

Meeting of the Federal Open Market Committee

March 31, 1981

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, March 31, 1981 at 9:00 a.m.

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

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

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

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

Messrs. Burns, Danforth, R. Davis, Ettin, Keir, Mullineaux, Prell, Scheld, Truman, and Zeisel, Associate Economists

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

Mr. Coyne, Assistant to the Board of Governors  
Mr. Siegman, Associate Director, Division of International Finance, Board of Governors  
Mr. Smith <sup>1/</sup>, Assistant Director, Division of International Finance, Board of Governors

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<sup>1/</sup> Entered the meeting prior to the action to amend the Authorization for Foreign Currency Operations and left following the action to reaffirm the agreement to "warehouse" foreign currencies.

CHAIRMAN VOLCKER. A low; it was a high in the numerical sense, a low in reality. That was what--three or four weeks ago now, I suppose?

MS. GREENE. Just before the Bundesbank's move, yes.

CHAIRMAN VOLCKER. Since then, it has come off that very low valley. The market has continued erratic, but I don't think there's any great judgment that there was much to be done about it. The tendency was not cumulative in one direction or another. At the same time, we've entered into some discussions with the Treasury as to what their views might be on intervention. They're going to start out, as all new [Administrations] do anyway, by not being very--let me put it the other way around--by being quite cautious on whether intervention is useful or not. It remains to be seen. I don't think there's any big question here that a variety of influences have suggested that intervention under the current circumstances is not serving a terribly useful purpose. And there hasn't been any intervention except for yesterday, for what--three weeks or so?

MS. GREENE. That's right.

CHAIRMAN VOLCKER. The markets have been quite erratic on a day-to-day basis, but have shown no particular trend movement in one direction or another after coming off the valley or the peak, whichever way one puts it. I myself don't see any particular need for any systematic intervention, in the near future in any event. We'll see what happens in the market, but it has been rather trendless and featureless as I see it, though not featureless in the sense that there is quite a lot of short-term volatility. But that's the nature of the beast at the moment.

MS. TEETERS. But you would still expect [the Desk] to intervene on disorderly markets?

CHAIRMAN VOLCKER. What is a disorderly market? That is always the question.

MS. TEETERS. I realize that.

CHAIRMAN VOLCKER. No, this is not a--

MR. PARTEE. [Unintelligible] market.

CHAIRMAN VOLCKER. As with any new Administration, in terms of their own views, they are going to have to test their way in specific circumstances. We had a circumstance yesterday which was obviously of a highly exceptional character. But just forgetting about that aspect--though that's an important aspect--I myself do not see intervention as serving any particular purpose at the moment. And we haven't done any, so we haven't got a test of it. By some measures, I guess the market has been disorderly. By measures that we would have considered appropriate ten years ago, certainly, it has been disorderly. I think there's a question whether it is disorderly in the present context of things. That there is some inherent volatility here is, unfortunately, a fact of life. I'm not sure how it will settle down most easily, frankly--with an official presence or without.

VICE CHAIRMAN SOLOMON. I don't have, possibly, a full historical understanding of the policy [that was in effect] before I was at the Treasury. During the time I was there, it was understood that the Desk had flexibility [to intervene] in relatively modest amounts to counter disorderly markets, using its own judgment, and keeping both the Treasury and, of course, the Chairman informed. And it was understood that on larger interventions there would be authorization. I don't know whether we're moving in a direction now where, even on modest efforts to counter disorderly markets, there has to be specific authorization from both the Treasury and the Chairman, even in regard just to the use of Federal Reserve resources as distinct from the joint use of Federal Reserve and Treasury resources. I don't know what the situation was prior to my joining the Treasury. Was it that clean-cut that there had to be specific authorization?

CHAIRMAN VOLCKER. I think we've gone through every possible variant and permutation and combination of this through the years. Sometimes there has been [no intervention] and [that policy] was maintained for a considerable period of time. Sometimes there has been intervention with rather specific authorization each time and sometimes there has been a more flexible view. We will try to work this out a little over the next month or two in terms of consistency with the Treasury's views. There is no definitive answer to that question at the moment, so far as they're concerned. But as a practical matter, I don't see any urgent requirements at the moment. Now, that can always change on a day-by-day basis, and that is what will give us the grist for practical judgments in working this out.

VICE CHAIRMAN SOLOMON. Have there been periods of time, Paul, when there has been modest intervention to counter disorderly markets just using Federal Reserve resources?

CHAIRMAN VOLCKER. Oh, yes.

MR. TRUMAN. Generally in the past--

CHAIRMAN VOLCKER. I said "yes" hastily; I'm sure there have been.

MR. TRUMAN. Yes. Generally in the past, until after the early 1970s, the Treasury didn't have substantial balances of its own. So, most of the intervention was for the Federal Reserve account exclusively, both in terms of building up very tiny balances and in terms of all drawings on the swap lines.

CHAIRMAN VOLCKER. I think one can find every combination in past history in terms of what has been done. But it has been exceptional to have the Treasury participate to the extent it has participated in the last four years or so. Nevertheless, the question has been a repeated one going back to the earliest days of floating [rates], when I participated from the other side [at the Treasury]. Should intervention be joint, separate, or should the Treasury do it in the first instance or should we do it in the first instance?

MR. BALLE. You started all this!

CHAIRMAN VOLCKER. John Balles raised this question of a study. Let me suggest a procedure, if it's satisfactory. I'm not

sure whether you all are aware that some of these things were touched upon in a System study, the results of which were sent out a few months ago. Why don't you just say a word or two about that, Mr. Truman? Describe the nature of that study and its limitations for this purpose.

MR. TRUMAN. Well, the study was actually done in connection with the special System objectives for the calendar year 1979. [The intent] was to encourage economists within the System to look again at the floating exchange rate regime and how it had been functioning. Although there was some talk of encouraging staffs at the various Banks and the Board to identify a broad range of issues, there wasn't an attempt, as is often true in such a case, to arrive at a single conclusion. The result was that a large numbers of papers--I think numbering in the 40s--were prepared by various people, and they were summarized in the paper that was circulated to you earlier this year. One important section of that paper, in this context, had to do with the question of exchange rate determination. I would argue from an economic point of view that one has to resolve that issue in one's mind before one resolves questions about the effectiveness of intervention. I think it's fair to say, based on the paper--and in fact the concluding section says this--that the jury is still out in the sense that it is not entirely clear in purely economic terms what the effectiveness of intervention would be. You will find, though, among economists within the System, that both views are supported. And there are lengthy articulations of what assumptions they make about the substitutability of assets denominated in different currencies. The paper was put together by Jeff Shafer and Joanna Gray and Mike Keran and was in a form a little different than often is done; it was issued subsequently as a discussion paper by the Board staff. But it might be instructive. In fact, one of the reasons why we put together the paper was that it did present a reasonable review or survey on these topics without trying to come to a detailed conclusion.

CHAIRMAN VOLCKER. It is extremely difficult to identify any peculiar results from intervention per se economically. Intervention serves a number of purposes, some of which are inherently immeasurable, such as cooperating with a foreign central bank and maintaining some spirit of harmony in markets, and some of which more directly affect markets, such as a psychological objective as to the intentions of the government in combination with or apart from other elements of an economic program. Against that background, what I would suggest is that you take a look at that work, which has already been done. And we can consider next time, having looked at that and refreshed our minds about what has been done, whether we can identify more precisely what additional work, if any, might be desirable. If that's acceptable, we'll have a little discussion of it at the next meeting in that context. It may be that there are things to be looked at and we should have a go at it again; or we may conclude that there isn't much more to be done. But those studies are not fresh in my mind, to say the least. In fact, I would say I have not read them and some of the rest of you may be in that same position.

We have to ratify the transactions, if we're finished with this topic. Do we have a motion?

MR. PARTEE. So move.

MR. BOEHNE. Second.

CHAIRMAN VOLCKER. Without objection. Do you have any recommendations, Ms. Greene?

MS. GREENE. [Recommendation--see Appendix.]

CHAIRMAN VOLCKER. What was that concluding comment? I am afraid my attention wandered.

MS. GREENE. It was that we do not yet know whether the Riksbank will request us to renew the increase [in their swap line that was enacted last year]. In the event that they do, we probably will hear about it before the next FOMC meeting and we would like to be able at that time to recommend by wire that the renewal be approved.

CHAIRMAN VOLCKER. Well, we can take an action, if we want to. We can't wait until our next meeting, which comes [after] the expiration of the [increase in the] line. I don't know that this is a big issue; but I can just as easily wait and see whether they request a renewal.

MS. GREENE. We thought they might wish to talk about it at the time they repay. That is the reason we brought it up at this time.

MS. TEETERS. When are they scheduled to repay?

MS. GREENE. The 23rd of April.

MR. WALLICH. If we renew, does this mean that the implicit takeout from some further Euro-borrowing is pushed farther away in time?

MS. GREENE. I fully expect that they will repay the drawing. The question is, if there's an increase in the arrangement, whether that should also be renewed. The reason for bringing it up now, although they are two separate items, is that when we're talking to them about the repayment, we expect that they will ask for an initial reaction as to whether or not they could renew the increase in the line as well.

CHAIRMAN VOLCKER. I would think we could defer action on this, but if there's any expression of opinion that would be helpful in guiding conversations with the Riksbank, we might have such an expression of opinion at this time.

VICE CHAIRMAN SOLOMON. Well, Mr. Chairman, everything considered, I think it would be appropriate for us to agree to [extending] the increase if they request it. They are a responsible central bank and I think it would be a little strange--we'd have to have a good reason and I can't think of what reason we would offer--to refuse such a modest increase.

CHAIRMAN VOLCKER. The total amount of the line is what now?

VICE CHAIRMAN SOLOMON. \$300 million; the temporary increase is \$200 million.

CHAIRMAN VOLCKER. It's \$300 million, so it goes up to \$500 million. As I remember, when that line was increased last year there were some pretty clear understandings that it would be used--

VICE CHAIRMAN SOLOMON. As bridge money.

CHAIRMAN VOLCKER. --as bridge money to a financing, which in effect is what they did, or perhaps for other contingencies of that sort. But the obvious [purpose] was as a bridge financing to a market financing or to an IMF drawing, which was in the picture recurrently with respect to Sweden. Is that still in the picture, or do they feel so confident now that they're not thinking of IMF drawings?

MS. GREENE. I think that's something, if we are cooperative with them, that we could remind them about, if the situation so required.

MR. TRUMAN. Mr. Chairman, before the actions in January, there were some suggestions--

CHAIRMAN VOLCKER. Well, it strikes me that there are a number of reasons why, in fact, we should not make a decision right now. We can have some discussion and see what the attitude is toward these things. Assuming the attitude is favorable--and my inclination would be like Mr. Solomon's that we have the probability of a renewal [request] here--we don't have to take the formal action. We have to see the way they will present it. And we can take the action at the next meeting if it seems appropriate then, assuming they do request it. Any objection to that?

SPEAKER(?). No.

CHAIRMAN VOLCKER. If not, of course, we will conduct ourselves accordingly. Since we're on the subject of the foreign issues, we might as well jump to the amendments to the authorization for foreign currency operations and the renewal of the directives, which are standard material. The only [proposed] change involves what is essentially a cleaning up of the language in the authorization for foreign currency operations. Do you want to describe that, Mr. Truman?

MR. TRUMAN. Well, part of the changes are just a cleaning up. The one issue that the Committee might want to discuss is the question you have asked the staff to address of whether we should now incorporate the informal limits on System [foreign currency] balances into the formal instruments. We looked at the question and we suggested a way in which that could be done, but we also suggested that, on balance, we didn't think it was a good idea. Therefore, we recommended that any formal limit with respect to the System's overall open position be the limit that now exists. And in that connection, we suggested as a technical adjustment that the two numbers that now

appear in the authorization--one number is a footnote and one number is in the text, with the one [in the footnote] being eight times the size of the other--be combined to one number in the text and that the footnote be dropped. Assuming the Committee accepts the proposition that the informal limits be retained, we suggested that we might be able to simplify the presentation of those informal limits so that there's one overall number with three subnumbers rather than the--

CHAIRMAN VOLCKER. I'm a bit lost. What specifically, are you proposing? It's on what page of what memorandum?

MR. TRUMAN. The memorandum from the Secretary is dated March 24th. The first recommendation, on the first page, is that the formal limit on the overall open position be encompassed in the limit [noted in the text]. The second recommendation, on page 2, is that the number be moved from the footnote to the text. Those are the substantive recommendations.

CHAIRMAN VOLCKER. We now have an \$8 billion limit on our open position.

MR. PARTEE. In a footnote.

MR. TRUMAN. But it's in a footnote, and the number in the text is \$1 billion.

CHAIRMAN VOLCKER. Your recommendation is to move the \$8 billion from the footnote to the text?

MR. TRUMAN. That's earth-shaking, I know!

MR. GUFFEY. And change the \$8 billion to \$5 billion.

MR. AXILROD. We also suggest the possibility of changing the \$8 billion to \$5 billion.

MR. GUFFEY. Right. That's in the text.

MR. AXILROD. It would give the Committee more flexibility in decisionmaking.

MR. PARTEE. What is the open position now?

MR. TRUMAN. It's \$3.2 billion as I remember.

CHAIRMAN VOLCKER. Let me just make sure I am clear on this. The substantive proposal is nothing more than moving an \$8 billion limit, which is now in a footnote, to the text.

MR. TRUMAN. Right. But the substantive proposal with respect to your charge to the staff was not to incorporate the informal limits into the formal documents. That may require a positive decision, too, or a negative decision.

MR. AXILROD. Mr. Chairman, the total position, which is in the document in the footnote, is \$8 billion. That in some sense governs the total open position, and we would put that up in the text.

The informal limits on the individual currencies we would not put in the directive.

CHAIRMAN VOLCKER. But you rewrote them slightly, didn't you?

MR. TRUMAN. Yes.

CHAIRMAN VOLCKER. Where do the informal limits appear?

MR. TRUMAN. They don't appear anywhere; that's the issue that we addressed. They appear in the notes or the records of the Desk [and the Secretariat], which I think is the proper way to do it, after having listened to the informed discussion of the Committee.

CHAIRMAN VOLCKER. Well, how were they appearing in the notes that is different from the way they now appear?

MR. TRUMAN. That is listed on page 3 of the memorandum. We would suggest that the informal limit, as the Desk has it, be set at \$4-1/4 billion, with sublimits of up to \$2-3/4 billion in marks, \$1 billion in yen, and \$1/2 billion in all other currencies. That would just mean that subsequently, if the Committee in its discussion said that it wanted to raise those informal limits, any time it raised one of the three components that would automatically raise the total. It would save some time; it's a somewhat simplified procedure.

MR. WALLICH. Items 1-A and 1-B are the alternatives; we can do B while also doing A.

MR. TRUMAN. Yes, they are part of the basic recommendation.

MR. WALLICH. But 1-C would be a different procedure?

MR. TRUMAN. It is an alternative, which we do not recommend.

CHAIRMAN VOLCKER. All right, I guess I understand this. Let me repeat it. We have two proposals, basically. One is to move the \$8 billion from a footnote to the formal text. Is this in the directive?

MR. TRUMAN. The authorization.

CHAIRMAN VOLCKER. Authorization. The other is not to put an individual currency limit in the formal authorization. We are now confirming an informal understanding, stated a somewhat different way, that says the total limit on the balances is \$4-1/4 billion, the same as the present limitation, of which the limits are \$2750 million in marks, \$1 billion in yen, and \$500 million in all other currencies. That is the same as we have now, expressed a little more felicitously.

MR. TRUMAN. Right.

VICE CHAIRMAN SOLOMON. What gets published: the \$8 billion?

CHAIRMAN VOLCKER. The \$8 billion is the only thing that is published.

