

Federal Open Market Committee
Conference Call

April 28, 1981

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman
Mr. Boykin
Mr. Corrigan
Mr. Gramley
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

Messrs. Doyle and Smoot, First Vice Presidents, Federal
Reserve Banks of Chicago and Philadelphia,
respectively

Mr. Axilrod, Staff Director
Mr. Altmann, Secretary
Mr. Kichline, Economist
Mr. Sternlight, Manager for Domestic Operations,
System Open Market Account (New York)

Note: A complete record of staff attendance at this session was not
available in the Committee's files.

Transcript of Federal Open Market Committee Conference Call of
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CHAIRMAN VOLCKER. [Unintelligible] money supply figure. The next money supply figure, in case any of you don't know it, shows a sizable increase, which is not particularly in line with anybody's expectation or projection and puts us well above the last path we had. I'll get to that in a minute, but I want to put it in the perspective of these seasonals. And I'm afraid there was some misleading of the Committee at the last meeting in that it was said that it just doesn't make much difference. It makes quite a lot of difference--not the seasonal changes themselves, but how we treat NOW accounts. On the seasonals themselves, a tentative decision has been made to use the technique which, in effect, knocks out April to September of last year. If we don't, and just run an ordinary seasonal, a lot of the seasonal adjustment factors move in the opposite direction from [the way] they have been moving in recent years and the year-to-year changes in seasonal adjustment factors are much bigger than has been typical. There are 0.5 changes and 0.6 changes in particular months, which is very exceptional and doesn't look very reliable. Moreover, the other technique is at least consistent with what our outside consultants said to do when we had something unusual occur in a series in the space of a year. Also, it gives seasonal adjustment factors that are at least no more different than they ordinarily are; they change either 0 or 0.1 or, in a few months, 0.2; and they all tend to move in the same direction they have been moving in recent years. So, tentatively at least, we're operating with those kind of revisions in the seasonals.

As for NOW accounts, we are putting in the NOW accounts and seasonally adjusting them. Of course, they've gotten quite big this year, and there is a decision as to what to do. I think we can say there is no right way of doing it. We don't have any history that gives a particular seasonal for NOW accounts. We could do what we've been doing up to now, which is to assume they have no seasonal. We can do what we are tentatively doing, which is to assume that the proportion of NOW accounts that came out of demand deposits acts like demand deposits and the other portion acts like savings accounts. Or we can just seasonally adjust the [M1] series with NOW accounts in it, which is presumably what we would do in the long run. But, of course, we haven't got much experience for that either. So, tentatively, what we're doing is taking that middle course, which is to seasonally adjust the total of M-1B adjusted, in effect; and we get a seasonal that is almost the same as the demand deposit seasonal, but there's a big difference in the fact that we're including NOW accounts where we didn't before. This question arose at the Committee meeting [in late March], and the response was that it didn't make much difference. Well, it turns out that it makes quite a lot of difference on a month-to-month basis. An advantage of publishing this now is that it makes almost no difference from December through April. In other words, it would not change the April level appreciably. It would raise it by \$100 or \$200 million or something, according to our current estimates. But it does not make a very appreciable difference for the whole period from December through April. It does make a big difference for particular months. I'll read you what we tentatively have for the monthly adjusted figures.

MR. PARTEE. For M-1B.

CHAIRMAN VOLCKER. What we now have shows: +1.5 in January; -2.3 in February; and +8.2 in March. Just extrapolating what we have, with that big jump in the week we haven't published yet, April would be +18 percent. Now, choosing the seasonal that includes in effect two-thirds of the NOW accounts or a little more than that for the early part of this year, the monthly numbers would be: January, +4.1; February, +2.3, which is a particularly big change; March, +7.3; and April, +13.6. The quarterly change, which on the old method was -.2, becomes +1.3. The December-to-April seasonally adjusted annual rate, again using that April estimate, is 6.3 percent on the old basis and approximately 6.9 percent on the new basis. That change of about 1/2 percentage point is only a third of [the difference in the quarterly change] because this seasonally adjusted annual rate actually looks at the April level. The difference in the April level is between 0.1 and 0.2 percent, and 0.1 is maybe a little more than \$400 million, I guess.

MR. AXILROD. Well, it's about 0.2 off.

CHAIRMAN VOLCKER. It obviously shows a smoother pattern on the new basis, but it doesn't change the general trend. April looks much lower and February looks much higher. Let me just stop there and see whether there are any questions or comments.

MR. BLACK. Mr. Chairman, Bob Black. I commend you for this. I think this really ought to be done.

CHAIRMAN VOLCKER. Well, I think it ought to be done, too. But I'm not very happy about the fact that it involves such big changes and that the pattern looks somewhat different than what we had before.

MR. BLACK. But if we end up with 13.6 percent in April, that will look a lot better than 18 percent.

CHAIRMAN VOLCKER. I agree with that. People will say that's why we did it.

VICE CHAIRMAN SOLOMON. Paul, when we publish this on Friday, if that's what you intend to do, are we going to give it month by month?

