we had in October, November, and December.

MR. PARTEE. Oh, yes, but the 70 is less than the 90.

MR. MORRIS. Henry, you implied that we're in a new period in which the "presence" pronouncement of the joint Treasury-Federal Reserve [statement] somehow no longer has the weight it had before, and I'd like to understand why you feel that way.

MR. WALLICH. Well, we had a chance to change the perception in the market, technically to shift the demand curve. It may have had some such effect, but that effect has been established and absorbed now and we're back in the old game of meeting pressure on the dollar. I think we should not now, because we moved to this higher scale, go on spending more money than we originally [had in mind] to do. We entered into a new ballgame as far as magnitude is concerned and I think it was justified; it was a campaign. Now I think the time has come to review the results of the campaign and in my opinion beat an orderly retreat.

CHAIRMAN BURNS. I think this is also a matter that your subcommittee may want to make a recommendation on. The frame of reference originally was procedural only. But I don't think you need restrict yourself to that. Any thought on this subject now, I think, would be helpful. Mr. Willes.

MR. WILLES. I was going to change the subject.

MR. COLDWELL. Could I go back to Governor Partee's question for just a moment? He asked if you defended 2.04 the same as you defended 2.06 or something like that. You said "no."

MR. PARTEE. I said, "Did you defend it [more strongly]?"

MR. COLDWELL. All right. I think the question is not that but would you defend against a quarter percent reduction or deterioration in the exchange rate harder now than you did before?

MR. HOLMES. I don't think there is any discernable difference in our--

MR. PARDEE. It's a question of the trigger point in the scale in which we are prepared to operate at the moment. In the early operations back in October, November, and December, we were prepared to allow a quarter of a percent or a half percent drop in the dollar rate before we went into the market. And at that moment we would offer 20 million marks perhaps, and then back away. We backed away repeatedly as one or two or three banks each saw us there and said, "Aha! They are not willing to do 50 million marks" and they blew us out of the market repeatedly. We came in and we reported to you big operations, big increases in swap debt--$600 million in December, I think it was--and we were not being effective in the job we were trying to do. One of the important shifts for us on this active approach was the ability to stay in there when we did go in and take these fellows out of the market. Sure, on the days that we are operating we will operate on a bigger scale, but we've also been out of the market. There was a period of nearly four weeks in which we were completely out of the market except for some modest operations.

MR. COLDWELL. But when do you go into the market? That's the question.

MR. PARDEE. This is not so much on a quarter percent or a half percent. Yesterday I let the dollar drop a whole percent before we made a gesture to the market, which was sufficient at that stage. People saw us, [said] "Okay, fine" and then they went back about their business and the dollar rebounded. It's that kind of credibility that we need; then we don't have to operate on a big scale. As soon as the market recognizes that the Federal Reserve is [in the market they say], "Fine, we can buy dollars now." But it is when the market turns to us and says, "Where are you fellows?" that we then have to do the big amounts. That's the scale of disorder that we've had.

CHAIRMAN BURNS. I do expect that this will be the last meeting at which I'll be presiding. In view of that, I'll make a comment now which previously, under normal conditions, I would have delayed making. But in making this comment, I must advise the Committee once again that everything that is said in this room at all times must be treated on an absolutely confidential basis.

There are differences within the government about steps that can and should be taken to deal with the dollar problem. The more active our intervention is, the more excuse others within this government have for not taking some of the more fundamental steps that need to be taken to restore the integrity of the dollar in foreign exchange markets. That is a political consideration of the very greatest importance and one that I think we should very much keep in mind. And I would strongly support Governor Wallich's recommendations about the scale of our activity, not only for the reason that he stated, or even mainly for the reason that he stated or implied, but primarily for the political reasons that I indicated. Namely, [we should do so] to maintain a certain element of pressure on others in the government to the effect that this intervention activity is of ephemeral, transitory significance and that other steps that can be taken should be taken without further delay.

MR. BAUGHMAN. I think I understood the reports to suggest that when the Swiss announced their new posture, which in a couple of respects presumably makes it more difficult for people to acquire Swiss francs, the dollar responded favorably. It would seem to me that that should simply divert speculative funds from the Swiss franc to the German mark and have a negative effect on the mark-dollar relationship. Why is my view erroneous in that respect?

MR. PARDEE. There were some sales in Swiss francs going into marks but the basic unit for dealing [in the market] is the dollar. The dollar rate moved generally across the board against other currencies. There will be some movements in and out of these other currencies and between these other currencies.

MR. PARTEE. It's a bit like trading in bills, I think--the old argument. You're supplying, I guess, much needed or much desired foreign currencies through your swaps and there will be arbitrage between the currencies. And the question is: Do you get more by trading in a range of currencies or in only one currency and assuming the market will make the arbitrage? It's a lot like the bills only--

MR. PARDEE. Less so in the spot market than the forward market.

MR. BAUGHMAN. I assume it would be erroneous to take the next step and say that if the Germans also had done something similar to what the Swiss did that that likewise would have had a favorable effect on the mark-dollar relationship.

MR. PARDEE. Oh, yes.

CHAIRMAN BURNS. Well, we're finally ready for your question, Mr. Willes.

MR. WILLES. The second question: Is the probability that the government will take the kind of fundamental steps that you talked about going up, going down, or staying where it was?

CHAIRMAN BURNS. If anything, it's probably going down. On the other hand, the probability of certain bridging actions short of fundamental actions has gone up some.

MR. BALLES. Could you explain, Mr. Chairman, for my benefit at least, what bridging actions are?

CHAIRMAN BURNS. Bridging actions would include the sale of gold into the private market, the sale of SDRs to central banks, or the executive taking certain action on the energy problem such as imposing a ceiling on imports or imposing a special tariff. The President can certainly do the latter and I believe he can do the former. I would consider these bridging actions. The most important bridging action we've made no headway with, namely the sale of Treasury securities denominated in foreign currencies. But I personally have not given up on that because I think that's by far the most important and by far the most effective bridging action that can be taken at this time. Yes, Mr. Roos.

MR. ROOS. Would you include in your bridging actions or your fundamental actions a clear signal that we are determined to decelerate monetary growth relative to the rate of monetary growth of other nations involved? Would a clear signal by either this group or by the government that we are determined to come to grips with that not have an immediate beneficial effect in regard to this? Isn't our rate of acceleration of monetary growth relative to these others a very real and very specific factor in the [difficult situation] we find ourselves in?

CHAIRMAN BURNS. I think that is a question that we can best consider a little later in this meeting when we turn to the longer-range targets.

VICE CHAIRMAN VOLCKER. That's correct, Mr. Chairman. I don't want to leave the impression that our monetary growth has accelerated relative to the Germans, in particular. I think in fact it's the opposite.

MR. ROOS. Excuse me, sir, but from the graphs I've seen the trend in the direction of our monetary growth relative to the direction of monetary growth in many of these other nations I think is a negative factor. Certainly, inflation in Germany is higher than it is here, but the trend--

SPEAKER(?). It was lower.

MR. ROOS. The rate of growth of inflation is lower?

MR. WALLICH. The rate of money growth [in their] M3 is higher than in our M1, but not higher than our M3, which is really a different number.

VICE CHAIRMAN VOLCKER. Their M1 is higher than our--

MR. ROOS. The direction of the trend--

CHAIRMAN BURNS. I think that Mr. Roos is fundamentally correct if he's thinking of periods of a year or longer. There has been a deceleration in monetary growth rates and of inflation rates around the world in contrast to the United States.

VICE CHAIRMAN VOLCKER. In inflation rates.

CHAIRMAN BURNS. I believe in monetary growth rates as well. Well, it depends on the period. If you take longer periods--I'm not sure about this--I think as a broad generalization that would stand up.

MR. TRUMAN. I think, Mr. Chairman, that you're right. Though in particular in the German case, as Governor Wallich was commenting, I think the deceleration, if any, is imperceptible relative to the United States. But for most of the weaker countries, there has been a sharp deceleration in their rates of monetary expansion.

CHAIRMAN BURNS. Gentlemen, perhaps the time has come to move along in our agenda. Oh, I'm advised that Mr. Holmes has still another recommendation.

MR. HOLMES. Mr. Chairman, regrettably, I do have one final recommendation. As you know, the Committee has authorized an open position of $1.75 billion in foreign currencies. At the present time, we have a leeway of exactly $106 million, which is not very large relative to potential [operations]. Hopefully, we won't have to [breach] that. In between Committee meetings under the procedural instructions, our leeway would go up to around $2.15 billion; it would go up $500 million from where we started at the beginning of the Committee [meeting] until the next meeting of the Committee. There's no necessary reason why the authorization has to be exactly what is permitted in the procedural instructions, but obviously the authorization is the important [rule]; that's what rules us. So I would certainly recommend that the Committee at this meeting, since this has to be an action of the full Committee, increase the limit on the open position to $2 billion, which happens to be the limit on our German mark swaps.

CHAIRMAN BURNS. Let me ask you a question, a procedural question. You say this has to be an action of the full Committee. Could the full Committee delegate this power to its Foreign Currency Subcommittee?

MR. HOLMES. I believe it could, but I leave it to a parliamentarian.

CHAIRMAN BURNS. All right, we have Mr. Holmes's recommendation.

MR. PARTEE. That would give you about $350 million in leeway if we went to $2 billion?

MR. HOLMES. Yes, about $376 million.

MR. COLDWELL. Didn't you say [the open position limit is] $1.75 billion right now?

MR. PARTEE. Yes, but they're $100 million under that now.

MR. COLDWELL. I beg your pardon?

MR. HOLMES. We have $100 million of leeway and an additional $250 million would make it roughly $350 million.

CHAIRMAN BURNS. I personally would prefer to have that power delegated to the Subcommittee rather than have an enlargement at this time. But this is something for the Committee to decide.

MR. COLDWELL. What's the purpose of that? I don't understand your reasoning for the delegation.

CHAIRMAN BURNS. The reason for the delegation has been stated indirectly by Governor Wallich, who wants to keep a tighter rein on the scale of operations at the Desk.

MR. PARTEE. Mr. Chairman, I would prefer, I think, not to do it through that device. We have a $300 million limit on the Desk before the Subcommittee, as I understand, needs to approve an increase, and I would rather see us reduce that $300 million. But I think this [issue] of overall exposure is properly a full Committee responsibility and I think the full Committee ought to discuss whether it wants to have an exposure of as high as $2 billion, rather than leaving it to the Subcommittee. I would be agreeable to the $2 billion.

CHAIRMAN BURNS. You're agreeable to $2 billion?

MR. PARTEE. Yes.

CHAIRMAN BURNS. Leaving it at $2 billion or enlarging it?

MR. PARTEE. Well, it's $1,750 million now, as I understand it, and the proposal is to raise it to $2 billion, which would give the Desk in practical terms $350 million leeway. That leeway, however, could be constrained by the Subcommittee.

MR. HOLMES. It is constrained by the Subcommittee.

MR. PARTEE. And I think $2 billion is suitable. I hope you don't use it, but as a matter of protection, I think we need to give you that [leeway].

SPEAKER(?). I would second that.

MR. COLDWELL. No action would mean you'd have what?

MR. HOLMES. A [limit on the] total of $1,750 million, which would give us a leeway of about $100 million.

SPEAKER(?). About $100 million?

MR. HOLMES. Right, a little over $100 million.

MR. PARTEE. You could go over that on a really bad day.

MR. HOLMES. Mr. Chairman, my reason is thoroughly defensible. We can hit an emergency and while we can get to the Subcommittee reasonably promptly--

CHAIRMAN BURNS. You say reasonably promptly. I would say promptly.

MR. HOLMES. Sometimes, Mr. Chairman, we can't find people; it sometimes takes time. I would like to have something authorized by the Committee that would protect us in case we do run into an emergency situation because getting to the full Committee is much more difficult than getting to the Subcommittee or to you.

CHAIRMAN BURNS. Well, the recommendation is certainly a reasonable one. What is the consensus of the Committee?

VICE CHAIRMAN VOLCKER. It seems logical to me to go to the $2 billion, which is the size of the German swap. We might have to use that whole swap.

CHAIRMAN BURNS. Any objection? I hear none. That recommendation is accepted. Let's move on to Mr. Kichline's report on the economy.

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

CHAIRMAN BURNS. Thank you, Mr. Kichline. We're now ready for a discussion of the economic outlook. Let us keep in mind that the economic discussion will bear critically on our consideration of the longer-term ranges for the monetary aggregates. Partly for that reason and partly also because of time constraints, I think it would be best not to raise purely technical questions at this time. Those questions can be addressed to the staff later on.

