

Meeting of the Federal Open Market Committee

November 16, 1982

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, November 16, 1982, at 9:00 a.m.

PRESENT: Mr. Volcker, Chairman  
Mr. Solomon, Vice Chairman  
Mr. Balles  
Mr. Black  
Mr. Ford  
Mr. Gramley  
Mrs. Horn  
Mr. Martin 1/  
Mr. Partee  
Mr. Rice  
Mrs. Teeters  
Mr. Wallich

Messrs. Guffey, Keehn, Morris, Roos, and Timlen,2/  
Alternate Members of the Federal Open Market Committee

Messrs. Boehne, Boykin, and Corrigan, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis, respectively

Mr. Axilrod, Staff Director  
Mr. Altmann, Secretary  
Mr. Bernard, Assistant Secretary  
Mrs. Steele,2/ Deputy Assistant Secretary  
Mr. Bradfield, General Counsel  
Mr. Oltman,2/ Deputy General Counsel  
Mr. Kichline, Economist

Messrs. Ettin,2/ J. Davis,2/ R. Davis,2/ Keran,2/ Koch,2/  
Parthemos,2/ Prell,2/ Siegman,2/ Truman, and Zeisel,2/  
Associate Economists

1/ Entered the meeting following acceptance of Report of Examination of System Open Market Account.

2/ Left the meeting prior to discussion and adoption of domestic policy directive.

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

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

Mr. Coyne, Assistant to the Board of Governors

Mr. Gemmill,1/ Associate Director, Division of International  
Finance, Board of Governors

Mr. Kohn,1/ Senior Deputy Associate Director, Division of  
Research and Statistics, Board of Governors

Mr. Lindsey,1/ Assistant Director, Division of Research  
and Statistics, Board of Governors

Mrs. Low, Open Market Secretariat Assistant,  
Board of Governors

Messrs. Balbach,1/ Burns,1/ T. Davis,1/ Eisenmenger,1/  
Mullineaux,1/ Scheld,1/ and Stern,1/ Senior Vice  
Presidents, Federal Reserve Banks of St. Louis, Dallas,  
Kansas City, Boston, Philadelphia, Chicago, and Minneapolis,  
respectively

Mr. Soss, Vice President, Federal Reserve Bank of  
New York

Ms. Clarkin,1/ Assistant Vice President, Federal Reserve  
Bank of New York

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CHAIRMAN VOLCKER. We have a number of things to deal with apart from policy today. I am distressed about what happened after the last meeting, as you well know, and I am distressed by the actions that had to be taken for this meeting. We will return to that subject after we complete the policy discussion. But I think the procedure [regarding limited attendance during the Committee's discussion of monetary policy at] this meeting has been outlined to you. Now we need to deal with the minutes.

MR. PARTEE. So moved.

MS. TEETERS. Second.

CHAIRMAN VOLCKER. Without objection, we will approve the minutes. Next we have the report of examinations, which has been distributed to you. Do I hear any questions?

MR. PARTEE. It looked like a clean [bill of health].

CHAIRMAN VOLCKER. If there are no questions, we can have a motion to accept it.

MR. GRAMLEY. So moved.

MS. TEETERS. Second.

CHAIRMAN VOLCKER. It has been moved and seconded and without objection [it is approved]. We will go to Mr. Cross.

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

CHAIRMAN VOLCKER. Questions or discussion?

VICE CHAIRMAN SOLOMON. Well, as for the recommendation [regarding the Mexican swap drawings], we don't have any alternative.

CHAIRMAN VOLCKER. Well, we could put them in default. Do we have a motion on the recommendations [for renewal of all the swap lines for one year and renewal of the drawings by the Bank of Mexico for three months]?

SPEAKER(?). So moved.

CHAIRMAN VOLCKER. It has been moved. Without objection, we will approve that. No other commentary? We will go to domestic open market operations.

MR. ALTMANN. Are you going to ratify the operations?

CHAIRMAN VOLCKER. Oh, we have to ratify the [foreign currency] operations.

MS. TEETERS. So moved.

MR. RICE. Second.

VICE CHAIRMAN SOLOMON. I think it's worth making one comment. Our current account deficit is beginning to mount up; by almost any estimate it probably will be at least \$30 billion next year, but it might be as high as \$50 billion. At what point this will change market sentiment toward the dollar is unclear; that may require some other things happening as well. But I would assume that we are beginning to see a little strengthening in the yen, and the Germans are beginning to see some strengthening [in the mark] against other currencies except the dollar. So, there may be a change in this situation, although I don't expect it imminently.

MR. WALLICH. Well, the nature of this deficit is that it is the result of a high dollar, and the high dollar is the result of people wanting to get into the dollar, forcing, as it were, the financing of the deficit on us for the time being instead of wondering whether they ought to finance it. That is what I think keeps the dollar up in the face of this prospect of a huge deficit.

VICE CHAIRMAN SOLOMON. Another way of putting it is that the capital flows are swamping the equilibrium trade effect of an exchange rate. There's nothing we can do about that.

CHAIRMAN VOLCKER. Probably it will all reverse itself very suddenly and give us another problem. Mr. Sternlight.

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

CHAIRMAN VOLCKER. Questions? Discussion?

MR. BLACK. Mr. Chairman, would it be in order to ask Steve a procedural question somewhere along here? He might not want to do it at this point.

CHAIRMAN VOLCKER. I don't know what you have in mind.

MR. BLACK. Well, with our new targeting on M2 and M3, I think there are some interesting questions about whether these procedures work the way they did when we were targeting on M1. I don't know whether you would like that issue raised here or at some other point.

CHAIRMAN VOLCKER. It might as well be raised here.

MR. PARTEE. The steering mechanism?

MR. BLACK. Yes, the steering mechanism. I've been on the market call and I've been intrigued as I watched this develop. It has been a very interesting period to be there. We are following the same sort of reserve targeting procedures from all outward appearances. We still set a nonborrowed reserve path and we have a borrowed reserves target; and we've made some adjustments to the borrowed reserves target. As this period unfolded, I began to ask myself whether this really makes a lot of sense when we are using M2 and M3 as our targets. They include a pretty broad confluence of assets. Some are subject to reserve requirements and some aren't; some have interest rate ceilings and some don't; and some seem to move in the same direction as the federal funds rate moves and some seem to move in the opposite direction. So, I'd like to ask Peter if he really thinks it

makes a lot of sense to use this kind of reserve targeting procedure while we are using M2 and M3 as our primary targets, or even for that matter if he really thinks there is any effective way we can control M2 or M3. The bottom line on this is that I am asking whether the federal funds rate under current procedures is an effective operating instrument or whether it tends to become a target in itself.

MR. STERNLIGHT. Well, there are a lot of parts to your question, President Black. Just as a technical matter, I think in using and revising the reserve path there are some [specific] procedures called for. We had to do some of this adjustment for different factors even when we were targeting M1. But there are further adjustments of this kind to allow, as you say, for the fact that many components of M2 don't generate reserve requirements. Steve may want to comment on this, but what we have done as we've gone along is to revise the path as though there were reserve requirements against M2 in general, in a sense making up for the fact that some important components of it didn't have reserve requirements. When you ask if it is effective to control M2 via this means, I would have to say I have some real doubts as to how good our control mechanism is on M2. But I think that would be true almost whatever rules we live by at the Desk. I do think what we're following, though, is an effective response mechanism to growth in M2 that is either on track or below or above track. It is something whereby the performance of M2 can generate a greater or lesser provision of reserves that then impacts on the money market, on the economy, and so on, and eventually on M2. I think that this is a sensible procedure.

MR. BLACK. But the ratio between total reserves and M2 or M3 is so low or, to look at the other side, those so-called multipliers are so high. Therefore, if we miss our target--say we overrun the target--and we adjust by making the banks borrow that portion by which we have overrun the target, that's a pretty weak increase in the borrowed reserve target. Even if we do it on a one-for-one basis and even if that were the right way, I would wonder whether necessarily driving up the federal funds rate at a time like this would slow down a good part of M2. I think we would count on it affecting the M1 portion and probably the part of M2 that is subject to rate ceilings or reserve requirements. But some of these components are really money market instruments and they seem to move in the same direction. This is the kind of thing that has concerned me about it. I felt as we went through the period that the old apparatus was rather out of date when we were using this particular kind of target and that maybe we ought to go directly to [targeting] the federal funds rate, which probably sounds like heresy to a lot of people who have listened to me in the past, but--

MR. PARTEE. How would you slow down M2?

MR. BLACK. I don't think we can slow it down except through affecting M1 and those few assets in M2 that are subject to either reserve requirements or interest rate ceilings.

MR. WALLICH. Well, one way of putting what you said is that the funds rate is now an endogenous variable. Is it the result of trying to restrain M2 with reserves, or is it the other way--that we move the funds rate and try to restrain M2 and that more or less gives us the reserve level that is needed?

MR. BLACK. I think that's a good way of putting it. The whole thing just bothered me and I was hoping for some--

CHAIRMAN VOLCKER. Do you want to make any comment, Mr. Axilrod?

MR. AXILROD. Mr. Chairman, the comments I'd be tempted to make would be in a fairly broad range. There is a dilemma between the short run and the long run. It is probably true that because most of M2 doesn't have any reserve requirements this 2 percent average reserve requirement on M2 relative to total reserves is giving us a very weak response in the short run to overruns in M2. That assumes, if we just go to the 2 percent, that the response is somewhat proportional and that M1 together with the nontransactions component would be roughly [as variable as M1]. But as President Black pointed out, in the short run they clearly won't be; as interest rates go up, the market will raise rates on the nontransactions components and they will respond. So, in the short run probably we ought to react, [in effect,] by moving the reserve requirement on demand deposits. That is, if M2 is strong, the really practical option is to lower demand deposits substantially; so we'd have to use a demand deposit ratio in the multiplier--for the purpose of the [technical] adjustment [to the nonborrowed reserve path]--rather than the M2 ratio. In that case we would get a very powerful interest rate response. To reduce demand deposits sufficiently to offset an expansion in the nontransactions component would require a very substantial rise in interest rates. That's just another way of saying in technical jargon that the interest elasticity of M2 is low relative to the interest elasticity of M1.

So, to try to control M2 over a very short-run period risks very substantial interest rate movements. In the end, we would have to have enough [of an increase in interest rates] to bring income down and reduce the amount of money available to put into M2. That's the reason that we started using the 2 percent ratio--to moderate this particular impact, consistent with the Committee's decision. Also, it has a certain reality. When you think of the market response, the control horizon for M2 is [necessarily] somewhat longer than the control horizon for M1. Whether the Committee would then want to go directly to the control of the funds rate and make a deliberate decision about that instead of leaving it implied from a reserve path--knowing the control horizon for M2 might be a little longer, but implied M1 movements would still be substantial--strikes me as an issue that has more than economics in it. My personal preference, of course, would be to stay with a reserve path because I think it makes it a little easier in practice to get the movements of interest rates that the Committee probably would find tolerable and desirable under the circumstances.

MR. BLACK. Well, that's very helpful. I did not mean in any sense to be critical of what was done. I think Peter and Steve did a fine job in implementing exactly what the Committee had in mind, which really was a sort of money market directive. I was just getting at the kind of problems we would have if we continued this for some period of time. I think Steve and Peter both elucidated those very well. That was very helpful. Thank you.

CHAIRMAN VOLCKER. Let me just make a couple of comments. I don't think there's any question that the mechanism creeps when it is adapted to this purpose. I would not overestimate the precision of our control technique on M1 either, but there is no doubt that it looks more strained when we are doing it this way. I was going to mention later, but I will just mention it now, that we will have a paper prepared for the Committee looking toward the targets for next year. It will not be primarily on the control mechanism, although it may get into that. It seems to me almost certain now that [as a result of DIDC actions] we shortly will have a full transactions account with a market rate of interest. We are very close to that now anyway, and we'll have another account. We may have very close to transactions accounts without any reserve requirements on them. We virtually have that now. It raises all kinds of questions both about the impact this will have on differential growth among the aggregates and even total growth of the aggregates during some perhaps lengthy transitional period. And it also has a bearing on the control mechanism. I don't think we can solve those problems today; I'm sure we can't. But we can get this paper prepared well before the meeting at which we have to set targets for next year. We will get it distributed before the meeting and have a discussion then; I don't think we will resolve it then but we ought to be in a better position for resolving it at the following meeting.

MR. BALLE. Paul, I found the [DIDC] announcement in this morning's paper fascinating. Would it be premature to ask you whether in your opinion we will end up classifying these new accounts as M1 or M2?

CHAIRMAN VOLCKER. I've been assuming we will put them in M2 and it probably is premature to say that. It's a very ambiguous account. Beyond that, I don't know when it will be introduced. But there is a meeting of the DIDC not very far off--in three weeks or something like that. I don't know whether the DIDC will approve what in effect will be a lifting of the interest rate ceiling on NOW accounts, but I think it will go a long distance toward that. In two or three months prospectively, I think we will have that. This thing is so much like a transactions account now. If banks use it as a sweep account--it's not quite clear that they will--it's on the margin there. If it were any more liberal than it is, they would certainly use it as a sweep account and I don't know how one would distinguish it from a transactions account. I'm not sure we'd stop short of that margin.

MR. FORD. Excuse me, in that regard, was the newspaper article accurate that the DIDC has approved in addition to the six transfers--three checks and three preauthorized--telephone transfers without limit at least until the next time this is looked at?

CHAIRMAN VOLCKER. That may be reversed, but that's the way it is now--[unlimited] telephone transfers into one's own checking account.

MR. FORD. Into one's own checking.

MR. PARTEE. Or a personal visit.

CHAIRMAN VOLCKER. Well, a personal visit was always allowed.

MR. FORD. On top of the other six transactions.

CHAIRMAN VOLCKER. That decision will [be reviewed]. One of the people who voted for it immediately wanted to change his mind after the meeting and he was not allowed to change his vote. So, it may be reversed in a subsequent meeting. But that bears upon how transaction-like it is, of course.

MR. FORD. Was it a 3 to 2 vote?

CHAIRMAN VOLCKER. It must have been, because the one vote would have swung it. Now, we still have a decision to make on that, frankly. According to our present rules, an account of that sort will have a reserve requirement. I think that is correct. And if we just keep the reserve requirement on it, I presume that banks will not offer that service. I doubt it would be worth it, in terms of paying the 12 percent reserve requirement.

MR. PARTEE. Paul, I think we are going to have to look at the control mechanism definitely by the time we choose targets for monetary policy for next year. We probably will never be able to steer on M1 again. But M2 or any other aggregate we might choose, such as bank credit, has to have some concept for translating undesired behavior in an aggregate to action. And this 2 percent rule is a minimal response and couldn't be expected to have any effect in steering the aggregates if that is what we really want to do now. We might want to take as our aggregate nominal GNP, but even then we need a control mechanism. That is the vital part to be studied, because what we have now really doesn't have any tie to aggregate targeting or aggregate control--not with a 2 percent presumption on running above or below on the reserve effect of the aggregate.

MR. BLACK. One thing we could do is to make the change in the borrowing target some multiple of the overrun or underrun.

MR. PARTEE. Sure, we need an [amplification].

MR. BLACK. It doesn't have to be one-for-one; that's rather arbitrary.

MR. PARTEE. We don't look at M1, but of course we are going to affect M1 by what we do.

CHAIRMAN VOLCKER. Well, "We don't look at M1" is a little strong.

MR. PARTEE. I want to put it that way, though. Even if we never published the figure on M1 or looked at it or anything else, in trying to steer M2 we could have a process that would have big effects on actual M1 or the availability of M1.

MR. BLACK. It would inevitably have to work that way.

MR. ROOS. Would you think it would be helpful in making some of these very basic decisions, if some input were invited from whatever Reserve Banks might be interested in getting into the act on these studies, as far as just expressing themselves? There are some very fundamental changes in the wind and I would think that anyone

within the System who had intelligent input to offer should be encouraged. I think we ought to hear the Reserve Bank points of view as well as those of the [Board] staff.

MR. WALLICH. We at one time had a Committee on the Directive which got together when there were changes of this kind. Conceivably, we could revive that.

CHAIRMAN VOLCKER. Well, that's right. But let's see where we want to go from the preliminary paper. I think we're going to get it done by the next meeting. We can't be too cumbersome at this point, but any Reserve Bank that wants to contribute should be in touch with Mr. Axilrod. He has already been in touch with some people at the Reserve Banks.

MR. FORD. Will it include something about your idea, Frank, of how to control total credit? What would the control mechanism be under your idea? Would that be in the paper?

MR. AXILROD. We'll look at all the aggregates.

CHAIRMAN VOLCKER. The first focus is on which aggregates [to target] and how to interpret the aggregates. And that is partly--I suppose entirely in some sense--because M1 has problems at the moment that are looked at as a transitional thing. But it's very easy to get into a more general discussion, starting with a transitional problem, particularly when whatever else happens to M1, it looks as if there is going to be interest paid on it, which is going to change its behavior soon.

VICE CHAIRMAN SOLOMON. We will end up with an adjusted M1A, which will be called the monetary base.

CHAIRMAN VOLCKER. We need to ratify the transactions, and Mr. Sternlight made a recommendation to you.

SPEAKER(?). I move approval.

MR. PARTEE. Peter, did you have in mind longer coupons?

MR. STERNLIGHT. Well, we would look at the whole range; we typically do when we buy bonds.

MR. PARTEE. And you would do it in some volume today?

MR. STERNLIGHT. Yes. It could be roughly \$800 million to \$1 billion. That would be a rather normal bite, I think.

MS. TEETERS. Why are you buying? Are you buying for reserve purposes or inventory?

MR. STERNLIGHT. We have a reserve need running over the next few weeks. We already bought a large amount of bills at the beginning of this statement week and it would be a very normal pattern to follow up with a coupon purchase in the market.

MR. PARTEE. Do you think the market would make anything of the fact that this sizable and unusual operation is occurring while we are meeting?

MR. STERNLIGHT. I don't think so, Governor. There have been several occasions when there were coupon purchases on the Committee's meeting date.

MR. PARTEE. They are looking apparently for some sign that we are going to move interest rates down. The only concern would be--

MR. MORRIS. I would think the market would interpret this as a Federal Reserve concern about the backing up of interest rates.

MR. STERNLIGHT. It might draw some mild--

MR. MORRIS. I think that would be very constructive.

MR. RICE. We might get more leverage if we do it.

MR. PARTEE. Well, it's not really a neutral movement that is being proposed.

MR. BLACK. It is neutral so far as the money supply is concerned.

MR. WALLICH. Do you think an amount of that magnitude would affect the yield structure?

MR. STERNLIGHT. I don't think it would affect it very significantly. The market might draw some mild encouragement from it, but I wouldn't think they would make a big deal of it.

MR. WALLICH. I think some people will say: "I hear the Treasury is issuing these bonds and the Fed buys them."

MR. PARTEE. Are they in the market right now, Peter?

MR. STERNLIGHT. The new issues were delivered yesterday. It's a real question, with those coming at a current market yield and some of the other recently offered issues because of their high coupons having more attractive yields, whether we should buy them on a yield basis. We are apt to buy very few of the new one that just came into the market.