CHAIRMAN VOLCKER. Yes, we'll give the back data for last year and all the back data for this year, including the weekly numbers. We haven't got the weekly changes worked out yet. It obviously won't change the direction of week-to-week movements, but it will change the week-to-week movements in some way that corresponds with this monthly change.

VICE CHAIRMAN SOLOMON. But the week-to-week numbers that we've been publishing--

CHAIRMAN VOLCKER. We would also publish a long explanation of just what we did.

VICE CHAIRMAN SOLOMON. All right. And in the future when we give the monthly adjustments for the correction of the NOW accounts, we would give it seasonally adjusted?

CHAIRMAN VOLCKER. Well, that adjustment factor I don't think is seasonally adjusted, but we will show the adjusted figures seasonally adjusted. We have two adjustments here: The first adjustment is called shift adjustment; the second adjustment is called seasonal adjustment. We will print seasonally adjusted, shift-adjusted, figures.

VICE CHAIRMAN SOLOMON. And that will be just once a month?

CHAIRMAN VOLCKER. Yes.

MR. SCHULTZ. And that's going to clear everything up!

CHAIRMAN VOLCKER. Now, on this seasonal--nobody knows what May is going to bring anyway--it reduces the April growth and it would increase whatever May growth there is. Or if May went down, it would go down less because the seasonal happens to work in the other direction. The way it works out, these NOW account additions don't make much difference on a quarterly basis. But they make a lot of difference in the months within a quarter. The seasonal adjustment factor tends to come back to about the same thing in the first month in every quarter as a kind of first approximation. So, when you look at a figure from January to April, or April to July, or July to October, it doesn't make much difference whether you seasonally adjust the NOW accounts or not. But whenever the seasonal adjustment factor moves by a large amount, it makes a large difference because NOW accounts are now \$60 billion or whatever.

SPEAKER(?). Well, let's just forget about this--

CHAIRMAN VOLCKER. We have another conversation on [this telephone line], I guess. Either that or I can't hear somebody.

MR. CORRIGAN. No, there's at least one other conversation going on here, Paul.

CHAIRMAN VOLCKER. I don't know whether it's more interesting than ours. Mr. Secretary, can we clear this up?

MR. ALTMANN. We've been working on it since before we got started.

MR. BLACK. Mr. Chairman, he said what had been done couldn't be undone. He must know what the April figure is!

MR. SCHULTZ. I don't think we're in any danger. Anybody listening in on this conversation is going to be totally confused!

CHAIRMAN VOLCKER. Well, I wish this could get cleared up. Is there any more comment on this?

MR. BALLEES. John Balles, Paul. Am I understanding correctly--

CHAIRMAN VOLCKER. Just a second, John. We have to get that other conversation off of here. Can we start it over again or what?

MR. ALTMANN. We can.

CHAIRMAN VOLCKER. Look, we're going to hang up and start over again.

MR. PARTEE. Communications.

CHAIRMAN VOLCKER. All that fancy telephone [junk] they've put in here.

MR. PARTEE. Well, that's just for within the Board.

CHAIRMAN VOLCKER. Can't I call someone now and--

MR. PARTEE. That doesn't take care of outside; in fact, we can't call outside.

MR. ALTMANN. When we started out, at least, we interrupted a conversation.

MR. PARTEE. I thought we had dedicated lines. I didn't think that could happen.

MS. TEETERS. Well, maybe it's because they're switching all the other ones.

MR. PARTEE. What is our range for M-1B adjusted?

MR. AXILROD. 3-1/2 to 6 percent.

MR. PARTEE. So 6 to 9 is distinctly high?

MR. ALTMANN. Oh, I don't think they hear us.

MR. AXILROD. But that's not what it would be quarter--

MS. TEETERS. It's a quarterly target.

MR. PARTEE. Naturally, we get a funny first quarter because--

MR. ALTMANN. Does anyone still hear the other voices? I think we need to run down the list once again, which we can do quickly, to make sure we haven't lost anybody. [Secretary's note: All Reserve Banks reported that they had been reconnected.]

CHAIRMAN VOLCKER. I guess we interrupted John Balles, but let me just say one other thing. The implication of taking this kind of middle course on the seasonal adjustment, which looks best at the moment, is that we're going to have to change it again. At some point--I don't know when--we should just be seasonally adjusting the total series. You know, two years from now we're going to face this same problem and what to do about it. Presumably at that point, we may just shift over and seasonally adjust the whole series.

MR. PARTEE. We'll only have one M-1.

MR. BALLEES. Paul, this is John Balles. I was just going to ask a couple of questions. It is my understanding, and I'm asking for

confirmation, that this is the first time the shift-adjusted M-1B figures would have been published.

CHAIRMAN VOLCKER. No, we published them in footnotes at the end of every month.

MR. AXILROD. With the wrong seasonal.

CHAIRMAN VOLCKER. They were not seasonally adjusted. We had this bastardized series; the demand deposit component was seasonally adjusted, but not the NOW account component. But those figures with that earlier seasonal are in the public domain.

