TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

July 19, 1977

Prefatory Note

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

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

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

Staff Statements Appended to the Transcript

Mr. Kichline, Associate Economist
Mr. Zeisel, Associate Economist
Mr. Sternlight, Deputy Manager for Domestic Operations

7/19/77

Meeting of Federal Open Market Committee

July 19, 1977

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, July 19, 1977, beginning at 9:00 a.m.

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

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

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

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. Bernard, Assistant Secretary
Mr. Tuttle, Assistant General Counsel
Mr. Axilrod, Economist
Messrs. Balbach, T. Davis, Eisenmenger, Ettin, Kichline, Reynolds, Scheld, Truman, and Zeisel, Associate Economists

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

Mr. Hudson, Assistant to the Chairman, Board of Governors
Messrs. Coyne and Keir, Assistants to the Board of Governors
Mrs. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. J. Davis and Parthemos, Senior Vice Presidents, Federal Reserve Banks of Cleveland and Richmond, respectively
Messrs. Brandt, Fousek, Green, and Kaminow, Vice Presidents, Federal Reserve Banks of Atlanta, New York, Dallas, and Philadelphia, respectively
Mr. Bisignano, Assistant Vice President, Federal Reserve Bank of San Francisco
Mr. Kareken, Economic Adviser, Federal Reserve Bank of Minneapolis
Miss Lovett, Securities Trading Officer, Federal Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting of
July 19, 1977

[Secretary's note: The raw transcript begins at this point. The meeting began with Committee approval of the Minutes of Actions of the meeting of the FOMC held on June 21, 1977.]

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

CHAIRMAN BURNS. Why do you say it's overdone in terms of fundamentals?

MR. HOLMES. I think, Mr. Chairman, there is nothing that's happened since June 23--taking that as the base date--that would cause a 4 percent depreciation of the dollar against the mark and the Swiss franc.

CHAIRMAN BURNS. No, nothing has happened since June, yes, but what about what happened before then, and the market was quiescent in absorbing it?

MR. HOLMES. Well, if you take last year, Mr. Chairman, we have depreciated by about 14 percent against the mark, the Swiss franc, the Belgian franc, and the gilder and about the same amount against the yen. So over a longer period there has been a substantial movement of exchange rates.

MR. PARTEE. With a differential in price increase of about 4 percent, I guess.

MR. HOLMES. I'm sorry?

MR. PARTEE. About a 4 percent difference in price increase, I would guess.

MR. HOLMES. Yes, right, right.

MR. PARTEE. And a 14 percent depreciation.

MR. HOLMES. Going back to June 30 of 1976.

MR. PARDEE. The Bundesbank reaches to the beginning of 1976, and they say it's on the order of 19 percent.

MR. HOLMES. Now, there have been developments this morning, Mr. Chairman. As I say, we intervened yesterday, more than we have, but still a modest amount, and not enough to keep rates even steady, but [continuing to moderate its] going down. Today the Germans have already bought $191 million. They see signs of OPEC flows of money into marks and out of dollars, and there are all sorts of rumors of other such flows. A more forceful approach to the market may be really necessary if we want to avoid some potentially disturbing flows of funds out of the dollar by important countries. And this could again thoroughly unsettle the exchange markets and then lead to a further depreciation of the dollar, which I do not think could be justified by any fundamentals at the [present] time.

I'd be prepared to recommend that approach today, but I think this requires further discussion within the System. It would require the full agreement of the Treasury, which, while posing no objections to the intervention we've been doing so far, has at least been lukewarm in agreeing to these efforts. So I think we have a new situation in the exchange market. It could correct itself; on the other hand, unless we want to see things going even further than they have, and fast, in a disorderly manner, we may have to be prepared to draw a bit more on the swaps than we have so far.

Now, in our other operations, we of course are continuing to repay on our long-term debt in Swiss francs. We're paying a further $56 million right on schedule, with our remaining liability just a bit over a billion at current market rates--which are getting worse every day. That's all I have, Mr. Chairman.

CHAIRMAN BURNS. Well, my own feeling is that the markets are behaving quite rationally in view of the magnitude of our trade deficit--it's enormous. In view of the prospect--these things get around--that no improvement in that trade deficit or in our current account deficit, for that matter, is in sight. In view of some acceleration in the inflation rate in our country, I think the markets are behaving quite rationally. And now the implication of that for operations of the Desk are not entirely clear. When you speak of disorderly markets, it's one thing; when you comment on fundamentals, well, you may be right, but that's not my present interpretation of what is going on.

MR. HOLMES. Mr. Chairman, as you know, what we've been doing is just following the rate down, not trying to maintain it at any rate. At some point I think it becomes much more expensive to operate in that way, and I'm not suggesting that we ought to have pegged rates here, by any means. But the continual depreciation in a rather bad atmosphere--if you're close to the market and listening to comments from traders, one gets the impression that it's reacting more to what they consider to be an official policy, that we want the rate down, and nobody knows how far.

CHAIRMAN BURNS. Well, I think some pronouncements by the Treasury have been unfortunate, and I think it's always an unhappy day when the major financial officer of the government conveys the thought that his country does not care about the value of its currency in a foreign exchange market. And something approaching that apparently has occurred. I still think that markets by large are behaving rationally. And to go in on any large scale--I don't think we can stem the basic tide, and I see no point in inviting large financial losses, if my interpretation of the trend is anywhere near the mark.