MR. TRUMAN. That is the number that is now published. Both the \$1 billion in the text and the \$8 billion in the footnote are now published. So, nothing is changed.

CHAIRMAN VOLCKER. The way it is now, the authorization is for \$1 billion and then there is a footnote that says, in effect, except the Committee decided on \$8 billion. So the \$8 billion is moved up to replace the \$1 billion. Let's just focus on that one for a moment. Is that acceptable?

MS. TEETERS. Is the \$8 billion regardless of signs?

CHAIRMAN VOLCKER. That's right.

MS. TEETERS. And the \$4-1/4 billion is a plus.

CHAIRMAN VOLCKER. The \$8 billion would mean that if we were long \$4 billion in one currency and short \$4 billion in another, the net is not zero but \$8 billion. It covers our overall exposure. Is that acceptable?

MR. GUFFEY. There is another part of the recommendation, and that is that rather than put \$8 billion in the text, we would put \$5 billion; it retains the language that's now in the text with respect to the Committee's authorization.

CHAIRMAN VOLCKER. We can put any number in there we want to. We got to \$8 billion during the '78 operation, I guess.

MR. TRUMAN. It was raised, I think, by \$2 or \$3 billion in December of 1978 and that limit has been there ever since. We never got there, but we came close.

MR. GUFFEY. Well, to go at it another way, if I understand the recommendation, it would be to go to \$8 billion in the text and delete the language that would permit the Committee to increase it.

MR. TRUMAN. No.

MR. AXILROD. We didn't assume the Committee needed permission.

MR. TRUMAN. The reason for the proposal that that language be deleted is that when this document was last thoroughly overhauled, there was an express authorization with respect to the old Swiss franc debt. And the express authorization said to treat that debt, which was part of the open position, outside of the \$1 billion limit. That was the reason for the language that we now suggest be deleted. It's not that we're trying to reduce your flexibility.

CHAIRMAN VOLCKER. I'm not sure how that language got in there, but it seems clear that the Committee can always change this to put in whatever number it wants to put in, either larger or smaller.

VICE CHAIRMAN SOLOMON. Mr. Chairman, it's a good suggestion. It's strictly procedural. [But] I think it would be a mistake to change the number; the markets might read something into that if we were to change the number. I see no reason at this point,

particularly with all the discussion in the markets about a policy shift in the Treasury in regard to intervention, for us to feed that.

CHAIRMAN VOLCKER. Well, we can make the substantive decision, but I think we have to have a reason for making it. If we want to reduce it, we can reduce it. But if there is a strong feeling about not suggesting a policy change here, or explaining what we are doing, the straightforward thing is just to do the \$8 billion.

MR. PARTEE. But certainly we need to have some reason. I don't know why we have \$8 billion, but I don't know why we would change it to \$5 billion.

CHAIRMAN VOLCKER. Well, I think we had \$8 billion because that was the guess of what might have been necessary at the time of the '78 operation.

MR. PARTEE. I think it was a building up of several things.

MR. TRUMAN. Well, in December of '78, [our open position] went up to \$5-1/2 billion at the end of year.

CHAIRMAN VOLCKER. We had increased swap lines at that point and so forth.

MR. TRUMAN. I think it had previously been \$5 billion and it was raised by enough so that, during that environment, the Committee wouldn't have to adjust it every three weeks.

MR. PARTEE. So it is whatever is needed to keep from impeding any operations we'd like to undertake. It's a great limit.

VICE CHAIRMAN SOLOMON. The more meaningful limits are the informal limits.

CHAIRMAN VOLCKER. Is \$8 billion acceptable?

SPEAKER(?). Yes.

CHAIRMAN VOLCKER. Without objection, we will have \$8 billion. Now, this other issue, if I understand it correctly, is the way it is recorded in the notes. Again, there's no substantive difference. It would be recorded in the notes slightly differently, in a simpler way, which is what gave rise to the discussion. There is a straightforward limitation on how much in total we can have and how much of that total can be in marks, how much in yen, how much in everything else. And it's exactly where we are now in substance.

MR. CORRIGAN. Is it exactly where we are now? I thought that under the way we operate now, if we changed one component, we didn't necessarily change the total. Whereas this contemplates that if you went to--

MR. TRUMAN. Well, in effect, yes, we've been doing it that way. That was the source of the confusion during the discussion in December, though, and that's why we suggested that we change it this way. The only thing that has been changed recently has been the mark total. But since we had an overall limit, every time \$1/2 billion or

\$1 billion was added to the mark total we had to push everything else up, especially since we were holding, and still are holding, about \$250 million worth of all the other currencies.

MR. CORRIGAN. But the presumption here would be that there's an automatic dollar-for-dollar lifting in the total.

MR. WALLICH. Well, these currencies aren't substitutes necessarily. So, if there's a reason for raising one, that's no reason to reduce another if that were to be the consequence of having a ceiling.

MR. AXILROD. But it's conceivable, if the Committee wished, that it could reduce the yen limit and raise the [mark or the other currencies limit]. It's not impossible to substitute among those things.

MR. TRUMAN. Right, but it would be separately--

MR. CORRIGAN. But then the understanding would be, barring an express decision that way--

CHAIRMAN VOLCKER. How much do we have now?

MR. TRUMAN. As Gretchen said, in marks we have \$2566 million, or almost \$2.6 billion. We have \$399 million of yen, and \$260 million of everything else.

CHAIRMAN VOLCKER. So, if we approve this, it implies a leeway of approximately \$200 million in marks, \$600 million in yen, and \$240 million in everything else.

MR. SCHULTZ. I thought we had more Swiss francs than that.

MR. TRUMAN. No, it's \$257 million or something like that of Swiss francs and the rest of it is--

MR. SCHULTZ. Where did I get the idea that we had more than that because we have a Carter bond?

MR. TRUMAN. We, the United States, do; we, the System, do not.

CHAIRMAN VOLCKER. That's the Treasury.

MR. SCHULTZ. Oh, I see; we've already sent it over. We bought it for them. The total position we have in Swiss francs is a little over \$1 billion, is that right?

MR. TRUMAN. The United States has \$1.3 billion. It's \$1.4 billion, using the historical rates, of which we have \$250 million.

MR. SCHULTZ. Okay.

CHAIRMAN VOLCKER. The substance of what we're saying here is that these numbers are not changed from what we now have, but there isn't much room for increasing mark balances and there isn't much room

for increasing other balances. There is a fair amount of room for increasing yen balances, but we have no intention of doing so.

MR. BLACK. But we're going to say that a lot better than we were saying it.

CHAIRMAN VOLCKER. It says it more straightforwardly. That's right. But there isn't a lot of room here, actually, in these current informal limits for increasing [our holdings of] anything.

MR. TRUMAN. Actually, my figures are absent the \$74.4 million we sold yesterday. My figures don't include that.

CHAIRMAN VOLCKER. So, we have a little more room for increasing marks, having sold some yesterday. Is that acceptable?

MR. PARTEE. Sounds fine.

CHAIRMAN VOLCKER. Was there anything else? [Next] we have paragraph 3 and paragraph 5. This is an attempt to have more straightforward wording again, isn't it?

MR. TRUMAN. Right, in paragraph 3. Paragraph 5 deals with the fact that we now have a broader range of things that we invest in. Paragraph 6 reflects the fact that we no longer send out a daily call to the members of the Subcommittee. To reduce paperwork some time ago we combined that with the 2:30 call that goes to all members of the Committee along with the Manager's regular reports.

CHAIRMAN VOLCKER. I don't think any of these changes is substantive. One purpose of the change in paragraph 5, at least in part, is that we now have authority to invest in foreign government securities and, in effect, we are limiting that and making clear that these [investments] are to be in liquid form. Are these all acceptable?

MS. TEETERS. Wasn't there some question as to whether we were going to put the informal limits directly in the directive?

CHAIRMAN VOLCKER. Well, I assume that we made the decision not to, in accepting the other alternative and these language changes. Hearing no dissent, I guess we need a motion. This is the formal [authorization], isn't it?

SPEAKER(?). Yes. So moved.

MS. TEETERS. Seconded.

CHAIRMAN VOLCKER. Without objection, we will adopt those. One other issue in this area is warehousing. Mr. Truman, are you going to comment on warehousing?

MR. TRUMAN. We have had this agreement, the current one, formally since January 1977. The limit on warehousing foreign currencies for the Treasury and the Exchange Stabilization Fund is now \$5 billion. The total that is now in use under that arrangement is a little over \$4 billion. The Treasury would just as soon renew the authority. They may well be using some of those balances over the

course of the next year to repay some of the Carter notes that come due over the period.

CHAIRMAN VOLCKER. You are recommending no change here?

MR. TRUMAN. No change.

CHAIRMAN VOLCKER. This [issue] comes up every year as to whether we want to continue it. There's no change [proposed]. It is being used to the extent of over \$4 billion against the \$5 billion authorization. Do we have a motion on this one?

SPEAKER(?). You have a motion.

CHAIRMAN VOLCKER. Without dissent, we will approve the renewal of the warehousing [agreement]. Mr. Altmann tells me we have to approve one other thing here.

MR. ALTMANN. We need approval of the foreign currency directive and the procedural instructions with respect to foreign currency operations in which no changes have been proposed.

CHAIRMAN VOLCKER. These are the basic authority for the foreign currency operations. There are no changes. They are just reviewed every year and accepted or not accepted. Obviously, changes can be proposed, but there are no changes being proposed by the staff. This is the basic [directive] for foreign currency operations and the accompanying procedural [instructions]. They have been in effect [in their present form] for three or four years.

MR. WALLICH. It is noteworthy that any change in intervention policy can be accommodated within this document, no matter what we do.

VICE CHAIRMAN SOLOMON. That's very appropriate.

CHAIRMAN VOLCKER. Without objection, we will renew the foreign currency directive and the procedural instructions. That concludes all the foreign-related matters. We did ratify the transactions, did we not? I think we are finished with the foreign side. We will go now to Mr. Sternlight.

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

CHAIRMAN VOLCKER. Comments? Governor Partee.

MR. PARTEE. Peter, going back to your comments on the path for nonborrowed reserves: Did I understand you to say that you considered the reduction in the path that was agreed to roughly at the time of that telephone conference call to be a temporary reduction and that in the most recent 4-week period you are back to the previous path?

MR. STERNLIGHT. That is correct, yes.

MR. PARTEE. Well, I hadn't understood that that was going to happen. I can see how that would be an interpretation, but this is

the first I have heard of that--that it was a temporary reduction and then the path was restored.

CHAIRMAN VOLCKER. I'm not sure that's quite right.

MR. PARTEE. Well, that's why I asked the question. Peter seems to think so.

CHAIRMAN VOLCKER. We set the path.

MR. STERNLIGHT. That's my understanding of what was done.

MR. AXILROD. That is exactly what was done after the February 24th call. The borrowing level in the last 2 weeks of the first 4 weeks of the 8-week interval--I don't know what it was in the 3rd week, but it was very low in the 4th week--would have been zero. It was understood after that call that half the adjustment would be made to keep it at around \$1 billion. And in the next 4-week period, we reverted to the original path, which itself implied borrowing of around \$1 or \$1.1 billion at that time. I thought that was made clear at the time.

MR. PARTEE. It just shows how tricky this whole thing is; I hadn't understood it. I think we have to be very clear in terms of what the understandings are. Nothing happened adversely as a result of it, but I thought we had made a downward adjustment in the path that [would not be changed] until the Committee reconsidered the matter.

MR. AXILROD. Well, if we had made the same adjustment downward in the path that we made in that two weeks, it would have implied borrowing rising to a considerable amount.

MR. PARTEE. Well, this has explained something to me. In fact, I just asked yesterday: Why is the market acting the way it is? Well, it's acting that way because we have reverted to the [original] path. I had never understood that. I might have expected the rapid growth in money of the last month or so to have brought some tightness in the market and it hasn't brought very much. Now I know why.

MR. AXILROD. Yes, because in effect the Committee is still under its path that it adopted--

MR. PARTEE. At the last meeting?

MR. AXILROD. --at the last meeting.

MR. PARTEE. But not as amended in the telephone conference.

MR. AXILROD. Our interpretation of that amendment was that it applied to the first 4-week interval. The second 4-week interval was leading to borrowing that seemed likely to bring the federal funds rate back up to the 15 percent lower limit, so that no further adjustments were necessary one way or the other to bring to the Committee's attention.

MR. CORRIGAN. What did borrowings average in that second four weeks?

MR. AXILROD. They were a little under \$900 million, I think.

MR. STERNLIGHT. About \$900 million. This week they are running higher, and the average may move up some this week. My recollection of that would be that there was flexibility, [based on] the Committee's decision, to have made some further adjustment if it had proved necessary to keep--

MR. PARTEE. On the down side. Yes, I agree with that.

MR. STERNLIGHT. --the funds rate from tending to slide off below 15 percent; but as it was shading up, it didn't [prove necessary].

CHAIRMAN VOLCKER. I am a bit confused at this point. Maybe the way to state it is this: That I didn't realize you were back on the original nonborrowed reserve path. Well, that's right. My understanding is the same as yours, but I suppose you could say that this may be the source of the confusion. With total reserves running low, you might have raised that path and you didn't.

MR. AXILROD. Well, that's right. Total reserves have been running well below.

MR. PARTEE. That's an additional or separate conceptual adjustment.

CHAIRMAN VOLCKER. [An adjustment] was not made which might in other circumstances have been made. Maybe that's it.

VICE CHAIRMAN SOLOMON. Even though we didn't explicitly discuss a return to path in the second 4-week period, it was formulated the way Peter suggested, and Steve also, that the flexibility was for as long as necessary and that when it was no longer necessary in terms of the fed funds rate, then it just automatically made--

MR. AXILROD. Mr. Chairman, I'm sorry, but I'm quite sure that it was pointed out to the Committee at the time that one of the reasons for making the adjustment to keep borrowing at \$1 billion was that looking ahead to the next 4-week interval, it was apparent at the time of the February 24 call that, unless something weird happened, borrowing--given an adherence to the nonborrowed path--would move up.

CHAIRMAN VOLCKER. That was certainly a factor.

MR. PARTEE. But it didn't move up much. Is that right?

MR. AXILROD. Well, it moved up. I don't know what the average is going to end up being; it will be something like \$900 million or maybe a little higher.

MR. STERNLIGHT. We were looking at about \$900 million last Friday as the average borrowing in the second 4-week period.

MR. WALLICH. Essentially, we seem to have targeted on the funds rate.

MR. AXILROD. I'd say we have targeted on the nonborrowed path; we had to in the last four weeks. We adjusted the nonborrowed path for the first four weeks downward in order to keep borrowing in line with how it appeared to be evolving. That's how I would put it.

CHAIRMAN VOLCKER. Let me be clear about the funds rate. This is my interpretation, obviously. We made a decision on the 24th or whenever it was which, in my judgment, overrode the funds rate. We said: This is the way we are going to set the borrowing path. Now, there may be some fogginess, and I can't put myself back there. Once having set the borrowing path there, the federal funds rate came out where it came out regardless of where the limits were on the federal funds rate. The path was reset. The only question is: reset from what to what? It was reset, based upon some judgment of what the aggregates in total were doing combined, I'm sure, with some feeling in the mind of Committee members--and each one probably had a slightly different feeling--as to the implications for interest rates. But, once having made that decision, the federal funds rate was no longer relevant. We had our consultation when it moved below 15 percent. The result of the consultation was to set a certain nonborrowed reserve path, and the federal funds rate then fell out regardless of the 15 to 20 percent limit. And, in fact, it ran below 15 percent almost all that time. That was of no concern to me because in my mind the Committee had made a judgment that it would be overridden.

MR. WALLICH. What I meant to say is that we targeted on borrowed reserves, which is very similar to targeting on the funds rate.