MR. BALLEES. The one thing that's worrying me is the point that some of you will remember from past years when we got into this seasonal adjustment problem. It is what Arthur Burns used to call the 4 equals 12 problem. The different techniques are all equally valid but yield different answers. I'm just wondering whether by publishing the new seasonals we're adequately going to guard our flank, so to speak, by pointing out that the seasonals are a matter of some judgment.

CHAIRMAN VOLCKER. We certainly intend to say that. And it's very unusual for [alternative techniques] to make so much difference. As I said earlier, I don't think there's any theoretically right answer to this. The fact is, first of all, that we don't know the shift adjustment, which bears upon it a little; that's an estimate. But we don't know whether NOW accounts behave the way demand deposits did before they became a NOW account. There's no way of knowing that until we get some experience.

MR. BALLEES. Certainly, these published seasonals will be for weekly as well as for monthly [data]?

CHAIRMAN VOLCKER. Yes.

VICE CHAIRMAN SOLOMON. Paul, this is Solomon. Is the staff taking one average shift adjustment assumption? Or are they taking it month by month as far as where the NOW accounts came from?

CHAIRMAN VOLCKER. Well, we made the arbitrary judgment that it's two-thirds [from demand deposits], I guess, throughout 1980. Then in 1981 it's month by month. It started at 80 percent, Steve?

MR. AXILROD. It started at 77-1/2 percent out of demand deposits, then 72-1/2 and 72-1/2 percent. Now we're estimating 70 percent for April, but we don't have any real data yet for April.

CHAIRMAN VOLCKER. Okay, did you get that? It's 77-1/2 percent for January; 72-1/2 percent for February and March, and a guess of 70 percent for April. That's based upon some analysis of asking banks and asking consumers.

MR. AXILROD. Also, we did a cross-sectional analysis of 9,000 commercial banks through an econometric technique. And we're planning to--

CHAIRMAN VOLCKER. Whatever that means, it came out to the same answer.

MR. MORRIS. Paul, this is Frank Morris. It seems to me that the new numbers are a little more compatible with what we know about the real economy than the old numbers were, if that's any consolation.

CHAIRMAN VOLCKER. Yes. Well, it reduces that extraordinary velocity in the first quarter by 1-1/2 percent. It's still an extraordinary velocity figure, but it runs in that direction. When they revise the GNP figure downward, we'll lose another 1-1/2.

MR. WINN. Paul, what does this do to M2?

CHAIRMAN VOLCKER. I don't have the M2 figures with me now.

MR. AXILROD. I don't have it.

CHAIRMAN VOLCKER. It's obviously not going to move as much because this is a small part of the M2 series. But I presume it will raise January and February and lower March and whatever estimate we have for April. I presume I can say this: That it won't change the April level of M2.

MR. AXILROD. We have M-1B and then we have to seasonally adjust the other components.

CHAIRMAN VOLCKER. Okay, have we finished with that subject?

MR. WALLICH. Could I ask?

CHAIRMAN VOLCKER. Wait a minute. Henry Wallich.

MR. WALLICH. Have we tried alternative seasonal adjustments of the kind that in the past gave us these wide variations?

CHAIRMAN VOLCKER. I'm not sure what you mean.

MR. WALLICH. Have we tried different systems of adjusting the same data?

CHAIRMAN VOLCKER. Well, we did the two systems. We did just the straightforward X-11, or whatever it's called, leaving in April through September. And we tried it basically by flattening out those April through September figures. Those were the two main alternatives that were looked at.

MR. AXILROD. Well, one can combine those in a way. We tried 6 or 8 different ones because we had this technique that the Chairman mentioned of, in effect, leaving out part of last year. We also made a similar kind of intervention for late '78 and early '79 when the ATS accounts were introduced; that would distort the demand deposit figures for M-1A and we had to do something. So we could do it with or without that. And then we used 3 or 4 different methods of trying to figure out what to do with the other checkable deposits.

MR. WALLICH. But always on the X-11?

MR. AXILROD. Always on the X-11, which the consultants who were making the report found to be the best thing to do, although they had certain other things they would like to maneuver. But essentially it was an X-11 program. We have not found a superior program, but we felt assured by the consultants in some sense on that.

CHAIRMAN VOLCKER. Let me just repeat something Steve mentioned, in case you missed it, because I didn't mention it before. The staff did this same so-called intervention technique, smoothing out a three- or four-month period, when ATS accounts were first introduced. This led to a valley in demand deposits at that time. That valley was smoothed out; that was at the of '79, I guess.

MR. AXILROD. '78.

CHAIRMAN VOLCKER. The end of '78.

MR. BLACK. Mr. Chairman, could I ask Steve one minor technical question? Steve, it looked to us as if the 18 percent April figure was based on a 72-1/2 and 27-1/2 percent break rather than a 70 and 30 percent break. If we are right on that, you'd get a little lower figure than this with a 70/30 split.

MR. AXILROD. We'll recheck, Bob. That would make about a 1/2 point difference.

MR. BLACK. Right, [unintelligible] comes out 74. I don't know exactly what it would do on that seasonally adjusted figure that had been previously shifted; we figured about 0.6 of a percentage point on that one.

MR. AXILROD. Well, we'll recheck that. It should have been worked out on a 70/30 split. We may in the end have to go back to the other, but we'll recheck.