MR. PARTEE. I might say, I agree with you, Mr. Chairman, and I also think that it's not clear to me that it isn't U.S. official policy to let the mark and the franc and other countries with balance of payments surpluses as current account surpluses rise against the dollar, so I am not at all sure that it would be--without a great deal more checking--appropriate for us to intervene in any sizable scale. Because I'm not quite sure of the U.S. policy.

MR. WALLICH. I wonder how we'll proceed in the market. Is the market aware of the moderate intervention you've been doing?

MR. HOLMES. Yes, I think they have become aware of moderate intervention.

MR. WALLICH. And how are we perceived by the Europeans? As doing enough so that we're not going to [be] blamed for benign neglect?

MR. HOLMES. I think the impression would be that we're not doing enough under current circumstances.

MR. JACKSON. But are they doing too much?

MR. HOLMES. Well, up to just recently, when the Germans came back in, the Germans and the Japanese were really staying out of the market. The Japanese intervened heavily the day before their Sunday election, I think for political purposes. The countries that have been intervening are the weak currencies--the pound sterling, the lira, the French franc. And they have picked up tremendous amounts of money, over $3 billion in the last three weeks.

MR. PARDEE. One of the problems that we've had with floating exchange rates is the tendency to overshoot and to have exaggerated movements of rates. Many people in the central bank community have been rather pleased that they have avoided some of these wide swings that we had in '73, '74, and coming into '75. And now, partly [given] the perception in other markets, but more on the basis of these announcements, we have a very sharp swing effect. There's no stopping the sharp swinging effect. We're running the risk [that] other wide fluctuations will perhaps have to develop later on, which, as far as U.S. policy is concerned, would be embarrassing. So it's better to have something that is in line with fundamentals than exceeding it.

MR. WALLICH. The underlying economics are quite debatable, it seems to me. An exchange rate move does not change a current account very much until a year or two later. So that's really what we're saying--these exchange rate movements are necessary to alter the German, Japanese, etcetera, surplus one or two years down the road. Now, by that time, who knows what cyclical developments may have done. We think that part of our present deficit is cyclical. It will continue to be so next year but perhaps get somewhat worse. But eventually, one would think that other countries would catch up with us. Meanwhile, the short-run effect of an exchange rate move is the familiar J curve. In other words, the Germans sell the same amount of goods at slightly higher prices and realize higher dollar receipts and a bigger surplus, for some months at least.

MR. HOLMES. Mr. Chairman, if I may add one other point. It seems to me that one of the reasons that investment demand has been so sluggish in Germany [is that], if they see a continual appreciation of the mark against other currencies, they don't quite see where their markets are going to be in the future. I think a further appreciation of the mark could rebound to have an adverse effect on the growth of the German economy, [growth] that everybody, including the Germans and us, wants to see. Which is really the way they're going to cut back on their current economic surplus--by internal growth.

CHAIRMAN BURNS. What about the U.S. economy?

MR. PARTEE. That's the opposite side of the plan.

VICE CHAIRMAN VOLCKER. Where do we have a current account deficit from? We've got it partly from oil. It's our own oil program as well as expansion. I think the rest of it is largely cyclical, as Henry suggested. And it is likely to continue. And I do think there's a question whether this exchange rate change, going much further, anyway, is productive or counterproductive in terms of the cyclical forces in both places--for the reason Alan suggests in Germany, [and] in the inflationary psychology it may stimulate here. At some point, when this gets in the newspapers and gets in the consciousness, I think it [will be] upsetting in terms of what we're trying to achieve through a steady monetary policy.

I don't know what the rate should be fundamentally now--I don't think anybody does with these imbalances in current accounts. But I do think we're now verging, more than verging, on the risk of the rate [movement] being overdone in terms of rapidity, with destructive psychological effects cyclically, both here and abroad. I don't think that means we can act very aggressively if the Treasury is going to be talking the other way. But I think it does suggest that we ought to have some renewed consultations with the Treasury at this point to see whether they don't want to take a little more overt line, given that the rate has gone as far as it has in the last month since they gave the tone of acquiescing--at the very least--and we have had a significant change since that time. So the rate of speed is certainly at issue at the moment, it seems to me, given what's happened in the market in the past week, and particularly in the past couple of days.

MR. WALLICH. And the rate of speed is really the only thing we can influence. When you look at these large amounts that Europeans, not primarily Germany and Switzerland--Alan said the British and the Italians--billions they've thrown into the market. We couldn't operate on that scale, and so we could not expect to do very much to the longer-term outcome of the rate movement. But we can moderate the speed of the movement, and to the extent that that has something to do with the long-term outcome, then we do have some significance.

CHAIRMAN BURNS. I am not sure you're right about that. I think that operating on the scale on which Alan has been doing isn't going to make much difference one way or the other in the present mood of the market.

MR. WALLICH. Well, I'm saying, to the rate of movement, not to an ultimate equilibrium level.

CHAIRMAN BURNS. That's what I'm addressing myself to.

MR. EASTBURN. Mr. Chairman, could I ask a factual question? Alan, how does the amount of intervention by all countries in this current situation compare with other situations since we've had trouble with the British?