CHAIRMAN VOLCKER. We always target on borrowed reserves.

MR. WALLICH. Well, that's why we always target on the funds rate.

CHAIRMAN VOLCKER. I don't think that's true. I don't agree with that at all.

MR. AXILROD. The reason borrowing dropped below the \$1 billion we thought it would be at the time of the February 24th [telephone] meeting and [the assumption of] \$1 billion we set for the next two weeks was that in the next four weeks required reserves turned out to be weaker than was thought at that time. So, borrowing dropped and the funds rate dropped. If required reserves had been what we expected at the time of the conference call, borrowing would have stayed at about \$1 billion. In the event, borrowing has come back up in the last couple of weeks.

MR. WALLICH. We start by [making a borrowing assumption] in this way; subsequently [the actual level of borrowing and thus] the funds rate [are] free to move. To make the place for that--

MR. AXILROD. I'm trying to say we're adhering to the nonborrowed path and borrowing is fluctuating.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. I'd like to address this question to Peter or to Steve. As one whose brain is not as facile as many of yours, when I

sense this confusion among so many of you, would there be an easier or simpler way of conducting this to be more effective and less complex?

MR. STERNLIGHT. Maybe I didn't report on it clearly enough. I don't see a simpler way of accomplishing the Committee's objectives.

MR. ROOS. A total reserves operation wouldn't help?

MR. PARTEE. No, because still the question would be whether we were reducing it temporarily or reducing it for the whole period.

CHAIRMAN VOLCKER. The confusion here arises, in my mind anyway, [in that] I had kind of forgotten what the implicit path was for the next 4-week period. We certainly lowered the nonborrowed reserve path for whatever period of time was left in the then current period being used for operational purposes. That's clear. It was done against the background of a high M2 figure and the relatively low M1 figure at the time, and whatever judgments various members of the Committee had in their minds as to what was going on in the money markets. I did not remember that the new path was exactly the same as the old path. That may be true. In any event, we forewent what could have been a possible increase in that path when [borrowing was] running low. I think that was implicit in the decision. And I repeat: Once having made that decision, it was my conclusion or my interpretation of that decision that the federal funds rate limit was no longer binding. It's never binding in the way we formally set forth the directive, but we had an inconsistency, we had a consultation, and we reset the reserve path. Whatever happened to the federal funds from then on happened to the federal funds rate in the light of that path, barring any further consultation, which we did not have.

MR. BOEHNE. Maybe we ought to have more confusion, because I think things turned out pretty well over the last six weeks! It seems to me that we did follow the spirit of the new procedure without being mechanical. There was some judgment involved, and interest rates dropped; there was an adjustment to demand factors, but we avoided a free fall in interest rates, it seems to me. This is about the way I think we would have wanted things to come out, if we could have [planned it].

CHAIRMAN VOLCKER. I don't disagree with that. We made the judgment in the reserve path. I think what is different and what will appear a little different to the market when this decision is published is that previously when we ran into the federal funds constraint, we said something about the federal funds constraint per se. This time we didn't say it openly; we said it implicitly, in my judgment. And the implicit judgment was reflected in the fact that for at least two weeks or maybe three weeks--I don't remember exactly --the rate was clearly below the 15 percent limit.

MR. STERNLIGHT. Well, one week it was 13-1/2 percent on average. Another week it was just a hair below [15 percent].

CHAIRMAN VOLCKER. Just a little below. So, one week it was way down and in only one other week was it below.

MR. ROOS. You mentioned the events of the period, draining reserves because of the--

MR. STERNLIGHT. Just before that February 24 telephone discussion, President Roos, when the funds rate was flirting with the lower bound--it was tending to drop down to 15 percent or lower--there was one day when our projection suggested that maybe we should be draining a little, but because the funds rate was dropping below 15 percent we drained a fairly sizable amount, more than we would have done just on the reserve numbers alone. I think that was a Friday; the following Monday, when the projection showed no need to drain, funds ran below 15 percent and we did drain that day. I'd say there were those two occasions when we were guided by the funds rate.

MR. ROOS. That was a time when we were concerned about reserves growing too slowly, right?

MR. STERNLIGHT. Well, reserves had been growing slowly but, also, the Committee had not held its telephone consultation. After that, as the Chairman said, the funds rate did not constrain us and it dropped down a bit.

VICE CHAIRMAN SOLOMON. At this point, there is no floor to the fed funds rate. And it seems to me that in the future, if we continue with this operation, every time there's a telephone consultation and a decision is made to change the nonborrowed reserve path--ignoring the floor or ceiling as the case may be--then for the rest of the intermeeting period we are operating without a floor or without a ceiling.

CHAIRMAN VOLCKER. We could arrive at a different decision. I think that was the decision we arrived at [in this case].

MR. PARTEE. We could do both, I think: reset our path and reset a floor or a ceiling. We just didn't want to reduce that floor, that's all.

VICE CHAIRMAN SOLOMON. Well, I was a little confused immediately after the meeting until I talked with Paul a couple days later because during the consultation Paul had said--and everybody went along--that he wouldn't be particularly disturbed if the funds rate went as low as, say, even 14 percent and then there might or might not be a need for another consultation. And yet we were required to add reserves when it was down to about 13-1/2 or 13-7/8 percent. So, I was thinking that maybe we had a kind of rough floor set around 14 percent. But then I realized, after talking to him, that the way he was interpreting this was that we basically didn't have a floor.

CHAIRMAN VOLCKER. Let me say that if I had thought the funds rate was declining way down and was going to stay down, obviously, we could have had another consultation. But I didn't feel that was necessary in the--

MR. PARTEE. You thought it was very temporary.

MR. SCHULTZ. It's also important to clarify that there was nothing mechanical here. Just because the funds rate dropped below 15

percent didn't mean that automatically the Desk was going to drain reserves. They look at the projections, both the Board and New York projections, and they look at the funds rate as an indication of what the conditions are in the market. And if the rate falls below 15 percent, then the market is saying that things are easier than the projections would seem to suggest. So, it's important that maybe there was the sense that 15 percent was regarded as an absolute floor by the Desk and the minute it went below that, then an automatic response would be triggered. That is not the case. That's not the way the fed funds rate is being used at this point in time. It is a consultation point; it is not a mechanical thing on which we target.

MR. WALLICH. We also now use the term "taken over a period of time," which indicates that there is that flexibility you speak of.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. I was obviously one who was thoroughly confused in this second four-week period. Is it not true, despite all of this, none of which I disagree with, that had we not adjusted the nonborrowed path back to where it was the probabilities are that the funds rate would have been down over that three-week period, anyway-- just as a behavioral thing.

MR. STERNLIGHT. You're talking about the second four weeks?

MR. CORRIGAN. Yes. Had we not readjusted the path back--

MR. STERNLIGHT. We didn't readjust it back because we had never really adjusted that second four-week part of it.

MR. AXILROD. I'm not sure what would have happened if the Committee hadn't met on February 24th and said it was all right to lower the nonborrowed path for the last two weeks of the first four-week period.

MR. CORRIGAN. Okay.

MR. AXILROD. The funds rate would have dropped to, say, 2 or 3 percent in that two-week period.

MR. CORRIGAN. That I have no problem with.

MR. AXILROD. And then looking at the projections of deposits and required reserves, our numbers would have suggested that adhering to the nonborrowed path going into the next four-week period would have brought the funds rate back up to 13 or 14 percent at that time, because borrowing at the time of that February 24th meeting was projected at \$937 million precisely. So, if the adjustment hadn't been made and we had just followed the nonborrowed path constructed for the first four weeks [in the] second four weeks, funds would have dropped to around 2 percent and then moved back up to on the order of 14 percent. What the Committee's action effectively did was to stop that drop down to around 2 percent.

CHAIRMAN VOLCKER. I think the Committee's action did two things. I'd just forgotten all the details here. It did what you just said and it forestalled what might have been a judgmental

increase in nonborrowed reserves to take account of the shortfall in total reserves.

MR. AXILROD. Oh, yes. Well, I was assuming that all through that period normal procedures would have meant raising nonborrowed reserves even further. And, of course, I would just assume that that was forestalled by the Committee's action.

MR. CORRIGAN. Let me ask my question differently. For that 2-week period at the end of the first four weeks, I understand perfectly what was done and why it was done. I, too, have been under the assumption, obviously erroneous, that the path that you established for the last two weeks of the first 4-week period was the same one you were going to stay on for the second four weeks as a whole. My question is: Had that been done, would we still have seen in that roughly 3-week period the funds rate below the original 15 percent floor?

MR. STERNLIGHT. I think it might have been to a lesser degree. I can't say for sure exactly where it would have been.

MR. PARTEE. We would have had \$200 million more borrowing, I guess, throughout that second four weeks than we in fact had.

MR. STERNLIGHT. About \$160 million [more] of borrowing.

MR. AXILROD. Well, I'm sorry. I'm not misunderstanding your question, Jerry, [but] I can't put the question in that framework. The way my mind works on this, there's something I'm missing on that. That path in the last two weeks was simply to keep borrowing at \$1.1 billion for a two-week period.

MR. CORRIGAN. I thought it was a new path for six weeks.

MR. AXILROD. Oh, no. I'm sorry, there must have been something lacking in our communication with the Committee at that time, then. No, that was not--

MR. CORRIGAN. That's all my question is. I thought it was for six weeks. And my question is: Had it been for six weeks as a whole, would we have had more borrowing and presumably a somewhat higher funds rate? And Governor Partee's and Peter's answer are the same.

MR. AXILROD. The question would have arisen as we looked at it, going into the next four-week period. Holding the path that we had originally constructed after the Committee meeting, if it looked as if borrowing was going to have to be very low again, then the policy decision for the Committee would have arisen.

MR. CORRIGAN. I think we're saying the same thing.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Well, I just want to go on record to say that I didn't understand either, and that may not be unusual. I understood the same thing that Jerry Corrigan just explained. When we dropped the nonborrowed path, I thought it was for the remaining weeks in the

period before the next FOMC meeting, which would have been five or six weeks.

MR. AXILROD. It would have been six at that time.

MR. GUFFEY. Further, there was a misunderstanding on my part that when we took the action that the federal funds lower bound was no longer a constraint.

CHAIRMAN VOLCKER. That's right.

MR. GUFFEY. I have no recollection of any discussion, either inferred or otherwise, indicating that to be true other than, I believe, Mr. Chairman, you stated--and I may have asked on the telephone what you meant by reaching the lower end--that the federal funds rate would be something below 15 percent. I asked what area you were speaking of and you would not be pinned down, as I recall. But it was also fairly clear to me at that time, apparently erroneously, that as we moved into the remaining weeks of the period the 15 percent would still be a constraint or a consultation would have taken place.

CHAIRMAN VOLCKER. Well, that is an interpretation that ought to be cleared up because my interpretation, as I stated it, was that the directive literally says that we will consult if these things are inconsistent. We consulted. And my assumption was that the decision was made and we recognized that we were flirting with 15 percent and it might go below. I think that much was explicit. And, therefore, the new reserve path was controlling. Now, that does not say as an exercise of judgment that if the rate had really gone down, we would not have had another consultation. We would have.

MR. MORRIS. I think I'm right, Steve, in saying that the Committee actually got a lower nonborrowed path in the second 4-week period because, in the absence of the [telephone] meeting, you would have been required to raise the nonborrowed path.

MR. AXILROD. Oh, absolutely. Sure, we would have been required to raise it the first four weeks.

CHAIRMAN VOLCKER. I think that's probably the source of the confusion: What you would have done in the absence of that [consultation]. I had forgotten, but technically it seems to be the case that the path was set just where it would have been set tentatively four weeks earlier. But the issue just ordinarily arises as a matter of discretion. If total reserves are running [off] enough, we raise it. We didn't do that.

MR. AXILROD. We didn't do that in either the first four or the second four weeks.

CHAIRMAN VOLCKER. I hope this has clarified things a bit.

MR. AXILROD. I hope it's clear. I tried to explain in the Bluebook that the sharp drop in nonborrowed reserves in February, when total reserves also declined about the same amount, reflected the adjustment made in lowering the path below where it had originally been set. And the rise then in March kind of offsets that, because we

lowered it and kept the March levels. So, we get a bigger increase in March. The two months together are about right, so to speak.

MR. PARTEE. Well, that's just what you said yesterday when I asked precisely the same question, but we didn't focus on it this way. So I was still not communicating at that time.

MR. AXILROD. Yes, that's right.

CHAIRMAN VOLCKER. We have to ratify the transactions.

SPEAKER(?). So move.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection, we shall ratify them. If we could take a moment, just in logical order, we have the authorization for domestic open market operations to review. This, again, is a routine item for the [annual organization] meeting. There is no change proposed. It's the basic authorization for domestic operations.

SPEAKER(?). Move it.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Any discussion? Without objection, we shall approve it. Maybe we should just slip in this lending issue, too, while you have the table, Mr. Sternlight.

MR. STERNLIGHT. I don't have anything to add to the short memo that went around on that. We believe that the lending operation to avert delivery failures remains a useful item in the good functioning of the government securities market and, in that sense, is reasonably necessary to its smooth operation and, thus, an aid to the conduct of open market operations. And it's a modest money maker for us. It much more than covers its cost of operation.

CHAIRMAN VOLCKER. This one seems to be a little less routine than the others. We do have to justify this in terms of promoting the ends of open market operations, I guess, and that is a matter of judgment. Mr. Sternlight has so indicated. I'm not sure that this is a business that we should be in, as a matter of routine; it really should have that justification. But we have the authorization and we've done this for how many years now?

MR. STERNLIGHT. Oh, 6 or 8 years.

MR. MORRIS. Well, if we're going to continue to have \$50 to \$60 billion deficits, it's going to be an essential tool.

MR. PARTEE. There would be a greater problem if we didn't have a deficit. We wouldn't have so many securities available to deliver them.

MR. WALLICH. And eventually own them all!

CHAIRMAN VOLCKER. Well, I don't think the markets should use this as too much of a crutch. There is an effort--we charge a penalty rate on this stuff compared to what the market charges, don't we?

MR. STERNLIGHT. That's right, yes.

CHAIRMAN VOLCKER. That is at least one indication of [our objective of] discouraging it and not using it excessively. Do we have a motion on this one?

MR. CORRIGAN. Peter, on the first page of your memorandum, there is a reference to the volume of trading and that it may have put strains on your automatic clearing mechanism in government securities. Are you talking about our system or are you talking about the Street systems there?

MR. STERNLIGHT. Well, I was not referring to the System's open market operations but to the volume of traffic through the System's clearing mechanism.

MR. CORRIGAN. No. The clearing mechanism through the Fed?

MR. STERNLIGHT. Yes.

MR. CORRIGAN. The dealers, then, have never set up any kind of interface of their own with our system to move a lot of stuff out of ours.

MR. STERNLIGHT. No, but in a--

CHAIRMAN VOLCKER. I need a second.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection, we will approve this. I think that is all the authorizations and directives and so forth that have to be approved. So, we can go to the substance of our discussion. Mr. Kichline.

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

[Coffee break]

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

CHAIRMAN VOLCKER. I will just make one preliminary comment myself: As we focus on these numbers, let us recognize that we are not [skillful] enough to hit any of them. And we are engaged in an exercise [of assessing] which way the risks go in substantial part, following a period when velocity has been way off from expectations or interest rates have been way off from expectations, however you want to state it. In fact, they have both been off from expectations. I suspect that when we sat here the last time we were all somewhat [expecting], in setting the reserve path, that interest rates were going to go up with any of the reserve paths. Instead, they came down by quite a few percentage points, which cast a quite different light on things as the period progressed. There is nothing we can do to

eliminate those uncertainties. I just think we ought to be aware of them. Who would like to comment? Mr. Balles.