MR. BLACK. Okay.

VICE CHAIRMAN SOLOMON. I'd like to ask Steve a question, too. Forgetting about the seasonal adjustment of the NOW accounts--looking at the regular-type seasonal adjustments--have you assumed as speedy a check processing by the IRS this April as last April or are you going back to the earlier pattern?

CHAIRMAN VOLCKER. I think I can answer that. They didn't assume anything. But that is relevant to the next subject of discussion.

VICE CHAIRMAN SOLOMON. Okay.

MR. AXILROD. Yes, that didn't affect our seasonals. We couldn't find any effect. Looking through the data that we have here for '78, '79, and '80, one can't find any acceleration in collections over the course of April. A little more was collected in April in the past two years relative to earlier years, in terms of percentage distribution. But over the course of April you can't find any acceleration in collection looking at '78, '79, and '80. In '81 there might have been; it looks as if a little more was collected through April 28--leaving out two days in the month--than in earlier Aprils.

MR. CORRIGAN. Paul, may I ask one other question, please? Somebody mentioned M2. When we swing over and incorporate the new seasonal for M-1B, is anything going to be done in terms of the fact that the money market funds component of M2 is also not seasonally adjusted?

MR. AXILROD. We hadn't been planning on it. I don't think we have any experience whatsoever to find the seasonal on that.

MR. CORRIGAN. I don't suppose you do, but I just raised the question because those--

CHAIRMAN VOLCKER. It's the same kind of problem in theory.

MR. CORRIGAN. I know it's the same problem in theory. The question that has been running through my mind is: Is there any merit at all to applying the same solution to the problem, recognizing that the solution is imperfect?

MR. AXILROD. Well, one trouble, Jerry, is that here we felt reasonably confident about how much was coming out of demand deposits. And there we literally have no idea, and it's probably small.

MR. CORRIGAN. That's true.

MR. AXILROD. We don't know what came out of Treasury bills and what came out of savings accounts. It seems to me that it would be almost an impossible problem. And one would hope, since M2 is so big--it's \$1.7 trillion--that [the seasonal effects] would get much more swallowed up in M2 than they are getting swallowed up in M-1B.

MR. CORRIGAN. It might not be a bad idea to mention that in your explanation. Having done this with other checkable deposits is going to draw attention to the fact that we haven't done anything there and [that will] then raise more questions.

MR. AXILROD. We didn't seasonally adjust other checkable deposits separately. That ought to be clear. What we did for M-1B--

MR. CORRIGAN. I understand.

MR. AXILROD. --was the seasonally adjusted total of demand deposits plus two-thirds or whatever fraction of other checkable deposits.

MR. CORRIGAN. I understand what you did, Steve. I'm just raising the point that it might be a bad idea to be totally silent.

CHAIRMAN VOLCKER. Yes, I think you're probably right. Maybe we ought to fiddle around just for our own edification to see what difference it makes. We have time. I should mention one other thing, just for the sake of completeness, so long as we have M-1A. That is being seasonally adjusted with a demand deposit seasonal, which is probably wrong theoretically because a certain type of demand deposits, namely consumer demand deposits, is a smaller component of that now and that presumably changes the seasonal. But we don't know how [it does so] and there's nothing much we can do about it.

If that is behind us, let me just introduce the more current discussion by saying that, obviously, we have a high April figure. We have had upward revisions for about three weeks, which is always an ominous sign to me. Last week's preliminary number showed a fairly sizable decline. By the time we got around to publishing it--every day it got whittled down--it was practically no decline. At the same time, we have this high preliminary figure for the [week] we will publish next. And that is a little surprising, just with reference to the earlier question, because if the IRS is really processing tax payments more quickly, one would have expected a seasonally adjusted decline. I don't know what up-to-date information we have on that. I keep hearing that they are doing it quickly but, if that is really true, it makes the increase even more ominous. Let me just say that for several weeks the reserve path would have indicated some tightening; and in some statistical sense, that was right. But the market hasn't reflected it until the last day or two; it is now reflecting it quite strongly. But last week, on these normal conventions we use, we expected borrowing to be \$1-1/2 billion and it was well below \$1 billion because instead of having positive excess reserves we had minus excess reserves of \$450 million. That is bigger, I understand, than anybody has been able to find in recorded history. Let me have Steve describe the last few weeks and the outlook and then Peter can describe the market.