Let's turn to the outlook for the coming year, indicating in particular the degree of agreement or disagreement [with the staff projection] or any special point of view that you may have with regard to the economy, or agreement or disagreement with the analysis--I think, very able analysis--upon [which the staff projection is based]. Mr. Partee, please.

MR. PARTEE. Well, Mr. Chairman, I'll start today by saying that I agree with the staff projection. I think it presents a very reasonable configuration. I had felt earlier that the car sales and housing starts figures were a little high and I think now they're very much in accord with my expectations of the most probable [outcome] for the economy as the year goes on. [The staff projection] does call for only about a 4-1/2 percent rate of growth on a fourth-quarter-to-fourth-quarter basis, which is very close to the CEA projection contained in the Economic Report--maybe a trifle lower, but just a very trifle lower than the CEA. I think we can take that to be, in the absence of anything else, an indication of Administration desires as well as the projection of the Council [of Economic Advisers].

I do think that there are some uncertainties in the situation that lead me to say that there is also a chance that the economy will be weaker than projected. Jim did not mention the stock market. The stock market continues to bother me quite a bit. There has been a fairly [large] decline in the six weeks since the last Committee meeting and I think it indicates a continuing lack of confidence about the prospect for business and the prospect for business profits that can be undermining in effect. I agree with the thrust of Jim's comment that we ought to have a sharp recovery from what seems to have been a weather-induced and an energy-induced shortfall here earlier this year, but I'm not quite as sanguine as he was. Sometimes strange things happen in the course of the dynamics of a slowdown that can affect the subsequent recovery. In particular, what bothers me is the fact that incomes are also being negatively [affected]. And an income loss, even temporary in the first instance--if it feeds through to demand and smaller sales--can have the beginnings of a change [or of a] groundswell in the economy. So I do think there are some questions.

I also continue to be bothered very much by the world outlook, which hasn't been touched on. That's not so much the declining value of the dollar which is, I think, inflationary in its character for the United States. But I still don't see clear signs of a [foreign] recovery of the sort that is anticipated and underlies the trade deficit estimates and so forth in the Greenbook. So I think there are some questions about the economy that we'll have to look at very carefully as the weeks pass. But I agree that the most probable course is that there will be a quite moderate, continuing expansion, barely enough to reduce the unemployment rate over the next year or so.

CHAIRMAN BURNS. Thank you, Mr. Partee. Mr. Baughman, please.

MR. BAUGHMAN. Mr. Chairman, I have no particular differences with the general forecast. I think it's a reasonable one. I think there is a reason for being concerned about the prospect for accelerating inflation, which is recognized there, but I think it's recognized appropriately. The main thing I wanted to comment on is that, as I look over the scene in the Southwest, I don't see any indication of any easing in the boom that is going there. In fact, it seems to be strengthening rather than weakening. It seems to me that the prospect is that it's going to tend to spread and influence other areas--that it's going to contribute strength rather than weakness to the general economic picture.

I might mention a few little things that possibly have somewhat broader interest. One of the things that we have inherited from the demonstrations utilizing farm equipment--in connection with the agricultural situation--is that some farm equipment loans now have a restrictive clause that this equipment may not be used in any public demonstrations. A couple of bankers have told me recently that they are carefully reworking their bond portfolios. This is apparently in the anticipation that credit markets will tighten up somewhat and that any weak bonds will look rather bad in their portfolios; so they are undertaking to move them out at the present time.

CHAIRMAN BURNS. Does this refer to municipals?

MR. BAUGHMAN. Municipals were mentioned specifically in this connection, but I have the impression that it's not exclusively municipals. In the Greenbook or the Bluebook it was noted specifically that this does not show up yet--whether or not it will eventually--in the yield spreads. But it's something I wanted to mention in case other people are hearing similar [comments] so that it might be appropriate for us to know it.

We're seeing what I would characterize as really a rather spectacular rebound in cattle prices. It's quite possible that that's being overdone. And we have reports that the snow birds of the north are flocking to the south, apparently in their pickup trucks, in such numbers--into a rather [snowy] south I must say--that they're interfering with the ability of the day-to-day activity that is being carried on in some of the so-called valley cities. They're fairly small cities we're talking about and they're just so jammed with people that you can't get into the banks, get through the streets, and [so forth]. That's all I have to say.

CHAIRMAN BURNS. Mr. Eastburn.

MR. EASTBURN. Thank you, Mr. Chairman. I'd like to take some issue with the snapback scenario that seems to be quite prevalent. We've been doing some research on the question of uncertainty and this research suggests that there is some connection between the level of uncertainty about inflation and the effect that that has on unemployment. Apparently there is a connection. And the relevance of that for the current situation is, I think, that we have been experiencing external shocks to the economy in the form of the weather and the coal strike, and it may be not appropriate to think of this as simply temporary, as it was last year. The reason is that the declines that we have been experiencing have been larger than they were last year. If you look at industrial production, retail sales, durables, housing starts, and so on, the declines have been larger than they were a year ago. Another reason is this fundamental change in the automobile sector, which was strong last year and is weak now. And, finally, on the demand side there's the overhang of the rapid money growth we've had in past months, suggesting that this will increase relative demand as compared with a year ago.

So the shocks affect the supply side and the demand pressures affect the demand side, possibly accelerating expectations and [increasing] uncertainty about inflation. As we see data coming in, like the consumer price index figures released recently, I think we will be seeing uncertainty about the inflationary outlook. And if our research is right, this will be showing itself in real output and unemployment later on. On balance, I do have some concern, as I gather Chuck does, with [what is] perhaps an undue readiness to think that these are simply temporary phenomena that will pass, as they did [after the first] three months last year. I guess this [makes] me a little more pessimistic than the Greenbook.

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

MR. MAYO. Yes, Mr. Chairman, thank you. I find I am a little more in agreement with the forecast in the Greenbook than perhaps Dave is. Like Chuck, I'm glad to see the housing starts figure move down to what I think is now a completely reasonable estimate. I think it was high for several months. At our Board meeting last Thursday we had quite a discussion on the outlook, with particular reference to housing and to automobiles. And I found a little more strength of confidence in our directors' discussions on both of these areas. [As] I expected, in both areas they feel that financing is adequate and that there will not be any particular problems of crowding out. They find their suppliers to be in reasonably good shape, and indeed they are looking quite confidently to the rest of the year and would not characterize the outlook for either housing or automobiles as weak--perhaps not quite as heady as last year, but still a strong outlook.

I would also mention--although, again, one swallow doesn't make the summer--that I get a little more of an impression of improvement abroad than was implicit in Chuck's remarks. We have seen some industrial production increases in October and November and in the figures that are available for December for some of our friends abroad. And I am hoping--maybe it's only a hope but this does give us quite a bit of encouragement--that indeed this solution, which is obviously the preferred solution, of better business abroad rather than poorer business at [home], will help significantly in rectifying our own balance of payments problem and, in [turn], have some effect on our sagging stock market before we get too far into the summer.

I'd also note on the credit side that the flow of funds data, which I must confess I don't always look at but I did this time, do show to me that the economy can accommodate the increases in credit in '78 without any increases in interest rates that are in excess of what's in the Bluebook. I assume those projections are, of course, consistent. So I come to the conclusion that higher interest rates are not impeding our opportunities for economic advance this year and that we are in pretty good shape.

On Ernie's point, the farmers strike and the action in Texas, I can report that approximately 30 beautiful farm vehicles, including a couple of mobile homes but mostly huge tractors with air conditioned cabs, complete with stereo and so forth, were parked outside of my window on LaSalle Street about three weeks ago as they gathered to protest to the Board of Trade in Chicago about the middle man sucking out all of the profits, et cetera. They couldn't have made a worse impression because of the luxury of the vehicles, most of which had Texas license plates.

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

MR. KIMBREL. Thank you, Mr. Chairman. I too think that the staff projections appear very reasonable this time. Like others, we too are happier with the projections for the automobile and housing numbers. As we had commented a couple of times previously, we thought they were a little ambitious; these appear more attuned to our own beliefs.

It may be only in degree but we are somewhat more optimistic about the unemployment possibilities; we may be influenced by our own area but we're slightly more optimistic about the total employment picture than is projected [in the Greenbook]. We seem to be reaching, in some areas particularly, a situation that I think simply cannot be characterized as unemployment, so we feel somewhat more optimistic. On the contrary, though, we feel somewhat less sanguine and less optimistic about the prospects for inflation, influenced maybe by the continuing high Federal deficit and the trade deficit. We are impressed also by the fallout of the coal strike, both its determination of increased utility rates and also the likelihood that the final settlement will be somewhat higher than we anticipated and may well contribute to other larger labor negotiation increases. Continued comment by the Administration about voluntary wage and price [restraint] is almost a red flag as far as our business people are concerned. It generates what we would characterize as a self-serving expectation of inflation that may very well be somewhat higher than the staff projects. But other than that, we think the [staff's] numbers are very reasonable.

CHAIRMAN BURNS. Thank you, Mr. Kimbrel. Mr. Morris.

MR. MORRIS. Mr. Chairman, we are somewhat more pessimistic than the staff forecast. Whereas the staff has a 4-1/2 percent real rate of growth from the fourth quarter of '77 to the fourth quarter of '78, we would be inclined to think more in terms of 4 percent. The housing sector is one area where we differ. We think that the projected housing [starts] are still on the high side. It's difficult for us, if we accept the staff's Bluebook numbers of an 8 percent federal funds rate in the last half of this year, to have that associated with only a very modest rate of decline in housing as the staff has projected. On the other hand, while we're more pessimistic, we're not entirely unhappy about our projection in the sense that, given all of the inflationary forces and the position of the dollar and so forth, perhaps a 4 percent real growth rate will not be a bad result for this year.

CHAIRMAN BURNS. Thank you, Mr. Morris. Mr. Coldwell.

MR. COLDWELL. Mr. Morris just made my speech, Mr. Chairman. I'm pleased that the staff is moving back down the pike a bit from where they were last time. They have a bit left to go to reach what I think is likely for the rest of this year. I still believe that we're going to have a snapback from the cold weather and the coal situation. It's hard to tell whether it will hit the last month of the first quarter or the first two months of the second quarter. Even if it were not for the coal and cold weather problems, I think we have an inventory rebuilding problem on our hands which is likely to boost activity considerably in the first half of this year. But beyond that, I see problems looming on the construction side, higher prices and maybe some impacts on buying, capital spending reductions, and certainly a problem in our international relations. All of these [factors] say to me that we're going to get lower rates of real growth in the latter part of the year and higher rates of inflation. And I don't think [the economy] is going to be growing fast enough to [produce] any measurable reduction in unemployment in the latter part of the year.

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

MR. WALLICH. I'd like to look at the situation with a point of view that is perhaps a little more broadly [focused] than just the present forecast. Being where we are in the evolution of this cycle, I think we have to look for a soft landing--that is, phasing into a long-term rate of growth that is sustainable at somewhere around 3-1/2 percent or so. In those terms, moving down from an expectation of 4-1/2 to closer to 4 percent growth is not an unreasonable thing. I think we're sort of getting ready for that soft landing.

Nevertheless, we're developing a number of imbalances that raise questions about the sustainability of the position ultimately reached. One very large imbalance is the net export deficit; we have a big hole on the foreign trade side. We have a moderate-sized hole on the side of business fixed investment being partly remedied. And the Administration keeps saying that we have a hole on the side of expenditures by state and local governments, citing their large surpluses, which usually include their pension funds. If you eliminate the pension funds--and I see no reason for including them as part of the state and local surplus because they are really private-type pension funds, tax demands probably "financed"--there still remains a sizable state and local surplus. So those are the things that are reducing purchasing power. And that is matched by an enormous federal deficit, which threatens to remain even as we get to full employment. In other words, we've worked the economy now to a point where the private sector apparently can't give us full employment without the aid of a federal deficit. This, I think, is a very ominous situation.

Even so, it's the job of fiscal and monetary policy to try to keep this expansion going as best we can, but some things could happen along the way that would throw a roadblock into it. Suppose the rate of inflation should accelerate significantly; and some of the things that have been said here suggest that that could happen. Is that the kind of signal then that historically has called for central bank action to slow down the economy and maybe significantly reduce the rate of growth? Central banks typically are supposed to act when the economy gets to booming. But without getting it at all booming, it could get more inflationary. And the question is, what will we do then? Likewise, even without it getting more inflationary in a visible way, the aggregates might accelerate, indicating that there's inflation ahead somewhere down the road. Then again, what is the function of monetary policy, if an expansion can be nursed along only by tolerating more inflation or accepting the prospect of more inflation into the future? These are the difficulties I see, possibly along the way to a soft landing.