MR. BALLE. Mr. Chairman, I would like to make a comment and ask Steve some questions. These figures on adjusted M-1B, of course, are going to be the great guessing game of 1981. There has been a lot of solid analytical work done at the Boston Bank and by the Board staff on what happened in earlier periods when NOWs were introduced and so forth. We have some survey data already. We intend to do some more surveys. Yet I, for one, Steve, end up with a feeling of a little skepticism about how much we solidly know. I'm told by my staff, whom I have had looking into this, that if we took at face value the survey data that came in from the banks and the S&Ls for January and February and assumed that about the same results prevailed in March that prevailed in February, we'd end up with something like a weighted average for banks and S&Ls together of 82 percent of the source of NOWs being demand deposits and the balance being non-transaction accounts. That is in a bit of contrast with the best judgment of the Board staff. It came out in the Greenbook, for example, that in January 80 percent of the NOWs came out of demand, and the figure for February and March was 75 percent. Using the figure that we came up with of an 82 percent weighted average as a rough estimate for the first three months of the year--and I don't say that I have complete certainty on that either--rather than the [Board staff] figures I just cited, we would come up with a 5.2 percent annual rate of gain, seasonally adjusted, for M-1B from December to March, versus your figure of 3.2 percent. In other words, it would be a full 2 percentage point difference and the level of M-1B would be \$2 billion higher.

CHAIRMAN VOLCKER. That's from January to March or December to March?

MR. BALLE. December to March. And we would, in fact, be fairly close to the midpoint [of our target]. It's just a word of caution that, from my standpoint at least, I would feel a little safer if this Committee for its own deliberations had in mind a range of possible outcomes rather than a pinpoint figure, because at least at this point in time, I don't feel we have enough information to have a solid figure that's measurable to the extent we do for a lot of economic statistics and so forth. Having expressed my misgivings, I am turning to you, Steve, to see if you can reassure me or tell me that things are better.

MR. AXILROD. Since I don't know the method of calculation used by your staff, I certainly can't do much reassuring. The percentages we took were based on the surveys from banks. We asked what percent came from demand deposits and what came from other accounts. We got similar percentages out of the Michigan survey of consumer attitudes. For the S&Ls we took the percentages that the Home Loan Bank people told us came out of their own accounts versus what came from other institutions. The amount that came from other institutions we divided up in the same way as on the banks' reports and we rounded a little. We came to 80 percent for the first month and then 75 percent for the next two months. I'm not sure of the exact number, but I think it probably came out at something like 76 or 77 percent. Probably the best thing to do is for us simply to send to the Committee a note on the exact calculation method we used, and then

it would be verifiable against how other people might like to view exactly the same data.

MR. BALLEES. Maybe I could pinpoint this a bit more. Is my understanding correct--I got this from somewhere--that you judgmentally shaded down somewhat the survey data that came in from the institutions, at least for January if not February, in terms of the percent they reported as coming from demand deposits?

MR. AXILROD. Well, I'm not certain of that, President Balles. I know that we tried to make allowance for the fact that the sample we used was wrong--well, not wrong, but it had more large banks relative to small banks than there are in the nation as a whole. So, therefore, we tried to weight it so that we gave more weight to small banks [in the survey], in line with their role in the nation as a whole. We didn't simply average it, so to speak, which would have resulted in a higher number because the sample had fewer small banks relative to large banks than is true nationally. Now, that could be a difference. I don't know whether, in fact, it is.

MR. BALLEES. The only other comment I wanted to make on this, Mr. Chairman, is that some of these fine and really well-designed analytical studies that were done, say, with respect to the New England experience, lead to a conclusion that probably about two-thirds of the source of NOWs was demand deposits and the rest was from savings and so forth. We have a feeling that that might not be applicable to the United States as a whole in 1981. We see that a very large number of respondents to the surveys, contrary to what I understand was the case in New England, are permitting minimum balances to be held in various forms of savings instruments, such as passbook accounts, money market certificates, the 30-month small savers certificate, etc. At least in the West, the largest banks and the largest S&Ls, in fact, are permitting those so-called minimum balance requirements for NOWs to be held in savings instruments, which I understand contrasts somewhat, Frank, with what had been the experience in New England. If that practice should prevail as we continue to keep this under observation during the rest of the year, it might lead to a greater proportion of NOWs coming out of demand deposits and less out of savings. So, there is the possibility that the present methodology could be understating the adjusted growth in M-1B. But I think that needs some more study.

CHAIRMAN VOLCKER. Well, I think your comments are very well taken in the vein that there is uncertainty here, which I doubt we can resolve completely, but we've got to keep looking at it. I think we just have to recognize that there is a band of uncertainty. And in that connection, we assumed in the target for the actual figures, the equivalent target, that this would pretty quickly go down to two-thirds, didn't we?

MR. AXILROD. Well, but we changed that assumption.

CHAIRMAN VOLCKER. You have? We haven't published a new one. The question is when we should indicate that there is a new target equivalent for the actual figures, if we change that assumption.

MR. AXILROD. We have postponed that two-thirds because the latest data coming in suggest that [proportion from demand deposits] remains very high, and we have stayed with the same [assumption].

CHAIRMAN VOLCKER. But at some point we will have to change that other target, won't we?

MR. AXILROD. Yes, that's right. But we haven't. For sure we would do it around midyear. But whether we would want to do it before then--

CHAIRMAN VOLCKER. Well, I might want to do it before then if I thought it became big enough so that it was really significant. It's the other side of saying that this adjusted figure may understate what actually has been going on.

MR. BALLE. I can only speculate that the extraordinary increase in velocity of M-1B, as reported based on the adjusted figures, could not have been so big if the adjusted figures should have been adjusted higher. We get those sorts of interactions going on. So I, for one, just have to express some skepticism. All I'm doing is trying to find out how solidly we know what the adjusted results are. And, if anything, I have a hunch--and that's all it is--that perhaps we should be addressing--

CHAIRMAN VOLCKER. The answer, of course, is not very solidly, which is a matter of curiosity. It may affect how people think, if people were suspicious of this estimate we made of 75 to 80 percent, depending upon what month. If you had to guess, is it the general feeling that that percentage sounds too low, which is what you are suggesting, John?

MR. BALLE. Yes.

MR. CORRIGAN. Well, we did a more comprehensive survey of institutions up in the Ninth District. While it wasn't a big survey, it was done very carefully; we did in-depth interviews with the accounting officers and all the rest. We are finding the same thing Mr. Balles was suggesting, including that for large numbers of these accounts the kicker is in what they call a "hostage" account, a savings account. And, therefore, there is no minimum balance to speak of at all in the NOW account itself. I'll send that to you, Steve.

CHAIRMAN VOLCKER. We will never resolve this because, even if we did it very accurately for this early period, which we can't, we just don't know how it affects the behavior from then on. And no banker can tell us because he doesn't know either.

MR. MORRIS. I assume the purpose of this scheme is to reduce reserve requirements.

MR. FORD. Sure. They want to keep the money in the bank but in the form of an account that has the lower reserve requirements. That's why some of them, I'm told, are continuing the ATS approach, which one would have thought would have been outmoded.

MR. BLACK. Well, a lot of them are not even offering NOWs but are sticking with ATS accounts because that stays in for that very reason.

MR. FORD. So, from the [market] I think what you are hearing here is--

CHAIRMAN VOLCKER. The ATS account ought to work the other way. I would think the inclination would then be just to call the savings account an ATS account, which means it's all--or a large portion of it--coming out of savings accounts. It's very difficult. Well, Mr. Ford.

MR. FORD. I wanted to ask one question, in the same vein as John's about how some of the technical work was done, on this issue that has been raised by some of the money market gurus about the seasonal adjustment: As I understand it, for the first quarter of the year it would not have made a lot of difference in the adjustments you made for December through March, but looking ahead to the next quarter of the year, there might be some problems with the big seasonal adjustment. I would like to hear, Steve, how you factored that into your projections and whether we are facing the possibility of any big surprises just due to the fact that we haven't yet been able to develop an appropriate seasonal adjustment.

MR. AXILROD. We will be putting out the revised seasonals in May. They are delayed this year because last year was so exceptional that we didn't feel we could run an ordinary X-11 and we were trying to do some modeling to abstract from the credit control program, which is a one-time event. But as a temporary ad hoc measure, we were thinking that what we should do is to take 80 percent or 75 percent, whatever the number is, of the other checkable deposit increase above trend in 1981 and put it back into demand deposits when we seasonally adjust. So we would not be adding it in unadjusted; and that's what the market is focusing on. I asked the fellows back in January, right after the first week was so big, to keep track of a series on that to see what difference it made. And as you suggest, it doesn't make a substantial amount of difference in January, February, and March. The growth rate in January, as we do it now, was 2.9 percent; if we had thrown the demand deposits back in, it would have been 2.0 percent. This would be partially but not entirely offset in February; where we have now a -2.3 percent, it would have been zero. And then in March, it doesn't happen to make any difference. You are quite right that when the seasonal factors get large in April, May, and June, it makes more of a difference. On our current estimates of the distribution of OCDs between savings and demand, it would lower the growth rate for April, and I'm going to round, by 2-1/2 percentage points. The growth rate adjusted "properly" would be lowered by about 2-1/2 percentage points. In May it would be raised by 3-1/2 percentage points and for June it would be lowered by 2-1/2 percentage points. So, they're not quite offsetting, but that would be the relationship. We have presented the targets as we're [making these calculations] now. If we had presented them in these other terms, instead of 6 percent, let's say, for April, May, and June, we would have presented under alternative B something like 3-1/2, 9-1/2, and 3-1/2 percent. April would have been low, May high, and June low. But we are presenting them on something like a straight 6 percent if you take alternative B. And as long as we measure against the target in a way consistent with

how the target is set, I don't think we have troubles. We don't intend to measure it in an inconsistent way.

CHAIRMAN VOLCKER. It seems to me what you are saying, if I understand you correctly, is that one can pick any one of these alternatives and seasonally adjust it the other way, which seems more sensible to me, and the growth would be bigger.

MR. AXILROD. The growth would be--

CHAIRMAN VOLCKER. Bigger or smaller?

MR. AXILROD. Well, the growth would be somewhat smaller, the way it works out on these figures. The growth, by the way, from January to June evens out entirely.

CHAIRMAN VOLCKER. It would be smaller in April, bigger in May, and smaller in June.

MR. AXILROD. The numbers I gave add up to 16-1/2 percent the other way and to a little under 18 percent the way we are doing it currently.

MR. MORRIS. Well, it's still smaller than the average noise factor in it.

MR. AXILROD. Well, that's right. Also, we think the seasonal is going to change in any [event]. And that isn't done yet.

CHAIRMAN VOLCKER. Well, it bothers me a little, because it just seems conceptually that we should seasonally adjust these things.

MR. AXILROD. Oh, that's right. Given the size of the shifts, we should. But this is very ad hoc. We don't know because we don't know how the OCD series is going to behave once [the shifts have] happened. This is just putting back into demand deposits what was shifted out. But once it is shifted out, combined with some savings deposits, it bears interest. Given that interest payments are made, we don't know that the seasonal behavior is going to be the same.

CHAIRMAN VOLCKER. I know you don't know. But as a first approximation I would think it would be more like the demand deposit seasonal than no seasonal at all.

MR. AXILROD. Well, I think [that's true of] the shift. But otherwise I doubt it. When interest rates fall, I don't know what is going to happen to these accounts. Their behavior is going to be very different, I'm convinced, than demand deposits. We might be able to get the cyclical movement out, but it's going to be something of a problem. But we intend in May to get this all corrected. As of the moment, we are operating in this way. And I don't think the Committee is being misled as long as we set the target and measure against it in a consistent way.

CHAIRMAN VOLCKER. Mr. Schultz.

MR. SCHULTZ. Mr. Balles talked about a range of possible outcomes. It's rather important to think along those lines because, at this point, it's easy to parade the horrors. In spite of my great respect for Mr. Kichline, I think his forecast is not likely to come to pass. If you look at what he has for budget deficits--\$85 billion [in 1981 and \$94 billion] in 1982--and then look where he ends up with his GNP forecast, which is for very sluggish growth, I think the proper assumption is that we have very high interest rates during that period. From my discussions with bankers around the country, I just don't think the real world is going to operate that way. I get the feeling that they're pretty concerned about the financial condition of a lot of corporations out there, and I just don't think a lot of companies can stand that kind of environment for that length of time. I don't know what it's going to be like, but I doubt that it's going to be like that forecast. Take two possibilities. One is that this M2 growth is more meaningful and that we get tax cuts this summer, which are going to be very expansionary. We [could] get an enormous surge in money growth in the last half of the year and very high interest rates, and then get socked like the devil in 1982. Or take the other way around that we are going to have a much weaker economy short term than now appears likely, so [money] growth is going to be much slower. Add to the whole problem what the House Banking Committee said--I was struck by this--which was that they could accept the upper end of the target ranges for monetary growth for 1981 provided that budget and other fiscal policies offset the high unemployment effects that the monetary policy is expected to produce. That seems to me to be a scenario for absolute disaster. If they are going to continue to look to us to hold the line, I don't think we have a choice. We've said what our path is going to be and, if we were to attempt to ease, it's pretty clear that everybody would think we had let the inflationary cat out of the bag. And it seems to me that interest rates would be even higher under those circumstances. So, I don't think we have a choice; we have to stay on our general path here. But the scenarios of what could possibly happen can be pretty wild. So, it's rather crucial at this point to try to retain what flexibility we can and to have some range of options because this is a pretty tough period we are heading into.

CHAIRMAN VOLCKER. I'm not quite sure where that leaves us. Mr. Black.

MR. SCHULTZ. Scared!

MR. BLACK. I can't answer that question, Mr. Chairman. I had something in mind I wanted to ask and get an answer on. Bill Ford made the main point I had, but I would add that what really concerns us is the bulge that we ordinarily get in M-1B in April on an unadjusted basis. If the NOW account portion is not somehow seasonally adjusted, that bulge is going to be overstated and the psychological effects on the market concern us. We were going to suggest that we try some kind of ad hoc adjustment on that, Steve, along the lines that you were playing with, just to avoid that adverse effect. We played with it by applying the demand deposit seasonal adjustment to that portion of the NOW accounts that we thought came out of demand deposits and the savings deposits seasonal adjustment to the other portion. We estimated that in April, which was the month that concerned us, it would probably be overstated by about 3-1/2 percentage points, and that seemed to be a very bad time for that

figure to be appearing because we seem to be making some progress toward our ultimate objective. We were hoping we could do something about that, although--

CHAIRMAN VOLCKER. If we seasonally adjusted it, it would be 3-1/2 percent higher than if we didn't.

MR. BLACK. No. If we don't seasonally adjust the NOW portion, the seasonal will pull [it up]. April has a very high seasonal adjustment factor and if we don't apply that to the NOW account portion, then we estimated--this may not be exactly right--

MR. PARTEE. It's a build-up for the tax payment, I guess.

MR. BLACK. --that it would be overstated by about 3-1/2 percent above what it really was in fact, as nearly as we could estimate at all. I'm well aware that we don't have all the information we need for any kind of rigorous seasonal adjustment, but that one month really concerns us. It doesn't make that much difference in what The Wall Street Journal is covering, I don't think. But it could at that particular juncture.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Mr. Chairman, I feel that we're really trapped or tripped up by our own procedures. We built in the expectation that we've lowered the ranges and yet we make no allowance for base drift in our targets.

CHAIRMAN VOLCKER. Let me just say, if I may insert a comment relevant to base drift, that I look at these targets somewhat differently. We look at these cones, which always gives us an impossible problem at the beginning of the year; because the cone is so narrow at the beginning of the year, we're always outside it. If we were to attach this cone to where we, in fact, ended up last year--and we concede that we ended up high last year--and took the targets from the fourth quarter and showed where we wanted to end up this year, I think one can argue that we are now about in the middle of the range where we should be. I am sorry that I don't have the picture with me but we're about in the middle of that channel.