MR. HOLMES. I would think that the gross amounts are not far different than from other periods. There have been other periods where it's been even greater. And you had a different composition of intervention when the Japanese used to be very heavy interveners. They have really refrained and intervened only once, I think quite heavily, in I don't know how many weeks, but in a number of weeks. There is an acceptance by the Japanese and the Germans and the Swiss that their [currencies] ought to appreciate. Their concern is that appreciation does reflect something fundamental and not [just] people talking the rates up or down. I think that is where their main concern lies.

MR. PARDEE. Probably a statement by the Treasury that it's satisfied with the rate movement would help a heck of a lot more than any intervention.

VICE CHAIRMAN VOLCKER. I agree with that

CHAIRMAN BURNS. I don't agree with that. I think Treasury ought to keep quiet for awhile. That's the best contribution they can make now. In fact, I advised them that way this morning at a breakfast.

Well, this isn't easy, gentlemen. You know, we all would like to see the world stand still--let's not kid ourselves, that is a bias that everyone has. And the world will not accommodate us. We're paying a price now in exchange markets for the policies we have been pursuing: The rate of inflation has intensified; people read the newspapers, they know what has happened to our balance of trade; they read about the minimum wage and labor legislation and the way it's moving on Capitol Hill; they know that the budget deficit next fiscal year will, according to present projections and plans, be higher than this year.

Now markets, I think, are behaving quite rationally. We wish they didn't behave that way, just as the Germans would, sure. But my guess is that, to influence the market at all perceptibly, we would have to move on a very large scale. The time for that may come, [but] I don't think it has come yet. And massive intervention may be necessary later on, but not as of today.

MR. COLDWELL. Mr. Chairman, I don't see how we can jump into a massive intervention if the Administration part of this government is going to talk the other way.

CHAIRMAN BURNS. Well, needless to say, I've thought about that. I don't know what else we can do here, really. What is your recommendation, Alan? Do you have any? Or do you want us to just sit here and shed tears along with you?

MR. HOLMES. I think, Mr. Chairman, for the moment, we should temporize. Talk to the Treasury and see if we can pinpoint their views, whether they feel that they've had enough adjustment for the time being. Again, I am not thinking of a permanent peg but sort of a relief from what has really stemmed from too much talk and too much [news]paper comment. If you talk to the exchange traders, they will point much more to the talk than to anything fundamental as being the cause of current movements in exchange rates.

CHAIRMAN BURNS. Well, that's the way traders think--what happened yesterday. But the underlying forces do catch up with them. Well, look, we're talking to the Treasury, you keep on talking, that will go on--

MR. HOLMES. Yes, sir. I should suggest that we go about as we have, maybe intervening on the scale that we had to yesterday, perhaps a bit more. This would entail additional drawings on the swaps, but not massive drawings.

MR. JACKSON. Alan, what are the ramifications of significant changes in official holdings?

MR. HOLMES. Well, this is a thing that does concern me, because we are relying really on large OPEC flows to finance our current account deficit, which isn't going to change overnight. And if you get a redirection of those flows--even [if] they are not terribly large, because you know, there's not too many places they can go in any size--it doesn't have to be very large to have a rather significant impact both real and psychological on the exchange market.

CHAIRMAN BURNS. Well, now, you refer to a flow of OPEC money into foreign currencies. Is this a rumor, or is this a fact? Do you know?

MR. HOLMES. I think, in our conversations with the Desk this morning with Germans, they see some as a fact. I think there is much more in terms of rumor than there is in fact, but I think there is something in fact.

CHAIRMAN BURNS. Well, would you try to ferret out precise facts for me, please?

MR. HOLMES. We will, indeed, Mr. Chairman.

MR. WALLICH. Are you referring, Alan, to switches of existing holdings or redirection of the new money that they have to--

MR. HOLMES. I think it's more the switches of existing holdings. But we had huge payments into OPEC accounts just over the last weekend and yesterday--the midmonth oil payments. Some of that is in overnight money and can move out very rapidly.

MR. JACKSON. To what extent has that total flow been reduced by the change in levels of exports as a result of seasonal impact and also by all reserves having been built up?

MR. HOLMES. I don't really have current facts, Governor, on that.

MR. JACKSON. As I recall from the weekly report last month, at least one of those countries that had normally made substantial RPs [repurchase agreements] had substantially reduced deposits to transfer what small amount there was to Europe immediately to cover some of their old--

VICE CHAIRMAN VOLCKER. I don't really think you are going to find much statistically here. And this floating rate system--you can't have a net capital flow except to the extent there's intervention--for every transfer, you're going to find somebody in the other direction. The question is at what rate it's taking place?

MR. PARTEE. Well, there's been over $3 billion on interventions.

CHAIRMAN BURNS. Any further comment? Is there a motion to approve transactions at the foreign Desk?

SPEAKER(?). So moved.

SPEAKER(?). Seconded.

CHAIRMAN BURNS. A motion has been made and, I take it, approved. Do you have any recommendations, Mr. Holmes?

MR. HOLMES. Mr. Chairman, we have no swap maturing in the current period. And as I say, we have started drawing on the German swap--for the first time in I don't know how many months, we've had to draw on a swap line.

MR. WALLICH. Have they been at all restrictive, as they sometimes have been?

MR. HOLMES. No, I discussed it very briefly in Basle as a contingency, and they had no problems.

CHAIRMAN BURNS. How are you getting your Swiss francs now, Alan?

MR. HOLMES. We are buying them from the Swiss National Bank.

CHAIRMAN BURNS. Not in the market?