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

VICE CHAIRMAN VOLCKER. I'll be very brief, Mr. Chairman. I thought initially that Mr. Partee made four-fifths of my statement for me, and I think Mr. Wallich just made the other one-fifth. Maybe the proportions are wrong, but I generally do think that the forecast is very reasonable, with all the qualifications that Governor Partee mentioned earlier.

I am struck particularly by the continuing lack of buoyancy in plant and equipment where we had some hopes that the earlier forecast might be raised. I don't see any signs [of that] in talking as I do with businessmen and otherwise it's very unrealistic to think that the survey numbers are going to be missed on the upside. The trade deficit remains a very large problem. I'm not as optimistic about that as the staff is--and they're not terribly optimistic, but they do have some reduction in the forecast for the deficit. I think that is going to be very hard to achieve against the background of what I see going on abroad. [The latter] has been already mentioned and that's a pretty big sector in the economy that we sometimes overlook and deemphasize, apart from all the problems that it implies for managing the dollar in the year ahead.

I think by far the most important [issue] is the one that Governor Wallich just ended up with--inflation and the risk that it will accelerate during this year. I think this may create a severe dilemma for monetary policy. I myself do not think it's something that monetary policy can very adequately handle by itself, unaided by new policies elsewhere in the government. I know all the difficulties of that, which leaves me with a little tinge of pessimism about how we can make this soft landing that Governor Wallich referred to. While the expansion doesn't show gross signs of imbalances and excesses, it is getting older; and maintaining a forward momentum against the possibility of an increasing rate of inflation may prove increasingly difficult as 1978 wears on. I'm not expecting a downturn during the course of this year--or a recession or real curtailment of growth out of line with the forecast. But one can see problems mounting on the inflationary side as the year proceeds, raising questions about 1979. And I think it is going to create a very difficult problem on how to manage monetary policy should the inflation rate accelerate at this point mainly due, as I see it, to cost pressures.

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

MR. WINN. Mr. Chairman, living in an environment in which it has been difficult to get one's feet on the ground for the last three months, it's hard to get a perspective on the economic scene that is not influenced by the environment. I don't have any really basic quarrel with the projection of the staff, but I would like to raise two or three questions. First, with respect to structural changes in the financial area that impact on [the economy], to what extent has your automobile outlook factored in the very sharp transition that has taken place [on the] terms of automobile credit and the normal kinds of rollover? What is happening as some of these [terms are extended] and what does this do to debt and so forth? Second, what is the reality with respect to real estate financing? Is it for real estate, or are [people] using this device now because of [more favorable] terms to finance an expansion of consumer [expenditures] other than in the real estate area--for automobiles, living expenses, and other things? And third, on the aggregate analysis on the impact of consumer credit, it doesn't look too bad, but I am wondering if this area isn't one where we should know more about the individual incidences of these [types of financing] because this is likely to affect our behavior down the road. In some places, the aggregate debt of the consumer--if you add real estate plus the consumer debt in certain family situations--really looks horrendous. What does this means for us?

The fourth financial item I'd mention is that, while we project an increase in Regulation Q ceilings in the future, I would hope that would occur before we reach the active disintermediation stage. We're having the horrible development of the so-called "honor bond" in the Midwest. That troubles me a great deal and I would like to see that stopped by more legitimate kinds of channeling savings rather than this device. I think this is going to rebound unfavorably on the banks and I am really concerned about this device.

MR. MORRIS. Can you explain what that is?

MR. WINN. The banks are issuing bearer certificates from $25 up to $10,000 or $20,000 and [that's where] the honor bond comes in. [You are on] your honor to report it to the IRS. They are being sold as a way of avoiding income tax and I think this is a very bad kind of development on the part of banks.

CHAIRMAN BURNS. Mr. Kichline, have you been following this development?

MR. KICHLINE. Honor bonds? I never heard of them before now.

MR. EASTBURN. In Pennsylvania, the banking secretary has ruled against [the honor bond] as being unsound.

MR. JACKSON. It is featured thus far in Ohio; however, the interest [in it] is expanding nationwide at a rapid rate.

MR. PARTEE. I heard [about it] just yesterday, incidentally. I had an inquiry from the homebuilders. They want to object to the use of this thing because it is diverting funds from the thrifts to the banks, presumably on the presumption that people won't pay the taxes.

MR. WINN. It's a disintermediation reaction.

VICE CHAIRMAN VOLCKER. This is purely at banks?

MR. WINN. Banks have gone into it. They call them freedom bonds--freedom from taxes--or honor bonds. I think it is a very unfortunate development, which is really a reaction to the disintermediation problem. Some of [the banks] said they are competing--

CHAIRMAN BURNS. It may be a taxpayer's revolt, but it's taking an unwholesome direction. I'm in favor of a taxpayer's revolt within the law. Well, Mr. Kichline, you ought to start following this.

MR. BAUGHMAN. Are they sold at yields higher than [Regulation] Q ceilings?

MR. WINN. On the [ones with] longer terms, they are. And they're advertising that you can use them as cash. It's very bad advertising.

MR. PARTEE. You mean the bank is violating--

MR. WINN. No, on their longer terms, I don't think there is a violation. But the rates are what--7-1/2 percent? And they sell them up to--

MR. AXILROD. It's not a Q ceiling problem; it's a different kind of problem.

MR. WINN. No, but it's a reaction because of disintermediation.

MR. BLACK. Why don't the banks report the earnings--the interest they pay on these--to the IRS?

MR. WINN. They say [to customers]: "We don't require your social security number."

MR. BLACK. How do they get away with that?

VICE CHAIRMAN VOLCKER. I thought this problem came up years ago and I thought they did have to report [unintelligible].

MR. WINN. [Let me mention] three other quick items, Mr. Chairman. First, the price developments are troublesome, at least in our area, with the very rapid rise in utility rates both [because] of a very cold winter and the rapid increase in rates with changes in fuel sources--adding that [directly] to the fuel bill. And increases in the telephone rates and other utility rates are accelerating very rapidly. Second, a positive thing: The machine tool people are reporting quite expanded interest in their activity. How much of this is the automobile changeover that's still down the road for us, I'm not quite [sure], but they're having a really good year and good interest is being shown in [terms of] future orders. And finally, school financing in the Midwest is really in serious trouble and this may be partly a local situation.

CHAIRMAN BURNS. What does that mean--school bonds are not selling or what?

MR. WINN. Because of tax limits and because of the inner city problem, practically all the major cities in Ohio are faced with school closings due to the finance limitations that have been placed on them. Local schools are $40 or $50 million in debt and they--

CHAIRMAN BURNS. School closings rather than cutting down on expenditures?

MR. WINN. Well, some of them are going to have to close because of dates by which [the local entities] can get approval for increased taxes. They got in a mess with the local banks on short-term borrowings, and it's a very, very messy situation, overlain in part by integration efforts mandated by the courts. It's the [total] school picture--school financing and higher education financing. It is a very serious problem and hopefully the surplus can be diverted in this area.

MR. MAYO. Is this essentially [because of] restrictive provisions in Ohio law?

MR. WINN. I think part of it is that, Bob.

CHAIRMAN BURNS. Thank you, Mr. Winn. Mr. Guffey now, please.

MR. GUFFEY. Yes, Mr. Chairman, thank you. We join those who take some comfort in the staff's projection this time. I have a couple of comments about particular sectors. With regard to housing starts, which have been revised downward somewhat, we think that [projection is] reasonable. There is a development that apparently is prevalent in our area at least that involves the construction people, and that is that there is more residential construction going on now under contract as opposed to speculative construction. If they're under contract, [home building] will continue on through perhaps a good part of this year at a fairly high level. A second aspect of that seems to be the consensus that rates will not be a constraining factor in this inflationary period--on residential construction at least. Most people perceive the fact that if they invest today in residential construction, it will be the best investment they will have made and, therefore, what they pay for the money to build a new home or to get into another home is not much of a constraining factor.

One other point that has not been mentioned around this table: We're finding rather universally throughout our District that the unemployment rate is much lower than the national average. It's probably down around 5 percent or even below 5 percent in most of the central and high plains areas. As a result, we may get some price-wage pressures as we go along this year.

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

MR. JACKSON. I generally concur with the thrust of the staff analysis. If it could be faulted, it would probably be on the inflation side. I would guess that as the year unfolds, the translation of certain changes in food prices, which have been good news for the Agricultural Belt, will become especially bad news to the consumer. Likewise, if the analysis of the slowdown in single-family housing starts is accurate--and I happen to feel it is on target--the consequences will be further increased pressures on housing costs, probably based on increased rents. Therefore, with a sluggish increase in the supply of rental properties, you're likely to see very significant increases in gross rents, which will show up in the CPI--or whatever the new word is. I haven't caught on to the new concepts of inflation yet--that if we don't like the old one it looks like we think of a new word to describe it. At any rate, if you look at those two sectors of the consumer price question, I think we're in for some tougher periods ahead which, in turn, will impact on the general spirit of confidence.

I don't think the fundamentals underneath the whole picture are that bad, though, and for that reason I think the overall real GNP forecast is probably about on target. I'm not as pessimistic about the automobile [sector] and other aspects [of the projection] because I do concur with the [view] that, thus far, the consuming public seems willing to take on more debt and has a reasonable degree of confidence. I'm afraid that our concept of employment is distorted by the aggregate figures. It seems to me that what we have is a relatively tight labor market among the trained in certain geographical locations combined with nightmare situations of severe unemployment in other geographical locations and other sectors of the society so that, in the aggregate, we're seeing [the situation] as being worse than [it is] from an economic point of view. As a consequence, I think those people who are employed and are consuming probably have a greater degree of confidence than we are giving them credit for having, despite the increasing levels of debt. So I would say net on that score that we will probably see a continued expansion. I do think the issue of inflation, and particularly the dollar, should begin to have an impact on capital spending in this country, and for that reason I don't think we're likely to be surprised by an expansion in that sector. We would all like to be surprised, I suspect, but I don't think we're likely to see it.

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

MR. BALLES. Turning back to the general business outlook, Mr. Chairman, I can be fairly brief. Messrs. Morris and Coldwell have pretty well expressed the view that we have. Even with this fairly recent somewhat lower [projection] the Board's staff now sees, we still remain a little less optimistic about the second half of the year in particular, especially because we see a less ebullient picture in autos and housing, even [relative to] the revised forecast that Mr. Kichline talked about. In autos, I think he said [the forecast was revised] down 150,000 to 10.5 million or thereabouts [unintelligible] several months, something no better than 10.4 million of auto sales. On housing starts, we're still somewhat lower than the Board's staff forecast. I think the differences come up principally in the second half of the year. We would expect real GNP growth fourth-quarter-to-fourth-quarter of 4 percent, close to what Mr. Morris talked about, which implies in the second half of the year a real growth rate of less than 4 percent.

I have been interested in some research that our people have been doing lately on what constitutes the full employment unemployment rate. We know the CEA has come out with about 4.9 percent and [in light of] some of the work we've been doing reexamining some of those assumptions, we would think that the figure is somewhat higher--perhaps 5-1/2 to 6 percent or perhaps above 6 percent. Having seen a 10 percent increase in employment since the start of this expansion, and with about 58 percent of the working age population now at work, it seems to us that there's a considerably large excess in the labor markets of usable types of labor skills in the economy. I don't know whether "usable labor" is a viable term, but you get constraints on capacity showing up in a number of lines now, at least in the West; certainly the aluminum industry is one of those. I think this provides a real constraint on [the economy's] ability to grow at somewhat above normal rates than would have [been the case] in the past few years. In short, several members around the table have mentioned that we probably will be facing a dilemma that may show up especially in the second half of the year, with the economy going to shambles and signs of a marked slowing in real growth and an acceleration of inflation on the other hand. That's a first-class dilemma for monetary policy.

CHAIRMAN BURNS. Thank you, Mr. Balles. Mr. Roos, please.