MR. AXILROD. Well, Mr. Chairman, just to step back a minute, I think the Committee will recall that two weeks ago we were expecting borrowing to rise to about \$1.3 billion, given the shortfall we had in borrowing in the week of April 8th. In the event, in the week of April 15th, we did get borrowing of close to that; it was \$1.1 billion. [As a result] of an overshoot in market factors affecting reserves, we had somewhat higher nonborrowed reserves in the week of the 15th--by about \$100 million or so--because, as I say, on Wednesday market factors supplied more reserves than projections had suggested they would. On April 22, the week just past, we had assumed the nonborrowed path implied borrowing of \$1-1/2 billion. Again the Desk was very close to path; in fact, Peter, if my memory's right, we ended up a little below path even, and borrowing turned out to be only \$864 million. That was because, instead, the market reduced excess reserves by \$700 million from a plus \$300 million that we thought they'd have to a minus \$435 million. That was the actual number. So, borrowing, in effect, was \$700 million less than planned and there was very little pressure on the markets, even with this large negative excess reserve number. Given the shortfall in borrowing in that week, borrowing falling out of the path for the current week, the week ending April 29th, looked like \$1.7 billion. And we left the path there, implying that level of borrowing for the current week. In a very technical sense, it turned out that the data we got last Friday suggested more downward multiplier adjustments than we had made. We had made none because we had evidence of only small amounts, but it suddenly got large. And if all those had been made that were possible to make, this \$1.7 billion would have risen to an order of magnitude of \$2-1/2 to \$2-3/4 billion.

Now, this week is the end of a so-called four-week period; and for the next three weeks the path would have implied borrowing of \$1.7 billion. So, in a sense, to smooth the transition between the two paths we left in that \$1.7 billion for the week of the 29th; it would move toward \$1.7 billion in the weeks of the 6th, 13th, and the

20th. That \$1.7 billion in this forthcoming three-week period reflects essentially the strength in required reserves above what one would have expected if we were on target with the Committee's objectives for M-1B and M2. In essence, it's M-1B that is running a lot stronger than had been expected and that is strengthening the required reserves. It's also, of course, strengthening the total reserves; with borrowing running at \$1.7 billion, total reserves are running about \$500 million above the path for total reserves that had been set at the time of the Committee's meeting. Over the next three weeks we would expect total reserves to be coming in about \$500 million above the path. So, this level of borrowing of \$1.7 billion does not reflect any downward adjustment in the nonborrowed reserve path to compensate, as it were, for the increased bank demand for reserves and to try to put even more pressure on the banking system. It is at the moment, as it were, the minimal borrowing that would fall out of just merely holding the nonborrowed path where we were. As the Chairman mentioned, the funds market, yesterday and today, is beginning to show the pressures of the squeeze on reserve availability relative to demand; but the market didn't show it for a couple of weeks--last week largely because of this sharp drop in [demands for] excess. Prior to that, the market was just going ahead as if the funds rate wouldn't change and banks didn't do any borrowing until extremely late in the statement week.

CHAIRMAN VOLCKER. Peter, do you want to report on your view of what has happened here?

MR. STERNLIGHT. Well, as you said, Mr. Chairman, the banking system has been slow in catching up with the increased degree of pressures that should be falling on it as the aggregates strengthened and as their demand for reserves grew. Much of that, as Steve noted, is that they just didn't cover their reserve needs last week. But yesterday and today it is catching up more forcibly so that the funds rate, which had been averaging pretty close to 15-1/2 percent for a few weeks, was around 16 percent yesterday. Today it started out around 16 percent but it got up to the 17-1/2 percent area. We're looking at a very large reserve need in this week just to meet path. And even if we met path, there would still be a need; but because available collateral has been in short supply we haven't been able to put in very many of the reserves that we had planned to supply today. We said [when we presented] our program this morning that we would be putting in something like \$4 billion in two-day RPs and we've only been shown about \$1-1/2 billion; we may do a couple of hundred million or more than that later. So, we're building up to what looks like a very large reserve need and borrowing need over today and tomorrow. Probably most of it will fall on tomorrow. That's all I have, Mr. Chairman.

CHAIRMAN VOLCKER. Well, we have a situation where we have had some statistical pressure, but it was all in the statistics and not in the market until very recently. And now this statistical pressure may be even greater just because technically we can't get the reserves in. That may be a good thing; I don't know. But there is going to be a lot of borrowing, I suspect, today and tomorrow, as Peter suggested. It will probably be tomorrow because there has been no eagerness to borrow before people are really under the gun. I don't think we require, in any technical sense, any Committee decision. What I would plan here--and we can discuss it--is that we

might think of taking some of the adjustment implied by the high level of total reserves, which we would normally do in this kind of circumstance. Since even without that we have a level of borrowing going toward \$1.7 billion, if these calculations mean anything, that does imply a sharply tighter market for the next few weeks unless the money supply turns around. Obviously, this high figure, which is supposed to be published on Friday, hasn't been confirmed yet. My short-run error analysis says it's going to go even higher than the preliminary figure. But we don't have anything for the following week yet; and if we have a big decline, then things will look quite different for May. But I just have no evidence of that at all at this point. And if something is going on here in the tax collection area that is affecting this--we do know these are extremely difficult weeks because of the big tax collections--we just don't know how it's affecting these weekly figures. One other thing I should mention in this connection is that, while we're obviously above the path that we set at the last Committee meeting, we are still, I understand--but Steve better confirm this--just slightly below the midpoint of the basic annual path.

MR. AXILROD. Yes. On the new numbers we would be \$300 million, and on the old numbers \$500 million, below the midpoint.

MS. TEETERS. May I ask a question?

CHAIRMAN VOLCKER. Sure.

MS. TEETERS. Steve, you said that you thought the total borrowing would end up about \$500 million above the path. Is that correct?