MR. HOLMES. No, Mr. Chairman. Once in a while, we have a chance to pick some up from one of our customers who's a seller, and we do that from time to time.

CHAIRMAN BURNS. Well, for a while, I'd stay out of the market.

MR. HOLMES. Oh, absolutely. We don't want to make it any worse than it is.

MR. PARTEE. I might just note that, when you speak of massive intervention, that is a residue from a previous massive intervention with the support of the Treasury. Still paying it off, six years later.

VICE CHAIRMAN VOLCKER. A somewhat different context. Oh, fixed rates.

MR. WALLICH. Was that required by law at that time? Legally, we couldn't have done anything else, could we, but perhaps defend the dollar?

VICE CHAIRMAN VOLCKER. We were on a fixed rate then.

CHAIRMAN BURNS. We could have gotten off the gold standard faster.

MR. WALLICH. But that was a very major action.

MR. PARDEE. The Treasury could have bailed us out.

CHAIRMAN BURNS. Gentlemen, let's look to the future. And we will do that presently. Mr. Kichline, may we have your views on the economic outlook?

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

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

CHAIRMAN BURNS. Mr. Kichline and Mr. Zeisel, I think you have provided this Committee with a very illuminating set of charts and interpretations. We're all very grateful to you. Any questions or comments? Mr. Wallich, please.

MR. WALLICH. I'm a little puzzled by the balance of forces that I see projected here. With the rate of expansion that is indicated--that is, a slowing in 1978 even below 5 percent--I don't see much wrong because, as time goes by, we are getting closer to the full-employment ceiling and, even sooner probably, to the manufacturing capacity ceiling, the capital stock ceiling. So we have to think of not going much above the trend rates of growth as we get in the neighborhood of these limits. And I guess that slowdown is in the works now.

But at the same time, I see some things that suggest to me that strongly expansive factors may be at work, especially the federal deficit. We've got a rise in the federal deficit projected in a range, I guess, of $10 billion to $15 billion. And state and local expenditures, which I haven't observed, apparently are growing very sharply--there may be some overlap here. Can you give us an evaluation of these conflicting elements pushing very strongly and yet the overall tendency [going] toward slowing down?

MR. ZEISEL. Well, as you point out, this is a matter of offsetting forces operating. On the positive side, you point out that fiscal policy is becoming somewhat more stimulative, but only rather briefly. It happens to be occurring over the next half year or so, and then the high-employment budget begins to move back into balance again, in the absence of any new fiscal initiatives, toward the end of 1978. And that's one of the factors tending to retard growth.

But on the negative side, we've had an extremely rapid recovery recently in residential construction activity. Housing starts for single-family housing are at record levels. While there probably will be some further gain in multifamily housing activity, it's not likely to be providing the kinds of support that the growth in single-family construction has provided us over the last year, and this will begin to be a retarding factor as we move on.

We have similarly had a fairly substantial recovery recently in inventory positions. Our attitude, in part, reflects the recent very conservative attitudes on the part of businessmen toward their inventory positions. But unless they change their views significantly, we feel that inventories are likely to be providing less support to the economy from here on out. Similarly, consumption--

CHAIRMAN BURNS. If they did give support to the economy, it wouldn't last.

MR. ZEISEL. It would be a very brief kind of activity, and possibly a destabilizing one at that.

MR. PARTEE. You have supportive business inventory numbers, as I read it.

MR. ZEISEL. I am sorry, sir--

MR. PARTEE. You have supportive business inventory numbers. That is, you don't have any collapse in inventory accumulation at any point. But it isn't contributing in an algebraic way very much more to the growth in GNP.

MR. ZEISEL. That's right. So basically, we have several sectors of the economy which have provided very substantial support in the recent past which are beginning to fade. And happily we have some components to the economy which are coming along to provide some support and give us a rate of growth which, in our projections, seems like a reasonable path toward higher employment.

CHAIRMAN BURNS. All right, thank you. Mr. Mayo, please.

MR. MAYO. Jerry, the high-employment budget chart strikes me as being even more artificial than usual, if I may use that phrase. How do we calculate the high-employment budget balance these days? It certainly still isn't back at 4 or 4-1/2 percent unemployment.

MR. ZEISEL. No, the unemployment rate at the moment is about 4-3/4 percent.

MR. MAYO. Yes. And that's why it looks so artificial.

MR. PARTEE. What about the inflation rate? What's the inflation rate that's assumed? Is it the projection?

MR. ZEISEL. This is our calculation and therefore a projection. Yes, and different from the Council [of Economic Advisers]'s projection, to that extent. The key point here, of course, is not so much the level, which will differ depending upon who does the calculation, but the movements. And my presentation really was to suggest that, interestingly, the last half-year was a period in which the full-employment [budget] moved into surplus [with] a rather large, rapid increase in real GNP, and that it moves back into deficit because of fiscal initiatives and certain other factors later this year. And [it] tends to act as some support, particularly in terms of the grants to state and local governments.

MR. MAYO. Well, I guess my point is, my problem, Jerry, is that the concept is just becoming so obscure that I'm wondering why we even pay much attention to it, calculated that way, with participation in the labor force on an entirely different structure. Even the goal of 6 percent unemployment seems difficult to attain these days. And to even show figures--I'm not criticizing staff--the basic idea, I think, becomes misleading. Anybody who saw a chart like this would say ho-hum, we've got everything under control, if they look at it just as the chart shows, wandering between around zero here, or to the other extreme--it's absurd. I'm dramatizing it perhaps a little too much, but I feel that this is almost a waste of paper.