MR. ROOS. Mr. Chairman, I'll be brief. We have just concluded an extensive series of meetings with businessmen throughout our District and there is nothing we heard that would lead us to question or to be more pessimistic than the staff [forecast]. There is moderate optimism, depending on the elimination of many of these uncertainties that disturb business people. I would subscribe, and I won't elaborate on it, to John Balles's concept of what realistic goals for a reduction of unemployment should be; we don't think they're as low as others seems to think they are. I would subscribe wholeheartedly to Governor Wallich's concept of a realistic target for a soft landing and I think that we should not be panicked by a gradual reduction in real growth to what we're talking about--4 to 4-1/2 percent.

I am perplexed about two things that I've heard, and it's not only what I've heard this morning. One is the chronic tendency to be pessimistic about what might happen just over the horizon. I think if we had verbatim transcripts of every meeting we've had in the last two years--and I can't speak with experience prior to that--[they would show] the same sort of expressions of concern, namely that out yonder later this year or later [next] year, problems are going to arise. Some day I assume those problems will occur, but we always seem to be somewhat pessimistic. Maybe that's a way those of you who are much more skilled in the science of economics than I hedge your bets. But what really perplexes me, Mr. Chairman--and I don't say this to be critical--is the fact that so many sitting here today can recognize, apparently all of a sudden, that one of the big problems we face is inflation and one of the big inhibiting factors that is stopping businessmen from engaging in capital formation projects is their concern about and their uncertainty with regard to inflation and that somehow, maybe somewhere along the line, monetary policy ought to concern itself with inflation. If that is literally something that is only occurring to us currently, Mr. Chairman, I don't understand the rules of this game because we've all been talking about it for some time. I apologize for those remarks, but those are my observations.

CHAIRMAN BURNS. Thank you for your remarks, Mr. Roos. Mr.Willes now.

MR. WILLES. Thank you, Mr. Chairman. It's interesting to me in the meeting today to hear a number of people express feelings about inflation in stronger terms than I think they have in some recent meetings. That has been typical of my experience with people outside of this Committee. [Inflation] does seem to be a concern that more of our people have, and for that reason the major difference we have with the staff forecast is on their expectation of inflation. They might be right; we hope they are right. [But] inflation could well be higher than they have projected and I guess the point I want to emphasize is the one that Dave first made--that it's perfectly consistent to be increasingly pessimistic about inflation and, at the same time, to be increasingly pessimistic about the real economy. [That's] because, given the state of expectations people have, based on what has gone before, additional inflation does create additional uncertainty, both from the point of view of what that means for the kinds of positive calculations [they] have made and for what that implies in terms of what they think government policy might be. All of those things added together raise real questions as to how viable plant and equipment spending projects might be, whether it really pays to invest in a new automobile and all kinds of things. So it's perfectly consistent to become increasingly pessimistic on inflation and on the real [economy] at the same time. The policy dilemma, of course, is that you may then reach the opposite conclusion in the current environment [than] you have in previous years in trying to respond to that. But that's a discussion for the next part [of our meeting].

CHAIRMAN BURNS. Anyone else want to speak, or speak again? At this time, let me make a few comments. I have no quarrel with the staff forecast. I want to say only that if I had been giving the report, I would have emphasized the degree of uncertainty that attaches to the forecast somewhat more than Mr. Kichline did. I think uncertainty with regard to economic prospects has been increasing. The evidence is all around us. I think also that the typical view that there are no serious imbalances is a mistaken one. I think there are serious imbalances. We have an imbalance in the realm of foreign trade. Our imports are certainly out of balance with the world economy. We have an imbalance in the sphere of business capital investment; that is certainly out of balance with the growth of our nation's overall production. I think consumer credit is out of balance with personal income. I think wages are out of balance not only with productivity but also with the level of unemployment. I think the profits are out of balance with personal income and also with the cost of production. I think the stock market is out of balance with corporate profits. I think the state of general confidence is out of balance with the performance of the economy. I think our governmental deficit is badly out of balance with the behavior of the rest of the economy.

I want to make one additional comment connected with the last [point]. I think our federal budget is in a very sorry state. It is a budget that is built on the assumption of nothing better than a lucky performance of the economy. And we may indeed be lucky. But make the arbitrary assumption that we get into a recession and then the presently projected deficit--which is in the neighborhood of $75 billion, counting off-budget outlays as we should--could easily go to $120 or $125 billion this year or next year. If it did, would we ever in our lifetime--and I refer to the younger men around here who are the great majority--get back to something like financial stability? I think, as we turn to the next question, our longer-range targets in the years ahead, members of this Committee will have to keep asking themselves a question each time and I think they should: Who will fight inflation if the Federal Reserve does not?

We probably ought to break for coffee and return.

[Coffee break]

CHAIRMAN BURNS. We are turning now to consideration of the longer-term ranges for the monetary aggregates. There is an arithmetical point that Mr. Axilrod wishes to bring to the Committee's attention before we [proceed].

MR. AXILROD. Thank you, Mr. Chairman. We are almost finished with our revision of the money supply series, which this year includes not only the benchmark and seasonal [revisions], but we're also considering some of the changes the Bach Committee has recommended with regard to certain techniques of measurement. [Those involve] relatively minor conceptual problems. I can report to the Committee the results of the benchmark; we have now the revised data from the FDIC and have worked it into the series. [The benchmark revision] would imply for the year 1977 an increase in the rate of growth for M1 of 0.4 of a percentage point over what it would be unbenchmarked. The increase is all in the first half where [the benchmark] increases M1 growth on the order of 1 percentage point and there is virtually no change in M1 growth relative to what it would be unbenchmarked in the second half. The effect of the benchmark on M2 is to increase its growth rate for the year 1977 by 0.2 of a percentage point. I just wanted to report that to the Committee, Mr. Chairman, before its discussion of the long-run ranges.

CHAIRMAN BURNS. All right, thank you. I'd like to make just a few brief remarks to introduce the subject. Let me address in particular the M1 growth rate. In general, if we are to do what we can to reduce the rate of inflation over the longer run, I think we in this Committee will need to adjust downward our monetary growth rates. I think we all recognize that and we don't want to lose sight of that. Secondly, we should recognize, and I think we do, that M1 grew more rapidly than we intended last year and that a reasonable case, therefore, can be made for a compensating downward adjustment at this time. But that, I'm afraid, is only the beginning of a true analysis of where we are and where we ought to try to go, insofar as we can arrive at a judgment at this time. If we lower the range for M1 growth at this time, I'm afraid that such a lowering would appear to lack credibility in view of the actual performance [of M1 relative to its range] during the past year. The opposite side of that coin is that if we sought to lift the range, I think we would run a risk of strengthening inflationary expectations, which are already in the process of intensifying. And I think that such a decision on the part of this Committee could have an extremely adverse influence on the foreign exchange value of the dollar at this time. I'm inclined to think, taking things all in all, that we ought to leave the range where it is at present, bearing in mind the desirability of lowering it in the future. And if we do succeed in keeping actual growth within the current range, that in itself would mean an appreciable decline in M1 growth this year relative to the past year. And I think that the uncertainty that I and others have pointed to with regard to the economy perhaps also argues for keeping the range where it is at the present time.

As for the higher Ms, in view of the likelihood that the inflow of funds to thrift institutions will be on the low side this year--I think all the evidence is pointing in that direction--it would be realistic, I think, to lower the M3 range somewhat, as suggested under alternative B on page 5 of the Bluebook. Or possibly, instead of lowering both the upper and the lower limits by a full percentage point, we might want to lower them by 1/2 percentage point. But I think some lowering would only be realistic and it would be honest. Well, that's all I have to say at this time. Who would like to speak first? Mr. Kimbrel.

MR. KIMBREL. Just a question, Mr. Chairman. That means you would leave M2 unchanged?

CHAIRMAN BURNS. I think I would leave M2, since the problem is clearly one of the thrift institutions rather than of the commercial banks. But some of the influences and thinking on thrift institutions with regard to savings deposits [and] time deposits will also influence commercial banks.

MR. KIMBREL. Just to proceed. I followed you very carefully and [was] right with you all the way. I do think our credibility is involved. And I think it's becoming maybe more important to hit the targets than it is to set them. I guess my only possible variation would be on M2. I might lean to reducing the upper end of that 1/2 point also. But otherwise I share completely your views.

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

MR. ROOS. Mr. Chairman, may I throw out a suggestion that I don't think represents any significant departure from the philosophy you have just enunciated? It might enable us, however, to signal that we're trying to do something about the problem of inflation and we're also concerned about anything that might have a negative effect on real growth. [My suggestion is] that we might consider reducing the upper end of the M1 range from 6-1/2 to 6 percent and raising the lower end of the range from 4 to 4-1/2 percent. The rationale would be that at 6 percent we would not really be doing anything to reduce the rate of inflation--assuming there's a relationship between this aggregate and inflation--below what it currently is, although we would be signaling to the world that we're at least adjusting the upper limit slightly downward, and I think this might have a beneficial effect on the dollar situation At the same time those people who would feel that we're not concerned about any possible softening in the economy would be reassured by the fact that we have raised the lower limit from 4 to 4-1/2 percent. That does narrow the range somewhat, but I think psychologically it could have a salutary effect from both points of view.

CHAIRMAN BURNS. Well, I think this could be a suggestion the Committee may wish to consider. In view of the uncertainty that now exists--and I think we all, in varying degrees, are aware of that--it strikes me as being questionable whether this is the right time to narrow the range. Also, once we narrow it, we may be stuck with a narrow range; the Congressional Committees have been trying to push us in this direction. Some members of this Committee have thought all along that the range should be narrower. The question raised, I think, is a very fair one. I personally wouldn't do it at this time. Mr. Jackson, please.

MR. JACKSON. Before I start, may I ask Mr. Axilrod a question? In your relative analysis of M2, do you consider the present definition, which includes non-negotiable large CDs, to be potentially subject to a substantial error because of the expansion of large non-negotiable CDs?

MR. AXILROD. Well, of course, the reason that we have not lowered [the range for] M2, whereas we lowered [that for] M3, is because the CDs have relatively more weight in M2; they're in both M2 and M3, but they have relatively more weight in M2. The CDs are quite volatile, but I would hesitate to say that the estimate of that particular component is subject to more error than our estimate of deposits that are subject to ceilings. I don't have a basis for saying that that's subject to more error than the others.

MR. JACKSON. I bring that up, Mr. Chairman, because as we talk about narrowing these ranges as we go through this exercise, I think the uncertainties of our present definitional imperfections, as I call them, is a subject we need to bear in mind significantly. I would endorse the proposal that we stick with the [current] 4 to 6-1/2 for M1 and the 6-1/2 to 9 for M2 under the circumstances. I think a half point reduction in M3, given the type of potential problem is more realistic than a full one percent. I can perceive, frankly, a prospect that the thrift industry will be an active participant in the CD market--perhaps to the degree we have not previously [seen]. And it's for that reason that I'm not sure M3 will degenerate to the extent that we are proposing.

MR. AXILROD. I should add that we have not assumed that the thrifts become active in that market.

CHAIRMAN BURNS. Are you thinking of large CDs?

MR. JACKSON. Over $100,000.

CHAIRMAN BURNS. Is there any clear sign of that developing?

MR. JACKSON. Not yet. But if we get pressures on rates of growth in the thrift industry, I can [conceive], particularly if the level of outstanding commitments stays large and the inflow [of funds] is restrained, that [thrifts] may turn to this as a way to raise funds as an alternative to borrowing from the Federal Home Loan Bank System. That would, of course, impact on [the M3 growth] rate. I think it's important, as we communicate this to the world and to our Congress in particular, that this not be perceived as a weakening of our resolve on the inflationary front. But on the contrary, with the changes that we've seen in velocity and financial technology and so forth, and particularly as the pressures of increased inflation are upon us, it is entirely possible that by maintaining the present ranges we will have a very responsible monetary policy in light of these conditions rather than irresponsible.

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

MR. MAYO. First a question to Steve. I think I'm correct in interpreting what you've been saying here and in the Bluebook that what the staff has set up for M2 and M3 does assume on the various dates an increase in Regulation Q ceilings.

MR. AXILROD. Yes, of 50 basis points on time deposits.