MR. AXILROD. Yes, \$500 million above where it had been originally set by the Committee at \$1150 million.

MS. TEETERS. Now, if we adjust for that, won't that just send the borrowing up to [nearly] \$2.3 billion instead of \$1.7 billion? Won't the total reserves be approximately the same, and we would just be adjusting the split between borrowed and nonborrowed?

MR. AXILROD. In the very short run, that may be the result. Of course, the question would then be: Over a longer run than two or three weeks, would it begin to cause faster adjustments in the money supply back toward the Committee's path?

MS. TEETERS. So the short-run decision here is whether we shoot the borrowings up to \$2.3 billion, is that correct?

MR. AXILROD. No, I don't think--

CHAIRMAN VOLCKER. Well, we won't go all that way, I don't think, but typically we take a partial--

MR. AXILROD. Governor Teeters, maybe I wasn't clear enough. What I tried to say was that if the full multiplier adjustment had been made--. We divide the period into a four-week and a three-week period. We're now in the last week of the first four-week period. We got a surprising downward multiplier adjustment. If we had taken that in the current week, we could have had borrowing as high as \$2.7

billion. We didn't because, without doing it, borrowing was \$1.7 billion and taking that multiplier adjustment for the next three-week period would have left the borrowing at \$1.7 billion. So, in effect, we just left one week of it off.

MS. TEETERS. But any of the actions that you are talking about now implies borrowing rising?

CHAIRMAN VOLCKER. Yes.

MR. AXILROD. Yes, that is right.

MR. PARTEE. Right.

CHAIRMAN VOLCKER. Just let me interject another question. Does anybody have a feel about what economic activity is doing now? I would personally volunteer that on the basis of very little--just casual comments one picks up--I don't have a feeling that April was a terribly weak month. Quite the contrary. But I don't know whether anybody out there is getting a feel on the change in the business situation.

VICE CHAIRMAN SOLOMON. Paul, I have the impression from people I've been talking to in the financial market--not business people so much--who are following this very closely that they expect a significantly higher rate of real growth than the completely flat forecast that the staff had last time. People here are talking about 1-1/2 to 2 percent real GNP in the second quarter. Has the staff revised its forecast for the second quarter?

MR. KICHLINE. No, we have not at this point. I would not think that the difference between zero and 2 or zero and 1-1/2 percent would be that large. I think if we were to take all the incoming information available and redo the forecast, we'd be close to very little growth, which I define as within that kind of range.

VICE CHAIRMAN SOLOMON. Well, let me make a general comment then. It seems to me that there is a much greater probability of overshooting in the second half of the year, and I think we want to take as much advantage of undershooting as we can get in the meantime so that we don't repeat the pattern of the second half of last year. It would seem to me, therefore, notwithstanding the big seasonal question mark for April, that it would be best to reduce the nonborrowed reserve path substantially, let the fed funds rate move up, and not be as timid and as late as we were in the second half of last year. I think it's quite clear, even if the tax cut gets delayed until October 1st, that with defense spending building up the way it is and the very big real increase in business spending that we've been seeing we're going to have a heck of a problem later on. So, my instinct would be to move quite vigorously, to the extent that we work out the adjustment of the nonborrowed reserve path.

MR. SCHULTZ. This is Fred Schultz. I agree with that statement.

MR. BLACK. This is Bob Black. I do, too. I think these seasonals will scare the devil out of the market even though they're a touch below what we originally thought.

MR. PARTEE. This is Chuck Partee. I don't think it's so much a question of undershooting, Tony. I think our problem may now be that we're beginning to move into a surge that will give us an overshoot right now, regardless of what happens in the second half of the year. I realize all these seasonal changes are very complicated and confusing, but whether we say that March was 8.2 percent and April looks like 18 percent or that March was 7.3 percent and April looks like 13.6 percent, they both have the smell of a surge in growth that is awfully difficult to control and awfully difficult to know how far it might go. So, I would agree with the thrust of your remarks, and those of others, too, in that I think we have to resist this and we have to resist it strongly--not so much to save our pennies for the second half, but to keep within a reasonable range right now.

CHAIRMAN VOLCKER. April has used up our pennies.

MR. MORRIS. This is Frank Morris. I would agree with Chuck and Tony. One other element in the picture is that, while the M-1B figure may be near the middle of the range, the broader aggregates, which are probably more reliable guides now, are above the tops of their ranges.

CHAIRMAN VOLCKER. That is correct. I haven't got those figures right in front of me but they are all hovering just above or a little more than above the top of their ranges. They are also not showing this surge and this seasonal [adjustment revision] shouldn't change that. You're quite right that they're high. If anything, they're showing somewhat decelerated growth but they are high.

MR. WALLICH. This is Henry Wallich. I think we need to show a strong effort to get the aggregates back on track. We want to do a good job. Also, we don't want to lose further credibility. The question is how we should do this. One way is to lower the nonborrowed path. The other would be to increase the discount rate and surcharge. That clearly would be a more visible action.

SPEAKER(?). Sure.