I also have another question. It's a much more short-term question. I was curious--on this chart on personal saving, is there any theory that some of this dip in the personal saving rate reflected an anticipated rebate that didn't occur? People spent the money before they got the rebate, and now an effect is showing up? Is there any of that in there?

MR. ZEISEL. We expect 32 Ph.D. dissertations on the subject, but at the moment we don't have any definitive way of answering that. That is certainly a possibility

CHAIRMAN BURNS. The 33rd dissertation will have the definitive answer.

MR. PARTEE. Until the 34th comes around.

MR. MAYO. Sounds like a Masonic Lodge to me. One further question that's more broadly based as it relates to our upcoming discussion on the range of our goals over the next year on monetary aggregates. If you were to construct these figures--your outlook on 5 percent as against 5-1/2 percent as a central tendency--would you have significantly different results? I am not asking for detailed answers, but do you find that the change in the basic assumption on M1 and M2 makes only a marginal difference or a significant difference on the basic economic factors?

MR. ZEISEL. We specialize. Mr. Kichline will answer that one.

MR. KICHLINE. Before answering, let me just say that we're having a great deal of difficulty with the econometric model in the money demand function, which has been causing most people difficulty. And so I think the confidence which we would associate with our alternative M1 rates of growth and what the impacts are is less today than what it would have been two or three years ago.

For what it's worth, in the first year, if you go from Q2 1977 to Q2 1978, a half a percentage point less M1 is worth, in terms of real growth, according to the model, about 2/10 or 3/10 percent, and it's worth 1/10 percent rate of growth on the deflator. As you stretch on in the second year, the impacts become considerably larger, especially on the deflator. It's worth about 3/10 lower price inflation there in the second year, and it's worth about 5/10 or 6/10 lower real growth.

MR. MAYO. Well, thank you very much.

MR. PARTEE. That was a 1 percent difference?

MR. KICHLINE. One-half--

VICE CHAIRMAN VOLCKER. If I can follow-on there, Mr. Chairman, with a question in this connection? If I have my facts straight, your projections this time are very close to what they were last time, within a tenth or two. But the money supply assumption has implicitly been changed because you're assuming 5-1/2 from the second quarter instead of from the first quarter. So, the result is a money supply assumption of something like 1 percent higher over the course of the year. And with the same economic projection and the higher money supply projection, the implication is, I guess, one of two things happening: One is that the business situation basically is somewhat weaker, offset by higher growth in the money supply, so you came out the same. Or you discounted the change in the money supply.

MR. KICHLINE. The former. The rate of growth is about 3/4 percentage point more--I think it's the equivalent of 6-1/4 percent versus 5-1/2. It's reflected in our projection most explicitly in the fact that we have lower interest rates now associated with virtually the same level of nominal GNP. But the incoming information, as we've read it, has, on average, been weaker, and so it works out essentially to an unchanged overall position.

MR. PARTEE. May I ask a question about capacity utilization? I know the projected rate of utilization reaches around 88 percent by the end of the projection period--that is, the fourth quarter of 1978--87.7 for materials and 88.3 for all manufacturing. And the unemployment rate is still 6-1/4 percent or thereabouts. Now what I wonder is, what kind of pressure that capacity utilization rate would imply in light of what seems to be an Administration program for continuing to have growth through the '70s--that is, until 1981--on the order of 5 to 5-1/2 percent? Does this imply that we've reached capacity bottlenecks long before we get the unemployment rate down to the objectives, in your view?

MR. ZEISEL. Those rates are pretty high relative to the peaks that we obtained in 1973--particularly for manufacturing, a little less so for materials. Actually, the 88 percent is very similar to the peak rate that we achieved for total manufacturing through 1973. Materials a little better. Our peak in major materials was 93 percent.

CHAIRMAN BURNS. 90-what percent?

MR. ZEISEL. 93 percent. So we remain a bit under there, and of course this is the sector where we ran into trouble back in 1973.

MR. PARTEE. Quite a bit, this is 87, this is 88.

MR. ZEISEL. It's 88.

MR. PARTEE. You're 5 points below

MR. ZEISEL. We're 5 points below, so we still have a fair amount--not a fair but a reasonable amount--of margin there. But certainly we will be approaching the position where selective problems will be developing, I would think.

MR. PARTEE. Which would have implications for the rate of inflation.

MR. ZEISEL. In terms of your reference to unemployment, I think one has to, as you know, recognize structural changes that have tended to occur in the labor market--tended to bias up the unemployment rate. And, in addition, we've just recently been through a period of enormous growth in the labor force, which was very largely made up of women, who tend to have high frictional rates of unemployment. I think the 6-1/4 percent rate, really, for comparison with past periods, has to be adjusted down somewhat.

MR. PARTEE. You mean 6-1/4 might be a pretty good rate of unemployment?

MR. ZEISEL. Well, 6-1/4 by capacity, yes.

MR. PARTEE. Although I haven't heard anything here in the city that would suggest acceptance of that.

MR. ZEISEL. Not at 6-1/4, but as a goal. But the Council [of Economic Advisers] has recognized--the government, Administration--has recognized the fact that a goal of 4 or 4-1/2 is now unrealistic, and we're talking about 5-1/2, 5-3/4, in that neighborhood.