MR. GRAMLEY. How long has it been since you've made coupon purchases?

MR. STERNLIGHT. Oh gosh, several months.

MR. PARTEE. And of this size that must really--

MR. STERNLIGHT. I think it was early last summer. The size would be a normal size; we did \$800 million about 3 or 4 months ago.

MR. WALLICH. I am a little skeptical of this. What would happen if you postponed this?

MR. STERNLIGHT. Well, we have a reserve need to meet for next week and, given its persistence, it ought to be met in sizable measure through outright purchases. So, if we don't buy coupons, we'd probably want to do another sizable purchase of Treasury bills. It would be somewhat of a surprise to the market for us to do that because they have come to expect that after doing some sizable bill buying for a while we would intermix that on occasion with coupon purchases. I think they would take it as a deliberate shunning of the coupon market if we didn't get in there. I don't think it absolutely has to be today; it seems like the most logical day to me from the standpoint of our reserve needs. If we did it tomorrow, then people could read that even more in the context of the Committee meeting than if it is being done on the day of the meeting.

MR. WALLICH. I think you should do a mixed bag of short-medium- and long-term issues.

MR. STERNLIGHT. Well, Governor, when we buy coupons it is just that. It's not all long-term bonds. We buy the whole range of coupon issues. To intermix bills and coupons I think would be a terribly cumbersome, totally novel, excursion in the market.

CHAIRMAN VOLCKER. Well, I don't think this is the most vital issue of the day. If there is a lot of discomfort about doing it today, it will be done presumably on Thursday or Friday.

MR. GRAMLEY. I have no problems.

CHAIRMAN VOLCKER. If that makes people feel more comfortable, we can do that.

MR. MARTIN. I have no problem going ahead today. I'd rather see us go ahead today than tomorrow given all this mumble-jumble misinterpretation we've been referring to.

MR. PARTEE. Yes.

MR. WALLICH. If we're going to do it this week, it would be better to do it today.

CHAIRMAN VOLCKER. Do we have a motion?

MR. MARTIN. I move.

MS. TEETERS. You have a motion that has been seconded.

CHAIRMAN VOLCKER. I wasn't sure what that motion was.

MR. RICE. The motion was to accept the recommendation.

CHAIRMAN VOLCKER. Well, we also have to ratify the transactions and I didn't ask anyone for--

MR. PARTEE. The motion I think is to add a billion dollars to the [intermeeting] limit.

MR. MARTIN. Raising it by \$1 billion [to \$4 billion].

CHAIRMAN VOLCKER. Any objections?

MR. WALLICH. I think I'll vote against it if it's pure coupon purchases. If it's just to add a billion dollars [to the intermeeting limit], I can't be against that.

CHAIRMAN VOLCKER. I don't think we really want a vote appearing in the record that we voted on a particular operation and had an objection. If you want to persist in your objection, I think we ought to defer the whole thing.

MR. WALLICH. No, I'll withdraw my objection.

CHAIRMAN VOLCKER. The action has nothing to do with coupons; it's just to increase the limit.

SEVERAL. That's right.

CHAIRMAN VOLCKER. We also need a motion to ratify the transactions.

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. [Approved.] Mr. Kichline.

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

MR. BLACK. That's finished goods, Jim?

MR. KICHLINE. That's right--total finished goods.

CHAIRMAN VOLCKER. Why don't we just go on to Mr. Truman and get the complete picture.

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

CHAIRMAN VOLCKER. Well, I won't describe the picture domestically and internationally but open it to discussion.

MR. BALLE. Mr. Chairman, looking back over the last six months, it's a little unnerving to witness the failure of prosperity, which was supposed to be right around the corner, to emerge. Laying aside political figures, as I recall, Jim, there have been respected people in the forecasting fraternity who were predicting that an upturn would begin as early as last May or last June. One month after another after another right down to the current one, as we know, that has failed to happen. Looking back, can you put your finger on any particular factor that has produced this outcome? I'm thinking that despite the tax cut for business last year and despite the October '81 and July '82 cuts in personal income taxes and all these wonderful things that were supposed to get us off onto a new road here, [recovery] keeps eluding us. Looking back, I wonder why.

MR. KICHLINE. I think there are a number of factors. It's not really comforting to know that we have had a lot of company, but you are quite correct that the general expectation for the second half

of the year has not been met. In part, from our side, I think we perhaps underestimated the interest rate impact on a variety of sectors, and in business fixed investment it was not just the interest rate impact but more broadly an erosion of confidence in that sector. That's the one area that we have written down substantially and it accounts for the major drop in activity late in this year. The export side is one that has been weakening as well in recent months, given the deterioration in international conditions. So, both of those sectors are now heading down with a vengeance. I would say there are obvious impacts on income and consumer spending flows from that. If you look around at what went wrong, it is a bit weaker virtually every place. I don't know any place in our forecast where we tended to revise [our estimates] up. Some revisions have been large on the down side and others small; but they all have tended to run in a negative direction. I think it's a whole host of factors. I would say also that the tax cut was a little weaker than we anticipated earlier, but it was so small that it pales by comparison with the other things going on and it just doesn't matter in the aggregate.

MR. PARTEE. We didn't have a rise in personal savings, particularly, as a result of the tax cut, which suggests that income growth was so much poorer that it used up the benefits of the tax cut.

MR. KICHLINE. That's right. The monthly savings rate numbers are a little hazardous to look at, but September now is down to the 6-1/2 percent range. The temporary blip has been all but erased and a lot of income has been destroyed in effect or lost from the fact that these other sectors were deteriorating.

MR. BOEHNE. I think we can trace most of [the economy's weakness], John, to very high interest rates. That stares us right in the face. We have extraordinarily high interest rates. If you look back at other recoveries, real rates have been a good bit less. I've noticed in my District, for example, that the drop in rates over the most recent months and its impact on the stock market has had a positive effect; there is less pessimism and some increase in hope. I think that will be quickly erased if rates reverse themselves to any significant degree. I believe the recovery eludes us because rates are too high, and we won't get a recovery until we have lower rates.

MR. BALLE. I happen to agree with that, Ed. I didn't want to put words in Jim's mouth. I think that's the way it came out, though. The key factor, I think you said, Jim, was the interest rate impact particularly in the business fixed investment area and the export area. Is that correct?

MR. KICHLINE. I think that's right. I would say that we had high interest rates in our forecast and we still had a recovery. So, looking back, I'd say either we misestimated the impact of those rates or attitudes changed. But it's very clear to me that one can't ignore the rate impact in terms of what is happening in the economy.

MR. PARTEE. The velocity numbers have been very unusual, haven't they? We've had pretty good monetary growth throughout but velocity has been negative instead of positive.

MR. KICHLINE. Steve is going to be discussing that, I believe.

CHAIRMAN VOLCKER. Who sees the recovery beginning?

SPEAKER(?). Beginning?

SPEAKER(?). Some flurries.

MR. CORRIGAN. I do get a little sense of it, at least in an anecdotal sense; there certainly are no hard statistics at this point. But I do have a very distinct sense of a bit of a change in business attitudes and so forth just in the timeframe of the past month or so. One place where it is very evident, as Jim mentioned, is in the housing sector. There clearly is a little action developing--I don't want to say a burst of activity--in the housing sector.

who is in the wood products business even acknowledged that in a very forceful way last week. In terms of the number of plants making wafer board and that type of thing, all of a sudden they are back on 7-day workweeks. So, I think there is something there. More generally, I do perceive in a variety of places and contexts a sense that a bit of momentum is beginning to materialize.

VICE CHAIRMAN SOLOMON. There is going to be a substantial decline in commercial construction next year, so even though lumber may be benefit, net, I'm not sure that the overall construction impact is going to be that significant.

MR. CORRIGAN. The commercial construction situation is really very, very bad. Indeed, not only do I suspect that that sector of the economy is going to remain very soft for a long time but I think that is going to show through in another clustering of real problem situations for the people who are financing these buildings that are just being finished.

MS. TEETERS. What is the state of the farm economy?

MR. CORRIGAN. It's not good. Certainly, the price situation is terrible. These people, though, really do have remarkable staying power, in our District anyway. I sent my staff out to visit 6 or 8 major agricultural lenders to try to get a first-hand picture of what they thought was going on, and I was astonished. We are seeing a lot of problem situations and problem loans and all the rest, but it's still the Main Street [retailers] and the implement dealers [that are mainly affected]; the farmers themselves are hanging in there pretty well. The livestock people, again despite low prices for livestock, are benefitting obviously from lower grain, feed, and energy prices. So they actually are hanging in there in a reasonable fashion. But with regard to farm-sector purchases of any equipment, they are virtually non-existent.

CHAIRMAN VOLCKER. Let me ask the question the other way in the interest of even-handedness. Who sees a continuing momentum of decline?

MR. MARTIN. I'd like to speak to the housing sector.

CHAIRMAN VOLCKER. We'll come back to you in a second.

MR. GRAMLEY. Let me just make one comment. I have always found it interesting and useful when I'm uncertain about whether my forecast is right or not to do what I call a "National Bureau exercise" in which I look at what I think are the better leading indicators of economic activity to see whether they confirm or deny my thinking. Of course, I play this game in my own way; I choose the ones I think are best. I don't look at the leading indicators, but I look at things like the average workweek in manufacturing, initial claims for unemployment insurance, orders for durable goods, and industrial raw materials prices. And they are all still going down. I'm quite convinced we will find that the recession not only has not ended in October but that it will not have ended in November either. And while I would make a forecast like Mr. Kichline's that recovery probably is right around the corner, I made that same forecast at midyear, as he did, and I was dead wrong. So, I think we have to reckon with a quite high probability that recession may well continue through the first quarter of 1983.

MR. CORRIGAN. There's a point that I think is lost here. We keep talking about the fact that interest rates have come down. I don't know what the real interest rate is, but if you look at the relationship between current nominal interest rates and current rates of inflation, the reduction in real interest rates, if it's there at all, certainly is not very significant.

MR. GRAMLEY. The other aspect of this interest rate movement that I think we need to take carefully into account is that this recession is quite unlike earlier ones in terms of the international component. A very large part of the decline in real GNP since the middle of 1981 can be explained by the drop in real merchandise exports. Now, that's a consequence partly of a worldwide recession but also of a very substantial increase in the value of the dollar in exchange markets. And the drop in nominal interest rates has not reversed that. That negative effect is still there in spades, as the International Finance Division has reminded us.

VICE CHAIRMAN SOLOMON. Even though unemployment levels don't track real GNP that quickly, the view on Wall Street--I would say the consensus view--is that unemployment will continue to rise. I hear estimates of from 10.6 to close to 11 percent. Some people say it will peak by the end of this year but others say it will peak in the first quarter of '83. We could have some plus--a tiny little plus--in real GNP and still get rising unemployment.

MR. PARTEE. Oh, sure.

VICE CHAIRMAN SOLOMON. But that wouldn't be perceived as recovery, I think.

MR. WALLICH. Well, we're not thinking in terms of interest rates very much. We should remember that when we used to do this we allowed for a lag of 6 to 9 months before [the economy] turned. I would think these lags have shortened, particularly in housing, and expectations tend to shorten them. But this fall in interest rates wasn't all that long ago that we could expect very great results by now.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. I've noted along with President Corrigan a few signs of housing recovery. Like Jerry, I've talked with both lenders and developers and found from them the first sparks or glimmerings or very preliminary indications of some recovery. But we have to put that into the changed institutional framework in which the lenders and the developers and the sellers of existing housing now operate. One of the positive indicators, of course, is the substantial upswing in FHA applications. That is a positive, but those FHA applications generally deal with housing, in submarket by submarket, that is at the lower percentiles of the housing market. It would be difficult to have a 1.3 or 1.4 million housing start number based only on that segment of the market. It would be difficult to have that kind of recovery in housing from the 800,000 to 900,000 level unless existing home sales revive and continue to support the month or two upswing in new home sales. The question is whether even that one or two month increase in new home sales will persist. The question is where the financing is going to come from to handle the need for the financing of the foreclosed properties--and they would be foreclosed if they didn't have to be shown in certain asset categories of the thrift institutions and the commercial banks. That kind of financing, of course, is taking and will continue to take first priority over adjustments and accommodations to the regular borrower. I note that there is a question about the thrift institutions with this marvelous new account, which is primarily a transaction account and will be looked on by their managers as a short-term source of funds. Do we really expect them to make 30-year fixed rate, fixed term loans with 5 or 10 percent down? That kind of contract is going to be what it takes to get to a 1.3 million level, supported by some multiple of existing home sales of 5 million or whatever it takes to support the 1.3 million. I don't see it that way.

MR. PARTEE. You don't think the public will buy a variable rate mortgage?

MR. MARTIN. I think the public will buy a variable rate mortgage. That gets us to the complication of qualifying the buyer, particularly the young buyer, in what more often than not won't be a variable rate but a renegotiable rate mortgage. That gets us to the second problem of qualifying the young buyer particularly and other buyers where the lender demands a pledged account mortgage--where a savings account has to be put up in order to qualify the borrower because the income-to-debt-service requirement is such that they can't handle it without debiting a pledged account. In other words, the institutional context in this recovery period for housing is significantly different from any recovery period we've had before. So, if you foresee a consumer-led recovery with housing as the harbinger, I suggest you take another look.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. Jerry Corrigan captured the theme that I wanted to express. And that is that the discussions in October with businessmen and bond dealers in our area and at our board meeting involved probably the grimmest, gloomiest reports on the business outlook that I've experienced since I've been with the Federal Reserve. Interestingly, at the most recent board meeting and in meetings with businessmen in November, there was this glimmer of hope that things indeed were getting close to improving.

There was some report, for example, that housing in the Oklahoma-Colorado area particularly, which has been a very vigorous economy, is continuing fairly strong.

As far as the agricultural sector is concerned, while I do agree with Jerry that the agricultural sector has great resiliency, in talking to the farmers and [others] and also as a result of a quarterly agricultural farm survey that we conduct, we find that the foreclosures or the estimates of near foreclosures, which include substantial sales of assets in order to provide liquidity to the producer, are increasing or expected to increase rather dramatically in our area. One other thing we hear from farm credit people as well as bankers is that they are very conscious of [the desirability of] not putting very much foreclosed farm real estate onto the market because the market is already depressed in value by some 25 percent from a year ago. They are going to hold that farm real estate in some fashion rather than flood the market with it, which would push values and prices down [further], thus jeopardizing the collateral on outstanding agricultural loans. The bright spot in agriculture is the red meat area; hogs and cattle, for example, both are in the black as far as profits are concerned. So there is some hope.

MS. TEETERS. How much of the glimmer of hope you are seeing stems from the drop in interest rates and the anticipation of their going down further?

MR. GUFFEY. Nancy, I'm not sure I can identify all that goes into that glimmer of hope. But the fact that interest rates are lower certainly has to be an important factor. There is obviously some broad anticipation of a further drop in interest rates. I'd just suggest that without a further drop or with some backing up I think that glimmer of hope could vanish immediately. It would not only go away but that would worsen the potential outlook.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLEES. Just to reinforce what Governor Martin was saying on housing, the forest products industry, one from one of the biggest firms in the West, say that there indeed have been signs of a little pickup. Translating that into what it means for 1983 as a whole, they are still pretty bearish in the sense that 1.3 million would be about as much as they are looking for in new housing starts. And in a broader sense that industry is still in the doldrums because of what the foreign exchange business is doing to log exports; that is a very, very severe blow. And finally, the pulp and paper business, which is another important leg of that industry, is really in the doldrums. So, at least in our forest products firms, I don't find any great optimism these days.

If I could finish with a question, Mr. Chairman, I'd like to ask a question of Ted Truman, at the risk of repeating what perhaps already has been said, which I didn't understand. In view of what has happened to interest rates in this country, with lower nominal interest rates at least, is there any good reason you can think of why that darn exchange rate is not only hanging up there but getting stronger?

MR. TRUMAN. Well, as was noted earlier, it has moved down a little and may be coming [down more]. But the staff, at least at the Board, has pretty much run out of what I might call good reasons on that. And, not satisfied by the staff, I've noticed that several people we've had in here--the Board [staff] having been exhausted--were asked the same question. One clear factor seems to be the uncertainty and the safe-haven arguments. There is something there; how much one can't say. That kind of argument is very difficult to measure in terms of how important it is. Another factor is this recent phenomenon, as Sam mentioned, that there does seem to be a sense in the market that even though U.S. interest rates have moved down, foreign interest rates, even if they didn't move down in this period, are expected to move down further. We saw some of that phenomenon in the market yesterday when there were reports that British interest rates were going to drop very dramatically over the next six months; that knocked down the pound quite markedly against the dollar and other currencies at that time. So, there is a sense in which there is a decoupling of interest rate policy [whereby rates coming down in] other countries at the same time our interest rates are coming down has led to some marking up [of the dollar]. One thing that we do sometimes lose sight of is the fact that our inflation performance has been better than expected and better relatively than expected. All three together suggest that the dollar in a sense is not quite as high as we think it is.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. Well, I have [heard] the comments that would suggest that emotionally there is perhaps a better tone in the market, but I really think it's only because the previous period had been so very, very bad. In answer to Nancy's question, I think [the weakness] is entirely interest-rate driven. With rates having been so high, that created such a very bad attitude that a reduction, even a modest one, has been well received. But looking aside from the emotion into the basics, I think the situation is continuing to deteriorate. The basic industries, particularly those in the Midwest, are continuing to decline. That tone comes through in the Redbook; the Redbook made for pretty consistently gloomy reading this particular time. I think we are at a point where, if the rate structure doesn't stabilize or indeed doesn't continue to go down, this emotional improvement is going to deteriorate pretty rapidly.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Well, I would pretty much be where Roger and Jerry are. My overall reading of the Eleventh District [based on] our own internal forecast that we've just gone through at our Bank is slightly more optimistic certainly than the Board staff's forecast. I don't know how much of this is hope. But I see things that I find very hard to understand. This is strictly anecdotal, but with regard to housing, Sunday afternoon out of curiosity I visited two housing developments in Dallas. At one, the builder apparently was pretty optimistic; he had just completed 10 specialty homes beginning at \$375,000. And the crowds [were so big] you could hardly get in the houses. I was impressed with that, so I went across the road to another new development, and the lots began at \$250,000.

MR. PARTEE. The lots?

MR. BOYKIN. The lots.

MR. BLACK. That's low income housing in Texas!

CHAIRMAN VOLCKER. There is a lovely countryside.

MR. GRAMLEY. Each has its own golf course!

MR. BOYKIN. Three homes had just been completed and were on show and we could not get in them because of the crowd. They begin at \$1 million and they have "for sale" signs on them.

CHAIRMAN VOLCKER. People aren't buying; they're looking.

MR. BOYKIN. But what builder has that kind of financing and that kind of optimism to build a million dollar [spec house]? And one that is about half completed is going to be priced at \$1.8 million.

MR. MARTIN. Bob, there's an old maxim that builders use, which is: "I'll build anything [the lenders] will finance."

VICE CHAIRMAN SOLOMON. But, Bob, isn't the number of rigs in use up?