VICE CHAIRMAN SOLOMON. Henry, I think it's a little premature to move that quickly on the discount rate, given the question mark of April. Right now we could lower the nonborrowed reserve path pretty strongly but at the same time keep an eye on the discount rate. [The picture] may begin to sharpen and we could move then.

CHAIRMAN VOLCKER. Well, obviously the discount rate question arises here. We're not going to make that decision today.

MR. BOYKIN. This is Boykin. I would agree very much with what Tony Solomon has been saying.

MR. WALLICH. Henry Wallich. I've always argued for a higher upper limit on the funds rate, and this may be my chance for testing your feeling on that. It's now 13 to 18 percent, isn't it?

CHAIRMAN VOLCKER. Yes, I'm at your service. But I don't think we have to take any Committee [actions] today. That would be one. This situation may bear some watching and we may want to have

another telephone meeting next week because what this next money supply figure shows, I think, could be quite important in view of all this uncertainty surrounding the tax [processing]. I think we have to play it safe now--defining safe as has been discussed--but things could look either quite worse or better very quickly.

MR. GRAMLEY. Mr. Chairman, Lyle Gramley. I would support that. We have a piece of information coming out this week on Friday--the employment report for April--that will be quite useful in finding out whether our judgments on the second quarter are right or wrong. In general, I think the economy this year has been a lot stronger than anybody had expected. The first quarter may get revised but, if it does, it could just as well get revised up as down. The inventory figures assumed for March look funny. And I have come to the conclusion that interest rates are not high enough yet to control either economic growth generally or money supply growth in line with the Committee's desires. So, I think it is time to move now on the nonborrowed reserve path. Then, if on Friday we see figures on employment that indicate that the economy is still going like gangbusters in the second quarter, we can take the next action: that is, to change the fed funds rate range.

MR. CORRIGAN. This is Jerry Corrigan. I will be brief. I agree with almost everything that has been said, certainly in terms of adjusting the nonborrowed path now.

MR. BALLE. This is John Balles. I would add my support to that proposal. I would also want to keep a careful eye on that discount rate in case we [get the] higher funds rate that appears to be in prospect.

MR. ROOS. This is Larry Roos. I want to agree with the reduction of the nonborrowed reserve path and with almost everything that has been said.

MR. SMOOT. Philadelphia can agree with that also.

MR. DOYLE. This is Dan Doyle in Chicago. I would certainly agree with the general direction here, but I have to point out like a broken record that this part of the country in particular, as it reflects the auto industry and housing, is still in a very bearish situation. And, if anything, those sales numbers are expected to deteriorate rather markedly over the next several weeks.

CHAIRMAN VOLCKER. You remind me to note, in connection with the broader aggregates, that bank credit, which was quite strong earlier in the year, is quite weak now. It's still above the range as I remember, but that is the one measure that has shown the most pronounced weakness recently.

VICE CHAIRMAN SOLOMON. That may be, when you add the foreign branches in. The bond market and commercial paper market all together do not add up to a weak credit picture, though.

MR. RICE. This is Emmett Rice. I agree with most of what everybody has said here, particularly with what Chuck said.

CHAIRMAN VOLCKER. Well, I don't know if anybody else wants to say anything. I think, at this stage, this is not a Committee decision in any formal sense. We are confirming that we will tighten up the nonborrowed path, which is what we would normally do under circumstances of this sort.

MR. PARTEE. Do you have a feeling for how much, Paul? A couple hundred million?

CHAIRMAN VOLCKER. I would say we have a choice between \$200 or \$300 million, I suppose.

MR. AXILROD. I should mention that when I said total reserves are running \$500 million above the path, that assumed a certain multiplier adjustment. These things change quite rapidly.

CHAIRMAN VOLCKER. These get looked at every week in that sense.

MR. AXILROD. So, by Friday it may--

CHAIRMAN VOLCKER. I think I am correct, but I stand to be corrected if I'm not right, that we have not had borrowings above \$2 billion. Late last year when we had the maximum tightness, the borrowing level was something short of \$2 billion, as I remember it.

MS. TEETERS. Well, on Wednesday--

MR. AXILROD. Borrowing was \$2.1 billion on average in November 1980, and in December it was \$1.7 billion.

CHAIRMAN VOLCKER. Okay, I stand corrected. It got a little over \$2 billion, right?

MR. PARTEE. It's tight, though; there's no question about it.

MR. GUFFEY. Mr. Chairman, Roger Guffey. If I understand where everything ends up--and you appear to have a fairly good consensus--we're talking about dropping the nonborrowed path, which I assume would elevate our borrowing level above the \$1.7 billion that Steve was talking about earlier.

CHAIRMAN VOLCKER. Yes.

MR. GUFFEY. My understanding, at least according to my staff, is that that implies an interest rate level that is at least at the top of the range--18 percent--and quite likely something more than 18 percent.

CHAIRMAN VOLCKER. Well, maybe yes. I would say it's quite likely, too. But the reserve path that we had for the last three weeks should have been implying a federal funds rate about 2 percentage points higher than it in fact was. So, unfortunately, those guesses are not too reliable. But I think you're probably right that the market has gotten in a different mood after the last couple of days or is getting there.