MR. JACKSON. Well, as I recall the figures, if we had a labor force composition similar to that of 1970--teenagers, women, and adult men--the consequences today would be roughly 1 percent lower on the unemployment rate.

MR. ZEISEL. The mid-60s, roughly.

MR. JACKSON. If you had the same composition--

MR. PARTEE. Going back to the mid-60s--

MR. ZEISEL. What--

MR. PARTEE. If you went back to the mid-60s.

MR. ZEISEL. --about 1 percentage point difference.

MR. ROOS. Mr. Chairman, may I talk. In focusing on your capacity level, have you taken cognizance of the full pack of energy regulations and anything like that, which could reduce that capacity level below the 88?

MR. KICHLINE. We haven't explicitly considered that, but we are aware that there are some problems. The aluminum situation in the West is one. We understand that there are some aluminum facilities in the Southwest that use natural gas that are not effective in today's environment. They are included in these numbers in the capacity side. But clearly, the energy situation in some industries has reduced potential capacity, and it's just very difficult to get at that. So I think perhaps the energy situation has, in effect, lowered the full capacity utilization rate from what it would have been otherwise. But by how much, it is difficult to tell.

MR. ROOS. But your projection is basically exclusive of those problems, but it may have reduced them?

MR. ZEISEL. We will know more about that as we get reports in. Basically, we derive our stock figures, our capacity figures, from producers themselves, and there is some lag in getting that kind of information. But as we get it, of course, we will build that in, and it will reflect their view of what the energy situation has done to their capacity.

CHAIRMAN BURNS. Well, I think we should move on. Mr. Balles, please.

MR. BALLES. Well, Mr. Chairman, my question has already been anticipated by Bob Mayo, but I would like to elaborate a bit and perhaps suggest something in terms of how we deal with this matter in the future. Since we're faced with a choice of alternatives A to D in terms of the longer-term growth ranges of the aggregates today, I was wondering if the staff could, as a regular part of this presentation in the future, and however imprecise these estimates might be, give us some charts--as I seem to recall that we have seen earlier--on the implications of these alternative growth paths, not just for the two variables that you mentioned, which would be real growth and the deflator, but also on the unemployment rate. And perhaps not for just one or two but perhaps even three years ahead, in view of the long lag that obviously exists, especially on the implication for prices. Now perhaps you don't think that's useful anymore, perhaps there are too many difficulties. But I'd like to get the staff views on why you have discontinued it--if my recollections are correct that you used to do it.

CHAIRMAN BURNS. All right.

MR. KICHLINE. You recollect correctly, and I think the last time that it was done might have been something like a year ago. And I believe that the major difficulty that we faced is our own concern about measuring policy impacts in a model in which the money stock is quite important, or interest rates are quite important. You specify one or the other--we've been specifying M1--and we find that for the last two years, the equation has been off literally by 2 percentage points. And so it causes a great deal of difficulty. If it's a shift that stops and we go on from here, then we would have confidence in the output.

I think it's useful. We have been doing it at the staff level each month, looking at alternatives, and so I wouldn't have any difficulty in providing the Committee with the information. I would just feel less comfortable than I would have some time in the past. But we can certainly do it, and there is no difficulty in providing it.

MR. BALLES. Well, thank you. I was sure that the staff had some views on this and was undoubtedly doing some work on it. In our Bank, we happen to be convinced that, currently, M2 is a better predictor of the real economic variables than M1, and that was detailed in a paper circulated recently. My own staff does do these calculations for one, two, three years ahead for the alternative growth paths of the aggregates, and I for one would be very interested in seeing how our work compares with that of the staff down here. Because that is really the key choice we have to make today, I think, in terms of policy as among these alternatives paths. So if the staff believes this is useful and feasible, Mr. Chairman, I would like to suggest that it be a part of the regular presentation so we can study their figures and look at them during the course of the staff presentation prior to the time we get to the choice of the longer-term growth paths.

CHAIRMAN BURNS. I think that we must leave some elbow room for the staff. Unless there is a request of this kind from the entire Committee or a sizable number of Committee members, I think we should rely on the judgment of our staff. However, any member of the Committee who wants the calculation that Mr. Kichline has described, and which he has indicated the staff makes regularly and which he could supply very easily to any member of the Committee--I think all you have to do is ask for it and you will receive it.

MR. BALLES. What about--

CHAIRMAN BURNS. Whether it should be done as a regular presentation, I think that should depend partly on the thinking of our staff and partly on the wishes of the Committee. I don't think we can load up these meetings in response to individual requests. I think individual requests of Committee members should always be respected. But it is one thing to respect a request by an individual Committee member and quite another thing to expose the whole Committee to it formally.

MR. WALLICH. I might say, Mr. Chairman, that I have asked for the data, and they've been made available. It is a question of remembering to ask for it in time. If we can sort of put in a standing order, I'd be satisfied.

MR. PARTEE. Well, I see no reason why it can't be done in the same way the flow of funds table is done, except to make it just once a quarter. But I would be opposed to giving much Committee time to it, because I don't think those figures are worth anything. I mean I think that the aim of the Committee [as has been explained], properly, is to get the minimum tolerable growth in the monetary aggregates, and that really doesn't have to do with projecting a year or two or three ahead. It is a question of what you can get in the way of minimizing monetary aggregates over a period of time and still have an acceptable economic performance. And that depends on velocity, as the Chairman has so often said, and we have found that we are not able to predict the demand function--I believe that's what Jim said--well enough to make any difference between 4 and 5 and 6 percent, say, growth rates on M1. So I wouldn't want to see much time spent on it in the Committee.