MR. BOYKIN. The rig count has improved. There is a question of whether it is a real improvement or seasonal for tax purposes and so forth. But the rig count is up slightly. On the other hand, the seismic surveys are not showing that much improvement, so it does raise the question of whether it will hold.

MR. BLACK. Bob, doesn't your housing information support Pres' statement that the strength is going to be in the low income part of the market?

MR. MARTIN. In Texas, that's low income!

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. Well, I would say I get pretty much the same readings. I've been through three of my six locations in the last two weeks and there was a marked change from the last go-around. About half of my branch directors and Atlanta directors are now saying some positive things; it's pretty much concentrated, as others have reported, in housing and housing-related areas, which are sensitive to rates. One of \_\_\_\_\_ was absolutely euphoric. He said he had an infinite improvement in building permits; in Montgomery, which is a city with a few hundred thousand residents, permits went from zero to thirty. Of course, that was [unintelligible]. Another reported that he'd seen trucks going out of the local lumber mill for the first time in a long time; that is housing-related and is supported by some statistical data that are coming out.

We did a special survey of thrifts with regard to the questions that Governor Martin reported on and also the question of where the money is going. We looked at nineteen of the biggest thrift institutions in the Southeast and they account for \$1 billion of the nationwide total of all savers certificates. Half of it disappeared.

We compared September 20 to October 20 to see what happened to the money, and about \$500 million ran off from the all savers certificates. The thrifts were pretty cheered by the fact that the biggest chunk of it--\$150 some odd million--went into passbook accounts; they wish it were permanent, but they doubt it will be. Another big chunk--about \$30 to \$40 million--went into IRAs, which is long-term money. That might be the partial answer for why NOW accounts and IRAs and deferred comp accounts are starting to build up. Basically, I guess I have to go along with the general thrust of the reports here, which is that the only real optimism or rays of hope that we see are in housing and housing-related industries. There are a few minor exceptions; there's a bit of tourism and a little improvement here and there, but overall it is in the rate-sensitive sectors.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. Consumer credit interest rates are not coming down very much. I gather they are running 18 to 24 percent. Many department stores are keeping their rates at 24 percent. The argument is made that they had losses earlier when there were usury ceilings that they have to make up. Some of the banks say it is longer-term money that they have to borrow in order to finance automobiles, for example. Some of the upstate bankers in New York have said that their auto credit business has not picked up significantly. But one banker told me that he has offered a 12 percent rate on the condition that the customer open an account or had an account in his bank. And he said he is absolutely deluged with applications and that he did an enormous volume of financing of new auto sales at 12 percent. Now, Karl Otto Pohl in Germany made a public plea to the banks to pass on reduced interest rates in the consumer credit area, and a few of the banks followed with a one percentage point reduction. I don't know whether Chairman Volcker is thinking of making a comparable appeal.

CHAIRMAN VOLCKER. Are you recommending it?

VICE CHAIRMAN SOLOMON. Yes, I think it would be a good idea.

MS. TEETERS. I wasn't aware that consumer credit interest rates moved with the cycle. I thought that automobile and mortgage rates moved with the interest rate cycle, but that everything else was always at usury ceilings.

MR. MARTIN. Well, we have the impact of personal bankruptcy behavior patterns that lenders are taking into account a bit more than they did in the previous so-called recovery.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. In looking ahead, I think it's important to keep in mind several fundamentals. I don't think any economist I have heard from or read about really equates this recovery with other recoveries from troughs in economic activity in recent times. People are almost unanimous in anticipating that the fourth quarter of this year, which is the time we're speaking of right now, will be essentially flat and that there might be, and hopefully will be, some pickup going into next year, with maybe 2 percent real GNP growth at

best in the first half of next year. Some of us get exceptionally gloomy when we don't see the dramatic increase that has characterized previous recoveries. Just last week we had the chief financial officers of the largest companies in our area in for lunch. What many of you have reported was indicative of their points of view. They did recognize a rebound in home building and home-buying activity, but it was essentially in higher priced properties. The one significant hint of meaningful improvement came in the retail area where two large national retail firms, and another, said that they were sensing what they thought was an improvement that they hoped would carry over into Christmas as a significant improvement. But I think it's important when we get around to making policy that we not react in an inflationary manner to a gradually improving probability because I don't think there is any way that we will get the sort of dramatic upswing that has occurred in the past without fueling the [inflationary] engines to an extreme. But we saw glimmers of improvement among the contacts we had in the Eighth District.

CHAIRMAN VOLCKER. Ms. Horn.

MS. HORN. I suppose if I were grasping at straws to say something optimistic from the Fourth Federal Reserve District point of view, I would say that the comments I've heard since the last meeting have [conveyed] in some sense more confidence. But if one goes below the tone of the comments and into the statistics business people have been basing them on, in fact, the statistics don't seem to show any improvement in the capital goods industries. We hear about continuing deterioration and backlogs, for example. And the farm sector is much as several people have reported, in terms of what farmers buy and extremely weak land prices. But, in fact, the comments do seem to have a little more confidence in them, perhaps really because people are now beginning to say that they are going to take market share away from somebody else and somehow be at a competitive advantage rather than that they are seeing an overall improvement in the economy. I see this as heavily reflected in the consumer sector in the Fourth Federal Reserve District as in any other [sector]. But I could put an optimistic face on what continues to be perhaps not a negative set of data but a stagnant to negative set of data in our District.

VICE CHAIRMAN SOLOMON. One last comment I'd like to make is that I met with a group of about fifteen business leaders, and those among them who have been doing well in the last two years--three or four of the fifteen--continue to do well. Those who have been doing very poorly say they see the situation as absolutely flat; though it is not deteriorating further, they don't see any signs of recovery yet. And I found it interesting that when I asked about salary and wage increases, all of them, including those who were doing well, talked about increases in a range from zero to 6 percent, with the exception of the New York financial community.

CHAIRMAN VOLCKER. I'd say that you weren't talking to the New York bankers.

VICE CHAIRMAN SOLOMON. The wage increases that the New York bank community expects to pay within the next 12 months were running 8 to 10 percent, but the increases expected in the industrial community ranged from zero to 6 percent.

MR. PARTEE. I wonder whether the type of people you all talk to might not be considerably influenced by the 250 point increase in the DOW. It seems to me that that is one of those things that color attitudes. It may not add that much to consumer spending or anything, but most business leaders and most people who would buy a million dollar house have a considerable stake in the equity market one way or another, and they probably are feeling quite a bit better.

CHAIRMAN VOLCKER. We can turn to Mr. Axilrod.

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

[Coffee break]

[Secretary's note: The meeting resumed at this point with more limited attendance.]

CHAIRMAN VOLCKER. Well, we have to come down to making a decision. The assumption of the Bluebook is that we will keep the same general framework we had last time. I thought this [distortion in] M1 from the all savers certificates would sort itself out by this time. I'm not sure that it has; it appears that it has not. We still have that problem. A much more fundamental problem, implicit or explicit in the earlier conversation, is that the business situation doesn't look red hot. It has a lot of international complications. And, certainly, the relationships between the money figures and the economy have run way off the postwar track. We may be ending up with a tighter policy than we intended for that reason and not because we let [the aggregates] run above track. That's a judgment that has to be made. Without any question, they are off track; and whether they are going to return to track in the foreseeable future is a matter of faith. It doesn't surprise me, particularly, that they are off track now, but one can't judge the amount. I'm not so sure if we're really going to disinflate. We have all kinds of institutional problems with M1, but extracting from the institutional problems I think the basic trend in velocity might change. I've said that before, but I can't prove it. It certainly has changed in the short run and I'm not sure why. I would think that the basic trend in M2 and M3 ought to change. But that's really a problem for next year and not for next month. It's just a matter of judgment how much we allow for these liquidity pressures, and I suppose that gets mixed up in interest rate judgments. Who would like to approach the problem? Mr. Boehne.

MR. BOEHNE. Paul, I would like to start. I have made a list of the key points that have been made. We clearly have a weak economy and the prospects for recovery are elusive at best. The point has been made about some glimmer of hope at the emotional level, but I think that is largely a result, directly or indirectly, of lower interest rates, and it can evaporate very quickly if rates reverse. The foreign situation, at least from my perspective, is just plain scary. And there is the point that you just made: That the money supply figures have to be viewed with increasing skepticism in terms of their economic meaning, at least at this point and maybe for a long time. I might add a point that has not been made. We have had a much improved inflationary situation. There is no room for an inflation scene [but] I think we have to be prudent about the inflation problem. As I add all these up, and admittedly it's a judgmental issue, they

make a rather convincing case for a monetary policy that encourages some lowering of interest rates.

As for the alternatives in the Bluebook, that pushes me in the direction of "A." It may be "A" to "B," but I'm certainly closer to "A" than "B." If we did that, I would think that the funds rate would drop to 9 percent or a little under, and that also would open up a window for an appropriate drop in the discount rate, which I think has been discounted to some extent in the market. Unless we get some move there, we may give up some of the progress we've made on lower rates since the last meeting.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Mr. Chairman, I think we've gone a long way toward dealing with our long-term inflation objectives. That is not saying we won't have to deal with them in the future, but it seems to me that the immediate, imperative policy is to find the level of interest rates that is going to permit the economy to turn around. I think the evidence at the moment is that the current level of interest rates is too high and that the economy is still sliding downward. Quite clearly, the monetary aggregates are giving misleading signals. Their strength clearly does not reflect strength in the economy, but quite the opposite. It's a reflection of the weakness of the economy. In large part, I think the growth in the aggregates reflects the fact that the business community has not been able to fund their debt in the long-term bond market in the normal cyclical manner. And that has produced the unusual phenomenon of growing, indeed rapidly growing, business loans at banks all through a recession. I can't recall that ever happening before. Again, this sustained business loan demand, which has contributed toward the strength in the aggregates, as well as the liquidity preference factors are giving us very misleading numbers on the aggregates.

It seems to me that at the moment we have to go for alternative A; it is the only alternative that makes any sense to me. We have to set aside the aggregates as our prime objective at the moment. But if we go for "A," and I hope we do, that does mean we will have to inform the markets in some way that it is not necessarily our objective to bring M2 and M3 within their ranges because, if we get the markets anticipating that the Fed is determined to bring M2 and M3 within their ranges by the end of the year, we could very well not have the kind of response that we want. But that's a problem for you to figure out.

CHAIRMAN VOLCKER. I will be making a little speech tonight. Mr. Roos.

MR. ROOS. Well, I see this somewhat differently from Frank. First of all, I would ask Steve a question because I may be analyzing this incorrectly. One of the reasons for shifting our emphasis or attention away from M1 was to accommodate the distortions that the all savers certificates and other instruments might be causing as the all savers certificates [matured]. If we have the M1 growth that is implied in any one of these three alternatives and if we project that growth from the present time, aren't we in effect projecting 5 percent in the case of alternative C, or 6-1/2 or 8-1/2 percent from a base that includes the all savers certificates where they are now? In

other words, don't we in effect validate that bulge that is a result of the all savers certificates termination? Don't we take off from that higher level and doesn't that give us for the year growth in that aggregate that is way above the--

CHAIRMAN VOLCKER. Are you talking about 1983?

MR. ROOS. I'm talking about 1983, yes. What I'm trying to say, and I guess I'm saying it in a very clumsy fashion, is that I would feel no discomfort with 6-1/2 or 5 percent growth from October to December if that growth were after the effects of the all savers certificates have washed out.

MR. PARTEE. He's talking about the bulge.

MR. ROOS. I think we're really moving from an inflated M1 because of its all savers component; if we put in a 5 or 6-1/2 percent growth rate above that, we're really getting a much higher rate of growth relative to our original targets than we had originally contemplated. I don't know that I'm asking quite--

MR. PARTEE. One can see that; it's on the chart here.

MR. AXILROD. Well, the growth rates we have here are certainly higher than we assumed at the last Committee meeting would be consistent with your original M2 targets. The M2 target may be slightly higher, but not very much. A problem, as far as we can see from the casual information we get on bank deposits, is that the all savers certificate money that went into demand deposits has not come out yet. And we don't know when, in fact, it will come out. For all I know it may sit there and jump into this new money market instrument that the DIDC has authorized. So, in some sense, that temporary money is still in there and is raising these growth rates. I think that's what is causing these numbers--

MR. ROOS. Well, I would see the effects of this on interest rates differently from the way Ed Boehne and Frank Morris perceive them to be. Regardless of what we know about the behavior of the aggregates, there are a lot of people out there doing a lot of figuring. And if money--whether it's M2 and M1 or a combination of these various Ms--continues to grow at anything like the rate it is growing presently, even though that money growth is authorized as a means of achieving lower short-term interest rates, I believe the opposite is going to occur, and I think it will occur very quickly. In other words, we will start to get articles and a reaction that will boost rates rather quickly in the belief that we will reflate. Frank, I don't think we can turn this inflation [fight] off and on in any orderly way; people are still skeptical as the devil as to whether we are going to hang in there and keep our anti-inflationary posture. If we have three months or four months of really fast money growth, I think we will see these rates skyrocket instead of coming down.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I agree with those who have already suggested that we must find an appropriate interest rate level that will further our economic recovery. I'm not sure that

9-1/2 percent isn't it, but it certainly hasn't given a good signal yet that it is the appropriate level. That implies to me that we ought to move interest rates to a modestly lower level, and that lower level is, I suppose, something this Committee should decide. All the talk about targeting reserves and looking at M2 for some informational content as to what policy should be I think is a bunch of baloney in the sense that we are targeting interest rates. And we ought to recognize that. In that context, I think there are a couple of ways to go. First of all, let me say that I am not suggesting that we do away with or abandon the regime of targeting reserves and money supply, at least for public consumption. But around this table it seems clear to me that [we are on] an interest rate regime and we ought to target on the interest rate we think is appropriate to get the economic recovery started again. Having said that--

CHAIRMAN VOLCKER. I don't think that's quite accurate, Roger, if I may interject. Speaking for myself, I would have lower interest rates if these aggregates weren't rising so darn [fast].

MR. MARTIN. Would you?

MR. PARTEE. I agree with that.

MR. GUFFEY. I agree that we have to be concerned about--

CHAIRMAN VOLCKER. It's not exactly what I would target.

MR. GUFFEY. Well, notwithstanding growth of the aggregates, I would propose that some lower interest rate is necessary to trigger the recovery. The way to get there is what this Committee has to deal with. Others have suggested alternative A and that has some attractiveness to me. But there are a couple of ways to engineer lower interest rates in the intermeeting period. And I would prefer doing it by adopting "B" and having an initial borrowing level below that suggested in the Bluebook, which was \$350 million. I would make it \$250 million or maybe \$300 million, thus setting the reserve path in such a way that we would get a fairly immediate drop in interest rates; and coupled with a discount rate decrease, that would bring the funds rate to the 9 percent area. The reason I'm not terribly attracted to "A" is that, if I understand the Bluebook projections correctly, "A" [contemplates] about an 8-1/2 percent fed funds rate in the intermeeting period. That's a full percentage point decrease in a five-week period. That may be a little quicker than I'd like to see happen. I'd like to go down gingerly and see what happens so that we could continue a downward trend. And thus, I would opt for "B" with a lower initial borrowing level as the prescription.

CHAIRMAN VOLCKER. Mrs. Teeters.

MS. TEETERS. Well, what I would recommend is not new. I think we have to get interest rates down to get the economy started. Therefore, I'd opt for alternative A. I did an interesting thing last week. I realized I had never actually looked at the numbers from the early 1930s, so I went back and took a look at them. There is no question but that we are not in a situation like the 1930s. [Then the economy] just went straight down; in the current situation, it has been going sideways for three years. But there is one thing that is very similar to the 1930s and that is the international crisis. What

made the depression so extended was that all international credit flows essentially stopped. Our interest rates, the lack of recovery in this country, and the high international value of the dollar are creating a situation in the international field that could lead us into something very similar to the 1930s, and I'd be very careful. So, not only for domestic reasons but also for international reasons, I think it's imperative that we get our interest rates down and down to a level that will start a recovery. In addition, more and more people and more and more members of Congress are pointing the finger at us, saying that the lack of recovery is solely a result of either high nominal or real interest rates. If that continues and more blame is heaped on us, the possibility of major institutional changes is looming in the next year. I wouldn't change [policy] solely for that reason, but the economic and international outlook are such that we can't afford to stay at these rates. Therefore, I would strongly support "A."

CHAIRMAN VOLCKER. Let me just say a couple of words about the international situation. We have an IMF agreement--letters of intent anyway--with Mexico and Argentina. Their problems are far from being solved, but that's a very important step. Mexico still doesn't have much money and their economy is winding down for lack of imports and other things. There is going to have to be a big negotiation with the banks to get them to put up some credit. I don't anticipate that we will be asked to do anything more but it's not inconceivable [that we may be asked]. I just don't know how much [it might be] in the short run. The U.S. government is certainly going to be asked to do something on Argentina. I don't think it necessarily is going to involve the Federal Reserve. I have taken the opposite view. It's a very complicated situation. It depends upon what kind of security arrangements can be developed and it depends upon whether any foreign central banks will join in. It's in a state of being unresolved.

As for the Brazilian situation, they had their election yesterday. I don't know what happened. It probably will take them a week to count their votes, but at least they have that behind them. They may have special vote-counting techniques for all I know.

VICE CHAIRMAN SOLOMON. Are they counting the way they do it in Illinois?

CHAIRMAN VOLCKER. That comment doesn't go in this report.

My only point is that it may clear the way for a more open discussion of the Brazilian problem. There was an article in The New York Times a day or two ago, which you may have seen, that is fairly accurate. That is going to burst upon the world's consciousness a little more fully in the next few days. The Treasury has provided \$500 million to Brazil already and probably will do another \$200 to \$300 million very shortly just to keep them afloat until the timing is right for them to go to the Fund and try to deal with the problem more openly, which is certainly going to have to be done. It is still a very uneasy situation. The IMF negotiations, on the other hand, are being speeded up, and that should be of some assistance. I think that will be resolved in the next month or so in terms of enlarging quotas in the special fund. I interject that because it arose in a couple of comments. Mr. Gramley.

MR. GRAMLEY. I am with the majority view that is beginning to develop. That view is that we have to do something to make sure that a recovery begins soon. Frank used the word "imperative" and I think that is quite right. It's a matter of urgency. Looking at the domestic economy, I have a feeling that the widespread expectation of the business community at midyear that the recession was over and that a recovery would begin led to actions that were deeply disappointed when the growth in final sales that was expected to come from the consumer sector didn't happen. We had a very serious worsening of expectations during the course of the summer and a drop in the demand for business fixed investment among other things. And I think there is more than a small risk that it might happen again. If I were forecasting, I suppose I would say it is probable that the recovery will begin sometime early in 1983. But there are no concrete signs as yet that the recession is over.