MR. PARTEE. A longer range, sort of starting off in the beginning of '80.

MR. MORRIS. That's for M-1B, right?

CHAIRMAN VOLCKER. Yes. We're clearly high on M2 and M3; I'm just talking about M-1B. In other words, stated another way, we ended up the year high, so having a low quarter brings us back to where we should be.

MR. WINN. That's right. That would be my point: We're in the upper end of the old range even though we're below the range for the--

CHAIRMAN VOLCKER. Or stated another way, we didn't change the target's slope much. If you just extended that target for last year, we'd be at about the middle of it now.

MR. WINN. Well, that again is where we've tripped up. If we start to adjust the aggregates for the transaction part of money market funds, that is clearly one thing. It's not the total money market funds, but we see the transfers going through on our check clearing operations, so they are being used. Second, we have RPs and Eurodollars and one can argue how much of that belongs in the picture. And if we adjust the aggregates on a real M-1B or transaction type basis, it results in a much higher figure than we're reporting. So, not only have we got our targets out of focus but the bullets [with which] we're trying to hit the targets all seem off to me. We really have two major sources of confusion for which I'm afraid we're going to get beaten over the head no matter what evolves. Add onto that a look at the economic analysis: We have inventory certainly tight or under control; we have consumers who certainly have behaved far stronger than anybody thought they would, but they're continuing to do that; we've projected construction expenditures in office buildings, apartment houses, and hotels that really are starting to jump in a very big way; and we have the stimulus from the deficit that's certainly a pretty big one. And we ought to recall that we've been projecting declines since 1979. Now, one of these times we may get that, but we're not sure we're going to get that. So we're higher in the range than we think we are. We're much higher if we adjust the aggregates. And we may have a stronger economic picture than we think we are facing. All of these factors give me pause as we start to set our objectives for the next three months.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Well, Mr. Chairman, let me start with a word on the price outlook. I sense for the first time at least a few straws in the wind that are consistent with some backing off on inflationary expectations. I don't think there's much hard evidence one can point to, but I do get a little flavor of that. It's also true that we could get lucky in terms of the consumer price index toward the end of this year. Now, if the staff's estimates about mortgage rates [are right]--that they're just going to stay high--they presumably won't be adding. And I think the outlook for food prices, assuming we continue to get some moisture in the Midwest, is a good deal better than it was even a few months ago.

CHAIRMAN VOLCKER. Did you get some rain in the last few days?

MR. CORRIGAN. Yes, some rain is starting to come. And the energy price outlook, I think, is also distinctly better. So, maybe there's a little ground for optimism there. On the economy, I look for a flattening out in the second quarter, but I think the potential for strong upward pressures later in the year is very real. And in line with one of Mr. Schultz's two scenarios, I think the potential for strong financial pressures in the second half of the year and strong pressures on money growth is very real. I noticed in Mr. Kichline's forecast, for example, that he has the Treasury borrowing almost \$50 billion, \$49.2 billion, in the fourth quarter, which is considerably greater than even the \$35 billion we had this [quarter]. So, I sense that whatever problems we may have now with controlling money and interest rates are only going to get worse as the year goes along, partly because the risks are that the economy is going to be stronger rather than weaker in the second half of the year. And I

couple that with my sense that M-1B is giving us the wrong signals. On this money market fund thing, for example, we did a little exercise. It doesn't mean anything, but just as an example: If you took the growth in money market funds over December to March and just added in one-tenth of the growth to M-1B, that raises the growth of M-1B for the quarter to 6.2 percent. And that, again, doesn't say anything about this other matter that Mr. Balles was pointing to earlier.

MR. FORD. How would you rationalize doing that?

MR. CORRIGAN. No rationalization. It's just a guess, just a number. You just take one-tenth of the growth in the money market funds phased in at the rate at which they actually grew and add that into M-1B.

MR. PARTEE. But you should have taken two-tenths of the decline in savings accounts and added that in, too. You didn't do that.

MR. CORRIGAN. Why should I do that?

MR. PARTEE. Because savings accounts are transactions balances also.

MR. CORRIGAN. Well, but they're in M2. I don't think it makes--

MR. PARTEE. So are money market funds.

MR. CORRIGAN. Well, we can dispute that, but I think this understatement of M-1B is very real.

MR. PARTEE. I don't know.

MR. CORRIGAN. Well, whether or not it is, I think it is. It just adds further weight to the argument that M-1B is giving us some false signals here. When I put it together, in terms of policy, I would not be allergic to giving a little more weight to M2 in line with one of the points that Steve made. Also, the whole [situation], at least in my mind, argues in the direction of doing the best we can now to keep well within the targets because later on I think it's only going to get harder.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. Looking at the situation that we have, the economy is much stronger than we had expected. Once again, we've had a recession predicted that so far hasn't materialized. As a result, the degree of slack in the economy and the pressure on prices and wages are less from excess capacity. The conclusion one is driven to is that our past policies, which we thought were quite restraining, were much less restraining. As for why that should have been, I share the views that have been expressed around the table. M-1B is probably misleading. People are probably treating their money market mutual funds and other sources of liquidity as at least a factor that allows them to use their checking accounts more actively. At the level of holders of very large liquid assets, bear in mind that the Treasury

has issued an enormous amount of bills, including cash management bills, which at least go into L if they don't go into the lower aggregates. While these would be absorbed again as the Treasury avoids borrowing and people use this liquidity to pay their taxes, nevertheless, there is probably some additional liquidity, and some residual liquidity will remain. So, if we were to look at these broader aggregates, including all short-term assets, we'd probably see a higher degree of expansion. Now, M2 is probably a more relevant guide than M-1B. I don't want to bore you again with my views about interest rates in real terms after tax and why they haven't been very restraining.

As far as the outlook is concerned, I think there is a sense of unrealism about the Greenbook. It would be nice if things worked out that way with slow, stable growth. We have to bear in mind that [the level of economic activity] is really a little higher already than we thought it would be as a result of the strong first quarter. But the realism of the outlook is undermined by the fact that we use M-1B at 4-1/2 or 4-3/4 percent. I think the chances are that we will be pushed at least to 6 percent, the upper limit. We have had base drift raising the whole level of the aggregates over time. So, I find it hard to believe that we'll get quite the same pressures in terms of restraint that are seen in the [staff's] outlook. I do see that we're going to get strong budgetary pressures. My impression is that the risks are very much on the up side and much less on the down side. That would encourage me now to want to accumulate such reserves of restraint as we can. We're lucky in a way to have undershot the [targets], at least with respect to the narrower aggregates. And I'd husband this reserve. We'll probably be pushed off that point later in the year. There's no reason to volunteer [to go] in that direction now. Thank you.

CHAIRMAN VOLCKER. Governor Teeters.

MS. TEETERS. I would like to remind you that those deficit numbers are not independent of the forecast. Our projected deficit for next year is considerably above the Administration's, primarily because of a much, much weaker forecast--a 0.5 percent rate of real growth rather than 5 percent, and higher unemployment rates and interest rates. I think we added back in about \$18 billion for interest payments based on our interest rate forecast rather than the Administration's, and we're losing about \$25 billion in deficit per point of unemployment, if you compare the 6 percent with 5 percent. So, if Henry's scenario that the risks are on the up side comes true, the size of the deficit will be considerably below what is being projected at the present time. As I understand this forecast, the staff had a great deal of difficulty getting any of the GNP numbers to work out because of the paucity of money. It is a very tight forecast. And the interest rates that would have come out of just a mechanical running of the model are considerably higher than what are being shown here. So, in contrast to what Henry says, I would think that the risks are on the other side. The consumer is running out of steam; the automobile [sales] probably won't last. [Businesses] can slow down investment. I don't feel strongly enough about it to say that [the risk on] the forecast is on the down side, because I think we have some real demand pressures which are being suppressed, namely in housing at the present time, which with any sort of readjustment would rise.

This forecast is one of the gloomiest I've ever seen. And it certainly is gloomier than any forecast that is in the public [arena] now, mainly because of the underlying assumptions about interest rates. I don't particularly want [policy] to let up. On the other hand, I don't want to screw it down any harder at this point. It seems to me that the best way to do this is approximately alternative B because what Fred says about other corporations [is true of the thrifts]. We're going to have impacts on the thrifts. If we keep interest rates up there, we'll get a lot of emergency reaction in trying to rescue them. A very good study was done here at the Board on the number of corporations that have had their ratings in the bond market downgraded. It's not only surprising, it's fairly widespread. There are going to be a lot of corporations in trouble, and I don't see making it any worse for them. I would also point out that we have M2 misspecified relative to where we've set the M1 measures. We have decided to keep the M2 target where it was last year, even though the staff's best estimate was that it would be higher. So we're trying to get M2 into a slot that's inconsistent with M1. And if we just look at the fact that we're over [our target] on M2, I think that is going to lead us to actions to depress its growth and depress the M1s [more] than ever. And we've got the money market mutual funds. We have an interest-sensitive, very interest-sensitive, [component] in the M1 measures, and if interest rates begin to drop, we're going to be sitting here worrying about the fact that M2 is going down, not that it's going up--and for [a reason] that's not connected with our targets. In terms of the alternatives, I come out for "B."

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I have the same sense of disquiet that's being voiced around the table, because somehow everything doesn't seem to hang together. We really can't explain why the economy has been as strong as it has been over the fall and winter. And not being able to explain why it has been so strong, we don't have a very firm grasp on what it's going to do in the period immediately to come. I think we have to be pretty flexible and await developments. I have a sense of trepidation that Fred's expectation is going to work out: That the rest of the year will be stronger than we are now anticipating and that there will be a tendency toward very rapid money growth. I hate to talk about these neat little adjustments of what ought and what ought not to be counted, but just in plain old M-1B terms, as velocity turns around, I think we're going to have very fast growth to contend with. And the tax cut will [create] some stimulus to the economy and, therefore, a difficult situation for us to contend with as the year goes on from the standpoint of our target ranges.

Now, I don't think interest rates are so low, as Henry does. Looking at the Bluebook [appendix], you find that the long-term government bond yield is 13 percent, the long-term corporate bond yield is 14 percent, and the long-term mortgage rate is 15-1/2 percent. It seems to me that those must all be positive real interest rates by some margin, but they are not, except in the case of mortgages, having that much effect on behavior. That troubles me because I think they will come to have an effect on behavior. And when attitudes shift, then we could find a rather sharp [deterioration] in the [economy]. So, I wouldn't urge deliberately going about raising interest rates, but I think we ought to stick with the course we've set. I didn't mean to offend Jerry on his money

market fund calculation, but the fact of the matter is that the turnover of savings accounts is greater than the turnover of money funds. So, if you add some portion of money funds in, you ought to add some portion of the decline in savings accounts into the calculation. You'll never reach an end on this because of the great difficulty of dealing with these problems.

I come out, Mr. Chairman, somehow right where Nancy did. I think we just ought to follow alternative B, which is somewhat of a middle course, and have plenty of room to adjust as we go along in the spring. I like "B" because it doesn't use up our room too rapidly. Our previous experience, you'll recall, is always that things go along pretty well until we get to a double-digit month--and one will be coming before very long--and then perhaps we'll have to cope with a very low one. I think ["B"] is the way to go. I am troubled by the seasonal adjustment problem. If the April number has something like a 3-1/2 percent overstatement, it's not going to be good psychologically because it will probably give us a pretty high April number and will look bad as it develops. I don't know what to do about it, but we ought to think about that.

CHAIRMAN VOLCKER. Well, the other side of that coin is that if we don't get a high April figure, we really have a much lower number than we think we have when we're publishing it.

MR. PARTEE. Well, we might get a very high April figure. How would you handle 15 percent for April?

CHAIRMAN VOLCKER. Well, at 15 percent it's not so bad. We'd know it's high.

MS. TEETERS. But remember last April we had an estimate at this time of the year for a very large growth in April because of the enlarged refund. And, in fact, it came in at -14 percent, as I remember.

MR. PARTEE. Yes, there's tremendous volatility in that month.

MS. TEETERS. April is just a terrible month.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I have listened to all these concerns, which seem to be pointed in one direction. But it seems to me that the scenario could be quite different in that the second quarter could turn out to be much weaker than the staff is projecting, and I'm inclined to think that that will be the case. Not that it will be a second quarter such as we had last year, where we had a [GNP] drop at a 10 percent annual rate, but that it will be a sufficient drop to put us in the situation of having to decide whether we are going to follow a monetarist course and let interest rates drop substantially or whether we're going to decide that we will do things differently this year--maintain a relatively high level of rates in the face of a weak economy and perhaps produce a much poorer third quarter than we have projected as well. It seems to me that this is just as logical a scenario as the ones that have been written so far. The fact is that at the moment we just don't know to which of these to

attach the higher probability. So, therefore, the staff comes out with zero, which I think is a commendable position if you have to come out with a number. But I'm really concerned about facing exactly the same problem we did last spring.

CHAIRMAN VOLCKER. It's much easier to disagree with the staff forecast than to come up with one of your own.

MR. PARTEE. It's the statistical--

CHAIRMAN VOLCKER. Does this lead you to any particular conclusion among these alternatives?

MR. MORRIS. I think "B" is the one that I would support.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. Even though I agree that there's a lot of uncertainty as to how much the second quarter will weaken and how much increased strength in the real economy there will be in the second half of the year, I feel that there's a greater presumption of strength in the monetary aggregates. Now, I'm not talking about April, but we're not likely to see the same velocity of circulation, and there are increases in defense spending and tax cuts of some kind coming long. Therefore, it seems to me that to position ourselves as flexibly as possible, we ought to aim for a return to the bottom end of the range by June rather than to the midpoint. However, even though that's alternative B, I think a \$1.3 billion borrowing assumption would be just as compatible with that as a \$1.5 billion assumption. I'd go on to suggest that to the extent opportunities arise for a discretionary adjustment of the nonborrowed reserve path during the intermeeting period that we bear in mind the overshooting of M2. If that continues to overshoot in a significant way, that should be factored in. Our analysis is that alternative B, even with a \$1.3 billion assumption, probably means a rise in the fed funds rate of maybe a point or so from present levels. That's a very rough guess, but we might have something close to the 15 to 17 percent range. If you take the midpoint, it would be a marginal increase, but I don't think it would be that significant that it would cause a lot of reaction. And that's the best position we can be in; I think it would be a great mistake to go either to "A" or to "C."

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. Yes, sir. I would opt for alternative C and I would base that on the following rationale: I assume that our primary objective is to achieve a start on reducing the rate of inflation we have had and that there is an effect on inflation of reducing the growth of, let's say, M-1B. We had M-1B growth last year at about a 7.3 percent rate. A reasonable reduction, if we're able to achieve it, would be from that 7.3 percent to 6 percent growth, let's say, for the period from February through the end of the year. If we set the paths for growth as reflected in "C," I think we can achieve that 6 percent annual growth. I think we can do it without having an impossibly low rate of output. We project, assuming 6 percent M-1B growth for the year, real GNP of something in the area of 0 to 1 percent. That's obviously slow growth, but it's not negative growth. I don't think that we can achieve a fast growth of output and still

have the necessary degree of monetary restraint to achieve a reduction in inflation. Now, that 6 percent I'm referring to is on an unadjusted basis. We assume--and maybe some would argue-- that NOW account flows have almost ceased and that in the period ahead we can use an unadjusted aggregate and not be in trouble inasmuch as we believe that the big NOW account change has already occurred. So, to make a long story short, I think the best way of achieving our targets and the best way of bringing down M-1B growth as necessary to have a salutary effect on reducing inflation is "C."

CHAIRMAN VOLCKER. Steve, what is the latest on NOW account growth in the last couple of weeks? I forget. Has it come down further or not?