MR. MAYO. Chuck, I think you're right on the allocation of time here, which is precious, but I found the staff's answer to my question important and yet I don't want to pursue it in detail. They have developed a model--we certainly are all sophisticated enough to know the perils of these models. And their judgment as to the increased perils in this particular case, we have that in mind, plus the observation that over the next year it's only 2/10 percent difference in real GNP and 1/10 percent difference in the deflator. [But] even if it's double or half of that, I find that [result] sufficiently in what you might call a philosophical ballpark to have some influence on my own thinking as to the long-range paths on M1 and M2.

MR. WALLICH. Well, it's particularly [useful] running it out a long time, even though it's very hazardous and all the qualifications attached. Since we're dealing with something that has an effect only with a long lag, it isn't really helpful to ask ourselves what it will accomplish over a year. It accomplishes minute differences. Now, if it accomplishes anything, it does so at the best over two or three years, and we ought to at least have a shot at it.

MR. MAYO. But we are revising these paths quarterly, so I take some shelter in that.

VICE CHAIRMAN VOLCKER. I don't want to prolong this unnecessarily, Mr. Chairman, but I find myself very sympathetic with what Mr. Partee had to say. It seems to me there is some danger of lending more weight to this than it's really worth. What we have is an equation, as I understand it, that's always going to have more or less the same answer. And if we get the equation once, we ought to understand the answer that the equation has. But arraying it every month in terms of the marginal effect on GNP and prices is telling us the same thing every month. It tells us what this rather inadequate equation discloses, which is not a very weighty piece of information, I think, to have before us every month.

MR. BALLES. Paul, I wasn't suggesting every month. I was suggesting like once a quarter, when we consider the longer-term ranges.

MR. PARTEE. I think Paul's point is still that the staff can give you the schedule that's good for all time on what 1 percent [more] or 1 percent less of the money supply will do one year, two years, three years out in terms of real GNP and the price deflator.

VICE CHAIRMAN VOLCKER. Until they revise the equation.

MR. PARTEE. That is, if you're just reading the model. Now, we used to try to adjust the model. We never did present to the Committee just the econometric model. If you go to the econometric model, which I think is really all that can be done now [given] the state of the information we have, why, it will give you the same answer every time.

MR. BALLES. Well, Chuck, I'll say one more thing on this and then I will shut up. Does that suggest to you, then, that this choice among alternatives A, B, C, and D, isn't really a meaningful choice?

MR. PARTEE. I think it's meaningful in the sense that I expressed it earlier. We are trying to probe to see what is the minimum rate of growth we can achieve. And I think, in that sense, you do have, indeed, ranges of choices of the kind that are shown in A, B, C, and D. Except for D, there's not very much difference between them.

VICE CHAIRMAN VOLCKER. That would only say that you have to make up your mind.

CHAIRMAN BURNS. In the last analysis, what are we talking about? We're talking about being guided by judgment or being guided by a mechanical model. And some of us may wish to be guided by the latter. May God bless the efforts of those who proceed in either way. Let us move on.

MR. WALLICH. That's--forgive me, Mr. Chairman, but that's really not the issue. The issue is time. We take these one-year data. We always find that, for a painful increase in interest rates, we get very little gain on inflation--

CHAIRMAN BURNS. That's what the model tells us. And then if we take two years, it increases; take three years, it increases more. And that answer is given once and for all, as Mr. Partee and Mr. Volcker have indicated. We know what the model is going to tell us. If we don't, we haven't been listening.

However, look, I have no objection whatever to having the staff provide any member of the Committee who wishes it. Each month. Why not? You want it, you are entitled to it. In fact, let's make it mechanical--if you want to, send it to everyone. Some will memorize what is on the chart, others will not even look at the chart.

MR. KICHLINE. Mr. Chairman, we can put that--

CHAIRMAN BURNS. It's a free society, and each of us thinks for himself, thank God.

MR. KICHLINE. We can put that together. I would hope it's quarterly and not monthly, though.

CHAIRMAN BURNS. No. We've talked too much about this. Let's move on to Mr. Baughman.

MR. BAUGHMAN. Mr. Chairman, a question with respect to the inventory data. You have the impression that these data attempt to take into account the continuing shift of business firms to the so-called LIFO method. Or [do] they just kind of pass that by and [are] based largely on inventory estimates at current market prices?

MR. ZEISEL. Well, the GNP inventory estimates attempt to make--

MR. BAUGHMAN. I'm sorry, I can't hear you.

MR. ZEISEL. I'm sorry. The GNP inventory estimates attempt to make an adjustment for shifts between LIFO and FIFO. They do surveys periodically to get some kind of estimate of the percentage of firms using each of the types of accounting procedures and adjust for it. Now, there is obviously a lag in that kind of calculation because they get that kind of information, at best, yearly, and it's probably not very accurate. But an effort is made to put out a figure which is a real deflated inventory total on a consistent basis.

MR. BAUGHMAN. But if the attempt is to deflate the inventory, then we could be looking at a series of inventory-sales ratios which do not adequately reflect the volume of goods and inventory in relation to the volume of sales being valued at current prices. And I am wondering whether there is a possibility that we've got more goods in inventory than either the inventory figures or the inventory-sales ratios suggest.