I agree with Governor Teeters that the international considerations are pointing strongly in that direction, too, as well as considerations about what Congress might do. It's not just a question of potential anti-Federal Reserve legislation, but we badly need to have action that is going to reduce the prospect for growing deficits in the out years. And it's going to be extremely difficult, if not impossible, for the Congress to go in that direction if the economy is still falling. I look at the present level of interest rates and I have to acknowledge that I'm not sure the present level of interest rates is inconsistent with recovery. But if it's the wrong level, it certainly is not that interest rates are too low. On the contrary, they are more likely to be too high. I don't think there's any significant danger that what we do between now and the end of this year is likely to provoke a massive turnaround of inflationary expectations. I think we have established our credibility. I think we have to follow a course now that prevents any possibility that interest rates might go up. So, "C" and "B" are quite unacceptable to me. I wouldn't want to take such aggressive action that the markets would think we were throwing in the towel. I would be inclined, therefore, to go somewhere between "A" and "B" with an initial borrowing of maybe \$250 million, as Roger Guffey suggested. I wouldn't be reluctant to stick with the growth rate of M2 in "A" and I certainly would want to keep in the directive the statement that we included last time about uncertainties leading to exceptional liquidity demands. We ought to err on the side of providing more growth rather than permitting less.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. Well, I don't know what I can add to what seems to be an emerging consensus for alternative A.

CHAIRMAN VOLCKER. The consensus is mostly among non-voting members.

MR. PARTEE. I noticed that.

MR. KEEHN. I think interest rates really do matter. And given the noise in the aggregate numbers, we really can't be in the business of slavishly following statistics that may or may not make sense whereas interest rates, as I say, really do have a significant impact. All the sectors I deal with in the Midwest are precariously

positioned: The agricultural situation is serious; the industrial situation is serious also; and the consumer is at this point just plain scared. And I think consumers are not going to begin to move out until they get some confidence. Nothing will build confidence like a slightly lower rate structure and, therefore, I would be in favor of "A." I certainly hope that the fed funds rate would be under the 9-1/2 percent level--that it would tend to be around 8-3/4 or 9 percent and no higher than that. I think the borrowing level to accomplish that would be \$150 to \$200 million.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. I won't repeat the reasons that have been offered already on why I also share the view that interest rates should come down. Summing up, I think there is only a 50-50 chance that we will get a recovery. We need a little more margin there. We need some further relief on the international scene. So, the question is how to do it. It seems to me that even if we reduce the borrowing to \$250 million--and I can't see it going safely below \$200 million or probably \$250 million--the most we are going to get is less than a half-point drop from open market operations. It is going to take a discount rate cut to move it a half point. If it doesn't offend anybody's integrity, I would prefer to put a figure of 9-1/2 percent for M2 but have a \$250 million borrowing assumption and use the funds rate range of "A." The funds rate range doesn't have the same relevance it did earlier because if we have the same kind of language in the directive that we had last time, there is a considerable flexibility for the Chairman and the Manager. That's the combination I would prefer, but I could live with a straight "A" if others felt that it would be very inappropriate to have a 9-1/2 percent target for M2.

MR. BLACK. Is that 9-1/2 percent you are talking about for M2 for September to December, Tony?

VICE CHAIRMAN SOLOMON. Yes.

MS. TEETERS. Could we achieve that with a 9-1/2 percent federal funds rate?

VICE CHAIRMAN SOLOMON. What I'm assuming is that there would be a discount rate cut within a relatively short period of time. If that happens, then whether we have 9-1/2 or 10 percent doesn't make that much difference. Maybe it does by the end of the intermeeting period; I don't know. Steve might want to comment on this. Assuming we had a discount rate move in the next week or two, how significant would the difference be with an initial borrowing such as I talked about?

CHAIRMAN VOLCKER. Why don't we defer that question until we get into an elaboration and just get the general views now. Governor Wallich.

MR. WALLICH. I, like everybody, would like to see lower interest rates. But what is the way to get them? The basic reason they are so high, I think, is indeed that the targets were too tight; they were calculated on the expectation of something like 3 percent velocity gains and we've had the opposite. So there is less money in

the economy than there should be unless this turns out to be a temporary situation, as it quite conceivably may. We have suspended M1 temporarily; I think targeting on M2 is a good thing to state as a principle, but it's not a very easy thing to do operationally. The basic decisions we have to make are about the funds rate and the borrowing assumption. I think we have a certain degree of leeway as far as departing from the targets is concerned. The market has responded, I think, very well to our statement that we weren't going to adhere closely to M1. It hasn't had the effect of causing the long-term rate to go up, which would be the interpretation of a strict monetarist position; the long-term rate has come down. How long this condition will continue is a real question. Bob Eggert asked this question of his forty economists and got a response that no doubt ranges from 0 to infinity. But eliminating the [outliers], he arrived at seven months as the period of time over which perhaps a departure would be accepted by the market before people would begin to become uneasy and long-term [rate movements] would begin to become perverse. So, we have some leeway and we must make the optimum use of it. I'd be reluctant to spend it all right away and reluctant particularly to do what the market seems to want and to expect us to do right away, which does look like throwing the book at the recession now. So, I would like to postpone a more drastic action and would go with "B."

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Mr. Chairman, the way I view the current situation is that I just don't think it's possible that the economy can stumble along at essentially zero growth for much longer. The financial strains that are there just won't permit it. If we float around zero for too much longer, with very little difficulty we could end up in a more severe downside situation. It is clear from the international side that the LDCs need to generate some exports. On the domestic side, I suppose some consolation can be drawn from recent developments in the financial markets but, underneath all that, the extremely serious financial strains are still very much with us. My own bet is that, even with the current interest rate structure or something very much like it, the prospects for some growth in real terms emerging in early 1983 and getting up in a range of 4 percent or so are reasonably good. But at the same time, while that is my own bet, I have to concede that the amount I'd be willing to wager at the moment is not much more than a nickel.

There is another characteristic of the outlook for 1983 that I'd like to mention, too. All the forecasts, of course, assume that unemployment is going to stay high no matter what. I think something is going on that may make it stay even higher than the conventional forecasts. And that is that a lot of businesses have really cut into their management and white collar work force during this correction period, and I think they are finding that they didn't need all those people. As we begin to see a recovery, that phenomenon is probably going to make unemployment stay higher than it normally would, which simply is going to add more fuel to the fire.

Having said all that, in terms of the alternatives that are before the Committee, if I understood them or if I thought they meant anything, I would be inclined to alternative B. That may in one sense seem to contradict what I said earlier, but I don't think it really does. Again, I'm not sure what any of it means, but the thrust of my

position is that I would tend to be a bit on the cautious side right now, [given] the monetary growth that we are seeing--whatever the numbers mean. The potential is at least remotely there that we could find ourselves facing a bit of a problem in early 1983. The problem, other things being equal, might even call for a slight increase in interest rates. It seems to me that that is a total no-win proposition. That view is reinforced, at least in my mind, by the peculiarities of the operating environment that we are in. If we have to snug up, regardless of what alternative we are working from, given the way the path is drawn and the operational mode that we are in, the snugging up process inherently is going to be slower and less precise than it would have been under the former procedures.

The last thing that is relevant, in terms of being a bit cautious, is this new [financial] instrument. It really won't hit until December, but it seems to me that it is going to depress the growth of M1 when it hits; and on top of that it is going to produce a shift from higher reserve requirement instruments to lower reserve requirement instruments, which as that begins to happen would in turn mean that a given reserve path, however drawn, might have different implications for the amount of money growth, however defined, one might have assumed in the first place. That, too, leads me to the view of being a little cautious among those alternatives. I would hedge my bet along the lines of Mr. Guffey's suggestion of putting the borrowing level down a bit from the \$350 million that the staff associated with Alternative B so that we could see a reduction in the funds rate coupled with or followed by a reduction in the discount rate. I might even be prepared to go one step further. If for technical reasons, we aren't able to orchestrate that, I'd be inclined to take my chances with a reduction of the discount rate even with the fed funds rate trading about where it is right now.

CHAIRMAN VOLCKER. Mrs. Horn.

MS. HORN. Mr. Chairman, I'd like to ask you to expand a bit on a statement you made earlier, which was that you would like to see lower interest rates if that could happen in an environment of less money growth. I'd like to hear you talk about how much lower interest rates you think the market might tolerate in the context of various kinds of money growth. As I look across the alternatives in the Bluebook, it seems one could construct a situation where any of the three alternatives could be consistent with lower interest rates. I'd just like to hear you expand your comment a bit.

CHAIRMAN VOLCKER. My comment was a casual one, not an analytic one, but I will try to make a more analytic comment. I just meant to say that if I were plucking an interest rate out of the air, I'd pick a lower one if I weren't constrained by worrying about how fast the aggregates were growing. I don't know how responsive I can be to your question. Somebody--I guess it was Frank Morris--said that there may be a perversity in the aggregates' growth at the moment. I think we do know at the moment, whatever it means for the future, that there has been an increase in liquidity preference. It almost seems to me tautological that we would get a decline in [velocity] of the kind we got. People want to hold more money; they want to hold more M2 and more M1 relative to economic activity. And it has persisted long enough so that it has been of some cyclical significance. What motivates that? Well, Steve gave a complicated explanation, which I'm

not sure I followed entirely, about the differences between liquidity preference and spending preference or whatever. I'm sure it was analytically all brilliant. But there is some element of uncertainty here. People want to be more liquid but that is something I can't measure. To the extent that is true, I don't think it's inconceivable that if people had more confidence and saw the economy growing, at any given level of interest rates we would get less growth in the aggregates because they might invest in stocks, for instance, or put more in bonds, or lengthen maturities, etc. People would begin to look at assets that are outside these very liquid assets. I guess that's what Frank may have had in mind in part. I don't think it's the interest rate itself so much as a general feeling about the economy, which may be tied into interest rates. It isn't 100 percent certain, but if over a period of time--I'm not talking just about the next month--we got a different set of economic expectations, we might find these aggregates growing more slowly rather than more rapidly simply because of a return of confidence. One could argue--I don't know how far I'd want to carry this argument--that by taking a chance in the short run and departing from the usual analysis or the usual expectation of the way these things work that we might end up with lower growth in the aggregates than we would expect if indeed there were a change in the atmosphere and people had some confidence in the economy looking out three or four months ahead. But I can't prove that.

MR. RICE. Can you imagine that we could do anything about confidence without reducing interest rates somewhat from their current levels?

CHAIRMAN VOLCKER. Well, I can imagine it, yes. Things could just get better at current interest rates. What I'm saying is that if we chose to be more liberal on the reserve-supplying side in the short run, though this analysis suggests that that would produce higher aggregates we might be pleasantly surprised over a few months and find that it didn't work that way. Nobody will ever know because we won't know what would have happened if we had done the opposite. But the differences in these aggregates projections are so small; they are well within the range of our capacity to foresee developments, within a month anyway.

MR. ROOS. Do you have any uneasiness or any fear that if the markets perceive the aggregates to be growing [rapidly], the movement in interest rates would be upward instead of downward? Is that a [concern] that should be factored into our decisionmaking?

CHAIRMAN VOLCKER. Yes, [though] we may be in an impossible situation. The economy does not always develop in a way that there are any answers except after the passage of longer periods of time than we are thinking about. And I think that is a danger. That's why I pay some attention to these aggregates. What we have to balance is how much we think we can get away with, even if we recognize the dangers in the business situation and want to get interest rates lower. Even if we think that's where the balance of the risks is, we can't throw discretion to the winds for the reason you are suggesting. Where is that balance? I think that's what we are talking about. I think one would have to conclude from what has happened in the market that people haven't been that upset by what they've seen so far. I don't have the figures right in front of me but in fact the surprising

thing is that while Treasury bill rates and the funds rate are [not much] lower than they were in early September, CD rates and private rates are. And bond rates are way down, which seems to be the inverse of what you would worry about if there were, at this point anyway, a great fear about what the monetary expansion was doing to us. Now, there are obviously anticipatory effects, but that is roughly right, is it not, Mr. Axilrod?

MR. AXILROD. Yes, [but] the 3-month, 6-month, and one-year bill rates are down [some].

CHAIRMAN VOLCKER. Once we get out in the maturity range, including as short as 6 months, rates came down [more].

MR. ROOS. It does take a little while, though, for the recognition of the change to sink in.

CHAIRMAN VOLCKER. Well, that's the judgment we have to make. The biggest protection we have against that is that things have changed. I suppose what the market is telling us is that people are not going to get worried about that when they have a sense that the economy, if anything, is still declining. That raises the question of what will happen as soon as they get a sense that the economy may be in recovery; but we've got to get to the recovery first. Everything else is just an extreme example of what we are doing, which is balancing risks. If we had a clear answer, it would be easy to dump it into Mr. Axilrod's computer and he would tell us. But I don't think his computer is that good.

VICE CHAIRMAN SOLOMON. One thing that puzzles me in the market comments is that there is a very widespread view that even if rates come up again in the early part of 1983, they will trend downward during 1983. And yet these are the same people who believe there will be a modest recovery. I'm not sure how they arrive at that view. They have a feel for what everybody else is thinking in the market.

CHAIRMAN VOLCKER. Well, they have seen what is going on. But what I am saying explicitly in answer to Mrs. Horn's question is that I do not discount the possibility that with a feeling of economic recovery we could get a very rapid reversal of this velocity movement in M2. I wouldn't be so certain about M1. I think M1 is just [in a whirl] with interest being paid on it and a change in inflationary expectations and all the rest, so I don't have the same feeling about M1. But for M2 it's a little hard to see why the velocity should go down indefinitely--why people should change permanently the relationship between their liquid asset holdings and income. One could argue, I suppose, that institutional competition has made those instruments so much more relatively attractive than they used to be that we have had a structural shift in terms of how much of that kind of money people want to hold as opposed to stocks, bonds, or whatever else they can hold their money in.

MR. PARTEE. That's a good argument.

MR. CORRIGAN. One can't entirely dismiss that either.

CHAIRMAN VOLCKER. Maybe. I wouldn't dismiss it. The interesting thing is that M2 really hasn't budged for three years in terms of its growth rate, including this year. It has been practically the same every year while the economy is going up and down and generally trending lower in terms of inflation and in growth. We have had some tendencies toward a decrease in velocity for some time, although it has only been this year that it has become really pronounced. So, maybe there is a structural change here.

MR. CORRIGAN. If one looked at the composition of M2 three years ago, what percentage were demand deposits and savings accounts then? I don't know but it was pretty big, wasn't it?

MR. AXILROD. Yes. There has been a shift toward things that have a market rate of interest.

CHAIRMAN VOLCKER. It is rather interesting. Nothing could have been much steadier than the growth in M2 over the past three years while all this other stuff has been going on.

VICE CHAIRMAN SOLOMON. And we are going to have the same amount of overrun this year as last year.

CHAIRMAN VOLCKER. We keep the target the same and only slightly overrun it. One would certainly think, given that inflation is down, real growth is down, and nominal GNP is down, that if M2 growth remains at the same rate, obviously something structural is going on. But this year it must be something cyclical, too. I don't know whether that helps you. You pay your money and take your choice! It comes down to balancing out, as so many people have said, the need for providing some protection on the down side, so to speak, against the danger that it's possible to overdo it, as Larry Roos keeps reminding us. The way to reach that judgment is what we're trying to do today. Governor Rice.

MR. RICE. I'd like to join all those who feel that interest rates need to come down from their current levels for all the reasons that have been given, both domestic and international. I won't try to go through all those reasons again. I'd just like to say that it's clear to me that real rates are too high to permit a recovery and, therefore, they have to come down from where they are at present. Like Governor Gramley, I don't know to what level they need to come down. And for that reason we ought to try to get them down gradually. We ought to be careful not to overdo it. But at the same time I think we have to do what we can to move rates in the right direction-- downward--but gradually. I also agree with Governor Wallich that we have a limited amount of time during which we will be able to maintain our credibility and we ought to use that time wisely. The clock is ticking and we don't want to wait too long to have some effect on the current situation. I would conclude that we had better use some of that creditability soon in order to encourage recovery while we have time. If we wait too long, we may not make effective use of this credibility. Therefore, I would support alternative A in the belief that that will encourage a gradual decline in rates. I also think, if I understood correctly, that alternative B would not result in any decline at all in interest rates from their current levels. Is that correct, Steve?

MR. AXILROD. Well, if the aggregates came out that way, yes; it's set that way.

CHAIRMAN VOLCKER. And if all these other assumptions are correct.

MR. RICE. So, to support "B" doesn't seem to me consistent with the objectives that we all say we have. I would be content to be somewhere between alternatives A and B provided it resulted in some downward [interest rate] movement. But alternative A seems perfectly safe at this time and that's the way I think we should go.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. May I ask a quick question? If I did my arithmetic right, the midpoint of the fed funds range in "B" is about 1 percentage point below the current fed funds rate.

MR. AXILROD. Yes, for "B" we just put in the range that the Committee adopted at the last meeting. But our expectation was for a funds rate more like it is now.

MR. FORD. And in "C" the midpoint is about where today's rate is.

MR. AXILROD. Yes. We started with "B" as the range the Committee had, but the range--

MR. FORD. Well, I think you have characterized it exactly right, Mr. Chairman, in saying that we are at a point where we are weighing the [unintelligible]. The consideration is whether or not we're in a historical discontinuity. When I first joined this Committee I thought it was a line-up of Keynesians versus monetarists as to just what we needed to stimulate the economy. I'd like to review briefly what kind of stimulus we are now putting in from both [the fiscal and monetary] sides. As everybody knows, the deficit spending of the government really didn't explode until the second half of the last fiscal year. That is, through the spring we were running a deficit about the same as the previous year at about a \$60 billion annual rate. It was in the last six months ending with September that on a seasonally adjusted basis it went from around the \$60 billion annual rate up to \$110 billion. That means that fiscal policy has only recently become dramatically more expansive. We now apparently are running a deficit somewhere in the range of \$120 to \$130 billion [or as much as] \$150 billion for this fiscal year. In other words, fiscal policy was made much more expansive in the last few months.

Likewise, as Lyle mentioned last time, the question of what is happening to the real money supply depends on what kind of monetary theory one likes. If you look at what is happening to the real money supply--I'm sure you've all seen the little chart that shows that it has only been since last summer that the nominal money supply, M1 and M2 both, has been growing. And with the drop in prices, the fact is that what is happening right now is that the real money supply is expanding very rapidly whether one measures it in terms of M2 or M1. That, too, is a quite recent phenomenon; it has only been occurring during the last few months. Those two conclusions, together with the normal lags in the impact of fiscal and monetary policy, lead me to

the conclusion that the current set of policies on both the fiscal and monetary sides are very expansive. In terms of the fiscal thrust, the deficit is running at 5 to 6 percent of GNP; in terms of the full employment deficit, [the federal budget] is now in deficit at any reasonable definition of full employment. Real monetary policy is just expansive. And all that says to me is that we are sitting here reading each other the gloom and doom report, but unless we are at a historically discontinuous point in our economy, which a number of speakers have suggested in different ways [may be the case], we are running a high risk of throwing both of the throttles in our economic airplane fully to the wall and the plane has to take off. The great danger is that it will surge forward in the next few months after the normal lags on both fiscal and monetary policy take hold and then we will be in a position of having the worst of all worlds, namely, higher long-term interest rates--we may manipulate the short ones, but the long ones will get to us--higher unemployment, and price inflation starting to turn around against us, all without any significant drop in unemployment. And that's the scene that concerns me on the other side of this judgment we are making.