MR. AXILROD. Let me get the figure. Here it is. For the week of the 18th, it's only about \$500 million and we're projecting \$600 million for the week of the 25th. Our pattern had been that big increases occurred in the first couple of weeks and then they slowed down in the last couple of weeks of the month. In the early part of this month, increases had been about \$2 billion. I would assume from here on out--or early next month--that the increases might be more in the \$1 to \$1-1/2 billion range and then come down again. We are at a higher rate of growth than we expected.

MR. PARTEE. You are talking about several billion a month.

MR. MORRIS. Actually, Larry, the New England NOW account experience would indicate that we are not going to have a complete adjustment to NOW accounts for two years. The idea that the country is going to adapt to this in a few months just does not jive with the New England experience. Now, maybe the rest of the country moves a lot faster than we do in New England, but I doubt it.

MR. SCHULTZ. The fact that we have much higher interest rates now indicates that the adjustment would take place more rapidly. We are seeing shorter lag times in everything.

MR. MORRIS. Well, it may be more rapidly, but to argue that the adjustment is largely over I think is just wrong.

CHAIRMAN VOLCKER. Well, we will see. It would certainly ease our problems if it were over fairly soon. I'm a bit confused by what you said, [Larry]. I just want to clarify it. I'm a little surprised that you came out for "C." It's against that background that I ask this. My confusion is what numbers you are using. The numbers in the table, as I understand it, are adjusted M1 figures. So, when you talk about 7.3 percent last year, you are talking about the unadjusted figure.

MR. ROOS. Yes, I'm talking about the unadjusted figures: 4-1/2 percent March to June M-1B on page 7 under alternative C.

CHAIRMAN VOLCKER. Yes, but that 4-1/2 percent is adjusted. On an unadjusted basis, that means what: 6-1/2 percent or something?

MR. AXILROD. Last year?

CHAIRMAN VOLCKER. No, right now.

MR. AXILROD. 6 percent.

CHAIRMAN VOLCKER. It's only a 1-1/2 point difference now?

MR. AXILROD. That's our estimate. That's from March to June. From February to June it's 2 percentage points different.

MR. ROOS. In other words, that would give us a 6 percent unadjusted.

CHAIRMAN VOLCKER. And if you talk about 6 percent through the year unadjusted, this estimate may be wrong in the amount of shifting. You may be assuming less shifting but, as we have [now] estimated, it's at the bottom of the range for the unadjusted figure.

MR. ROOS. I think that's 6 percent from the first quarter of 1981 through the period ahead.

CHAIRMAN VOLCKER. Six percent from the first quarter through the last quarter, unadjusted?

MR. ROOS. That's correct.

CHAIRMAN VOLCKER. That would give you slightly less than 6 percent for the year then, which is at the bottom of the target that has been set. I just wanted to make sure that's what you were saying.

MR. ROOS. That's correct.

CHAIRMAN VOLCKER. You want to come in at the bottom of the target range for the year. I just wanted to clarify that. That means, in terms of the adjusted target, that you would be happy to come in at 3-1/2 percent or so.

MR. ROOS. Yes, but we have some differences with the degree of adjustment.

CHAIRMAN VOLCKER. Yes, that I understand may be a problem. But it's in that neighborhood, right? Mr. Black.

MR. BLACK. This futility that we all encounter in trying to forecast the economic outlook is perfectly understandable. That reinforces my basic belief that we ought never to lose sight of something that I think we all agree on: That we have to get these aggregates down over the long run. If we work in that direction, then we have an automatic stabilizer in place. And that is something we sometimes forget, I think. If the economy does turn out to be stronger, as it may, then that would tend to exert some kind of braking action; and if it turns out to be weaker, which I think you made a good case for, Frank, then we have an automatic stabilizer on the down side. So, in choosing our short-run targets, we always ought to bear in mind the risk involved. We have had three years in which we haven't been able to reduce the rate of growth in the aggregates as much as we wanted. We came in a little above target last time, so that leads me to suggest that we ought to resolve the risk by choosing a little lower rate than we otherwise might. And I think around 6 percent on an unadjusted basis, as Larry suggested, would be about right between February and June.

CHAIRMAN VOLCKER. The unadjusted basis?

MR. BLACK. Right. Unadjusted.

CHAIRMAN VOLCKER. So, you're on "C" basically; I just want to be [sure].

MR. BLACK. A little above "C" or between "B" and "C."

CHAIRMAN VOLCKER. Six percent on an unadjusted basis, from what Steve just told me, is equivalent to "C."

MR. PARTEE. March to June is shown on the next page here; it's 6 percent.

MR. BLACK. Yes, I'm talking about February to June.

CHAIRMAN VOLCKER. Well, you're below "C" then, if you're talking about February [to June].

MR. PARTEE. Yes, that's 7-1/2 percent on "C."

CHAIRMAN VOLCKER. I just want to clarify where you are.

MR. BLACK. Let me get my [Bluebook].

MR. FORD. It's on page 8.

MR. BLACK. Page 7 is what I'm talking about.

MR. PARTEE. Well, you're talking adjusted.

CHAIRMAN VOLCKER. They're adjusted.

MR. FORD. They're adjusted. The unadjusted is on page 8.

CHAIRMAN VOLCKER. Keep these two pages in mind.

MR. FORD. Do you know what they did? What's causing the confusion, I think, is that the staff switched what they put in parentheses and what they don't--

MR. AXILROD. That's right.

CHAIRMAN VOLCKER. If you look at the last line on page 8, as I understand it--. It doesn't seem right. Well, we don't look at March to June [on a quarterly average basis].

MR. BLACK. You want to look at February to June or March to June.

CHAIRMAN VOLCKER. Yes, that's right. February to June or March to June, whichever one you prefer to look at.

MR. BLACK. Yes, I thought I was in between "B" and "C" [with] the 6 percent on the unadjusted. The unadjusted is at the top, isn't it, and the adjusted is at the bottom? I meant 6 percent on an unadjusted basis.

MR. BALLEES. Vice versa, Bob.

CHAIRMAN VOLCKER. Wait a minute. We are saying on an unadjusted basis, February to June produces an adjusted figure considerably below "C." We better all try to get this straight in our minds. I think the confusion is because of the parentheses. The real figures are in parentheses; the adjusted figures are not. So, if you were saying 6 percent on the unadjusted figure, you're at only 4 percent on the adjusted figure, which is below "C."

MR. BLACK. Well, I did not mean to be below "C." I'm confused on this. It's devilishly confusing anyway. I thought what I was choosing was something between "B" and "C" on M-1B on chart 1.

CHAIRMAN VOLCKER. Well, that's okay. Those are the adjusted figures.

MR. BLACK. Okay. Well, somewhere in between there, erring a little toward "C" is really what I had in mind.

CHAIRMAN VOLCKER. Okay.

MR. BLACK. I [understand] this well periodically and then I get myself confused. It's tricky business.

CHAIRMAN VOLCKER. It's easy to get confused. I think we had better be sure what we have decided before we go on. Mr. Boehne.

MR. BOEHNE. I don't think I can add to the confusion, and certainly I won't try! I think a good plan, when you don't know what to do or what is going to happen, is to take the middle ground, and it seems to me that "B" captures that about as well as anything. So, I would be for "B." I would like to pick up on a point that Nancy made, however. The M2 target that we have is quite unrealistic in the sense that it's not consistent, at least in the staff's judgment, with the M-1B target. So, I don't think I would be maneuvering M-1B around a good bit to hit an unrealistic M2 target, which is another way of saying that I don't think M2 is much of a refuge just because we are having trouble knowing what is happening to M-1B.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. Mr. Chairman, I recognize, like Governor Wallich, that the economy has turned out to be stronger and has remained stronger for a longer period than one would have expected. Nevertheless, it's hard to see where the sources of continued strength will be. It's hard to see that the saving rate will fall much further than where it is at the present time and, of course, the outlook for growth in income does not leave much room for consumers to continue to spend heavily out of income. So, I wouldn't see strength continuing to come from the consumer sector. Again, it's hard to see that there will be any strong surge in investment spending. So, in contrast to some of the views that have been expressed around the table, it seems to me that the staff forecast is certainly as good as any I have seen and probably better than most. For lack of a better forecast, I would base my expectations on the staff forecast.

In the circumstances, I think we need to preserve our flexibility and, as has already been expressed, it probably would best be preserved by alternative B. I believe that in the circumstances we should give somewhat more weight to M2. Alternative B would do that to a degree. Certainly it allows for a gradual return of M-1B to a lower range in time. Hopefully, over the period of the year, we will get back closer to the top of the target range. I think the risk of alternative C is that we may force higher interest rates over time-- interest rates higher than are likely to be sustained. And we may then find ourselves facing a rather sharp fall-off from the peak rates that might be reached. So, I think alternative B is the one that assures us the most flexibility, the most ability to maintain stability, and at the same time maintains a posture of significant restraint.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. With respect to the staff forecast for the economy, I don't know that there's very much to disagree with if you can't come up with a better forecast. But since I'm not a professional economist, I guess I can take the liberty of suggesting that the forecast in the past has consistently undershot the actual performance. And queuing off of that history, I would believe that we may be looking forward in the period ahead to somewhat stronger growth than is evidenced by the staff forecast in the Greenbook. Having said that and then looking at what is described as the downward shift in demand for money that has been very great in the period just passed--and the sub-talk that we'll return to some more normal level in the period ahead--it suggests that we are going to have very strong money growth as we move to the second quarter and perhaps into the third quarter. If that's correct, it seems to me that we ought to take what we can get now, and that would suggest at least "B" and perhaps "C." And since I can't decide between the two, I would take something in between. The borrowing level that has been described in the Bluebook as being consistent with alternative B, and I believe that's \$1-1/2 billion, seems a bit high to me. Let me make the point that there has been some discussion about whether or not M2 should be taken into consideration for the period ahead. I'd like to see it taken into consideration in a sense that it is running very high. And at the time the staff sets the paths for the period ahead and the borrowing level consistent with those paths, M2 should be either explicitly in the directive or, because of the discussion around this table, implicitly be taken into consideration and not lowered. Thus, that suggests a bit firmer policy, or closer to "C" than to "B." I would just come out someplace between "B" and "C," which is about 6 percent from February to June.

CHAIRMAN VOLCKER. What was that last comment? It's the last sentence I need.

MR. GUFFEY. It's 6 percent if you are looking from February to June.

CHAIRMAN VOLCKER. Okay.

MR. GUFFEY. M-1B goes to 6 percent and M2 to 12 percent; or if you are looking at March to June, it's about 5-1/2 and 10-1/2 percent.

CHAIRMAN VOLCKER. Okay. Mr. Balles.

MR. BALLEES. Mr. Chairman, in terms of these alternatives, I too would favor "B" for many of the same reasons that have already been cited. But I do have one question. Perhaps I am the only one around the table who doesn't understand this, but I wonder if you would repeat what you believe to be the significance of the federal funds range associated with "B." We've had an extensive discussion--

CHAIRMAN VOLCKER. Well, Mr. Axilrod would have to address that. I will give you a general answer: The federal funds range that we cite in the directive is the trigger for consultation, and then what it means depends upon the nature of the consultation.

MR. BALLEES. My further question, Mr. Chairman, would be with respect to the telephone conference call on February 24, when I happened to be out of town and wasn't able to participate. It was decided, as I remember from reading the memos, that there would be no change in the official funds rate range at that time. But was that also meant to imply that the Desk was free in some sense to come in with an actual federal funds rate lower than the officially specified range? If that is the case, is that also what is suggested with respect to this future period? That's what I'm trying to get some clarification on.

CHAIRMAN VOLCKER. Well, I'm just taking it literally. I'm not talking about what numbers we put in there. The purpose of the funds range is that if an inconsistency develops, as it says, we will have a consultation. What happens during that consultation is an open question. It depends upon what the results of the consultation are.

MR. BALLEES. Well, to take an extreme point of view perhaps, I would want to know why it wouldn't make more sense to have a federal funds rate range centered pretty much around where we are now.

CHAIRMAN VOLCKER. Well, my comment is entirely independent of where this federal funds range is set, which is something nobody has addressed yet. You may want to address yourself to that question.

MR. AXILROD. I probably should say something. There are any number of ways one could set this range. One is to project what interest rate level the staff thinks is consistent with these aggregate targets and set a range of plus or minus 2 to 3 percentage points around that. That would again be different than taking the current range, because we don't think the current range is particularly consistent except for "A." We have done that in the past under previous kinds of operating procedures. I have felt reluctant in general to make the range substantially different, even though our staff forecast might be substantially different in a sense, from where the Committee had been. So, what these ranges really represent is some skewing of the present Committee range; they are skewed to allow for where we think the funds rate will be, but there is more room on top because our projection is that, if anything, rates will go higher than where it appears the rate will start off and not that they will go lower. So, they're in some sense judgmental in that respect, trying to distend the existing range to make allowance for how we think the funds rate comes out of the analysis.

CHAIRMAN VOLCKER. I will tell you what my personal attitude toward setting those ranges is. I look at what the staff has to say, but I don't think that's the controlling thing. It's where do we want to have a consultation if it went either down or up, which may or may not be consistent with where the staff estimates that the market might bring it. Those estimates are not very good. They may be the best estimates that can be made, but I look at the range and say, as a first approximation: What level of interest rates might disturb us enough to want a consultation?

MR. GUFFEY. That would suggest we could narrow it to 2 percentage points.

CHAIRMAN VOLCKER. Well, we'd be having a consultation all the time, I suppose.

MR. BALLE. Well, to take an extreme view, which I'm not necessarily proposing here: Since the recent fed funds rate has been around 14 percent, if we want to allow some room both on the up side and the down side for the Desk to operate without the necessity of a consultation, we might specify a range of something like 11 to 17 percent to go along with "B."

CHAIRMAN VOLCKER. Quite possibly.

MR. BALLE. If there's some flaw in that argument, I wish somebody would point it out to me; there may be a flaw.

MR. AXILROD. Well, it depends. There's no flaw in the logic of the argument, clearly. But the staff expectation of "B"--what we presented--is a borrowing level of \$1-1/2 billion. If the Committee chose that borrowing level, I believe that the funds rate probably would be above 15 percent and maybe closer to 16 percent, although these relationships are loose. In that case, the range around that wouldn't be 11 to 17 percent; it would be quite a different range if that was where you wanted to start and you wanted to allow variation around that. If you wanted to start at 14 percent as you were suggesting and allow variation around that, then I don't think the borrowing level we specified for alternative B is consistent with that approach.

VICE CHAIRMAN SOLOMON. I think we have two choices. One is to take what we think it probably would be--let's say 15 to 17 percent--and then have a symmetrical range with enough room on either side. Or we can deliberately put it off center from that 15 to 17 percent--let's say, John Balles' 11 to 17 percent--because we want to trigger a consultation at 17 percent. I think we are better off continuing to have a 5-point range that is symmetrical [around] the most likely area it will be within because the Chairman can always call a consultation anyway.

MR. MORRIS. My concern, given my view of the second quarter, is whether, using John's range, we would want to allow the funds rate to go down as low as 11 percent before consulting. That's why I would prefer a higher lower limit than a lot of you.

VICE CHAIRMAN SOLOMON. If 15 to 17 percent is the best guess of the staff [at the Board] and in New York, then we can talk about something like 14 to 19 or 13 to 19 percent.

CHAIRMAN VOLCKER. Well, we haven't set the borrowing level yet. Let's finish the go-around and we'll get back to this subject. It's obviously a variable we have to set. Who hasn't been heard from? Mr. Boykin.