MR. MAYO. I find that a difficult assumption to make right now in our consideration of the targets for M2 and M3. If it were completely in the hands of the Board of Governors, I wouldn't make this point, but I have a very definite opinion that the Federal Home Loan Bank Board may have something to say about this and that there will be considerable opposition in various quarters to a raising of Regulation Q. If I am correct or even partially correct on that, I think we might be ill-advised to continue in our M2 and M3 targets for growth or our growth range statement here an assumption that would encompass an increase in Regulation Q. I would, therefore, wholeheartedly support what the Chairman has said [with regard to] a beginning of the eventual need to lower the targets, particularly for M1. I would wholeheartedly support the idea that our credibility [and] our determination as to whether we do believe in a 6-1/2 percent top on M1 is being tested right now in the public eye. Until we get the performance record well under 7 percent, I wouldn't want to change that 6-1/2, so I would subscribe to the Chairman's status quo recommendation on M1 without reservation. I would, however, suggest that we go to alternative C on both M2 and M3 and lower the M2 target by 1/2 percentage point from where it is now and the M3 target by either a full point or, as in the case of alternative C, by 1-1/2 percentage points.

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

MR. WALLICH. Well, on the previous occasion when we discussed the long-term ranges, I would have preferred raising the upper limit of M1 to 7 percent. I've changed my mind about that for two reasons. One, we've overshot that M1 ceiling anyway, and the Committee does not seem to be [of a mind] to get on a track that would substantially lower the growth rate of M1. Second, we have the problem with the dollar to contend with; and as the Chairman's pointed out, this could be a very dangerous signal.

Nevertheless, I think we ought to watch very carefully what the implications of what we're doing are for velocity and interest rates. The velocity projections seem to be that, with a rise in the Regulation Q ceiling of 1/2 percentage point and with interest rates rising the way they are supposed to rise under the alternatives--by maybe 125 basis points on the funds rate over a year for alternative B--we'll get a velocity gain of 5.6 percent. Now, that's a large gain. But given that interest rates are rising, that's of course not unobtainable. The rise in interest rates in itself presumably is factored into the projection, so that that 125 basis points on the funds rate is not going to have any additional adverse effects on housing beyond those already built into the forecast. If we can take this as a rough basis for what we expect about velocity, I think it is not impossible that it might materialize and that does not imply impossible interest rate assumptions. My own inclination would be to stay at the high end of that 4 to 6-1/2 percent range and if we overshoot a little, not to do anything about it as we have done in the past.

As far as M2 and M3 are concerned, I concur with the Chairman. I would leave M2 as it is in alternative B, pulling down the upper margin of that perhaps the next time around to continue this tradition of pulling the aggregates down. M3 allows a certainty to pull down [at least one of] the aggregates and maintain that tradition on the present occasion.

CHAIRMAN BURNS. Thank you, Mr. Wallich. Mr. Partee, please.

MR. PARTEE. Well, Mr. Chairman, I thought long and hard about this, too. I'm bothered by the same kinds of arithmetic that bothered Governor Wallich, and I really don't know what to do about it because I think psychologically it would be a bad time to increase the upper limit of the M1 range. But the arithmetic is that we should anticipate here in the next four quarters a rise of certainly 11 or maybe 11-1/2 percent in nominal GNP. The comment around the table today was that the staff's inflation rate may be understating what will occur. We certainly know that there's a built-in inflation rate of some considerable size resulting from the cost increases [in] the labor contracts that have been negotiated and will pay off regardless in this period to come. It calls for a very large rise in velocity to be able to be within the 4 to 6-1/2 percent range and to be able to accommodate an 11 to 11-1/2 percent [growth in] nominal GNP. And yet not to do so--not to accommodate for that--certainly means rising interest rates and a change in the whole economic outlook. That is a rise of size in interest rates and a change in the whole economic outlook that will unfortunately affect real activity as well as prices. In fact, every [study] that's ever been done suggests that the immediate short-run effect will be more on real activity than prices. I wish it were not so, but that's what every bit of analysis indicates.

So, although I also feel that we will have difficulty keeping M1 within the 4 to 6-1/2 percent range, I guess I'd rather continue with it for the time being, and if necessary err a little on the high side as time goes on. I really don't see any other short- to intermediate-run strategy that the Committee can follow. I wouldn't narrow that range. If anything, I would widen the range if I were making a change because I think so much depends on assumptions on institutional changes and on velocity and so forth that we can't with any conscientiousness say that we understand what, within a couple of points, is the right money supply increase for the economy to have.

On M2, I would make the same point that Governor Jackson did. You have to remember that a large part of [M2], an increasing part of that, is not subject to Regulation Q ceilings. And we've seen some very large increases in large non-negotiable CD sales at the banks and indeed, you remember, it even includes negotiable CDs if they're issued by other than the 350 largest banks. So

I think there is more room for expansion there than traditional analysis may suggest on the basis of interest rate relationships. Therefore, I think we're safe enough to leave that at 6-1/2 to 9. I would leave it in any event because of this tendency for a good many rather simple analysts to draw an identity between M2 and GNP growth. I think they would become really quite agitated at a reduction in the M2 range so that the top, and thus the implied increase in nominal GNP, is below 9 percent.

CHAIRMAN BURNS. You were doing beautifully up to this point. Stop worrying about those fellows!

MR. PARTEE. Well, there are a lot of them in the Street and among the monetarists and even in academic circles. On M3, I would be sympathetic with Bob Mayo's point of view, except that I don't really believe that the House Banking Committee is the group to tell that growth will be a lot less unless we can get an increase in Regulation Q ceilings. I think it would just cause trouble for the House Banking Committee, whereas the person that has to be told that sits in an office in another building in town. And there the problem is to convince them rather than just to assert it.

So I guess I'm being a coward today, but I think I would just cut the M3 range by 1/2 point as the Chairman has suggested, realizing that that may be high because it does probably require an increase in some sensitive area of Regulation Q ceilings by midyear. There, too, though, I think there might be a tendency to be overly affected by the very poor savings inflow figures that generally are inherent for February. They seem to me too radically lowered to reflect only interest rate differentials. There must be something else going on there, but it's probably an aberration and I think we'll probably get some recovery in thrift institutions in the period yet to come. So, for all those longish reasons, Mr. Chairman, I support exactly, I believe, what you proposed. But for M3, I would only cut the range by 1/2 point--that is, to 7-1/2 to 10 percent, simply because I think it would cause more trouble than it's worth to cut it a full point at this stage.

CHAIRMAN BURNS. Thank you, Mr. Partee. Mr. Coldwell now.

MR. COLDWELL. Mr. Chairman, Mr. Partee gave [many] of the same reasons that I would to support your package. I think there are two or three other points. First, if I understand the ballgame here, and I am not sure I do, if we go back to our normal [schedule for] reconsideration [of our long-run ranges] we'll be back to this subject very soon. And I really don't want to be launching into a whole new ballgame with [another review of these ranges] coming up within a month or two. Secondly, I would strongly resist the idea of narrowing the [M1] range, which flaunts the track record we've had on this. We can't even meet the upper [end of the] range the way it is now. If we narrow it even more, I think it would be a mistake. Third, on the M3 point, while it's a good theoretical exercise and we can speculate about what will happen to the savings and loans and their thrift record, in practical terms I don't find the Desk paying much attention to M3 in the day-to-day transactions. In fact, [while] M1 and M2 have some relevance, M1 seems to be the principal point of contact. So I guess M3 is a gratuitous type of figure to use--one that we ought to pay attention to, but not one that somebody else is paying a whole lot of attention to yet. And they're likely to as the economics change. If I thought we were really going to do something and use these ranges in a practical sense of setting policy, then I think my preference would be something like a 4-1/2 to 7-1/2 percent M1 range, which I think is probably more practical than what we have in front of us. But I'll take the coward's way out and stay with the status quo.

CHAIRMAN BURNS. Thank you, Mr. Coldwell. Mr. Morris now, please.

MR. MORRIS. Mr. Chairman, I think I come out in exactly the same position as Governor Partee.

CHAIRMAN BURNS. But I think the time has come to say that there are no cowards in this room, period. I don't want to hear remarks like that.

MR. MAYO. We're all realists.

MR. PARTEE. I only feel cowardly on M3, I think.

MR. MORRIS. I don't feel cowardly; I just want to exercise prudence.

MR. MAYO. Prudence came from New England, didn't she?

MR. JACKSON. How do you know the difference?

MR. BLACK. If he did it, it would be prudence; if you did it, it would be cowardice!

MR. MORRIS. So I would accept your specifications with the Partee/Jackson proviso of only cutting the range for M3 by 1/2 percentage point.

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

MR. EASTBURN. Well, I join the ranks of prudent men, too. The only question I have is that M2 ceiling. Really, this turns into a factual question more than anything else. In the short-term ranges, it's expected for the next two months that the large denomination time deposits will grow enough to offset the slow growth in time deposits subject to Regulation Q. I wonder if that assumption is true, however, when you're going a year out and whether, with Regulation Q ceilings biting into those smaller denomination time deposits, the relative weights of those would tend to shift in that time period. Making a guess that that might be true, my inclination would be to cut 1/2 point off of that M2 ceiling.

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

VICE CHAIRMAN VOLCKER. Well, it seems to me that the most important number here, in operative terms, is probably the upper limit on M1. And in terms of the mind of the market, and I suspect my own mind, as to whether we really mean it and whether we will attain it, I don't think we can afford to lower that at this point against our past record. I think 6-1/2 percent against the outlook that we have is not unreasonable. I don't feel so casual about missing it, as some of the comments earlier imply. And that gives me a little concern about what we do about M2 and M3. I recognize the difficulties of reducing those numbers, psychologically and in terms of the audience of the Banking Committee in particular. I'm a little afraid if we put in a high number there not on the feeling that it's prudent--if that's the right word--to lower the number but in the expectation that we will probably come in on the low side of that range, we may be kidding ourselves. I could foresee a warm glow of satisfaction later on when we miss M1 on the upside and we say we came in on the low side on the other ones, which we sort of expect anyway. So we congratulate ourselves that among all the targets, we haven't done so badly in terms of our objectives. I suspect there's a little trap there. So I would prefer, I guess, to be a little imprudent in the immediate presentational sense and do a little something about M2, like a 1/2 percentage point [reduction], and stay with the 1 [point reduction] on the M3 range.

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

MR. BLACK. Mr. Chairman, in your statement a while ago [you said that] if we don't fight inflation, who will, [and that] I think provides a pretty good backdrop for this. I share what I think [are the views of] everyone else here on GNP and inflation and inflationary expectations and that the accompanying low level of confidence probably poses the biggest threat to the continuation of expansion. So I think it's important that we give some kind of reassurance to the business and financial community here and abroad that we have some intention of trying to prevent any escalation of inflationary pressures. I think it's particularly important as the year develops, of course, that we avoid a repetition of what I now think in retrospect has been an overly rapid expansion in all three of the aggregates.

Getting down to the brass tacks, I would knock a percentage point off both ends of the range for M3 and 1/2 percentage point off the top end of the M2 range. My economic sense tells me that we probably ought to knock 1/2 point off the top of M1, but my sense of prudence tells me it's probably best to just leave that where it is.

CHAIRMAN BURNS. Thank you, Mr. Black. Mr. Willes, please.

MR. WILLES. Thank you, Mr. Chairman. I won't make any comments on the numbers. I'd just like to indicate that there seem to be two points of view expressed. One is that we don't need to do anything about M1 because it's nowhere near where we are anyway, so it's kind of irrelevant. The other point of view is, I think, the one you expressed initially--that we ought to leave it so that we can close the gap between where we are and where we say we'd like to be so that we increase [our] credibility. And I'd just like to align myself very strongly with the notion that we ought to take these long-run targets very seriously. We ought to make sure that in the short run we do what we can to get [monetary growth] in line with these targets and it's on the basis of that assumption that I think your proposal is the right way to go at this meeting.

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

MR. BALLES. Well, I share the view expressed by some others already that the announcement effects of these ranges are very, very considerable. And with inflationary concerns in the air both at home and abroad, not to reduce the ranges--I think we all agree--would have some very adverse effect on inflation expectations. Now, having said that, I think I'd agree with Mr. Kimbrel's remark a little while ago that, at this point, it may be more important to hit the ranges than to reduce them, in order to reestablish our credibility.

In terms of the specific numbers, I would agree with your proposal, Mr. Chairman, to leave M1 where it is. I agree that M3 should be cut. I guess I would join the so-called prudent crowd and cut only 1/2 point from both the lower and the upper limits. On the M2 range, I would go one step beyond what you are proposing and shave that down by 1/2 point to a 6-1/2 to 8-1/2 percent range. We've all got our variations on the same general theme here of getting some kind of reduction and maintaining our credibility. We haven't failed to shave the range on at least one of the three Ms, I don't think, every quarter since we first started. But one question I'm a little uncertain about is what will happen if the [proposal to allow] automatic transfers from savings to checking is implemented.