Given that we haven't allowed for the normal lags, I would say we need to wait a little longer and risk keeping policy where it is--that may mean something more like "C," whose average interest rate is right about where we are now--and see after another quarter if the economy does or does not respond to this tremendous stimulus we're giving it now. If at the end of that time, by late in the winter, we still see everybody pushing their forecasts of recovery forward, I would be more inclined to share the judgment a number of you are making, which is that we are already at a historical discontinuity. Then I would say we should go into our mode of being preventors of the great depression. If the problem is that we have had not just four or five quarters of unusual velocity behavior but that we are looking at six or seven quarters of it and the number is getting bigger and bigger in the wrong direction, at that point we should push this kind of stimulus. But until then I want to emphasize the risk on the other side, as noted in the comments of Mr. Wallich. All the business folks are saying they will give us a period of grace of, say, seven months; they will watch this and after that the indicators of expectations turning against us should probably start to break. I look at four things in terms of those indicators: the price of gold, which is turning against us; the exchange value of the dollar, which is currently all right or more than all right as a number of you noted; long-term interest rates, which are still declining, and as you said the market hasn't turned on us yet; and sensitive commodity prices, which are still reasonably okay. But if we go for "A" or anything like "A" to "B," I think we will start to see these things turn against us, and with the economy surging we really will be in the soup six or nine months from now. So, while I'm worried about what the Congress is going to do to us and I'm also very worried about the fact that most of you may be right and we may be [witnessing] a historical discontinuity, I still think we should lean on the side of not overdoing the monetary stimulus to complement the excessive fiscal stimulus that everybody agrees we now have. I'd go for "C."

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I'm pretty sympathetic to what Bill Ford had to say. I don't think we have allowed enough time to see the

effects of what is obviously a considerably more expansive monetary policy that was developing increasing momentum as we went through the summer and into the fall. It is very much like 1980 as a matter of fact. And the fiscal policy setting is certainly on the expansive side. I don't know that I would characterize it as expansive as you do, Bill, because I think we do need to look at the 6-1/2 percent full employment setting. It is negative but it's not so terribly negative at this point, though probably it will drift up rather than down because I think all the Congressional sentiment will be to raise the deficit rather than reduce it, in pursuit of particular job creating policies.

On the business situation, I agree most with Lyle. I think it is quite poor. And I'm very worried about the marginal indicators. Jerry Corrigan mentioned that employment may not do at all well, and I think that's quite right. I know of a plant that has reduced its office force from 1300 to 500. They are not doing much out in the yard, but they are going to have to do a lot more in the yard before they add back to that 500 they have in the office. That plant happens to be in a deeply depressed industry, but its [action to reduce office staff] is a mark of what a lot of business people are thinking about because they are very squeezed on cash flows and very scared about their financial condition. So, I don't think business is very good and it isn't going to get very good in the immediate future, but I do think we need to have some time to see what the effect of these policies may prove to be.

Over the years the Committee frequently has made serious errors by not allowing for the lag in [policy] effects because we always expect to see instantaneous results and we never get them in economics. I think we ought to wait a little while. I don't know whether interest rates are too high or not. I agree that one sympathetically thinks they ought to be lower because the real rates are so high; on the other hand, we have this structural problem in that they have to be disproportionately higher because of the government's financing needs. That is, the government is interest-insensitive in its demand for funds and it is going to take a substantial share off the top, so real rates have to be higher than in past settings in order to have a balanced economy with that kind of deficit. So, Paul, I come out for "B;" I think "C" is perhaps a little draconian. And I feel rather strongly that we shouldn't be posting in the directive expectations for the aggregates that are as far out of our expectational range of just 6 weeks ago as those in "A" would be. Even if we shade the funds rate range in "B," I think we ought to keep the specifications for the aggregates that are in "B" and wait until we see this staff paper and have a little more experience in order to see whether we have to shift our focus entirely in terms of aggregates. The 1930s do suggest that we might have some kind of change in the function here and that we might be back to that because we certainly are going to have many more failures in this economy and many more failures abroad in the year to come. Maybe that means that we have to have more liquidity relative to economic activity. But I don't feel prepared to commit myself to that at this point. So, I would go for "B," and I feel pretty strongly that I wouldn't want to see aggregate growth ranges above those specified in "B" by the staff.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. I think the case for saying that we are in a period of discontinuity is a mixed one. I don't think any of us can sit here and say that indeed the liquidity preference schedule has shifted--that the employment of liquidity and debt by the corporate sector or the private sector has really changed. But certainly there are a number of indications that indeed this may have taken place. To the extent there is credibility in the argument, one can look at the past two or three years and see two recessions back-to-back, with really no recovery. My colleague, Governor Teeters, occasionally asks: If one discounts the pseudo-recovery, isn't this the longest period ever of depressed growth? It's an intriguing idea. Obviously, there are many things to go by. That's the trouble. We know so many things that aren't [typical]: this very recent experience in the holding of liquidity; the recent experience of business firms restructuring themselves in terms of employment and outlook on markets; and the apparent significant change in the international situation. Those are facts that can be considered cumulative and they make the discontinuity argument.

I am not impressed by the current jargon on how narrow the opening of the window is--that it's only seven months or 19-1/2 days or whatever--because there is an awareness in the markets, as distinct from the flow of articles, Larry. I read all those articles and newsletters and whatnot, too. That is a cottage industry. I'm glad we have nearly full employment there! But I do believe there is a significant difference between what traders and portfolio managers do in the markets and what some very interesting people write in the newsletters and in the financial press. I'm relatively unimpressed by the flow of articles, although I'm vastly entertained by them. Looking at the recent experience of nonrecovery over more than a 2-year period, looking at the benign effect of lower interest rates, if you will, what has been the effect of the decline of 150 or 200 basis points in short and long rates in terms of the international situation, in terms of the amelioration of the fragility of our own economy? People are still failing there. I have major mortgage lenders who come in here and tell me that "they are still putting our friends out of business," a [reference] I take it to adhering to supervisory pressures to clean up the loan portfolio. The down side is still a specter that must be contended with and, therefore, I am an "A" to "B" person. I am bothered by a target of borrowing of \$150 million; it seems to me too low. I can live with \$200 million. I certainly can accept \$250 million in the short run. I am greatly bothered by the alternative B notion that we might behave in such a way as to produce a 10-1/2 percent federal funds rate.

MR. PARTEE. Take about 1/2 point off.

MR. MARTIN. I think a 10-1/2 percent federal funds rate would be a significant negative in the markets. They would understand that. They might not pay attention to 19 articles in that direction, but get that funds rate to 10-1/2 percent and I think we will continue to do damage to the economy. We have done damage to it. We, fiscal and monetary [policy] both, had to do damage. But there comes a point where the battering must stop. And 10-1/2 percent to me is cruel and unusual punishment. So, I'm an "A" to "B" person. I would hope to see \$200 to \$250 million as the borrowing target.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLE. I come back, Mr. Chairman, to your excellent statement on the balance of risks, and that has me in a coin-flipping stage, I guess. I join everybody around the table in wanting to get interest rates down as fast and as much as possible, but hopefully keeping them down. And that's the hang-up. In a day or so, I assume, Murray [Altmann], the directive from our October 5th meeting will be published and at that time the public will know of just one more key thing that they don't already know, and that is that we set a range of 8-1/2 to 9-1/2 percent for M2 and M3 [growth] at that time. They won't be too scared because the October M2 that has just been published shows 8 percent and that's so far so good. What they don't know and what we do know is that in October M2 was considerably higher than the path plotted by the staff. I'm afraid, given the low assumption on M2 that the staff made for October, that if we get a continuation of accelerating M2 growth in November, which clearly seems possible--I think I heard Steve say that--we could be in [danger] of letting things get out of hand on the up side.

Personally, I'm glad that we did in fact have the rapid M1 growth of August, September, and October, and that we got [interest] rates down in a rather dramatic way. But I'm a little afraid that we may begin to get some perverse reaction in the long-term bond market. This is always a judgment call, and judgment will differ around the table, but I begin to worry a bit--not that one swallow makes spring--about the articles I see such as the one on the front page of today's Wall Street Journal in the "What's New" column. The article said that officials of OMB and Treasury are beginning to worry now that we will see higher interest rates, higher inflation, and higher unemployment if the current monetary and fiscal policies continue. There are fears that the Fed's monetary policy has become too expansionary, [as reflected by] the fact that the money supply announcement yesterday was received poorly in the bond markets and bond prices went down. So far I think we've been lucky--not lucky in one sense because we have deserved what we have gotten, which is very good treatment--in the sense that our [monetary] expansion over the last three months has been accompanied by a downward drift in long-term interest rates in particular. I wouldn't want to overdo it; I wouldn't want to overplay our hand and carry that too far. As you said, Mr. Chairman, we just can't throw caution to the winds. And it's difficult to judge when you're overplaying your hand. I would join several of those who have already spoken in favor of tugging on the reins a little and, therefore, going with alternative B.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I think you expressed very well the dilemma that we face in trying to decide what to do today. I don't think there's any real difference among any of us around the table as to the objective we want, but we have some obvious differences about the means. At the last meeting I understood full well why we decided to deemphasize M1, given the international situation, the precarious domestic situation, and the noise in the M1 statistics. I thought we made a bad mistake when we did that but in retrospect I think it had a pretty salutary effect upon expectations, and it accounts to a large extent for this improvement we've seen in attitudes. But I do think a caveat is in order. Despite its having been maligned a great deal, it seems to me, from what I can understand in the literature, that M1 over the long run is still the best predictor of inflation and nominal GNP. Money thrown out to satisfy these high demands for liquidity in

a period of recession like this remains around; and when the demand for money shifts in the other direction, it can come back to haunt us. So I'm very much concerned about the [money] growth we've had in the last several months and I fear that this may go on into November. Bill Ford and Chuck Partee after him expressed much better than I my feelings on this. I believe the battle today--if there is a battle or if one can call it that--is going to be fought over the question of whether we move the federal funds rate down deliberately or whether we are going to stick with a steady money market directive somewhat like we did the last time. My choke point is right at that point. If we decide to keep the federal funds rate about where it is now, I can buy that. If we decide to deliberately push it down in the absence of a weakening in the aggregates, I choke over that.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. In trying to balance the risks, the down side is very frightening. There is a possibility, though, that there is a little [risk] on the up side. Obviously I'm influenced somewhat by a slightly more optimistic view of where the economy is heading. With regard to the lag effect, the argument has been made that we really have not had time to see the full effect of recent policy actions. I find that to be a fairly persuasive argument [so] the cautionary approach also has appeal to me. I think we can remain cautious and not take a very overt action at this point to deliberately try to bring rates down. So, if I were voting today, I would vote for "B."

CHAIRMAN VOLCKER. Well, let me make a couple of additional comments. I gave you a finely balanced statement of pros and cons before, I suppose. I have no doubt in my mind that we've had a change in liquidity preference. The argument is over how long that will last, but it has lasted for five quarters. Well, I don't know if one can say it has lasted for five quarters; the numbers always have bumps up and down in a quarterly series. But when velocity has declined for five [successive] quarters for the first time in the postwar period, something is different.

MR. PARTEE. Four quarters.

CHAIRMAN VOLCKER. Mr. Axilrod told me it was five.

MR. PARTEE. Including the fourth quarter?

MR. AXILROD. Including the fourth quarter of last year.

MR. PARTEE. And the fourth quarter this year?

CHAIRMAN VOLCKER. He's projecting this quarter.

MR. AXILROD. Yes.

MR. GRAMLEY. It seems a fairly good guess, Chuck.

MR. FORD. Is that what he said, or did he say since 1960?

CHAIRMAN VOLCKER. He went backwards only with quarterly figures. I used to watch velocity figures in the '50s and I will tell you they were rising, because I used to write stories about the belief

that they had risen so much they had to stop rising. And they've risen every year since then!

MR. GRAMLEY. You were sort of premature on your forecast!

CHAIRMAN VOLCKER. That shows you how great an expert I am on velocity! I remind you of Milton Friedman who, looking at a hundred years, wrote his book and said that velocity will always fall. Money is a luxury good and the most certain thing about monetary policy is that velocity is going to fall. Like all scholars he has caught up. I used to write internal memoranda; he had to get a book published. By the time the book came out velocity was already rising and it has risen every year since then, until last year. I think something is going on there; that is the only point I'm making. I have no doubts about that, but that doesn't tell you how long it will last.

In terms of the business situation, and putting the international dimension into it--I'm not thinking just of the financial strains, though they are very real--we have a world in recession the way we have never had it before. And now we have additional deflationary pressures rising in a developing world that are very strong and certain. There's no escaping them. In talking to my foreign central banking colleagues, which I have done a bit recently, they are approaching the stage of being--if I wasn't going to be recorded, I would say frantic. Discomfited, maybe, is the better word. There is virtually a unanimous feeling that some efforts ought to be marshaled to push--if that's not too strong a word--interest rates 2 percentage points lower. I don't share that feeling, but I cite it as a symptom of the atmosphere in the rest of the industrialized world based upon their observations and their appraisal of the prospects in their own economies. They may all be wrong. The picture is very sluggish and I think the risks are on both sides, but predominantly on the down side.

For better or worse, we're faced with an indefinite period that we are not going to be able to figure out M1 just purely for institutional reasons. I think there is a case to be made that it was the most reliable variable in the past, but I don't think that case can be made looking into the future simply because of the institutional changes, even abstracting from the issue of whether there has been any basic change in velocity on an unchanged concept of M1. We are not going to have an unchanged concept of M1. I think we have to hedge the risks a bit; it's a question of to what degree.

That brings us to the specifics. I think we have a choice, given where the weight of opinion lies. Mr. Solomon long ago suggested that we stick with the 9-1/2 percent [for M2 growth], which is within the range that we had last time. We could eliminate the 8-1/2 percent side of it, if I followed him correctly. There's quite a lot of feeling that we ought to reduce the borrowing level, starting off anyway. That is a feeling I share and it is the principal hedge that I would recommend.

MR. FORD. From what to what?

CHAIRMAN VOLCKER. I don't know where it is now, frankly, but we have had various proposals: \$150 million is the lowest one I see in my notes; more people mentioned \$200 or \$250 million; and the

highest was \$300 million among those who in general wanted to make it a little lower. Some people may not want to make it lower.

MR. PARTEE. Could we ask where it is? What is the case?

MR. STERNLIGHT. The borrowing level now?

MR. PARTEE. Yes, abstracting from that--

MR. STERNLIGHT. This current week [we expect] \$550 million because we started out with \$3 billion in borrowing on last Thursday.

MR. AXILROD. The last weekly number that we had that was independent of this problem Peter mentioned was something like \$366 or \$367 million. We never quite obtained that. Borrowing for the last five weeks has run, in millions, \$248, \$405, \$273, \$263, and then \$530 million last week, which was also influenced by that high Wednesday.

MR. PARTEE. Well, \$200 million or \$150 million would certainly be lower.

CHAIRMAN VOLCKER. There's no question about that. To put a number on the table--it is around the midpoint of what a number of people suggested and leans [in the direction favored by] those who wanted to hedge the bets this way--I'll say \$250 million.

MR. FORD. You're taking the alternative C growth [for M2] of 9-1/2 percent? Do you mean for October to December?

CHAIRMAN VOLCKER. No, I assumed the 9-1/2 percent meant September to December.

SPEAKER(?). Right.

MR. FORD. So you're on "B" for the growth.

CHAIRMAN VOLCKER. For the lower--

MR. GRAMLEY. Were you thinking of retaining that statement about precautionary demands for money? That would be a critical part of the directive, I think, saying that expected growth in September through December is at levels which might well imply the need to change the nonborrowed reserve path fairly soon.

CHAIRMAN VOLCKER. I can't find [my copy of] the directive.

MR. PARTEE. Well, of course, we're virtually unaffected anyway by overshoots.

SPEAKER(?). Why not?

MR. PARTEE. The 2 percent rule.

CHAIRMAN VOLCKER. That is not true. We increased it--in a muted way, I think it's fair to say--but we increased it from the way we [started out].

MR. PARTEE. You say muted and I say virtually unaffected.

CHAIRMAN VOLCKER. Well, virtually unaffected pushed the funds rate up and stopped the interest rate decline and reversed the stock market.

MR. GRAMLEY. The market went down again today, I understand.

CHAIRMAN VOLCKER. The stock market is way down today.

SPEAKER(?). It was against inflated expectations. But there certainly has been a trend in recent weeks toward a firmer tone rather than the reverse. It is quite noticeable in the market.

MS. TEETERS. What federal funds range do you get with the \$250 million?

CHAIRMAN VOLCKER. Well, all those federal funds ranges encompass anything I could see happening, so I don't feel terribly sensitive to it. I'd say it's at least time to knock the 1/2 off the 10-1/2 percent.

MR. PARTEE. Yes, I thought so, too.

MR. GRAMLEY. And why not make 6 to 10?

MS. TEETERS. Yes, 6 to 10.

MR. GRAMLEY. So we're not narrowing the range still further.

CHAIRMAN VOLCKER. I personally don't have any big problem with that, but with the present situation we aren't going to get down to 6 percent, given anything I see developing. Maybe we should, but we aren't.

VICE CHAIRMAN SOLOMON. But we don't want to go up to 10 percent either.

MS. TEETERS. We don't want 10-1/2 percent.

VICE CHAIRMAN SOLOMON. But we don't want to go up to 10 percent either. I don't think we're going to hit either of them.

CHAIRMAN VOLCKER. We're considerably closer to 10 percent than we are [to 6 percent].

MR. PARTEE. Yes, I could imagine 10 percent, but 10-1/2 percent would be a shock to the market.

MR. FORD. 10-1/2 percent is where it is now, right?

SEVERAL. No, 9-1/2 percent.

MR. GRAMLEY. I know he means the [upper end of the] range.

CHAIRMAN VOLCKER. Where the range is now.

MR. FORD. The present range is "B," right? So if we drop it to 10 percent, that indicates a further loosening of policy in the sense of where the band is.

MR. PARTEE. Very little.

VICE CHAIRMAN SOLOMON. The way we're operating now, we are not going to hit either end of these ranges. So it's partially psychological. I would assume that if the economy stays this depressed and we saw the rate going up to the 10 percent area, the Chairman would either feel he had enough leeway to make an adjustment or he'd schedule a conference call.

CHAIRMAN VOLCKER. Well, I assume more specifically that the funds rate is going to be within range of wherever the discount rate is. What is going to happen--

MR. FORD. May we ask what your feeling is on the discount rate? Should it be dropped another notch or left where it is?

CHAIRMAN VOLCKER. Going back to what I said earlier, if I were picking interest rates out of the air, I'd make them lower. So, I have some predisposition in that direction. Whether we have the stage set for it properly against all these other considerations, I don't know. But I wouldn't let a good opportunity pass.

MR. GUFFEY. In that connection, I think the question is whether we continue to do what we say we have done, which is to follow the [market] rate down, or whether this is an appropriate time to [lead] by moving the discount rate down.

CHAIRMAN VOLCKER. Personally--I can't defend this very strongly, but just as a matter of tactics--I'd rather have the discount rate down and the borrowings higher, for any given constellation of forces. I feel a little more comfortable when the banks have to borrow a little.