MR. GUFFEY. I think that's right, Mr. Chairman. I'd like to suggest that this time we observe the upper limits for the purpose of consultation and that at the time we crack through the 18 percent we have another telephone session.

CHAIRMAN VOLCKER. Well, I think we have to have one if it goes above 18 percent. But I was not suggesting that we just stop it at 18 percent.

MR. GUFFEY. Well, [with] the path on the down side, I'd just like to urge that we have a consultation at or near 18 percent.

CHAIRMAN VOLCKER. Well, we won't let it go too long before having a consultation. Any other comment? I think we have disposed of everything that I had on my mind. Thank you.

MR. WINN. Paul, do you get any indication of institutional stresses and strains?

MR. ALTMANN. He said: "Any indications of institutional stress or strain?"

CHAIRMAN VOLCKER. I'm just getting your question repeated to me, Willis. I haven't gotten anything new, no.

MR. WINN. I was just wondering if the interest rate pickup is going to cause panic in certain sectors.

CHAIRMAN VOLCKER. That has been so recent. What is surprising here is that the market has just refused to go up despite this statistical tightening.

MR. WINN. I agree.

VICE CHAIRMAN SOLOMON. Has any progress been made, Paul, on the regulatory proposal?

CHAIRMAN VOLCKER. Well, we are in rather intensive consultation with Congress, and I guess the answer to that question is "yes." The Administration is remaining in a posture of silence on the thing basically. But we are going ahead and trying to get a definitive bill, in consultation with the Congress. We are right in the midst of that process now and maybe by the end of the week we will have a definitive version.

MR. SCHULTZ. The Secretary of the Treasury said this morning that they were watching the situation and did not believe it to be critical and were not ready to propose any legislation. That, however, is not the position of the regulatory agencies.

VICE CHAIRMAN SOLOMON. I've looked at the mutual savings banks in New York and for some of them the situation is going to be quite bad by the first quarter of next year. A few of them, a handful, are going to have a very major problem.

CHAIRMAN VOLCKER. I'm glad this question was raised. Let me just say one thing in that connection and one thing in another connection. We're in the midst of this consultation process now. It

may be that when we get a bill it would be useful for you people to have a meeting with your thrift advisory committees or whatever equivalent you may have at your particular Bank to bring them up to date and talk with them about it. We have a potential problem of legislative tactics and all the rest in trying to get this bill through in a hurry with a minimum of controversy. And that requires, among other things, that the thrifts not bring out their laundry list of highly controversial amendments that they might want to make such as restoring differentials on money market certificates, doing something about money market funds, and mortgage warehousing schemes.

MR. PARTEE. Real estate.

CHAIRMAN VOLCKER. They have all sorts of proposals or wish lists, none of which, in my judgment, can conceivably go anyplace at the moment. And they would only make it difficult to pass this legislation if they press to try to amend the bill. I think this bill is in their interest, but they have to see it in their interest and let it go through and fight their other battles later. I don't know whether they will take that position or not. I suppose some of them will and some of them won't. I think what makes people edgy either in the Congress or among some of the trade associations is any smell of bank takeovers in extremis, which is in the bill, or any interstate mergers or acquisitions, which is also in the bill as kind of a last resort measure in the case of failing institutions. The capital injection side I don't think is going to raise many hackles, but this other stuff might.

VICE CHAIRMAN SOLOMON. Some of them also are very unhappy about conditions that might be laid down such as salary [constraints].

CHAIRMAN VOLCKER. I saw an article to that effect in the American Banker this morning. I've heard no discussion about salaries. It is true that there's nothing in the bill about conditions, but presumably the agencies would put on conditions, at least of a standby kind. They would write a contract--this has been their practice--that would give them very strong residual authority in a great many areas. I think that's part of the price they're going to have to pay. But it's not in the bill itself as now written. Now, this is all subject to further negotiation. The bill itself is one of those things that you can't understand when you read it because it amends a lot of existing language in random fashion. But it basically has only three provisions: authority for liberalizing capital injections; cleaning up some issues regarding mergers and acquisitions of failing institutions or at least broadening that authority; and adding a bit to the FSLIC draw on the Treasury. That's all that's in the bill.

VICE CHAIRMAN SOLOMON. When do you want us to consult, after publication of the bill?

CHAIRMAN VOLCKER. I don't know myself. We may do a little consultation with the national associations, but we haven't decided whether to do so before the bill goes up or when the bill goes up. So, I don't know [the answer to] that yet. There are conflicting feelings on the Hill about that. I wouldn't do anything at the moment, but I'd just be ready to do it.

The other thing I wanted to mention, and I don't think we ought to take any more time now, is that as time passes, I keep wondering about the attitude of the banks toward the discount window. We have the same dilemmas there that we've had before. I'm a little suspicious that one of the reasons that on some occasions we don't have much reaction in the market to a statistical tightening is that the banks all sit there and figure they can borrow from the discount window at the end of the week. We may want to do a little thinking about talking with some of the banks, if they're persistently running reserve deficits and not borrowing during the week but then popping in late on Wednesday afternoon when we can't say much to them. That's all I have. I'll resume my conclusion. Thank you.

END OF SESSION