CHAIRMAN BURNS. It's a new ballgame.

MR. BALLES. We'll have to address that at the time? Is that your point?

CHAIRMAN BURNS. Yes, it's a new ballgame, and I think the consequences for the monetary growth rates should be taken into account beforehand by the Board. It should be considered very carefully by the Board before making a final decision on that regulation, which--

MR. PARTEE. It wouldn't be for a long time anyhow.

MR. BALLES. Well, I just assumed that at that point we might have to readjust our view of what's feasible in terms of the ranges.

CHAIRMAN BURNS. Oh, if that regulation is adopted by the Board, it's a new ballgame and it would be a most confusing ballgame for quite a while. I think the Board will have to think very carefully before reaching its decision. And if its decision is to go ahead, then I think that our work in this Committee will be cut out for us.

MR. BLACK. What is a normal time frame for the Board's consideration of an issue like this one?

CHAIRMAN BURNS. Well, I think that a significant period needs to be allowed, first for study of the proposal. And second, if the Board decides to go ahead with the proposal, I think we need to give the Congress reasonable time to legislate against us if that should be the inclination of the Congress. I think it would be unwise for us to put any such regulation into effect immediately. So first we have to weigh the regulation. If we decide in favor of it, we ought not to put it into effect immediately because of our Congressional problems. I think decency and good relations with the Congress require that members of the Congress have a reasonable amount of time to legislate against us, if that should be their wish. There is a great deal of interest in the Congress on this issue. And, as you know, the savings and loans are carrying on an extensive campaign. Mr. Guffey now, please.

MR. GUFFEY. Yes, Mr. Chairman. I would join what appears to be a consensus with respect to retaining the M1 range. I'd like to specifically align myself, however, with Governor Partee's and Governor Wallich's comments with regard to probably hitting the upper [area] of that [4] to 6-1/2 percent, given the velocity projections by the staff, which we believe to be somewhat high. Secondly, I'd do nothing with the M2 range, but with respect to the range for M3 I'd join your recommendation--I believe it was your recommendation--to cut it 1/2 percentage point.

CHAIRMAN BURNS. My recommendation was neutral with regard to a half or a full point.

MR. GUFFEY. We would prefer cutting 1/2 point off M3, recognizing that we quite likely could come in toward the lower end of that range. But I would also suggest to you that you might take some comfort from the fact that we have missed the M3 targets since, I believe, the fourth quarter of 1975--always on the high side. So [if] we come in either in the lower part of those targets or even miss them on the low side, that wouldn't be of great concern.

CHAIRMAN BURNS. Thank you, Mr. Guffey. Mr. Baughman.

MR. BAUGHMAN. Mr. Chairman, it seems to me that the staff estimate that alternative B is consistent with the general economic forecast might well be given substantial weight at this particular juncture. It does give us no change with respect to M1 and M2. It gives us some significant change with respect to M3, but the conversation around [the table] seems to suggest that it's realistic. So I would be inclined to take alternative B all the way through, recognizing that this doesn't, based on our best estimates, indicate that we're making any additional move against inflation and that the projection contemplates some acceleration of inflation. But all things considered, it seems to me that that might be an appropriate place to stay at the present time.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Mr. Winn, would you be good enough to advise us?

MR. WINN. I vote for prudence under the circumstances. And I really haven't any quarrel with this [recommendation]. I think we ought to recognize just a little bit that our shifting base problem is happening to us in all this, however.

CHAIRMAN BURNS. All right, thank you, Mr. Winn. The Committee is unanimous on retaining the present range for M1, except for Mr. Roos who also agrees with the Committee on the midpoint of that range. As for M2, the majority of the Committee is inclined to leave the range where it is presently. And as for M3, the majority is inclined to lower both limits by 1/2 percentage point. Any further discussion? If not, I think our rules, as we now practice them, require a vote by the Committee.

MR. ROOS. Mr. Chairman, do we have to consider the aggregate versus the [money market] directive, or is that--

CHAIRMAN BURNS. No, that comes later in connection with the short-run ranges. We'll vote on growth ranges from the fourth quarter of '77 to the fourth quarter of '78 of 4 to 6-1/2 percent for M1, 6-1/2 to 9 percent for M2, and 7-1/2 to 10 percent for M3. And if the Committee will bear with me, we shall leave it to the staff to adopt an appropriate number for bank credit, which is what we've done in a good many--I think most--of our meetings.

VICE CHAIRMAN VOLCKER. I'm not sure why we adopt that number.

CHAIRMAN BURNS. There are very good reasons in dealing with the Congress, and also in our own thinking, to pay some attention to the credit side and not only to the money side.

MR. PARTEE. May I make only a comment with [regard to] setting bank credit? I think it's not such a very good strategy to be raising the bank credit range at the same time we cut the M3 range.

CHAIRMAN BURNS. Let us so advise the staff unambiguously.

MR. BLACK. Just so they find it compatible.

CHAIRMAN BURNS. That's a very useful reminder. Well, we're ready for the vote, unless members of the Committee would like further deliberation. Would you be good enough to call the roll?

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Governor Coldwell	Yes
President Guffey	Yes
Governor Jackson	Yes
President Mayo	Yes
President Morris	Yes
Governor Partee	Yes
President Roos	Yes
Governor Wallich	Yes

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

CHAIRMAN BURNS. Thank you, Mr. Sternlight. Are there any questions or comments?

MR. JACKSON. One question, Mr. Chairman.

CHAIRMAN BURNS. Yes, Mr. Jackson.

MR. JACKSON. This weather has produced such a substantial volume of float that our capacity for issuing currency has been potentially impaired. Has any thought been given to substituting agency securities for Treasuries so that we would still have additional leeway for the issuance of currency?

SPEAKER(?). It's not legal.

MR. STERNLIGHT. You could have a change in the law.

MR. JACKSON. Excuse me, did I say the wrong thing? I meant where we'd sell our agencies and buy the Treasuries. Did I say the wrong thing? I apologize.

MR. STERNLIGHT. I think it would be difficult for the market to absorb big sales of agency issues on short notice.

MR. JACKSON. Has some consideration been given to some careful but nonetheless deliberate shift in policy because of these restraints?

MR. STERNLIGHT. I'm not aware of such consideration.

CHAIRMAN BURNS. The Desk is allergic to any such activities. Isn't that true?

MR. STERNLIGHT. I think it would be hard for the market to absorb sales.

CHAIRMAN BURNS. Hard for the market to absorb even sales of insignificant volume?

MR. STERNLIGHT. Small sales? We have allowed some runoff to occur in agency issues as these reach maturity. That's just a runoff.

VICE CHAIRMAN VOLCKER. That does seem a very relevant question to me, Mr. Chairman. At the very least, it seems to be an indication that if the law isn't changed, policy somehow isn't changed in another respect. I think it does take a change in law; we have at the very least a very big yellow light on purchases of agencies--the net increase in agency holdings. I think we probably ought to be going in the other direction.

CHAIRMAN BURNS. I think it would be a good idea for the Desk to become--I'll use the word "courageous" today--or to become prudent or more prudent and to exercise its greater prudence by one of these days making a sale of an insignificant volume of agency issues.

MR. BLACK. In light of our earlier conversation, I'd say they have been prudent. And now you think they ought to be courageous?

CHAIRMAN BURNS. I think the Committee really ought to reach a decision on this--perhaps it's too late--and instruct the Desk to be somewhat flexible in that direction.

MR. PARTEE. We never sell agencies?

CHAIRMAN BURNS. And while we're on that, there is an age-old practice that I would like to see changed, but I don't want to spend more than ten seconds on the point. And that is when we formally vote, we vote to approve, ratify, and confirm the transactions [of the Desk]. I think it would be more accurate, and really more proper, simply to ratify them. It would serve every purpose. But since time immemorial, from a formal viewpoint we have approved, ratified, and confirmed. Those who support me in simplifying our procedure are being very radical today. On confining the vote to ratification, may I have a show of hands?

MR. MAYO. Mr. O'Connell isn't here to defend himself.

CHAIRMAN BURNS. Well, he'd have to defend all his predecessors, too.

MR. MORRIS. It's going to cause quite a stir in the market when we first start selling agencies. It seems to me that it's incumbent upon us at that time to explain to the market why we are doing it because the stir on the first occasion is going to be pretty substantial, I would think.

MR. BLACK. You're going to have to do more explaining to Congress probably, in spite of its wisdom.

MR. PARTEE. Peter, could we sell to the Federal Financing Bank?

CHAIRMAN BURNS. I think the explaining we will have to do, if any, is why we haven't done it in the past--not why we are doing it now.

VICE CHAIRMAN VOLCKER. I don't see why we can't do it as part of a general sale when we're selling other things rather than doing it alone.

MR. STERNLIGHT. We did undertake in the past, on two occasions, sales of relatively short maturities of agencies. On one occasion it went quite smoothly; on another occasion, it was rather upsetting.

CHAIRMAN BURNS. Upsetting? [Selling] small amounts was upsetting?

MR. STERNLIGHT. On the order of one or two hundred million, is my recollection.

CHAIRMAN BURNS. One or two hundred million? Well, I would not call that insignificant but, you know, I haven't kept up with this two trillion economy of ours.

MR. JACKSON. I think it is a policy question that the Committee would be wise to address in a definitive way.

CHAIRMAN BURNS. I think the Committee should address this question. And it should be on the agenda for another meeting. Mr. Axilrod, you have a genius for brevity and this is the time to demonstrate it once again.

MR. AXILROD. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN BURNS. Any question? If not, I'd like to go back, if you will permit me, to the question that was raised about the inclusion of a figure for bank credit in our longer-range projections. I quickly gave a reason for doing it. And yet, the fact that we as a Committee do not deal with it is troublesome. I would like to make a suggestion to Mr. Partee, or to your committee. We have made an improvement. We used a credit proxy and that behaved in a wild fashion--from our viewpoint, at least. The bank credit measure is preferable. I think the measure we really need and one that would be more nearly symmetrical with our monetary aggregates--particularly M3, the higher monetary aggregate--would be total credit. Our flow of funds projection gives us a basis for that. And I wish your committee would ponder the wisdom and the desirability of substituting total credit for bank credit in our longer-run projections.

MR. PARTEE. We can do that, Mr. Chairman--or perhaps [consider] institutional credit, which is quite [unintelligible] to M3.

CHAIRMAN BURNS. Maybe. I wish you'd think about that pretty carefully and then at a later time make a recommendation. Perhaps in the future, with a wiser or more defensible measure of credit, the Committee would want to ponder it or to take it into account. Well, I'm glad you'll undertake that study to find out.

I think we're ready now to move on to the shorter-range specifications. I find alternative B entirely acceptable. The only additional comment I would make is that in view of the position of the dollar in the foreign exchange markets--and that is something that is not likely to change quickly or dramatically--we ought to think most carefully about doing anything that would lower interest rates at this time. On the other hand, any appreciable rise in interest rates, in view of uncertainties that surround the economy, would also seem dubious. I'd be inclined to stick with alternative B and probably with a money market directive. Let's hear from the Committee. Mr. Volcker.

VICE CHAIRMAN VOLCKER. We've just talked about a little modification of alternative B, which I think is basically on the right track. I think there is a technical reason, as we discussed a few meetings ago, for keeping a range of 6 percentage points for M1 if M2 has a range of 4 points. I think statistically that just reflects the relative volatility of the two series; it is more consistent in that technical sense. But going beyond the technical, I would prefer to shade it down in the process of widening it from the 0 to 6 percent. I think our experience shows over and over that when we get into these little lulls in monetary growth--which are infrequent enough--if we don't take advantage of them, we just compound the longer-term problem of remaining within the targets. In other words, I don't think we should set these short-term ranges in a way that [threatens to] trigger a relaxation of the interest rate target because we will only make trouble for ourselves in the long run, even though the short run may look low relative to the longer-term targets. [So] the substantive reasons for at least shading M1 a bit make it consistent with the technical consideration.