MR. GUFFEY. If we had some assurance that there will be a discount rate decrease, I would agree to a little higher borrowing level for the intermeeting period.

CHAIRMAN VOLCKER. The trouble with that is that it gets too fancy and is hard to explain. We'd have to face the fact that we would reduce the discount rate [without] a clear signal from the market. But I wouldn't be unhappy to end up in that position somehow.

VICE CHAIRMAN SOLOMON. Well, I think what you're suggesting is okay. I don't think the funds rate range makes much difference. If we want to make the top side 10 percent, we could make it 7 to 10 percent or 6 to 10 percent. It's strictly psychological; it has no operating significance at all.

CHAIRMAN VOLCKER. I think the crucial point is where we start the borrowing. Frankly, I wouldn't put it above \$250 million. I wouldn't be unhappy to go lower than that, the way I see things.

MS. TEETERS. How much seasonal borrowing do we get on this, Steve--about \$50 million?

MR. AXILROD. It's running fairly low, Governor Teeters. We have had \$50, \$77 and \$90 million recently. It has been below \$100 million for the last five or six weeks.

MS. TEETERS. And the extended borrowing isn't in that number at all?

MR. AXILROD. No. That has risen a little; it's about \$190 million.

MS. TEETERS. But that's not in the--

MR. AXILROD. It's not in this number, but the seasonal is.

CHAIRMAN VOLCKER. I suppose I am affected by believing that in the short run the economy is still declining and industrial production is going to be down in November. Maybe I'm all wet there.

MR. KICHLINE. The way it looks now, yes. We have some information on raw steel output, and auto assemblies are down. It looks as if it's going to be a negative number.

MR. GRAMLEY. The other thing is, looking at the structure of industrial output in October, there isn't any evidence that it is consistent with an immediate turnaround. That is, one normally would expect in an economy that is about to pull out of recession and flatten out that production of materials will not go down as much as final product. In this case what we saw was a flattening out of materials production in the early summer and then it resumed [its decline] again and is still going down rapidly.

CHAIRMAN VOLCKER. I really cannot over-emphasize the extent to which my foreign brethren feel strongly about this. I don't care how conservative the central banks are, they are all in that direction and very strongly. I also do think that the current level of the dollar is catastrophic. As surely as we are sitting here, it's not only depressing the economy today but it is going to turn. We talk about the kind of current account deficits that are projected. I find them almost unbelievable because I don't know how we would finance them. We are going to be in Mexico's situation. The implication is that we are going to have a declining dollar and expect to raise \$50 billion in capital abroad. Well, who is going to put money into the dollar when they sense it is on a down trend?

VICE CHAIRMAN SOLOMON. Carter bonds. We made a lot of money that way!

CHAIRMAN VOLCKER. Well, we can do the Carter bonds once the dollar has dropped by 30 percent. That atmosphere is going to be awful if it develops.

MR. CORRIGAN. What about the exchange rate situation? Doesn't that situation give us a little more leeway in terms of being able to do something directly with the discount rate, without having to worry about finessing the market?

CHAIRMAN VOLCKER. If the discount rate were reduced, I think we would have to explain it as a straightforward concern about the economy and, in part, the dollar.

MR. GRAMLEY. Put more generally, the level of the exchange rate gives us more freedom to do something with money supply, interest rates, and so on without worrying that somehow it is going to have an immediate inflationary or expansive impact. We are not getting a symmetrical response to changes in interest rates. The movement upward in interest rates carried with it a very substantial increase in the exchange rate, so we had a lot of negative effects on exports from that. The decline in interest rates, it seems to me, has not had that effect. It's a lot less than the opposing effect on the up side.

MR. PARTEE. I think Paul is probably right that when it starts to run, it's going to run pretty fast.

CHAIRMAN VOLCKER. We are not going to be left alone in any interest rate decline that develops here. And, of course, that's one of the reasons the exchange rate stays so high. I guess Ted or somebody mentioned that there is--

VICE CHAIRMAN SOLOMON. They are going to match it point for point.

CHAIRMAN VOLCKER. And maybe more than that.

MR. MARTIN. They are holding their breath.

CHAIRMAN VOLCKER. I'm repeating myself, but there is a deep degree of depression and feeling of disturbance in every other industrialized country.

MR. RICE. Do you think this proposal of \$250 million on borrowing and, say, a 7 to 10 percent funds rate band is consistent with a decline in interest rates?

CHAIRMAN VOLCKER. Oh, it would take the edge off the federal funds rate, presumably. It may not right away; we're going to publish a high borrowing figure this week, but I presume the funds rate--

MR. MORRIS. It would take a cut in the discount rate, wouldn't it, to do something?

CHAIRMAN VOLCKER. Yes, and I think this might be consistent with the funds rate going slightly below the discount rate. It has been below it for months. It does not imply a change from where interest rates have been for the last month, in my opinion. That in itself [would require] a reduction in the discount rate. Even then I'm not sure it's a lot.

VICE CHAIRMAN SOLOMON. Short-term rates now generally are working on the assumption of an 8-3/4 to 9 percent funds rate. They did not align even with a slight upward movement. As I understand it, at least from some of my banker friends, short-term rates are lower than would be indicated by a 9-1/2 percent fed funds rate.

MR. RICE. Well, we would have to wait a while to reduce the discount rate in this current market environment. Interest rates are going the wrong way.

CHAIRMAN VOLCKER. Well, I think we would tell them that we don't like to see them going that way.

MR. RICE. That's why I think we have to do something here.

CHAIRMAN VOLCKER. It's a more difficult decision.

MR. RICE. We have to do something to nudge market rates down and then we can reduce the discount rate.

MR. KEEHN. How about using the fed funds range of alternative A the way it is written [in the Bluebook]?

MR. FORD. That puts me on the other side of the river.

MR. MARTIN. 6 to 9-1/2 percent?

MS. TEETERS. We could put it at 6 to 10 percent, which would give us a 4-point range.

MR. CORRIGAN. There you are.

MR. GRAMLEY. That doesn't have any meaning.

MS. TEETERS. I know it doesn't.

MR. PARTEE. Well, it does have some demonstrable meaning; I think 6 to 10 percent is okay.

MR. GRAMLEY. You mean when it's published.

MR. PARTEE. Yes.

CHAIRMAN VOLCKER. Let me sum up my own view another way. I think this general pattern is acceptable. It is playing it very close to the vest, considering what I see going on. The risks are unbalanced but they are on both sides. The risk is that this is not enough.

VICE CHAIRMAN SOLOMON. Or [the Board] could drop the discount rate a whole point. I'm not recommending it; I'll be sending in a 1/2 point recommendation this week. But there is just no more room in this nonborrowed reserve path. There isn't any room to do much more than what we are doing. If we go significantly below \$250 million, that runs some serious risks that we could have a very screwy market situation. We are better off with a move on the discount rate.

CHAIRMAN VOLCKER. One way of looking at it, I think, is that what we have been doing for some time is letting these aggregates run a little high because we recognize that there are liquidity pressures and we haven't wanted to move strongly against that. We haven't been very forward in pushing them higher. If we really felt that liquidity was changing and the market was terribly sour and it was going to last for a while, we would take that additional step and push them higher.

We haven't done that and I don't think what we're proposing does that; one might argue that "A" verges on that. If it turns out that velocity keeps declining, we should have done that.

MR. PARTEE. And we may need to do that, but it's premature.

VICE CHAIRMAN SOLOMON. Then we would really have a problem communicating that.

CHAIRMAN VOLCKER. It's easier to communicate the sourer the economy, I can tell you that.

MR. GRAMLEY. I think the case for waiting was a saleable one at midyear. But too much time has elapsed since then. I no longer think it's saleable to say that we will wait to see whether or not this velocity trend continues. It has been going on too long. So, I think we've got to err on the side of setting specs that give us a high probability that we will not see any upward movement of interest rates and that the greater likelihood is that they are going to move down. It's not guaranteed; one can't guarantee anything in this world. But I'm afraid if we have another recurrence of the disappointment that we have had with an economy not recovering, we're going to see a souring of attitudes, and this economy is going to get away from us. We then are going to have to take some very, very strenuous action on both the fiscal and monetary sides to rescue it. The international complications make this a profoundly different kind of recession than we ever have had before in the postwar period.

MR. ROOS. If you count four or five months into the future, I'll be fishing and you all will still be wrestling with this. But let's assume that by forcing rates down a little you do achieve an improvement in the economy and this stimulus starts causing interest rates to rise next spring as this long-sought recovery is reaching meaningful proportions. Yet money has grown so quickly that the prospect of inflation is heightened. Are you all going to be willing to apply the brakes at the time? If you don't apply the brakes at that time, we're going to be right back into double-digit inflation rates in a few years.

MR. MORRIS. Somehow, Larry, that scenario doesn't fly with me. I don't think that's the situation we're in.

MR. GRAMLEY. I'd sure be a lot happier about applying the brakes if the car were rolling rapidly down the hill than to roll it backward down the hill.

MR. PARTEE. We'll think of you though, Larry.

CHAIRMAN VOLCKER. I don't discount that [scenario] entirely. It is complicated by the budgetary situation. I don't know that it would happen as soon as this spring, but I think it is possible. As I said before, we will not find this particular monetary growth [pattern] again. I don't know what M1 is going to look like then. I'm not sure we're going to find M2 all that rapid in those circumstances, but we'll have to wait and see.

MR. CORRIGAN. But if we do something like setting borrowings at \$250 million and do whatever you want with the federal funds rate,

it seems to me that we have some reasonably high degree of assurance that we're not going to see interest rates higher than they are now; and depending upon finessing the market or [the Board's] willingness to do something with the discount rate in any event, there is the clear potential for lower rates. In the worst of conditions, [the Board could] reduce the discount rate even if the fed funds rate is at 9-1/2 percent; [you would] just bite the bullet and do it. My personal view is that the markets and everybody else would accept that.

VICE CHAIRMAN SOLOMON. The markets would love it.

MR. CORRIGAN. But I don't see that--

CHAIRMAN VOLCKER. I'm not so sure what would happen with reducing the discount rate by 1/2 point. They have all been expecting it and for that reason it may have very little impact.

VICE CHAIRMAN SOLOMON. No, I'm not saying it will have much impact, but if you don't do it--if you wait too long--there will clearly be a backup in rates. If we actually wanted to move the bond market and the stock market up--I'm not saying we should--then we'd have to consider a one-point move. But I'm not recommending that. I think, though, that you have to move 1/2 point.

MS. TEETERS. But 1/2 point doesn't have to be the end. However it develops, we can move the discount rate down to 8-1/2 percent after a 2- or 3-week delay and it's still--

VICE CHAIRMAN SOLOMON. This is true. Judgments can be made as we go along.

CHAIRMAN VOLCKER. Well, let's just see where we stand. Looking back at the directive, if I can find it, what I suggested and others have suggested is to put in 9-1/2 percent [for M2], which is within the range that we had but it looks a little easier. We can put the funds range at 6 to 10 percent if that's where the--

MR. PARTEE. We aren't using a range, though, [for M2]?

MS. TEETERS. No.

CHAIRMAN VOLCKER. Well, we could say "around."

MR. PARTEE. [This draft] doesn't have "about" or "around" 9-1/2 percent.

CHAIRMAN VOLCKER. I don't know about that phrase, just in terms of its internal consistency, "taking account of the desirability of somewhat reduced pressures in private credit markets." I'm not sure we're saying that this is going to produce in and of itself lower interest rates. We might just leave that phrase out.

MR. PARTEE. I would be inclined to take it out because we moved to the 9-1/2 percent on the M2 from 8-1/2 to 9-1/2 percent. We have already taken account of it.

CHAIRMAN VOLCKER. Actually, the private credit markets, as distinct from the public credit markets, have improved during this period. This great tiering and backing up tendency we had in those markets is not evident today.

MR. WALLICH. I would like to see that phrase removed.

CHAIRMAN VOLCKER. Well, does this suit, as well as anything is going to suit?

MR. BLACK. Could we ask Peter and Steve to tell us what they think would happen to the fed funds rate with this kind of directive, in the absence of a change in the discount rate?

MR. STERNLIGHT. I think \$250 million on borrowing would tend to produce a funds rate right around, or a shade below, the discount rate.

VICE CHAIRMAN SOLOMON. A shade below the present discount rate.

MR. STERNLIGHT. Right.

VICE CHAIRMAN SOLOMON. So, if [the Board] doesn't move the discount rate, it won't go down to 9 percent; it will stay at around 9-1/4 to 9-3/8 percent.

MR. BLACK. You are saying we really have a money market directive--a very tight money market directive, probably--if there is no move on the discount rate.

MR. STERNLIGHT. I don't think we'd have much scope for a downward movement in the funds rate with a \$250 million borrowing level without a discount rate change.

MR. BALLEES. Mr. Chairman, I have one other point to make on this directive. I'm a little concerned about the phrase in the opening paragraph that reads "the reinvestment of funds from maturing all savers certificates and the public's response to the new account directly competitive with the money market funds mandated by recent legislation." The latter half of that statement really flies in the face, I think, of what is said on page 7, paragraph 9 in the Bluebook. It is made pretty clear in the next to the last sentence of that paragraph--and I agree with what is said there--that the new money market account will only have a small [quarterly] effect on M2 when it becomes available in mid-December for the simple reason that it is not going to be around long enough in the fourth quarter. I tried my hand at writing a slightly different version of a directive. I don't know whether this will help or hurt the cause. The bottom line is to take out that phrase in the current proposed directive which reads "the public's response to the new money market account competitive with money market funds mandated by recent legislation." I agree it is going to be a big problem when we get into the first quarter; I don't think it's a problem for this quarter.

CHAIRMAN VOLCKER. Let me just raise a question. Why do we need this paragraph at all now? We needed it the last time to explain

what we were doing. Would we lose anything by just dropping the whole paragraph?

MR. AXILROD. No. The last sentence of paragraph 9 is our feeling about it. We're not certain when we--

CHAIRMAN VOLCKER. Well, presumably we will say something about this in the [policy record] discussion. But is there any operative need to put it in the directive at this point?

MR. AXILROD. No, but I do think there is some uncertainty related to both the all savers certificate and the new instrument about what is going to happen in the interim, [which should be in the record] for discussion purposes. I don't know where people are going to store their money in anticipation of those things. But you don't need it for operational purposes.

CHAIRMAN VOLCKER. The only significance of taking it out-- maybe it is too much--is that it says "much less weight." The fact is that it has some weight. If M1 had happened to be dropping off the table in the last couple of weeks, we would have behaved somewhat differently. If we leave it out completely, we lose any flavor of that.

MR. BALLEES. Yes.

MR. PARTEE. Well, I think we would have to explain why we haven't specified it. That is, the earlier paragraph [on the Committee's long-run objectives], which isn't here in the Bluebook, talks about the Committee's expectations for M1 and M2 and so forth. So we have to continue to say why it is that M1 is not figuring in this instruction to the Manager.

MR. WALLICH. That's very important, because otherwise we are in fact implicitly still giving weight to M1.

MS. TEETERS. It also has the advantage of showing that we were right for a change.

CHAIRMAN VOLCKER. I'm not quite sure what your particular suggestion is, John.

MR. PARTEE. This talks about M1, John. It seems to me that you were talking about M2.

MR. BALLEES. Well, I was talking about both. I happen to have some copies of this here for distribution. Maybe the easiest way, if it could be helpful, is to distribute them. The main burden of the message is that it backs away a little from what we said last time. There is still uncertainty about M1, but not as much as last time. The opening sentence is that the specification and behavior of M1 over the balance of the year are subject to fewer uncertainties now than at the last meeting in October. You may not agree with that, but that happens to be my view.

SEVERAL. No way!

MR. GRAMLEY. I don't want to give any kind of [unintelligible].

CHAIRMAN VOLCKER. Suppose we leave it the way it is now and just say the difficulties of interpretation of M1 continue to suggest that less weight--I don't care whether we say "much less" or "less than usual"--is being placed on movements in that aggregate during the current quarter. And we can forget about that M2 sentence, if that's troublesome.

MR. BALLEES. I ended up the first paragraph by saying: "Nevertheless, the difficulty of interpretation of M1 still suggests that less than usual weight be placed on movements in that aggregate and more than usual weight be placed on M2 during the current quarter." In order not to scare the heck out of everybody, I was wondering what we would really tolerate in M1. In the second paragraph, after noting whatever range we decide would be appropriate for M2 and M3, I'm toying with the idea of a proviso clause for M1-- "provided that M1 does not exceed x percent over the same period."

MR. PARTEE. 20 percent!

MR. BALLEES. Well, you name it.

MR. GRAMLEY. That's just not the way to go now. Later, maybe. We just have not had the uncertainties clarified [enough to determine] that figure.

MR. FORD. Paul, this really raises the question I wanted to ask, which is based on your perception of the usefulness of M1. I have the feeling that in your mind M1 is permanently [distorted], especially in light of what the DIDC is doing [and] the all savers certificates. If the consensus of the Committee is that M1 will never be used again, or at least not in the foreseeable future, then I think we ought to come out and say it and see what happens.

CHAIRMAN VOLCKER. Well, that's a bit of an overstatement of my feelings at the moment. I'm not saying never; never is much too long a period. The question is how soon we are going to be able to make some sense out of it, which is really the subject of this paper we are going to get next time. I wouldn't be too sweeping about any judgment until we have had a chance to consider that explicitly.

MR. PARTEE. Well, of course in January we have to specify aggregates ranges, and--

CHAIRMAN VOLCKER. Yes, I know. What I'm concerned about is what we specify next year, because I anticipate that probably by some time next year we will have full interest payments on transaction accounts at least of individuals. I think we are hanging by a thread, frankly, in terms of having reserve requirements on individual transaction accounts at this point. The new account is so close to it that I can see the lobbyists saying we have this account, which is practically a transaction account without reserve requirements, and you can't go back and put reserve requirements on something that is only marginally different from what Congress just told you to give us without a reserve requirement.

MR. FORD. Why don't you change the reserve requirements from 1 percent on transactions to one that they allow? When you get to 12 percent--

CHAIRMAN VOLCKER. This new account, depending on how it's developed, is going to be so close to a transaction account that maybe we ought to put it in M1.

MR. PARTEE. We'd get some phenomenal annual growth rates--a thousand percent!

MR. CORRIGAN. That will occur with reserves declining.

VICE CHAIRMAN SOLOMON. That would be quite impressive, though, wouldn't it--having a component in M1 that doesn't have any reserve requirements?

MR. MORRIS. When it reaches maturity in 7-1/2 years then we could do it.

CHAIRMAN VOLCKER. I would be inclined, in the interest of completing this [discussion], to modify this language to a more minimal degree. I'd say "considerable" or something like that instead of "unusually great". The second comment is not a sentence is it?

VICE CHAIRMAN SOLOMON. The dash is left in.

MR. PARTEE. After circumstances.

MR. GRAMLEY. Two dashes.

MR. FORD. Are we looking at John's [version]?

CHAIRMAN VOLCKER. I'm looking at the present one.