MR. BOYKIN. Yes, Mr. Chairman. I share many of the concerns that have been expressed with respect to the forecast. I think the economy is and probably will be a little stronger than is projected. Possibly I'm influenced by the people I've talked to down in our part of the country where things tend to be a little stronger. Also, I have a concern, obviously, about inflation in that there doesn't appear to be very much progress in that regard. For the reasons that have already been discussed with respect to the uncertainty about M-1B and also for the arguments that Steve presented on M2, my inclination would be to put a little more emphasis on M2 at least for the time being. I favor maintaining a fairly firm stance in the policy area and I do have some sympathy for alternative C.

CHAIRMAN VOLCKER. Mr. Doyle.

MR. DOYLE. Mr. Chairman, as many others have today, I come out on the gloomy side of the forecast on the real economy. The principal reason for that is that it's just inescapable in our District to come to any other conclusion. I know that the plight of the automobile industry has been widely acknowledged, but I think it's important that the impact of that industry and the state it is in be seen in terms of what it does to us in the Seventh District. For example, there are all kinds of numbers on just what the employment base is, but I will cite just a couple of observations about that. Even little American Motors, which I think had less than 2 percent of the market last year, is the largest single employer in the state of Wisconsin. While hundreds of thousands of jobs have gone down on the production side, their board just recently announced that they have terminated 60,000 salaried employees, and a cut into the staffing side is quite a change. The second point is that the plight of Chrysler, I think, has tended to overshadow somewhat some of the problems throughout the rest of the industry. Of all of the automobiles sold in the country last year--just the domestic models--Ford only had two models in the top ten, and one of those was the Pinto which is no longer made. One has to go all the way down to about the 21st rank before we find the car that used to be the number two and number one best seller in the country: the large size Ford. The most difficult aspect, however, is the future. The industry has always been a cyclical one and it has always been optimistic. But it is extremely pessimistic. I think that relates primarily to two things. One is the difference in wage [costs] as they perceive them between the imports and the domestic models. While those figures again are all over the board, they could be greatly understated if we take into account such factors as absenteeism and other benefits for the American worker. And the second is the growing conviction among the domestic automakers--and we hear this more all the time--that the large car must come back in order for them to survive. They are convinced that, given the choice between a high-priced small car and a high-priced larger car, the consumer is going to take that large car.

I'm not saying they're right; I'm merely reporting how they feel about it. But if they are wrong, that will have a very serious impact down the road.

Despite that, there are some bright spots in our area, particularly in steel and capital goods. But on balance, and despite the suggestion--and certainly our directors feel very strongly about this--that we should be easing economic policy, strong inflationary pressures still persist. That's particularly true in agriculture, where we probably have been lucky so far as price increases are concerned, as others have commented here. We possibly will see continued upward pressures on prices toward the end of the year. And beyond that, any arguments toward easing tend to focus more on the cost of money. In fact, I think many of us feel the reason why automobiles, for example, are not selling is because of the prices rather than the cost of money borrowed to acquire them. So, on balance, I would concur with alternative B.

CHAIRMAN VOLCKER. According to my little checklist, Mr. Ford, you talked but you didn't express any conclusion about where we should go.

MR. FORD. Well, after listening to all the discussion, I frankly am confused by the indicators we're getting on the real economy. I've never been a great believer in trying to fine-tune the economy from one month or one quarter to the next, anyway. I come out between "B" and "C," where a number of other people have, with John Balles' reservation, however, that we ought to allow the lower end of the funds rate range to be at least somewhat lower than what the rate is today as we're sitting here. I'd be inclined to go for a "B-" solution with a little more stringency in the control of the aggregates growth and a little more attention to M2. Although Nancy's argument about the unreliability of M2 also concerns me, I feel more nervous about the problems with M-1B than I do about the problems with M2. And looking at the growth rates that the staff has for M2 in these various [alternatives], I'd lean toward trying to come down on M2 a little harder than "B" with an in-between policy prescription somewhat like a number of others have expressed, except with the fed funds range having a lower low end that will allow some flexibility in the next few days so that if the futures market for the T-bills, for example, is right, we don't have to be on the phone with each other next week.

CHAIRMAN VOLCKER. Governor Wallich, you were not very specific. I gather you are on the lower side of things.

MR. WALLICH. I was for "C," and I would like to see the funds range a little higher than it is there.

CHAIRMAN VOLCKER. A little higher?

MR. WALLICH. Higher.

MR. PARTEE. He always goes that way.

CHAIRMAN VOLCKER. I wasn't quite sure how to interpret you, Mr. Winn, but I thought you were in the same direction. Is that correct?

MR. WINN. Oh, no, "B" to "C," or something like that.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. I'm kind of a "B-," but I could go with "B" if we put a little more explicit weight on M2, even if just in terms of looking at the path.

CHAIRMAN VOLCKER. Mr. Schultz.

MR. SCHULTZ. I was arguing against "A" and "C." So, I'm for "B" and I tend to agree with Tony that we ought to start out with borrowing around \$1.3 billion. And I would go with a federal funds range of 12 to 18 percent.

CHAIRMAN VOLCKER. Well, we have a lunch for Mr. Mayo and I don't think we're going to complete this [discussion] before lunch without forcing things a little faster than I think is appropriate, considering the uncertainties here. It's clear that nobody has been for "A." There are a lot of "Bs," quite a few "Cs," and some in between "B" and "C." We really have had very little discussion of the funds rate until very recently. I am comfortable myself on this. I don't think I would be quite comfortable flat out aiming for "C." I wouldn't be very comfortable going much above "B," depending upon how things happen here. It's a question of how we posture ourselves on borrowing and the funds rate and how we react to the inevitable uncertainties that arise. I may feel differently about the borrowing and the funds rate or whatever, depending upon what happens in the next couple of weeks. If it remains very quiescent for the next couple of weeks, we have quite a lot of room for growth. If we suddenly get a jump in April, we're on the other side of the fence, and I think we will need a little discussion of how to proceed under various hypotheses--or at least two hypotheses. One is if money supply comes in weak in the short run and the other is if it comes in strong in the short run. When is lunch scheduled--at 1:00 or 1:15 p.m.?

MR. ALTMANN. Guests are arriving in your office at 1:15 p.m.

CHAIRMAN VOLCKER. Well, if it's 1:15, I think we can proceed a little further. I'm a little worried about how the directive is written in the light of the various options before us. In general terms, I take it that people are prepared to react fairly strongly, by which I mean they are prepared to see the borrowing level go up and a discretionary adjustment in the path or whatever, if [monetary growth] began running significantly above "B." Nobody has been for above "B," so I assume that that is the implication of that approach. I assume that if we really got below "C," let's say--and there isn't a very big margin between these--in the way the numbers came in, that nobody would resist a decline in interest rates in that possible scenario. Where has the borrowing been just recently? It's under \$1 billion, isn't it?

MR. STERNLIGHT. This week it's coming in a little higher. It's averaging about \$1-1/2 billion because one large bank borrowed substantially this past Friday and that is tending to raise this week's level. The implicit level that we're shooting for in this week

is about [\$1.150] billion, but it seems to be running higher than that.

CHAIRMAN VOLCKER. It's that high, [\$1.150] billion? I guess I would at least raise the question why we should start out any higher than where we are, given that the money supply isn't moving in any particular direction. It's contrary to a "B to C" view of things until we get some evidence that it is moving in one direction or another. I just don't feel confident enough about any of these forecasts to suggest a strong view that we should move off the existing level. But the implication is--you know, literally it can happen in a week--that if a great big figure comes in as it sometimes does, assuming that it either happens in a week or over the course of two or three weeks, we would be prepared to move the path pretty quickly if we felt it was getting above the "B" path.

VICE CHAIRMAN SOLOMON. But isn't March fairly strong, Paul?

CHAIRMAN VOLCKER. Well, I don't know. I don't know how to interpret it. The latest estimate is 8 percent or 8-1/2 percent.

MR. AXILROD. Yes, 8-1/2.

CHAIRMAN VOLCKER. If you just look at March in isolation, that's a reasonably big figure. If you look at it against the previous two months, it doesn't seem very big, and the most recent figures are slack. And if I take the revisions as my leading indicator--that has been the most reliable indication--they're not very clear but they're certainly not being revised upward as they do when this gets a lot of momentum. If anything, the latest revisions have come in a little weak, haven't they, Steve?

MR. AXILROD. Yes. Last week we revised down the [most recent] weeks in March.

VICE CHAIRMAN SOLOMON. But isn't March M2 still running around 19 percent?

MR. STERNLIGHT. It's 16-1/2.

MR. AXILROD. Yes, M2 is around 17.

CHAIRMAN VOLCKER. M2 is certainly high; there is no question that M2 is high. The prevailing view--and I should say that not everybody mentioned it--among those who did mention it, with at least one exception, was to give some weight to M2. And I think that that's implicit. I should, though, make it explicit in what I'm saying, that we would give some weight to M2 in adjusting the reserve path. Again, I'm not quite sure what number to put down in the actual directive. But if I read the Committee right, the members are certainly more disturbed about exceeding "B" than falling somewhat short of "B."

MR. PARTEE. So long as it isn't short of "C," I think I would agree with that.

CHAIRMAN VOLCKER. I think that's probably a fair summary. What bothers me is how to word this. I'm not sure there's any massive difference of opinion. I do think all these federal funds ranges seem too high. All these ranges as stated, given the uncertainties that

exist, may be quite appropriate in terms of the best estimate the staff can make. But I would get worried if the funds rate shot up to 20 percent here, quite frankly, without reconsidering just where we were. I would not get particularly worried if it went down to where it was before, conceivably, depending upon how business [conditions] unfold in the next few weeks. The lowest was 13-1/2 percent on a weekly average basis. I can imagine circumstances in which that would not be at all disturbing and may be desirable. The numbers I had scratched down here before I heard any conversation were 12 to 17 percent, but I had no particular brief for that exactly.

MS. TEETERS. Why don't we make it 12 to 18 percent, as Fred and I [suggested].

CHAIRMAN VOLCKER. It is symmetrical around where we are, sort of.

MR. PARTEE. Where are we--around 15 percent or plus a little?

CHAIRMAN VOLCKER. Well, this week, I guess it would be a little plus.

MR. PARTEE. Probably 18 percent, given--

CHAIRMAN VOLCKER. The most recent figure is 14-1/2 percent or something?

MR. STERNLIGHT. This week it's averaging 15.07 percent so far.

CHAIRMAN VOLCKER. Well, it will probably ease for the rest of this week, given all the borrowing that has already taken place. That still doesn't tell me how to write the directive, which makes me a little hesitant. But I suppose we could put in a number somewhat below "B" if that captures the center of gravity, with whatever funds rate range--

MS. TEETERS. We've used language in the past that gave a number and then said we wouldn't be disturbed if it fell slightly short of it.

CHAIRMAN VOLCKER. Yes, we could use that kind of language. Maybe that captures it. We could say "B" or lower, depending upon--

MR. PARTEE and MS. TEETERS. Somewhat lower.

CHAIRMAN VOLCKER. What is the language we've used before? It was "somewhat lower depending upon"--

MR. AXILROD. I think "or somewhat lower."

MR. ALTMANN. "Somewhat less."

MR. AXILROD. Well, we had language about interest rates-- that you were not forcing them down.

CHAIRMAN VOLCKER. Yes. Did we actually put that in the directive or was that--

MR. AXILROD. There was such language. I'd have to look it up, but there was such language.

CHAIRMAN VOLCKER. Well, maybe that is the kind of language we need here. Can you provide that language to us, Mr. Secretary?

MR. ALTMANN. Possibly.

MS. TEETERS. What have the borrowings averaged in the last four weeks?

MR. STERNLIGHT. Last four weeks?

MR. AXILROD. Well, in the last three weeks, which is easy to [calculate], they were almost \$800 million.

CHAIRMAN VOLCKER. Yes, but what do we actually put in the [path]?

MR. AXILROD. But before that, they were in a range of \$1.1 to \$1.7 billion in that one exceptional week.

MS. TEETERS. So \$1.3 billion would be an increase in the borrowing level over where we've been most recently?

MR. AXILROD. Oh, yes. In some sense, for this four-week period that is ending, we are aiming at an average level of borrowing somewhere on the order of \$900 million. We're aiming this week at \$1.2 billion because in the earlier weeks borrowing had dropped well below that \$900 million. So, it's coming up this week.

CHAIRMAN VOLCKER. Let me just point out the consequences, not just the arithmetic consequences, of this decision in terms of its implications. If we went with "B" and if the forecast is [right]--and I think most people agree with it in terms of tendencies toward a weak economy in the short run and weaker than average in some sense for the year--a 6 percent growth in M-1B in the second quarter maintained through the rest of the year would leave us within our target, but barely, with the prospect of a pretty good interest rate fluctuation if this next quarter is really soft. "B" potentially forces [the funds rate] up against a natural tendency. "C" continued through the rest of the year, I guess, brings us--

MR. AXILROD. To the bottom end of the range.

CHAIRMAN VOLCKER. The bottom end for the year as a whole?

MR. AXILROD. That's right. And "B" to the middle.

CHAIRMAN VOLCKER. It might be more than the middle, wouldn't it? It's three-fourths [of the year at] 6 percent and one-fourth at whatever it was.

MR. AXILROD. [Unintelligible].

MR. PRELL. "B" would be in the middle by September and then you'd have to decelerate slightly.

CHAIRMAN VOLCKER. So we'd be above [the middle], yes. Well, these are monthly growth rates rather than quarterly. What is the equivalent quarterly growth rate here for "B"? It appears someplace, doesn't it?

MR. AXILROD. Well, the equivalent quarterly growth rate is 5.7 percent for M-1B over the 6 [months].

CHAIRMAN VOLCKER. Yes, so it's a little less. But we'd still be above the middle of the range, I think. It would not be running at the top of the range, but just slightly below it after a small first quarter. It's right at the middle of the range in September. Continuing at 6 percent must put us above [the middle], but not as close to the top as I thought.

MR. AXILROD. Well, yes, quarter-over-quarter.

CHAIRMAN VOLCKER. All that suggests, I think, that we should be more conscious of exceeding it than falling somewhat low. What language do we have that was actually in the directive?

MR. ALTMANN. It was in December [1980].

CHAIRMAN VOLCKER. Yes, that language was: "...some shortfall in growth would be acceptable in the near term if that developed in the context of reduced pressures in the money market."

MR. SCHULTZ. That sounds pretty good because, as I recall Steve's figures, the staff is looking for velocity to slow down some in the second quarter so you were anticipating that we would have to have the higher borrowing, weren't you? What were you looking at in terms of--

MR. AXILROD. In terms of the level of borrowing?

MR. SCHULTZ. Yes, for "B." You were talking about \$1.5 billion, weren't you?

MR. AXILROD. Yes. We had a rather high level of borrowing because we were assuming considerably higher interest rates than I think the Chairman or the specifications are either explicitly or implicitly assuming. So there would be a difference.

CHAIRMAN VOLCKER. Well, I'm not particularly assuming a level of interest rates. All I said is that I might want to consider [an adjustment] at some point if they got high enough. I'm suggesting that this is what the relationships look like and if we want to hit "B," we'd better go out and increase the borrowing right away. But I'm saying: Let's wait and see and get some evidence that that projection is in fact being borne out before we move. It may well be correct or maybe we will have to go even further, but let's wait and see.

MR. PARTEE. I don't think we'd have to be as specific as that language that you just read, Paul. I don't know why we don't

just say "growth in M-1B from March to June at an annual rate of 6 percent or somewhat less."

CHAIRMAN VOLCKER. Yes, that may be, because I'm not sure we're talking about reduced pressures. It might be that we'd accept somewhat less if [the funds rate] just stayed where it was.

MR. PARTEE. Yes, I think so too.

CHAIRMAN VOLCKER. Well, let me try to see what we're talking about. You said 6 percent is the figure you were thinking of for March to June.

MR. PARTEE. I was thinking March to June. After all, tomorrow is April 1.

CHAIRMAN VOLCKER. Right.