I do think the interest rate constraint is much more important, substantively. You mentioned the international reason, but for the reason I just suggested--thinking in general of the domestic side in terms of keeping on our long-range targets--we can say the same thing, namely, that we wouldn't want to reduce [the funds rate] below where it now is. Therefore, it strikes me that the most straightforward thing we could do would be to put a lower limit of 6-3/4 percent [on the funds rate]. I wouldn't want to move necessarily right away, so that also suggests that it be an asymmetrical midpoint. I don't want to go up all that much, which brings me precisely to the logic I think Governor Partee had last time. And we've only got three weeks between meetings, so I think we are talking about a range of only 6-3/4 to 7 percent. Anything else we might say would seem to me to be a little bit misleading, depending on what other people have to say around the table. Does anybody really mean that we should go above 7 or below 6-3/4 without something very drastic happening? I'll be interested in seeing whether anybody does, but I wouldn't want to. So 6-3/4 to 7 percent with a 6-3/4 percent "midpoint" reflects pretty accurately my feelings about the situation. In that context--I don't think really inconsistently--I'd take an aggregates directive. You can't move very far--

CHAIRMAN BURNS. I just object to that. That violates every canon of the English language, really, to have a range of 1/4 of one percent and talk about a monetary aggregates directive.

VICE CHAIRMAN VOLCKER. The question is what [triggers a] move within that 1/4 of one percent.

CHAIRMAN BURNS. We have gotten to a point of fine-tuning that is far beyond our knowledge or understanding or even our good sense. I've made myself clear, I hope.

VICE CHAIRMAN VOLCKER. I don't think your logic is inconsistent, but the nature of the directive is not a major preoccupation of mine. The limits on the range--

CHAIRMAN BURNS. All right. Thank you, Mr. Volcker. Mr. Coldwell now, please.

MR. COLDWELL. Mr. Chairman, I'd take alternative B. I have some doubts about the figures the staff is [projecting for] the rates of [monetary] growth in February and March. I have a suspicion that the March figure is going to be sharply higher than what [they're] showing. But there is some leeway in this averaging business, and as long as we are looking at a 6-1/2 to 7 percent range on federal funds, it doesn't disturb me a whole lot. I don't want to go down from 6-3/4 percent now that we're there for the moment, but I don't want to go up over 7 percent by any means until we take a good long look at it. I would even be a little reluctant to go beyond 6-7/8 percent, so if we are going to fine-tune it, a 6-3/4 to 6-7/8 percent range would be my ideal. But we might as well set a particular [rate]. We might even get to 6-11/16 but I hate those 16ths. So, as far as I'm concerned, alternative B is the best.

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

MR. BLACK. Steve Axilrod has reminded us all that we are approaching a pretty difficult period if we're trying to project the aggregates. And this year the [tax] refunds are expected to be larger and a larger percentage is expected to be paid in March, so I would share Governor Coldwell's idea about the prognostication for the March growth in M1. I think it's probably going to be right much above the 7.1 percent that the staff is now projecting. And certainly April, as Steve indicated very well, is likely to be pretty strong. If we're going to move toward a money market directive which I think is probably the best thing to do right now, though I don't like it in general, then I would want to pare those figures for the aggregates ranges down from what we've got here in alternative B. [I say that] because, if you've got a 6 percent upper [limit] and we don't move the federal funds rate until we are approaching or moving beyond the limits, with M1 having declined 0.4 percent in February, you could have a 12.4 percent increase in March [before the funds rate is moved] and I think that is too fast. And with the 8-1/2 percent ceiling on M2, [its growth] would also need to be in the range of 12 percent. So I would want to pare those down to 0 to 4 and 3 to 7. If you went for the aggregates directive, I think these ranges would be perfectly acceptable and ordinarily that is what I would prefer. But these are unusual times, so once more I would go with the money market directive despite my reluctance to do so.

CHAIRMAN BURNS. Thank you, Mr. Black. Mr. Wallich, please.

MR. WALLICH. I'm concerned about the wide M1 range. If you take February as given, that means the March M1 growth can move up or down 5 percentage points from where it is without triggering the funds rate if we're on the money market directive; it means a swing of 10 percentage points that we are allowing ourselves. What are we gaining? We think that we want to avoid triggering [a move in] the funds rate because if it goes down it hurts the dollar, and if it goes up it hurts housing; it's in a very critical, delicate position. But we don't really gain anything, we just postpone--

MR. PARTEE. It depends on how much volatility there is.

MR. WALLICH. We can have [by] the next meeting a strong move in the aggregates one way or the other, and we are going to be confronted with that situation of moving the funds rate whether we like it or not, and we are going to have lost half a month or so. So I think we are better off doing the following: Setting a narrower range and agreeing to be more ready to have a telephone call or telegram if [the range] triggers a movement in the funds rate. Therefore, we stay more in touch with the situation because that is important. But [we ought to] have more realistic aggregates ranges, so I would argue for M1 a range of 2 to 5 percent; that wouldn't change the midpoint. And for M2, [I'd favor] 5 to 8 percent, which also wouldn't change the midpoint. On the funds rate, I would be willing to go a little higher and say 6-1/2 to 7-1/4 percent, but with the midpoint staying where we are right now and an aggregates directive.

CHAIRMAN BURNS. May I point out one thing? The next meeting will be held three weeks from today. We will have figures on monetary aggregates that will be worth paying some attention to only by Thursday of next week, which is approximately a week and half from now. If there ever was a time to try to stand still, both because of the brevity of the [intermeeting] period and because of conditions in the foreign exchange market and the economy, I would think this is just about the time. Thank you, Mr. Wallich. We'll proceed with Mr. Kimbrel, please.

MR. KIMBREL. Mr. Chairman, these numbers associated with alternative B are rather attractive to me. If I had a personal preference, and absent your very last comment that maybe the time does argue for no change, I guess it would be easing down M1 1/2 percentage point [on the top and bottom] to 1/2 to 5-1/2 percent, M2 as suggested [in alternative B], and the funds rate as indicated there. I sure would hate to see [the rate] go below 6-3/4 percent and yet I absolutely would not during this period want to see it go above 7, although I have a personal bias against restricting the range any more than it is. So I am prepared to accept [the numbers in "B"] as they are with the single suggestion that, absent the timing [issue], I'd prefer to see the M1 range reduced 1/2 point.

CHAIRMAN BURNS. Thank you, Mr. Kimbrell. Mr. Partee, please.

MR. PARTEE. When we [discuss] the difficulty with the aggregates, everyone is assuming that March may be a very strong month. What if the coal strike goes on? March could be a very low month. I think there are so many uncertainties in the picture that we can't really, within a range of 10 points, say what M1 is likely to do in the month of March. I like Paul's suggestion because I think it is the truth. We aren't likely to cut the funds rate below 6-3/4 percent unless something really dramatic happens--in which case undoubtedly there would be a conference call. And we aren't likely to put the funds rate above 7 in this three-week interval, particularly since for half of it we won't know what the coal miners are going to do. Therefore, it is a strict old-fashioned money market conditions situation and we ought to recognize it as that and have a very small range on the funds rate. I don't really care [about the aggregates ranges]; I would be prepared not to have any aggregates ranges for this three-week interval because I just don't think they are at all reliable. But I suppose that's too dramatic a change, so I would take the alternative B aggregates as a good proxy for a wide range of the possible experience.

MR. BLACK. Taking no aggregates--without any ranges?

CHAIRMAN BURNS. Thank you, Mr. Partee. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I'm torn. When I first came and sat at this table--not this one but the other one--we used to have directives that said "maintain prevailing money market conditions."

SPEAKER(?). That's correct.

MR. MORRIS. I think you could make a case for doing that for the next three weeks. On the other hand, it seems to me that if we are going to establish a range, we could make a good case for having an asymmetrical range. If we get two months back to back of no M1 growth, this suggests to me that it would make just as much sense to go back to 6-1/2 percent [on the funds rate rather] than to advance it to 7 percent in case of various outcomes of monetary growth. I may be biased in the sense that I didn't vote for 6-3/4 to begin with, but it seems to me that if we respond on the funds rate because of a very marked slowdown in monetary growth, we ought to be able to explain that to the international financial [community] as not signifying any unwillingness to influence the money supply. So it seems to me that alternative B, as written, would be quite satisfactory. As a secondary measure, I would go back to our old 1968 [directive language] for this one occasion and say we're going to maintain prevailing money market conditions, period.

CHAIRMAN BURNS. Thank you, Mr. Morris. Mr. Baughman. This is turning out to be a very interesting meeting.

MR. BAUGHMAN. Mr. Chairman, I agree with the observation that this is a time to stand where we are, and I construe that as meaning primarily staying at 6-3/4 percent. I can't visualize a development in the next three weeks that would seem [to indicate] that we should go below 6-3/4 percent on the fed funds rate. However, it does seem to me that it is possible that there might be developments that would cause us to want to go to 7 percent or possibly above that. But I would assume that such developments would call for a meeting of the Committee and, therefore, it seems to me that a range of 6-1/2 to 7 is appropriate.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Mr. Guffey now.

MR. GUFFEY. Mr. Chairman, alternative B with a money market directive would be my choice but with one minor adjustment. Everybody seems to have their own adjustments this morning, but I think the risks of March coming in strong quite likely are greater than it coming in weak and, as a result, I would like to see the M1 range adjusted to 0 to 5 percent with a money market directive. My thought is that if we get up to around a 10 percent projected rate for March, we ought to be taking some action. I'd also take the B alternative on the federal funds range, but I would suggest that maybe we put a proviso in that it not go below 6-3/4 percent. I think we've done that before and I think it is quite appropriate at this meeting.

CHAIRMAN BURNS. Mr. Willes, please.

MR. WILLES. Mr. Chairman, I'm prepared to go along with alternative B, but I would just like to make a procedural comment or a theoretical comment or whatever kind of comment. While I understand the arguments for staying where we are, I have difficulty in my own mind knowing what it means to stay where we are. Chuck mentioned the possibility that we could get a very low March and I think that is a possibility. My understanding is that it is precisely in those periods of uncertainty of the kind that we are now moving into--and I'm talking about uncertainty in terms of the real economy, not money [growth] and that sort of thing--that we ought to pay more attention to the aggregates rather than less, because should we have made a mistake in our perception of how strong the real economy is, for example, the best hedge against that would be to keep the money supply from going very low for several months in a row. And, of course, conversely on the upper side. I'm not prepared to debate this today because it's not the time, but I think one of the real issues we have as we go down the road is what kind of uncertainty we have regarding the real economy and where that pushes us in terms of how we define staying where we are. If we think about that, we may well find that we want to flip on their heads the kind of rationales that we've used today and go in exactly the opposite direction.

CHAIRMAN BURNS. Thank you, Mr. Willes. But I do want to remind the Committee, once again, that we are talking about an intermeeting period of just half the duration of the preceding one. Mr. Eastburn.

MR. EASTBURN. Thank you, Mr. Chairman. As I listen to the discussion, I think this is an illustration of the danger of getting captive to our machinery here. It seems to me, given the short [intermeeting] period and the desire, as I hear it, of most people to stay where we are, that we need to tell the Desk to hold the rate where it is and watch closely and have a special meeting by wire if necessary, but it probably won't be necessary. So I'd accept alternative B and wait for three weeks.

CHAIRMAN BURNS. Thanks, Mr. Eastburn. Mr. Jackson.

MR. JACKSON. I think we ought to be aware that Mr. Holmes's ego is probably highly inflated by the procedure with which we have endowed him the capacity to manage affairs.

MR. PARTEE. He does very well.

MR. JACKSON. I know he does, but at the same time it looks like every time he does well, we want to make him do better. So I think that our focus on such an issue is not appropriate and, in view of the intermeeting period being discussed, I think we ought to take alternative B. And to me, the aggregates directive will accomplish the same result as the money market directive, because it's highly unlikely that in ten days we will have such wide swings in people's perceptions as to produce any difference.

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

MR. MAYO. I prefer the 6-1/2 to 7 percent [fed funds range], although I agree with Paul and others that the likelihood of going below 6-3/4 percent is very, very remote. I just have a constitutional objection to that narrow a range on fed funds. I prefer a wider range in "normal" circumstances. I like the idea of shading downward [the ranges for] both M1 and M2; 0 to 5 and 4 to 8 are fine with me--or 4 to 9 for that matter is all right. I would prefer the money market directive.

Apparently I'm playing a little game with the staff on the phrasing of the directive: Two months in a row and again this time I've suggested, and the Committee has bought, the idea of stating the directive in terms of a weekly average federal funds rate of about "the current level." Each time, the next month the Bluebook comes along and crosses out "the current level" and substitutes "___ percent." I still think it's a good idea, when we have the opportunity, to state it in terms of the current level rather than the precision of a digit. That's a terribly subtle thing, but I think it may serve us well if we lose the Merrill case, for instance.

CHAIRMAN BURNS. I would go along with Mr. Mayo. Yes, I think Mr. Mayo's right. Any objections to that?