MR. AXILROD. I guess there are special circumstances in connection with--

CHAIRMAN VOLCKER. I have done a great sample of two people who had all savers certificates. I was not making the survey, but much to my surprise in my sample of two both put the funds in demand deposits and still have it there. One of them is my wife. The other is a distinguished ex-member of the Federal Reserve Board.

MR. BLACK. Not even in NOW accounts, Mr. Chairman?

VICE CHAIRMAN SOLOMON. I don't want to nit-pick, but I don't see the point of deleting the words "much less than usual weight," as suggested because the Fed watchers are going to wonder what that means. They will wonder if that means we're giving it somewhat more emphasis now. Why don't we just leave it alone the way it was?

CHAIRMAN VOLCKER. I have it left alone in my present version. All I have is "Specification of the behavior of M1 over the balance of the year remains subject to considerable uncertainty." I think that's singular--["uncertainty" rather than "uncertainties"].

MR. PARTEE. "Substantial uncertainty," I think.

MR. WALLICH. I think we should say "continues to be" to refer back to what we said earlier.

CHAIRMAN VOLCKER. It says "remains." "Subject to substantial" is it?

MR. PARTEE. "Considerable" seems rather [unintelligible] compared with "unusual."

CHAIRMAN VOLCKER. "...substantial uncertainty because of special circumstances in connection with the reinvestment of funds from maturing all savers certificates and the public's response to new accounts directly competitive with money market funds mandated by recent legislation. The probable difficulties in interpretation of M1 continue to suggest that much less than usual weight be placed...."

MR. PARTEE. And then drop the last sentence.

CHAIRMAN VOLCKER. Yes.

MR. ALTMANN. Are you leaving "probable" in?

CHAIRMAN VOLCKER. No, I meant to leave out "probable." Well, unless there are some other proposals on main points, we are talking about 9-1/2 percent, 6 to 10 percent, and \$250 million. Any comments? If not, we will vote.

MR. ALTMANN.

Chairman Volcker	Yes
Vice Chairman Solomon	Yes
President Balles	Yes
President Black	Yes
President Ford	No
Governor Gramley	Yes
President Horn	Yes
Governor Martin	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Teeters	Yes
Governor Wallich	Yes

Eleven for, one against.

CHAIRMAN VOLCKER. Okay. I have a few things I have to do. We have to discuss a couple of things.

MR. ROOS. Mr. Chairman, may I just ask one question? Do we accept that the ground rules for this meeting are that we don't discuss even with our senior economists what we have done?

CHAIRMAN VOLCKER. I guess we better discuss that while we are in this limited session. It occurs to me that I have a speech to give tonight, unfortunately. Let me just read what I have here; I don't know whether I have to alter anything. Frankly, I think we ought to say something; I don't know if we have to, but this is how I started it:

As you know, most of the monetary and credit aggregates that the markets watch so closely are running somewhat above the targets we set for ourselves at the start of the year. So far as M1 is concerned, the data plainly came to be distorted by institutional change--particularly in October by the flow of funds into checking accounts.... Prospectively, the introduction of new forms of transaction or quasi-transaction accounts is likely to distort the figures further, although the direction of impact is less evident. In the circumstances we have had little alternative but to attach much less weight to that aggregate in guiding the provision of reserves until the institutional changes settle down.

More generally, current developments with respect to the growth of money and credit have had to be interpreted in the light of all the evidence we can gather with respect to the economy, price developments, interest rates, and financial pressures. Taken together the evidence is strong that the desire for liquidity has strengthened appreciably this year, as sometimes happens in periods of exceptional economic uncertainty. The turnover or velocity of M1, for instance, has declined appreciably this year instead of trending upward, as has been the pattern throughout the postwar period. M2 velocity--generally stable in most recent years--has declined even more sharply. In all these circumstances, the Federal Open Market Committee remains willing for a time--as we indicated at midyear--to tolerate monetary expansion at a somewhat higher rate than the targeted annual rate. That approach, in the light of the evidence of exceptionally strong liquidity demands, should in no way be interpreted as a lack of continuing concern about inflation--and happily I don't believe it has been so interpreted by the markets. The fact is that, with velocity patterns obviously shifting at least for a time, rigid pursuit of the targets would have the practical effect of a more restrictive policy than intended when those targets were set out. It's not without relevance, in that connection, to note that growth in bank credit, or private credit generally, has been relatively limited this year, tending to confirm that the greater liquidity provided has not spilled over into inflationary private credit expansion.

What recent developments do emphasize is that, in a time of rapid institutional economic change, we must be wary of highly simplified rules in the conduct of policy. That is why we have always looked to a variety of monetary and credit "targets" and retained elements of flexibility and judgment in pursuing those targets.

What we do not have the flexibility to do is to abandon broad guidelines for monetary and credit growth as the means of judging policy over a period of time. The danger of creating excess liquidity is not so much immediate when there is so much surplus capacity and unemployment, but rather when the economy begins to regain forward momentum. That is why we must continuously balance the need to meet liquidity needs today against the risks of building in fresh impetus to inflation tomorrow.

Then the speech goes on to talk about the budget imbalance.

MR. PARTEE. That's fine.

MR. ROOS. I don't mean to be a broken record, but I think it's important that we have uniformity in what we say or do not say to our own immediate, fairly eminent, associates such as research directors. Are we all going to talk about the--

CHAIRMAN VOLCKER. Well, let me talk about the public side first. What is distressing about this to me is that it obviously affected the markets and affected policy. Maybe we came out of it all right and maybe we didn't; I don't know. But it certainly gave rise to more dangers about misinterpretation of our intentions than I had bargained for. I might also say that we had a leak--and maybe more than one--about the Greenbook, as you know. I don't know whether it was from the Administration or the Federal Reserve. I have heard all sorts of allegations from the market--they may be without substance, but it worries me every time I hear this--that there has been an occasional leak of an M2 figure or an M1 figure, or whatever. I hope that is wrong, but it makes me uneasy when I hear about it. What worries me, just looking ahead, is this lack of discipline--if I can put it that way. It's like the vultures going after carrion. Every reporter in the world is challenged to make his own story, and the reporters who may have been involved the first time are all the more challenged to keep it up. I think there is a tendency on the part of any organization, for people to say "Damn it! If somebody else is leaking, I'm going to talk to a reporter, too, and get my story out." Unless this is stopped, it's just going to cut us up.

I am convinced that in a way it enormously complicates the policy problem because so much of policy is what people think it is or think our attitude is over a period of time as opposed to what we do.

This whole situation is intolerable to me. This organization, above all others in Washington--I used to think the Treasury was this way, but certainly do not now--does not leak. And I think it has been to our advantage to have that be both the impression and the reality. It has enormously increased our credibility, the credibility of official statements over the years, and the credibility of policy. I don't see any way we can operate other than on that presumption. We are dealing with a Committee; we are dealing with a lot of people. We can't have a lie detector at the door coming in or out of the office. We ultimately have to do what is right because there is a consensus that that is right and an understanding of what the rules are--an understanding of the people around the table and our associates. Frankly, I think we perhaps should tighten up the distribution of some of the materials--to go to your point--partly as a reminder of the sensitivity of this business. And we will be proposing some changes in that connection. Joe Coyne might just talk a minute about his understanding of the rules and then we'll have a more general discussion of this or of any ideas anybody else might have.

MR. COYNE. To be brief, my understanding is that the policy record, of course, comes out the Friday after the following meeting, and what that means is that we do not talk about what happened at that [earlier] meeting until that time. There are very, very, few exceptions to that. We can say we had a meeting; we can give the starting time and the closing time, and the attendance. And that's it. That has been my understanding since the Committee adopted the rules.

MR. WALLICH. That includes telephone meetings?

MR. COYNE. No, we do not mention telephone meetings until they are reported in the policy record. That is only for our face-to-face meetings.

MS. TEETERS. This is to reporters, Joe? This doesn't apply, say, if we are talking to the chief economist at a Reserve Bank?

MR. COYNE. This is to the outside world.

CHAIRMAN VOLCKER. We are now talking I think about the outside world.

MR. COYNE. Yes, anybody in the outside world.

CHAIRMAN VOLCKER. What I think I am bound to suggest at the moment is that we just don't talk to reporters for some interval after the meeting, however innocuously. The Washington Post this morning had a comment attributed to a Federal Reserve source. It was not the wildest thing in the world, obviously.

MS. TEETERS. It was just "a source"? It didn't say--

CHAIRMAN VOLCKER. Well, no. There was one comment that said "a Federal Reserve source." And it was the kind of comment somebody could make. The article is a little odd because it makes it sound as if the Federal Open Market Committee sets the discount rate. It said some Federal Reserve source said the option was between blank and blank or something. In the present environment even that kind of comment just feeds this atmosphere. I think it's fairly simple for us, let's say in the first week, not to talk to reporters. People talk to reporters once in a while, and it has to be done, I suppose. But it doesn't have to be done that first week. We typically meet on a Tuesday; it doesn't have to be done during the course of that week.

MR. COYNE. If I might, Mr. Chairman--

CHAIRMAN VOLCKER. Just to repeat the obvious: You could make a comment that seems pretty innocuous to you, and the reporter finds three more people to make a comment that is pretty innocuous to them. And then if he is any good and knows what the issues are, he begins putting together a story which may be partly right, as that one in The Washington Post was; but the total essence of the article I think was substantially misleading. And that's where we are going to get torn apart even with the most innocent of motives.

MS. TEETERS. Mr. Chairman, I presume we'll talk about this after lunch, but we could finesse the whole issue by releasing [the directive] right after the meeting, [as I proposed in a recent memorandum to you, which I also sent to all Committee members and other Reserve Bank Presidents].

CHAIRMAN VOLCKER. That is something I want to talk about during lunch or whatever, but let's assume that is not going to happen.

MR. PARTEE. It may be time to do it.

CHAIRMAN VOLCKER. Well, I didn't mean that. Does anybody else have any [comments]?

VICE CHAIRMAN SOLOMON. Did Joe finish?

MR. PARTEE. A blackout of the press is a little difficult.

MR. COYNE. About the points the Chairman made, a lot of reporters will do a round robin and call as many people as they can and compare answers.

MR. FORD. May I ask this? My feeling about this has been that we don't discuss it with outsiders, as you suggested, but that [is] the role of a Federal Reserve official, a senior Federal Reserve official especially, giving you the first shot at talking. For instance, the last time you should have had the first shot at that

meeting down at the Greenbrier. Now you are telling us you are going to do it tonight. But after that--

CHAIRMAN VOLCKER. These are very vague comments as you heard.

VICE CHAIRMAN SOLOMON. We should be guided, no matter how we feel individually, by the line that you are expressing. Basically, in a polar case there are two choices: Either we refer all calls to you or we make a best faith effort to state what the official line is, based on the way you interpreted it.

CHAIRMAN VOLCKER. No, we are talking about a specific decision at a specific meeting. Obviously you have to talk about the general policy line, so to speak. That's quite a different category. But you have to be careful about it. There is a real distinction between that general policy line and this--what the argument was at the Committee meeting, with views attached to individuals. The most damaging thing is to say "This is what we really meant or somebody really meant..." and getting into that kind of thing.

MR. ROOS. I think we have a potential problem, though, with our economists, some of whom are rather like prima donnas who have their noses out of joint by being expelled--correctly, I agree with you--from this meeting. And unless there is some agreed upon way of handling that, one of those fellows will go and tell somebody that the gag rule is on. I'm not disagreeing, Paul, with anything you have said, but I'd just like to get some agreement on this.

CHAIRMAN VOLCKER. Well, it's certainly a relevant question. You obviously have to talk to your senior people. I guess we have to leave it to you to talk with discretion and convey to them certainly the essence of the message that is more or less the common ground here. I would talk with each of those people specifically about this problem. Make sure they understand it. And if you are satisfied they understand it, you obviously have to talk about the policy decisions. I think you could use a certain amount of discretion in [not providing] blow-by-blow accounts, which are inevitably distorted. Everybody goes out of the meeting with a different impression of what was said or even what was decided in some sense except to the extent that it is written down. And people interpret every comment in the light of what they think; in some instances it may be quite different from what the fellow talking thought he was saying. And it might get dangerous when this kind of stuff gets talked about. I hope that we can get away from [attendance at] these sessions being as narrow as it was [today]. But maybe we can have it someplace in between for a while.

MR. FORD. If one is on the [morning] call and can't share [the policy decision] with our [appropriate senior staff], whoever that is, I don't see how we can have a meaningful thing to say other than to listen to the bell ring on the call. My people go to a lot of

trouble to keep track of your procedures. As I understand it, if we are on the call, we are supposed to be a representative of the group; we do not reflect our own views but whether we think the policy is being instituted in accordance with whatever the decision was. To do that we need somebody to try to track at least roughly how the calculations and decisions are made.

CHAIRMAN VOLCKER. I think your senior people have to know about the mechanics of the decision and the essence of the decision.

VICE CHAIRMAN SOLOMON. Well, what about next time? Are you going to settle that now, or are you going to [wait]?

CHAIRMAN VOLCKER. I would welcome any suggestions that you have. Let's not deal with them at the moment, but you can contact me later. We'll pick up this other issue later. Let's go eat.

[Lunch recess]

CHAIRMAN VOLCKER. [Unintelligible] tell it to me with enthusiasm and let me just give you one point that may or may not be in this memorandum. [Secretary's note: A copy of the memorandum, "Immediate Release of FOMC Decisions: Pros and Cons," from Messrs. Axilrod and Sternlight and dated November 12, 1982 has been placed in the Committee's files.] I can understand an argument that the way the directives have been written it would be much less of a problem than in other instances. But once that precedent is set, whatever operating technique we use, whatever kind of directive we use, we're stuck with it, I think, forever. If we really were operating as we used to on an interest rate target and we announced a different interest rate every month--in effect came out of the meeting and announced an interest rate--we would then be stuck with it and we couldn't change it without a subsequent public announcement. Then I think we would be in great trouble. That's just one other extreme form. When we are giving a directive of the sort that we've been using, it doesn't have quite the immediate interest rate implications; it doesn't freeze us in quite the same way. But it does require that every time we have a special meeting in which a decision is made--however much of an emergency the situation is--we would have to put something out right away. And it might be exceedingly inconvenient.

MS. TEETERS. I don't think that's necessarily so. I'd say two things, Paul. If we have to have telephone conference meetings or emergency meetings, I don't think we have to announce them. The [dates of] FOMC meetings are public knowledge. And when we were operating under an interest rate target, the market usually found it out by noon the next day. What we had done was not a secret at all.

CHAIRMAN VOLCKER. I think they found out; they obviously groped for it. But those [directives] were not worded in such a way as to [suggest that we would] stay there until the next meeting. There were certain criteria under which we could change. It wasn't

that the interest rates changed; they changed very little typically. But there were changes during the period which the market always was searching out.

MS. TEETERS. Well, I already have a call from The New York Times.

CHAIRMAN VOLCKER. Well, that's great! Everybody just has to stay in this room and go three days without any [unintelligible]. We have a bathroom facility right across the hall!

MR. BALLEES. And meanwhile all the telephones in the building are tapped!

MR. BLACK. Get me another sandwich, please!

MS. TEETERS. I honestly don't think that [immediate release of our decisions] will do any harm. It would solve the problem of leaks. And with a group even as large as this one--and the group was cut down from what it was--the idea that we can keep something a secret for seven or six-and-a-half weeks is really a big presumption, it seems to me. The way it's working now, if we do have these leaks--and there will be speculation, considering all the attention that has been given to it--the speculation may finally come down to a consensus of speculation as to what we did or didn't do. In effect, we're giving an advantage to the people who have a little inside knowledge instead of making it available to the public generally. And I think we're better off, even if we want to change the way we write the directive, if we make it publicly available. That doesn't mean that we are frozen into it. We can change our mind. We don't necessarily have to announce those changes in our mind. I think basically the public has a right to as much information as they can [receive] at this point. I don't think the leaks are really going to disappear. Paul. I think that you're going to get caught as I once did.

CHAIRMAN VOLCKER. If they don't, I'll disappear soon!

MS. TEETERS. Well, one gets cornered in an odd way. I once got caught--not here--but something got partially leaked and a reporter called me up and said "X happened." And I said "No, it was X+1," and I immediately realized that I'd done the wrong thing. If we have this speculation out there, we're going to get these wrong stories. And the temptation then becomes very great on people to correct those wrong stories.

CHAIRMAN VOLCKER. That is correct.

MS. TEETERS. We announce discount rate changes; we announce changes in reserve requirements because we have to. I don't see that this is greatly different from that. Under interest rate targeting they found out pretty well where we were. I think they have correctly interpreted what we've changed to this time around, with some help.

CHAIRMAN VOLCKER. There is no  
leaks.

MS. TEETERS. I have heard

outside the System.

MR. BOEHNE. I have an open mind on the issue of releasing the directive. If it were up to me, I'm not sure how I would come down. But I do have a question. Suppose the directive that the Committee just approved were released this afternoon. What would that really tell the market? It says that the M2 [growth consistent with our objectives] is around 9-1/2 percent; there may be a little message there. It says that the funds rate range is 6 to 10 percent. And then it has a lot of other gobbledygook that could mean a lot of different things. Maybe somebody could just answer my question. Suppose the directive were released this afternoon. What kind of information would that really convey? Or would there just be increased speculation on what that directive really means in an operational sense? How much would we have bought in terms of satisfying the public's and the press's appetite for knowledge about what we're doing?

MR. CORRIGAN. I think one thing we would buy is inquiries for more information.

MR. BOEHNE. Well, I think you have [a point]--a lot more.

MR. CORRIGAN. If they see the directive, they are going to say: "Well, I want to see the forecast that it is based on and all the rest of it."

MR. MORRIS. What if we were in a situation where the economy had picked up for a while? If we had announced a 6 to 10 percent funds rate range after one meeting and we announced immediately after the next one that our range was now 8 to 13 percent, what sort of market reaction would you expect in that kind of situation?

MR. PARTEE. Very little trading below 8 percent.

MR. FORD. You're positing that the band would be widened at both ends.

MR. PARTEE. He said 8 to 13 percent.

MR. BOEHNE. I suspect what the Committee would do is that it would gravitate toward even more vague directives.

MR. MORRIS. Precisely.

MR. BOEHNE. And then there would be a hidden meaning, which we'd all understand but the directive that we'd publish would give us so much flexibility that we could drive a truck through it a couple of times.

CHAIRMAN VOLCKER. Again, I think it would invite a lot of probing at the bottom [to determine] what the real decision was.

MR. BOEHNE. Yes, that's the question I'm asking.

CHAIRMAN VOLCKER. Yes, I share your instinct.

MR. RICE. Won't they do that now?

MR. BOYKIN. In fairness to Nancy, her argument, though, is that publication might tend to cause something that we were trying to make happen anyway happen just a little sooner.

MR. GRAMLEY. If it happened in a nice smooth fashion, that would be all right. I would not worry much about immediate release if I were quite sure we were going to stay with the operating procedures we now have. But we were talking earlier today about what will happen if [banks] begin to [pay] interest on all types of money. And I think the answer to that is that we would have the same kind of problem targeting on M2 that we now have on M1. It would make it very, very difficult to do. And we may end up deciding that, in fact, what we have to do is target on interest rates. And if we start targeting on interest rates and say that this month, by golly, our interest rate target is 1 percentage point lower, the markets are going to go absolutely bananas. And I'm not sure that's what we want.