MR. PARTEE. And it seems to me, even though we don't quite know March, we ought to--

CHAIRMAN VOLCKER. I think we ought to use March to June, too.

MR. AXILROD. Governor Partee, I would mention that we really only know half of March.

MR. PARTEE. I know. But people think we know it.

MR. SCHULTZ. People think we know a lot!

SPEAKER(?). As you can tell from the previous discussion, we have great faith in the forecast!

CHAIRMAN VOLCKER. Well, we can say 6 percent or somewhat less or I suppose we can say 5-1/2 percent or somewhat less. I don't know where you want to put the funds rate range. As I say, I would want to look at it even if the funds rate were at 17 percent if the economy were also quite weak at the same time. It wouldn't bother me at 17 percent if the economy were quite strong. But that's something we don't know until we sit down and look at it.

MR. PARTEE. Speaking for those who like a wide funds rate range, I could accept 12 to 18 percent. I think we ought to have a 6-point range rather than go back down to a narrower range.

MR. BOEHNE. I think 12 to 18 percent makes sense.

VICE CHAIRMAN SOLOMON. I would prefer 13 to 19 percent. It seems to me a little more symmetrically placed around--

MR. PARTEE. Well, if you think it's 15 percent now, 12 to 18 is even-handed. But if Paul is sensitive to high rates, as he seems to be, we're going to have a telephone conference call if the rate gets up there.

CHAIRMAN VOLCKER. I do have the feeling that at some point we would want to consult.

MS. TEETERS. I can support the 12 to 18 percent. Are you implying that we'd stay at about the \$1.1 billion in borrowing and then let it--

CHAIRMAN VOLCKER. Well, I wanted to get to that next. I was implying that until we get further information we'd stay roughly where we are, whether that's \$1.1 billion or slightly over \$1.1 billion. But consistent with this whole attitude is that if the money supply came in strong, we would be prepared to move pretty quickly, which might mean a discretionary move as the natural result of holding the nonborrowed path steady. And we'd be quicker to move in that direction if it came in strong than if it fell short.

MR. PARTEE. That is to adjust the nonborrowed path?

VICE CHAIRMAN SOLOMON. A more even pattern of borrowing yielding the same total as this week would probably give us a lower fed funds rate than the 15+ percent we're seeing, right? Therefore, if we're talking about keeping the present fed funds rate, which is around 15 percent, then--

CHAIRMAN VOLCKER. I don't particularly care myself about the present level of the federal funds rate.

SPEAKER(?). Well, I think this is going too far.

VICE CHAIRMAN SOLOMON. Well, we would certainly have to start off with it there. Then I think we probably are talking about something closer to \$1.3 billion than \$1.1 billion.

MR. WALLICH. As to the lower level of 12 percent [for the funds rate], if we get there, it would have to be below that on several days before we say that over a period of time it has been below that. And then we would have done about three-fourths of the drop that we had in 1980.

CHAIRMAN VOLCKER. Well, I have no vested interest in 12 percent. If you want to make it 13--

MR. WALLICH. No, I want to make it substantially higher.

MR. PARTEE. I don't think making it 13 is going to capture [Henry's vote].

MR. CORRIGAN. I would prefer to state the March-to-June growth rate at 5-1/2 percent or somewhat less. I could go either 12 to 18 or 13 to 18 percent on the funds rate and borrowings starting out in a range of \$1.2 to \$1.3 billion. But I still have a question in my mind. Suppose we did either one of these things and M2 continued to grow at, say, 15 percent. If M-1B was around 5-1/2 or 6 percent but M2 was 15 percent, what would we do then?

CHAIRMAN VOLCKER. Well, I don't think we can deal with every possible contingency, but I--

MR. CORRIGAN. No, I [realize that].

CHAIRMAN VOLCKER. Just to take the specifications you suggested, if M-1B came in around 5-1/2 to 6 percent and M2 was very high, we would lean on the tighter side. We might make an adjustment.

MS. TEETERS. But we'd do it with a consultation?

CHAIRMAN VOLCKER. I don't think that would require a consultation if the funds rate were in the range and so forth.

MS. TEETERS. Suppose it's all money market mutual funds?

MR. CORRIGAN. Well, there's a little more to it than--

MR. PARTEE. [Unintelligible] market rates.

CHAIRMAN VOLCKER. Well, I'm sure if it did, it will be all.

MR. PARTEE. [The money market mutual funds] are very sensitive to market rates. If market rates go above what the funds pay, the money that is in the funds will move back into the market.

CHAIRMAN VOLCKER. This is a question of whether we give some weight to M2. But we don't have to word the directive that way; it already does. The directive always gives weight to M2 as I recall.

MR. CORRIGAN. I'm reacting a little, Tony, to that memo that you distributed, which effectively points out that we don't make any adjustment in the paths for the nonreservable components of M2 regardless of what they do.

VICE CHAIRMAN SOLOMON. Even though I distributed the memo, on balance I would prefer that greater attention to M2 be done on a judgmental basis rather than a mechanistic one.

MR. CORRIGAN. I agree with that.

CHAIRMAN VOLCKER. Yes, I'm not talking about a formula. The directive just specifies a target for both, which implies that we take account of M2. I don't think we have to change the directive for that purpose.

SPEAKER(?). Okay.

CHAIRMAN VOLCKER. I think we have to have some knowledge among ourselves about what weight we give to it; I'm suggesting that be on a judgmental basis. If we want to give it weight, that doesn't in itself require a consultation. The substantive question is whether we want to give it weight.

MS. TEETERS. Well, it all depends, in Jerry's scenario, on what is making M2 go up relative to M-1B.

MR. BALLE. Mr. Chairman, without getting in a long digression, do you have any feel as to whether Mr. Fauntroy's bill on money market mutual funds has any chance of passing in the near future? That could have some bearing on the growth of M2.

CHAIRMAN VOLCKER. I have no particular sense that any bill on money market funds is going to be passed in the near enough future to affect anything before our next meeting.

MR. SCHULTZ. Furthermore, both bills have been referred to the Commerce Committee, which is a very unfriendly referral.

MR. BALLEES. Oh, really?

CHAIRMAN VOLCKER. There conceivably could be legislation, but I don't think it's going to take place in a way that affects anything before May 23rd, or whenever our next meeting is scheduled.

MR. SCHULTZ. Mr. Chairman, if we just go with 5-1/2 percent or somewhat less, doesn't that really give us the kind of flexibility that we need to take care of most of these [contingencies]?

CHAIRMAN VOLCKER. Yes. I just want an understanding of how we adjust as we go along. The basic [M-1B reference] is 5-1/2 percent or less, but I think it is appropriate to give some weight to M2. That's what most people are saying.

MS. TEETERS. How did we get to 5-1/2 percent? I thought we were at 6 percent?

CHAIRMAN VOLCKER. Well, we have to resolve that.

MS. TEETERS. All of a sudden we've dropped 1/2 percentage point.

CHAIRMAN VOLCKER. We are trying to find the center of gravity here.

MR. PARTEE. And it's falling.

MS. TEETERS. Yes. It was 6 percent or somewhat less and now it's 5-1/2 percent or somewhat less.

CHAIRMAN VOLCKER. Pardon me?

MR. ALTMANN. Peter Sternlight has a comment.

MR. STERNLIGHT. Mr. Chairman, you referred to giving some weight to M2 judgmentally. In the recent period, there was an opportunity to do that because the M1s were running weak and we could modify the extent to which we would change the path because of that. But that [situation] wouldn't necessarily arise in the future. You might not have the opportunity to give weight to a strong M2 if, for example, the M1s were running right about on path. Even if M2 were running very strong, I wouldn't see that same kind of opportunity to give discretionary weight to that.

CHAIRMAN VOLCKER. I don't understand. You would just reduce the nonborrowed reserve path.

MR. STERNLIGHT. But we might be right about on path.

CHAIRMAN VOLCKER. You might be on the M-1B path, but you would not be giving weight to M2. I don't understand how it differs.

MR. STERNLIGHT. If M-1B were on target, we might be just about on path. If that were the case--

MR. FORD. Paul, the way I hear the sense of the Committee is this: Whatever we want to argue about on M-1B, either 5-1/2 or 6 percent, even if we're hitting M-1B at 5-1/2 or 6 percent, the farther off M2 goes, the more we want to adjust. I think that is what you're trying to say.

CHAIRMAN VOLCKER. That is what I am saying, yes. Well, we have to go to lunch. We'll see whether we can resolve this in a hurry or not. We have a proposal for 5-1/2 percent or lower.

MR. PARTEE. Somewhat lower.

CHAIRMAN VOLCKER. I'll just put down 13 to 18 percent at this point on the federal funds rate.

MS. TEETERS. If we have [only] 5-1/2 percent, we can take that "somewhat lower" off.

CHAIRMAN VOLCKER. Well, let me finish.

MR. FORD. You may get a chance.

CHAIRMAN VOLCKER. I'm suggesting the level of borrowings about where they are, the implication being fairly rapid adjustment of the borrowing level if we exceed [the money supply growth specification]. There would be an adjustment if we fell short, too, but it would be a little more sluggish. That's what the "or lower" reflects.

MR. BALLE. Where are we now on the borrowings?

CHAIRMAN VOLCKER. About \$1.1 billion or slightly above, I think.

MR. AXILROD. Yes, we're aiming at that, but it is running stronger. We're aiming at \$1.16 billion. That's the point [target].

SPEAKER(?). [Unintelligible] decimal point.

MR. CORRIGAN. That's \$1.2 billion.

CHAIRMAN VOLCKER. \$1.150 billion. And there's a degree of consensus that we're giving weight to M2 if it gets wildly off the assumption here, which is about 10 percent.

MR. FORD. Are we leaving out M-1A altogether?

MR. PARTEE. Yes, it's about 10 percent if you--

CHAIRMAN VOLCKER. Well, [the "C alternative] is only 10-1/4 percent [for M2], so we're at about 10-3/4 percent for M2 or someplace

in there. If M2 were in the 11 percent area, it isn't going to get any weight. It's consistent if it's--

MS. TEETERS. What was your fed funds range in the directive?

CHAIRMAN VOLCKER. 13 to 18 percent. And the M-1B number in the directive is 5-1/2 percent or lower.

MR. BOEHNE. "Lower" or "somewhat lower"?

CHAIRMAN VOLCKER. Either one you would prefer. "Or somewhat lower" probably better captures it.

MR. PARTEE. "Or lower" is infinite.

CHAIRMAN VOLCKER. A consistent number for M2 is 10-1/2 percent, I guess, just looking here.

MR. ALTMANN. You need a time period.

CHAIRMAN VOLCKER. For the March-to-June period. Well, let me have a show of hands as to how many prefer this formulation? I think the obvious alternative is just changing M-1B to 5-1/2 to 6 percent and leaving everything else the same.

MR. PARTEE. You want voting members only, don't you?

CHAIRMAN VOLCKER. I guess so. We're on the 5-1/2 percent alternative at this point.

MR. PARTEE. 13 to 18 percent for the funds range and \$1.150 billion on borrowings.

CHAIRMAN VOLCKER. 13 to 18 percent on the funds rate and \$1.150 borrowings with more of a hair trigger on raising it if it comes in higher than lower.

MR. BOEHNE. Is this prefer or accept?

MR. PARTEE. Is anyone unable to accept it?

MR. FORD. Yes.

MR. PARTEE. Let's get it over with; somehow I'm able to accept it.

CHAIRMAN VOLCKER. Let's accept it.

MR. BOEHNE. Accept? I can accept it.

MR. RICE. I would prefer 6 percent or somewhat less, but I could accept that.

VICE CHAIRMAN SOLOMON. I'm still bothered by something. I want to be sure that everybody understands something, which is this: My gut instinct is that if we set the borrowings low at \$1.150 billion, we're going to see a drop in the fed funds rate in the next week or two. I realize that we'd be able to adjust it. But do we

want to see at this point a market signal that we are easing monetary policy?

MR. PARTEE. The funds rate is not a signal.

MR. AXILROD. Mr. Chairman, may I add on to that? I don't know what the funds rate will be with that borrowing. We had borrowing of \$1.145 billion in the week of [February] 18th and the funds rate was 15.81 percent. The preceding week borrowing was \$1.1 billion and the funds rate was 16.51 percent. And in the more recent week of March 4th, we had a borrowing level of \$1.3 billion and the funds rate was 15-3/4 percent. All this [suggests] that we can't be very certain where we're going to come out on this. But I would assume it's somewhere above 15 percent, which would be above the existing--

VICE CHAIRMAN SOLOMON. You mean with that \$1.15 billion?

MR. AXILROD. Yes.

MR. PARTEE. Holding it for a while?

MR. AXILROD. Yes. I think from this day it would be above 15 percent, but I can't be absolutely certain.

MR. STERNLIGHT. There's a range of uncertainty on these.

CHAIRMAN VOLCKER. Well, let's vote on this.

MS. TEETERS. Did you take a vote on the 5-1/2 to 6?

MR. RICE. Six percent or somewhat less.

MS. TEETERS. Or 6 percent and somewhat less.

CHAIRMAN VOLCKER. Well, we can explore preferences on that. How many people prefer 6 percent? Everything is the same except we would put a 6 percent number in there.

MS. TEETERS. I would prefer 6.

SPEAKER(?). Yes.

SPEAKER(?). I would prefer 6.

SPEAKER(?). I would prefer it too.

CHAIRMAN VOLCKER. One, two, three, four, five.

MS. TEETERS. Try 5-1/2 to 6.

MR. PARTEE. No, we have to have a number for targeting purposes.

MR. SCHULTZ. Yes.

CHAIRMAN VOLCKER. We're in an area where the [difference] is extremely narrow. How many people prefer the 5-1/2 percent?

SPEAKER(?). Or less?

CHAIRMAN VOLCKER. Before I ask how many would accept it, how many prefer the 5-1/2?

MR. WALLICH. Without accepting it?

CHAIRMAN VOLCKER. You've got to sneak--

VICE CHAIRMAN SOLOMON. I prefer the 5-1/2 to 6.

SPEAKER(?). You feel it has to be a single number?

MR. SCHULTZ. Well, it doesn't really have--

CHAIRMAN VOLCKER. We already have "or lower" and it makes almost no difference here.

MR. PARTEE. [The path would be drawn on] 5-3/4 percent if we said 5-1/2 to 6 percent.

VICE CHAIRMAN SOLOMON. Well, put me down for 5-1/2.

CHAIRMAN VOLCKER. Look, we're virtually equally divided as to preferences here. Let's go with the 5-1/2.

MR. PARTEE. I have a feeling it's the Chairman's preference.

MS. TEETERS. Well, if you're going to do that, it should be 5-1/2 percent or somewhat more. At least take off the somewhat less.

MR. SCHULTZ. It's only somewhat less, Nancy.

MS. TEETERS. Yes, and you'd let it come out as a minus 3.

CHAIRMAN VOLCKER. I think there is a--

MS. TEETERS. How far are we off the target for the first quarter? That was a 4-3/4 percent rate of growth or 3 percent or something. And we're coming in at what, minus 2 percent?

MR. SCHULTZ. I voted with you, Nancy.

CHAIRMAN VOLCKER. Let's have a vote at 5-1/2.

MR. ALTMANN. Or somewhat less, too?

CHAIRMAN VOLCKER. Yes, or somewhat lower.

MR. ALTMANN.

Chairman Volcker	Yes
Vice Chairman Solomon	Yes
President Boehne	Yes
President Boykin	Yes
President Corrigan	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Schultz	Yes

Governor Teeters	Yes
Governor Wallich	No
President Winn	Yes

Ten for, one against.

CHAIRMAN VOLCKER. Okay. Thank you. Without much delay we finished before lunch. If we make the lunch late enough, we can always finish before lunch!

END OF MEETING