MR. PARTEE. Mr. Broida wants to [comment].

CHAIRMAN BURNS. Yes, please.

MR. BROIDA. President Mayo, it is not the staff's intention to suggest to the Committee that it not use the phrase "the current level." If you look at the second form of the directive, it shows the proposed changes from last time in terms of strike-throughs and caps.

CHAIRMAN BURNS. Well, if you agree with Mr. Mayo, that is sufficient.

MR. BROIDA. Mr. Mayo seems to have the notion that the staff is trying to push the Committee--

CHAIRMAN BURNS. No, no, no. There's no such thing.

MR. MAYO. I'm amused, not annoyed.

CHAIRMAN BURNS. We'll move on.

MR. PARTEE. I might note, Mr. Chairman, that page 1 shows that over the last six weeks the Manager has deviated from plus 5 basis points to minus 3 basis points from a 6.75 percent average, so I think it's safe enough to say about the current level.

MR. MAYO. I guess I'm making the same point in a different way that Frank just made about prevailing [money market conditions] but in a 1978 environment instead of a 1968 one. Terribly minor, but I think it might have some significance.

MR. BAUGHMAN. That used to be cast more often in terms of net borrowed reserves instead of the federal funds rate.

MR. MAYO. That's all right.

CHAIRMAN BURNS. Thank you, Mr. Mayo and Mr. Baughman. We move to Mr. Roos.

MR. ROOS. Mr. Chairman, I am impressed with the logic of Governor Wallich's point of view and would like to be recorded as subscribing to his proposal. But I certainly am also impressed with the short time frame and would support and vote for alternative B. I would, Mr. Chairman, if I might, take the opportunity to address one remark to my good friend, Chuck Partee. For so long a time now, I've had to adjust to finding my aggregates objectives bloodied and buffeted, and now the threat of having my aggregates totally amputated is a bit of a shock.

MR. PARTEE. I can't believe that myself.

MR. [ROOS]. Well, what concerns me is the setting of a precedent. I fear that if [Chuck's] proposal had gone [through], next time there wouldn't be any aggregates here.

CHAIRMAN BURNS. Well, the aggregates are fully alive and we move on. Mr. Balles now, please.

MR. BALLES. Mr. Chairman, I can't help observing that occasional backsliding is perhaps understandable, but to backslide ten years is a little far back to go.

CHAIRMAN BURNS. Well, that's what bothers me. If you just went back 8 years--!

MR. [BALLES]. Governor Partee is playing out one scenario in which you may get a very low growth in M1 in March if the coal strike isn't settled. But I'd point out another possible scenario. As I look at page 4 of the Bluebook and see the way money growth--whether it's nonborrowed reserves, total reserves, or the monetary base--has been accelerating, I can't help but feel, Steve, that sooner or later that's going to catch up with us. Therefore, I share the view of some others, including Governor Coldwell and I've forgotten who else, who said they felt there was a good chance of March M1 coming in at higher than the projected 7 percent. It's going to be quite interesting to see, when we get to next month's meeting, how those figures have been revised. But, having said that, I still think there's a great deal of logic in holding steady as we are, and for reasons that have been set forth in detail, I would go with alternative B for this 3-week period with a money market directive.

CHAIRMAN BURNS. Would anyone else like to speak?

MR. WINN. Mr. Chairman, I have no quarrel with alternative B. I'd just like to see something in the release indicating the coal strike as one of the economic uncertainties that we face. We have only the weather [mentioned] as a cause of our problems. And second, is there any change in the status of the Merrill suit?

CHAIRMAN BURNS. On the Merrill suit, the Solicitor General will be recommending to the Supreme Court that the Supreme Court take on the case. That is a favorable development. Now, we're trying to move the two Banking Committees to give us legislative relief, on the assumption that down the road the Supreme Court will either be unwilling to take on the case or, if it does, may move against us and uphold the lower courts. The bill has been introduced in the Senate. I had talked to Mr. Reuss before in a meeting, telephoned him the other day, and sent him a letter yesterday urging him to introduce the bill without committing himself to it. Whether he will or not, I don't know. If he doesn't, we will get another Congressman to do it. It would be best, however, if the chairman of the committee introduced the bill without necessarily committing himself to it.

Well, gentlemen, I think that we've had a good deal of discussion, a good deal of banter, and some differences; the differences are really very minor. A very clear majority of the Committee favors alternative B. There was some uncertainty, however, in my own mind as to the directive. I think we'll need a show of hands on that. Those who are in favor of a monetary aggregate directive, kindly indicate.

VICE CHAIRMAN VOLCKER. [It depends on the] ranges.

MR. BLACK. Yes, it does.

MR. MAYO. It depends on the ranges.

CHAIRMAN BURNS. Let's say that the range is 6-1/2 to 7.

MR. MAYO/MR. GUFFEY. On the M1 range?

CHAIRMAN BURNS. I'm sorry. The M1 range that a majority favors is 1 to 6 percent as in alternative B. Let's make that assumption. Of course, we could proceed another way but I think that's the most reasonable assumption to make. The differences are not large, you know. The 0 to 6 is a difference on the midpoint of 1/2 percent; 0 to 5, yes, is a larger difference, but a majority clearly favors 1 to 6. Assuming a range of 1 to 6, would the Committee favor a monetary aggregate directive?

MR. BROIDA. Five. There are ten [voting members] today.

CHAIRMAN BURNS. That means I have no way of helping the Committee.

VICE CHAIRMAN VOLCKER. My interpretation of a money market directive in the context in which people have been talking is that people really are very reluctant to see [the funds rate] decline below 6-3/4 percent.

MR. PARTEE. Yes.

VICE CHAIRMAN VOLCKER. That seems to me the substance of the thing. Is that correct?

MR. PARTEE. Or go above 7.

VICE CHAIRMAN VOLCKER. I agree with that side, too.

CHAIRMAN BURNS. Well, actually, I would sum up the thinking of the Committee a little differently. If we had a range for the federal funds rate that is lower than 1/2 percentage point [in width], it wouldn't be 6-3/4 to 7, it would be something like 6-5/8 to 6-7/8. I think that's the thinking of the Committee at this time. A range of 6-3/4 to 7, despite the eloquence with which the case was first presented by Mr. Volcker and despite the enthusiasm with which it was endorsed by Mr. Partee, did not win any more adherents--not because the case was put poorly, but because this Committee is stiff-necked and did not want to move in that direction.

How do we resolve this question of the directive language? I'm not [feeling] very Solomonic today. Let me try again. This time my question is: Will the members of the Committee who favor a money market directive kindly indicate their preference by raising their hands.

MR. BROIDA. Four, Mr. Chairman.

CHAIRMAN BURNS. Now this time I'm going to proceed a little differently. How many who prefer a monetary aggregates directive would still not feel comfortable with a money market directive, whether or not you prefer it? Let's have a show of hands.

MR. BAUGHMAN(?). Whether we will lose sleep, Mr. Chairman?

MR. BROIDA. Seven.

CHAIRMAN BURNS. In fairness, I think I now have to ask the question: How many members of the Committee, whether or not you prefer a monetary aggregates directive, would feel reasonably comfortable with it?

VICE CHAIRMAN VOLCKER. With the other specifications?

CHAIRMAN BURNS. With the other specifications.

MR. BROIDA. Four.

MR. GUFFEY. I don't think I understand the vote, do you?

SPEAKER(?). I didn't vote.

MR. MAYO. I didn't either.

MR. GUFFEY. I would like to suggest that a 0 to 5 percent [M1 range] with a money market conditions directive would be very acceptable and perhaps equal in my mind to 1 to 6 percent with an aggregates directive.

MR. MAYO(?). I feel the same way.

MR. BLACK. That's a good statement, except I think your figure is a little too high. But it's good thinking.

MR. GUFFEY. Talking about the March growth--

CHAIRMAN BURNS. Well, maybe I should have been less fair. Maybe I should have stopped when I asked how many, whether or not you prefer a money market directive, could be reasonably comfortable for a three-week period with it. Perhaps I should have stopped there. Let me pursue this. Mr. Guffey didn't understand the question. Let me stay on this track of fairness, though not indefinitely. How many of you would feel reasonably comfortable with a monetary aggregates directive over a period of the next three weeks, whether or not you prefer a monetary aggregates directive?

VICE CHAIRMAN VOLCKER. Money market directive?

MR. MAYO. Aggregates, he said.

MR. GUFFEY. With 1 to 6?

CHAIRMAN BURNS. With a 1 to 6 percent [M1] range.

MR. BROIDA. Six.

CHAIRMAN BURNS. Now, we have the narrowest margin on the most subtle point in favor of money market directive--not in favor of but willing to live with it for only a three-week period. Unless there is a desire for further discussion-- Yes, there is such a desire.

MR. MAYO. Mr. Chairman, would it be fair for you to ask for a show of hands of those who prefer a money market directive with a 1 to 5 or 0 to 5 percent range as against those who prefer a monetary aggregates directive with the 1 to 6 range?

CHAIRMAN BURNS. The 0 to 5 range with a money market directive as against 1 to 6 with an aggregates directive?

MR. MAYO. Yes.

CHAIRMAN BURNS. All right. Those who prefer the former would kindly indicate that.

VICE CHAIRMAN VOLCKER. A 0 to 5 range with a money market directive?

CHAIRMAN BURNS. Three.

MR. MAYO(?). I'll resign!

MR. GUFFEY. So it's 1 to 6 with an aggregates directive. That's the alternative.

CHAIRMAN BURNS. No, don't resign. Apart from missing your cheerful countenance, we might be short of a quorum. I'd be a little worried about that.

MR. MAYO(?). Sorry about that.

CHAIRMAN BURNS. Gentlemen, I think we're ready for a vote. The vote is on a growth range for M1 of 1 to 6 percent; a range for M2 of 4-1/2 to 8-1/2 percent; a federal funds range of 6-1/2 to 7 percent; and a money market directive. Before we do that, on line 12 of the draft of the domestic policy directive, Mr. Broida suggests that we state 1-1/2 instead of 1 percent. I assume that has been checked out by the staff and I assume that it's [accurate]. Mr. Jackson?

MR. JACKSON. In our directive, we advise the Desk to take into consideration emerging money market conditions including the "unsettled" conditions in foreign exchange markets. While I would be the first to agree that they had been unsettled, by continuing to use that word are we in turn continuing to remind the world just how unsettled they are? Would we be wise to eliminate that word and just say "including the conditions in foreign exchange markets"?

CHAIRMAN BURNS. I would eliminate the word ["unsettled" and say] "including conditions in foreign exchange markets."

MR. JACKSON. That strikes me as more prudent.

CHAIRMAN BURNS. I think so. Any objection to dropping the word "unsettled"? I think it's better form. Thank you. Are we ready for the vote now? Would you call the roll?

MR. BROIDA.

Chairman Burns	Yes
Vice Chairman Volcker	Yes
Governor Coldwell	Yes
President Guffey	Yes
Governor Jackson	Yes
President Mayo	Yes
President Morris	Yes
Governor Partee	Yes
President Roos	Yes
Governor Wallich	Yes

Unanimous.

CHAIRMAN BURNS. Well, I want to thank all of you for a very interesting meeting. I didn't want to say this but I can say it now. If there ever was a time for this Committee to be unanimous, it was today.

Now, I got a note before--this came in about twenty minutes ago and I haven't had one subsequently--which reads as follows: As of this moment the Senate Banking Committee is now voting on waiving the 24-hour rule and will vote now on Miller. That means that Mr. Miller may be confirmed or perhaps is even likely to be confirmed by the committee today. If so, I think that would be good news for the System. I think we'll have more information at lunchtime. We are going to take luncheon together. Or for those of you who are [available], I thought we could have luncheon together. Those of you who have made appointments, of course, feel free to keep them. I have no specific agenda, but a room is reserved. What room is it?

MR. BROIDA. Dining room F, which has space for 20.

CHAIRMAN BURNS. Well, there are how many members?

SPEAKER(?). A total of 17 Board members and Reserve Bank Presidents.

CHAIRMAN BURNS. Well, if all of the Board members and Presidents come, we have room for our Secretary and for Mr. Axilrod. That makes 19 and I shall think about the 20th one.

MR. WINN. Mr. Chairman, how is Governor Gardner?

CHAIRMAN BURNS. I don't know, but he's been in the hospital since a week ago this Friday. He is continuing to undergo tests, which leaves us with a great deal of hope, but all of which does suggest that there are problems that require further explanation and may be serious. I hope not.

END OF MEETING