MR. PARTEE. I didn't think you'd ever say that, Lyle.

MR. GRAMLEY. Well, the whole problem would be that we would come up with a bunch of mush that could mean anything.

MR. MORRIS. And we'd get to the point where we were back in the Martin years.

MR. PARTEE. If we got back to an interest rate target and we couldn't put the target in the directive, we wouldn't be saying much. But that's a big if. It seems to me very likely that we'll always have some proviso on interest rate movements. I certainly am totally disenchanted about interest rate forecasting and I don't think I'll ever return to it. But I think we'd have some proviso. And it would

be measured relative to some objective performance indicator--maybe not money or maybe not even credit, Frank, but some objective indicator.

MR. MORRIS. If you eliminate both of those, you don't have an awful lot left!

MR. PARTEE. You have the--

CHAIRMAN VOLCKER. The Congress would just tell us to target interest rates also.

MS. TEETERS. I can't foresee that we're going to make any radical change, even as much as 2 or 3 percentage points, at any given meeting. Even when we targeted interest rates, I think the most we ever moved [the funds rate] was 1/4 to 1/2 percentage point. [Under current procedures] we've been moving it a percentage point in a 400 basis point range. We gradually move them up and down; I don't see that we're going to get major market shocks or anything of that sort. We did have one major market shock and that occurred when we changed to reserve targeting and a [wide] band on the interest rate target. And the market survived; it was shocked but it did survive. And then it settled down within the space of about a week. So, I don't see that we would be giving away that much information.

MR. MORRIS. But the kind of problem I'm concerned about is this: Let's say that we're in a period of uncertainty.

MS. TEETERS. We always are.

MR. MORRIS. Well, suppose we think that whatever we are targeting on is going to strengthen greatly between meetings, but we're not sure. So, we give the Manager a wide funds range in which to operate and he is supposed to use that range if the target shows great strength and not use it if it doesn't. In that case we would be publishing a much higher upper limit, and the market would be likely to move quickly toward that limit. Then if the events did not occur to justify the move, the Manager would not move the funds rate. Then the market would be stuck up here, and it would have to come down again. This would produce increased instability in the money market.

MS. TEETERS. There couldn't be much more instability than we have right now.

CHAIRMAN VOLCKER. I tend to agree with that, but I retain this great hope that it is going to settle down some day.

MR. BLACK. If we ever get into contemporaneous accounting and we really are targeting total reserves and controlling total reserves--

CHAIRMAN VOLCKER. If we have any reserves left at that point!

MR. BLACK. That's an "if." If we have a very wide federal funds rate range, I wouldn't worry about telling the market except for one thing, and I think that's the first argument against it. I'm very sympathetic to what Nancy says, but [I don't like] the idea of political pressure being exerted upon the Committee to change before the policy is fully implemented. And asking anyone who has dissented to justify his dissent when there's [as yet] no [written] explanation as to why he or she dissented in that directive, I think would be very divisive. That is what bothers me, although all my predilections, of course, are for releasing it because I hope we do get to that kind of total reserve targeting some day.

CHAIRMAN VOLCKER. Let me point out that we live in a world, a Washington world anyway, in which somebody has to trot up and testify about last month's consumer price index, which has no policy content at all. If we are going to announce our decisions after a Federal Open Market Committee meeting, I don't think it would be very long before we had a congressional hearing scheduled that afternoon.

MR. BLACK. That's what really worries me. That's the very point that tips me against releasing it.

CHAIRMAN VOLCKER. John Balles.

MR. BALLEs. If I could respond first to Bob's concern: If I dissent or somebody else dissents, that would come out immediately before the explanation came out as to why others had voted the other way. The way our minutes of action come out now--if we can keep them in that abbreviated form, not citing individual views--I could see the directive plus those minutes of actions being published on very short notice. And in my view--you might not agree--that would take care of the particular problem you were mentioning.

MR. BLACK. Yes, that would be a lot better.

MR. BALLEs. To return to the various points that Nancy is making: I sent around a memo generally supporting her proposal, as you may remember. It has occurred to me that there is another reason for supporting immediate release, but originally I was reluctant to put it in writing. I'm even reluctant to mention it now, but I'm going to nevertheless. It is bad enough to have leaks of the type we had, say, in The Washington Post on October 8, but even worse in my opinion is the risk of a leak we may never hear about. And that is somebody with access to our policy record feeding it to a trader, an investor, or whatever. If anything like that ever happened and was disclosed, that would be such a major black eye to us that it would make the leaks recently pale by comparison.

MR. GRAMLEY. When that sort of thing has happened with government statistics, though, the word gets around. The word gets around because it has a market effect and other people in the markets begin to learn about it and they call in. I agree with you that it would be a terrible black eye. But as far as I know, there is no reason to think that that would ever happen.

MR. BALLEES. I hope you're right, Lyle. I'm not all that positive myself. For example, though I don't have all the numbers with me--I wish I'd brought them--and I'm not sure how much they would prove implicitly what happened, my recollection is that the very day after our last FOMC meeting, Wednesday, October 6th, there was a major rise in bond prices and stock prices.

MR. PARTEE. Starting at 3 p.m. in the afternoon.

MR. BALLEES. Yes, exactly.

CHAIRMAN VOLCKER. That's right.

MR. BALLEES. And I'm adding 2 and 2 and getting 4.

MR. MORRIS. There was a statement by the Secretary of the Treasury on Wednesday.

MR. PARTEE. No, that was Thursday.

CHAIRMAN VOLCKER. You're talking about Wednesday?

MR. BALLEES. Yes, sir.

MR. PARTEE. The very next day, we had an afternoon rally. In fact, I went around to Joe Coyne and said "What's up?"

MR. COYNE. The Secretary of the Treasury's comments were on Wednesday morning.

SPEAKER(?). Yes, they were.

MR. MORRIS. Wednesday morning they were on the telerate.

MR. RICE. Peter, isn't it true that you get calls from people in the market saying that they know that other people have gotten privileged information?

MR. STERNLIGHT. We sometimes get calls that some statistical release from Commerce or somewhere is out early, yes.

MR. GRAMLEY. That is the sort of thing I was referring to. When we have heard that, we've typically heard back from the market as to what the information is all about and where it probably came from.

CHAIRMAN VOLCKER. Well, these are the suspicions that I've had reported to me recently, more or less casually, but they are worrisome. They are statistical, such as what the money figures are going to be tomorrow. The last one was what the M2 figure was going to be. Just to clarify what I know about this last episode: I had breakfast with the Secretary of the Treasury the morning after the meeting, as I do every week. The only thing I told him concerning what we had discussed was that we were going to put a lot less weight on M1 because of all the problems he knew about. We had a very short, two-minute or so discussion; he knew what the problem was. I also said I was going to explain this to the public on Friday because I would be going to the Business Council and it would be a good opportunity to put it in the right perspective. Two hours later, it's on the tape, because he literally walked out of that breakfast and went to a meeting of the dealer bank association--of all things, a public meeting--and said something about it. He said something vague about it when he was asked a question. What he said was accurate. But there it was. And then he didn't say anything else. Then Ken Bacon was snooping around. I don't know, but Joe Coyne's story is that Ken Bacon was speculating on this privately, as many of these things go, and assumed that we might have to come to that decision. It got confirmed by what the Secretary of the Treasury said and he ran with the story. He may not have had any other leak. The article was pretty accurate except for the headline, which said the Federal Reserve was easing or something. That wasn't the point. That is obviously not what I wanted to say. But except for that first sentence, it was a pretty accurate story. My speculation is that one reporter got something in the paper, which wasn't itself all that damaging, and it sent the other bloodhounds on the scent. They then got more substantive comments directly, obviously, out of the Federal Reserve. And that was the damaging thing, really. I was upset enough about the Secretary of the Treasury's performance and that story, but the really damaging policy story was the one the next day, which obviously did come from the Federal Reserve. I think it's a perfect example of how one leak generates another.

MR. CORRIGAN. That's the problem. In terms of the argument that releasing the directive would take care of the leak problem, I'm concerned that it will work the other way. If we put out the directive on the day of the meeting, in the form in which it is now written, we inevitably are going to get reporters snooping around asking "What does this really mean?" and trying to get interpretations. And we will end up with more confusion and not less.

MR. BALLE. Not if we don't talk to them.

MS. TEETERS. That's right. We don't have to take their calls.

MR. CORRIGAN. That's easy to say. But over a period of time--say we've put an absolute restriction on talking to the press for a week or something like that--that doesn't solve the problem.

MS. TEETERS. It would solve the problem though, Jerry, because by Friday it's a non-story.

MR. CORRIGAN. I don't know.

MR. MARTIN. No, anything about the Fed is a continuing story. This is a continuing saga of the mysterious--

MR. FORD. Wait a minute. I have to defend Nancy on this. The logic of it has to be that at the end of a month--with our next meeting only being a month away--they will have it. But somewhere between releasing it the same day and after one month, it becomes a non-story. That is witnessed by the fact that we usually don't get stories about the minutes when we release them.

MR. MARTIN. Yes, but by that time we've had another meeting.

MR. PARTEE. Our theory on the [release date], though, Bill, is that the directive is no longer current. We don't release it until after the next meeting has occurred and there is another directive.

MR. CORRIGAN. Until we've had another meeting.

MR. PARTEE. So that's an old directive.

MR. GRAMLEY. Well, the fact that somebody got some information and put it in the press did not reduce interest in the question of what was going on. It intensified it enormously. I think if we release the directive, which has in it some rather mysterious language about M2 and the fed funds rate ranges, and the language is changed a little--if instead of "is" it says "remains" and "unusually great" becomes "substantial"--then the phones will begin to ring off the wall. People will ask: "What does this mean? Did you guys cave in or not?" It just isn't going to change that problem at all.

CHAIRMAN VOLCKER. There is a growth rate figure there of x, so they will look at every figure. They will see if we are above or below X and ask if we are going to tighten up next week or three days from now or, if not, why not? That's what the directive says.

MS. TEETERS. They do it anyway.

CHAIRMAN VOLCKER. They do it less, surely, now.

MR. GUFFEY. I don't agree with those who say that releasing the directive will avoid the leaks. I agree with those who say that it might even increase speculation. But I'm a bit troubled with the proposal that we release the directive early, based upon the fact that we think we had a leak after the last meeting. I don't think that we could control leaks by releasing the directive immediately after a meeting. I think the issue that has given rise to the discussion today can't be cured by an early release. I'd also add a detail:

That we don't know how we are going to operate in the future and how that directive might look and how we might have to move one way or the other in the intermeeting period. As a result of that, it seems to me to be paramount that we maintain that kind of flexibility. If we can't control the leak problem by early release, then I would adopt a motto that has been used by others in the past and that is "If it ain't broke, don't fix it." I would continue to do what we are doing, since we can't control the leak problem in my view, and I would not opt for early release.

CHAIRMAN VOLCKER. I hope we can control the leak problem. We may not control it by that device, and it may aggravate it, but this institution has had a very good record on not leaking.

MR. GUFFEY. I'm just making the point that I don't think we would cure it by early release--

CHAIRMAN VOLCKER. No, I just wanted to clarify that.

MR. GUFFEY. --so why try to cure something we can't cure?

MS. TEETERS. But this is the second one this year. There was a leak between the end of June and the 20th of July on the Humphrey-Hawkins report. This is the second time.

CHAIRMAN VOLCKER. That is right.

MR. FORD. I hear rumors--I don't know because I wasn't here --that we've had sporadic leaks over the years. You may be right that we have fewer leaks than, say, Treasury, but haven't we had problems with leaks of this type for many years?

MR. PARTEE. Very occasionally. It has been very rare.

MR. FORD. Are you saying there has never been a leak until the last two times?

MR. PARTEE. No, there have been--

MR. GUFFEY. There have been a lot of other instances. I remember when Dr. Burns was Chairman that we did have a leak or a suspected leak, and certain members of the staff were excluded for, I think, two meetings.

MR. ROOS. If you do this, you'll deprive a lot of retired Federal Reserve people of a very important source of income, Mr. Chairman, trying to figure out what you folks are doing!

CHAIRMAN VOLCKER. I think you're wrong. I think it would increase the market. There would be text-analysis as well; we'd get all the English majors as well as the--

SPEAKER(?). They couldn't use English majors, Paul!

MR. WALLICH. I have been sympathetic to this proposal in the past. It has a lot of merit. What gives me pause is the argument in this memorandum about the impact on the policy process. We have some experience with open meetings. The public sits right there. They scribble, but they're not allowed to speak and, as far as I can see, have no real impact on our deliberations. It certainly doesn't embarrass me to say what I say. I have a sense that if I knew the next day there might be a hearing or that there might be a great press reaction, I would find it more difficult both to think and to decide, [particularly] to decide to do something drastic. Most of the time there's nothing to it. It's the critical instances where one worries.

CHAIRMAN VOLCKER. Let me put this in extreme form. You referred to these quiet little meetings we have in public. I'm not sure it has no effect at all, but those involve relatively noncontroversial issues by and large. We discuss consumer credit and some arcane regulations. Let me go on the other side of the spectrum where I've had a certain amount of experience. Those DIDC meetings are a zoo. Anybody who does not think the substantive result is controlled by the fact that those meetings are held in public doesn't have his head screwed on right. Now, we are not talking here about having a public meeting, but I'm afraid it's a step in that direction. In a public meeting one cannot make effective arguments or explore alternatives. And you cannot get anybody to change his or her mind once they have made a statement. And you end up with miserable decisions, in my humble judgment. And that is [true of the DIDC meetings] obviously because they are filled with enormous lobbying interests. You can imagine what interest monetary policy would have-- not quite interest groups, and maybe that would diffuse them, but political groups. If we ever got to that point, we could forget about having any coherent policy except by subterfuge. Somebody would talk beforehand and would announce that this is what the policy is going to be and everybody has agreed to say yes or no. In my opinion, that's the way those things have to work, if [the group] is going to make an intelligent decision at all.

MR. MARTIN. I don't believe that the extreme public scrutiny of our every word and our every action and the pseudo-actions that are attributed to us has made us a better functioning organization. I agree with those of you who say that immediate publication of this mysterious [document] would heighten the tension. The staff's memo indicates that the actual individual votes would be recited, and that would focus attention on individual differences. These are operating statements; they attempt to be helpful operationally. The public's right to know, I think, extends to our objectives, our performance, our structure, our composition as individuals here, and our backgrounds. The public interest is not endowed in the operational aspects of the organization. That's a different category. The approaches that we are taking to reduce leaks of information are

separate topics from this release [and putting us] in the spotlight. I would lean against the immediate release.

MS. TEETERS. Well, Pres, we already have computer systems that ring a bell and turn on a red light every time we enter the market in various--

MR. MARTIN. Is that good?

MS. TEETERS. Well, it exists. They are not going to get rid of it. My question to Peter is: Would it make any difference in the operation of the Desk?

MR. STERNLIGHT. I don't really think so. There would be times when an immediate release would have a market impact that we might not want. At times it could help to bring about the desired thrust in policy earlier. I may be out of order saying this, but having been associated with this for many years and having filed one of the statements in that Merrill suit in which I took a position on the ill effects of immediate release, I would say, after thinking about it long and hard for many years, that I don't think I could make that same kind of statement today because of the different nature of the directive.

MR. PARTEE. I did the same thing for the Board, Peter, and I have the same feeling. I couldn't support it now.

MR. AXILROD. I did the same thing, but I haven't changed my view.

MR. BLACK. Two flexible people and one inflexible one!

SPEAKER(?). You people with conscience!

CHAIRMAN VOLCKER. Well, I don't know whether it's worthwhile carrying this on any further. I don't detect a strong consensus to publish.

MR. FORD. I want to call facetiously for a vote, so I could be recorded as voting with Nancy on this.

MR. RICE. I would like to propose facetiously that we put it out for comment.

SPEAKER(?). For a year!

MR. WALLICH. It's very desirable to discuss this. Maybe we should take it up again at a future time when things are not quite so tense. I think we are doing something that we shouldn't be doing if there weren't strong reasons. We owe the public. That is the key more than the leak issue is the key. But I think the reasons against it are persuasive at this time.

MS. TEETERS. Henry, may I say that, given the center stage that monetary policy has moved into in the past 15 years, I doubt that we will ever find the time when pressures are not on us again--when we will be operating in a relatively quiet back-water sort of way.

MR. RICE. I was just going to ask if the Bundesbank does not hold a news conference after each meeting in which the result was some change in policy. If they change policy, they have a news conference immediately after the meeting. Is that not true?

CHAIRMAN VOLCKER. No. I feel as if I'm an expert on this, having consulted with my counterpart on this precise point. I'm not sure I know every detail. They do often have a news conference. But typically they are announcing a Lombard rate change or a discount rate change or something like that. Of course, we announce that, too, if we make a change. That is the typical reason for their having a news conference. If I remember correctly, they don't always have one even for those purposes. They specifically do not discuss open market operations, or their equivalent of open market operations, except in a rare instance, which is the issue here. That is what I asked them about. In fact, it has never occurred to them, according to him, to make a public announcement--except on the rare occasion when they want to--that they are going to provide more of less liquidity to the banking system. Sometimes they do that, but they don't do it as a matter of course.

MR. BOEHNE. I was going to add on to Henry's statement. I think the reasons are convincing to a lot of people around the table for not releasing it. I suspect that we would have a hard time convincing outsiders of the validity of those reasons. I think we all did hide behind the ideal that somehow [the release of the directive] would help rich people and give succor to the speculators, and I think that served the purpose for us. If we stood up in public and tried to give a convincing speech on why we ought to do it [the way we do], I think it would be difficult. That doesn't mean that I'm not sympathetic to not releasing it; I'm saying that if we tried to convince somebody from the outside, it would be pretty much an up-hill proposition.

MR. WALLICH. The not helping speculators is a better public posture. It is a less good argument.

CHAIRMAN VOLCKER. That is correct. Look, this memorandum, Mr. Altmann is reminding me, has no indication of confidentiality. I wouldn't like to see it spread around simply because the arguments that seem to us persuasive may seem, precisely for your reasons, less persuasive to others.

MR. FORD. That says a lot.

CHAIRMAN VOLCKER. No, I think it simply says that our interests may not entirely coincide with theirs. I would even go so

far as to say that we presumably have the public interest closer at heart than all those people who have reasons for wanting to see a different answer.

MR. BOEHNE. It says that central bankers have a wisdom that exceeds those of the more normal few.

MR. CORRIGAN. Is there any question of that?

MR. BOEHNE. No, not at all. I said it as a statement of fact!

CHAIRMAN VOLCKER. Well, I don't know as we can carry this any further. I suspect we may want to return to it someday. Maybe somebody can come up with a more effective argument on one side or the other and dispose of the issue definitively; I doubt it. I'm [pressed] for time myself. I have a legislative update, if you want to hear it. [Our FOMC agenda is completed.]

END OF MEETING