MR. ZEISEL. Well, it's certainly true that--

CHAIRMAN BURNS. I thought that there was a bias like that in those statistics.

MR. ZEISEL. What bias do you mean, Mr. Chairman?

CHAIRMAN BURNS. The kind of bias that Mr. Baughman is suggesting.

MR. ZEISEL. You mean as prices tend to rise, biases over a period of time exist?

CHAIRMAN BURNS. Now that the rise in price is clearly reflected in the sales figures and less so in the inventory figures.

MR. ZEISEL. That's correct. You would get that kind of thing. I think this is one of the most difficult areas to calculate, to deflate and calculate a real figure. But looking at the various kinds of inventory figures that we have available--the book-value figures are generally undeflated and without adjustments for types of accounting procedures; and the GNP numbers--the configuration certainly in a cyclical sense appears to be relatively similar. Over a longer period of time, you do get a bias introduced, and that is a problem. There is a real question about how much of a downward bias there may exist in inventory relative to sales.

MR. PARTEE. To clear this up, Jerry, they standardize inventory change in the GNP, but the book-value figures are not standardized--

MR. ZEISEL. The book-value figures are not standardized. Nor are--

MR. PARTEE. --and so the inventory-sales ratio is reflecting--in addition to a lag, say, at the time that Ernie is speaking of--changes in the mix, that is, changes as you get more and more LIFO firms and fewer and fewer FIFO firms; there would be a drift--

MR. ZEISEL. Absolutely correct.

MR. JACKSON. Would it be possible to adjust them based on a changing rate of inflation? Would that be just too complicated to be meaningful?

MR. BLACK. You do have such a series that does show that the inventory ratios are higher, I think, than you get on a conventional basis.

MR. ZEISEL. There is a deflated rate series on book value. Is that what you were talking about?

MR. BLACK. Yes.

MR. BAUGHMAN. Well, I understand that [the] Commerce [Department] does go through a process in which they attempt to neutralize the effects of the shifting proportion of firms that are on LIFO. But I guess it seems to me the meaningful inventory ratio to be looking at would be a ratio between inventories valued at market prices and sales, in view of the fact that sales are always reported at current prices.

VICE CHAIRMAN VOLCKER. My understanding of this is that there are two deflated series, and unfortunately they show different answers.

MR. ZEISEL. There is a series on book value that is deflated fairly recently, and there is the GNP deflated series.

CHAIRMAN BURNS. All this is terribly complicated. I don't know where we are going to get. The one simple thought to put to the statistical people is, in gathering their inventory figures, could they not get inventory figures for LIFO firms and then for other firms and examine these two bodies of data separately? Then you can get at these problems. In the absence of information like that, everybody is going to be guessing. And I should think that all you'd have to do would be to ask a question: Are your inventory figures on the LIFO basis or not? Or you can make that question a little more detailed.

MR. ZEISEL. Unfortunately--I don't want to [complicate] the discussion--but apparently firms switch back and forth, though they are not supposed to. At the end of the year they use one process, and then during the year they use another process. It's apparently a terribly, terribly messy business and tends to give you within-year swings in inventory. But certainly what you suggested is the approach, and Commerce is attacking it that way--inadequately, I might say--and we're trying to keep up with it.

MR. LILLY. Might I interrupt? There is a great problem connected with going on LIFO. Once you have gone on LIFO, you can't return periodically. And furthermore, you can't even indicate what the difference between LIFO and FIFO is in your annual statement.

CHAIRMAN BURNS. Of course, there may be a distinction between accounts kept for tax purposes, which is the point that you're referring to.

MR. LILLY. For reporting purposes.

CHAIRMAN BURNS. For reporting to stockholders, you cannot. What about your own internal--

MR. LILLY. You can only footnote it in your annual statement.

MR. PARTEE. What I think Jerry was saying [unintelligible] quarterly report from the annual report.

MR. LILLY. You cannot do it on your quarterly report, and on your annual report you can always footnote it in the appendixes, and this is an Internal Revenue [Service] ruling that came in the night.

MR. ZEISEL. Apparently there is some institutional problem in the sense that the people who report to the Census Bureau on book-value inventories give slightly different figures.

MR. LILLY. To the Census Bureau it's an entirely different matter, but to the public stockholders, I have gone through this point personally.

MR. BAUGHMAN. Just by way of comment, I thought it was interesting that in the Redbook this time there was reported quite a variety of views of businessmen--how businessmen view the inventory situation. And in that connection I would like to mention that the retailers represented on our board of directors--this was not in our contribution to the Redbook--have a very bearish view, I would say, of the inventory-sales situation in general-merchandise retail.

CHAIRMAN BURNS. Meaning by that there were--

MR. BAUGHMAN. Meaning that inventories currently are relatively high compared to sales. They are not optimistic on sales, and they observe a continuing high flow of new orders. And those who are in the manufacturing business, as well as retailing business, reported that they see this continued high flow of new orders to the manufacturing part of their business, whereas in the retailing part of their business, they feel that they are getting--

CHAIRMAN BURNS. I'm lost. New orders refer to what?

MR. BAUGHMAN. The placement of orders to the manufacturer.

CHAIRMAN BURNS. For what?

MR. BAUGHMAN. For--

CHAIRMAN BURNS. Retail goods of a kind sold by retailers?

MR. BAUGHMAN. Yes.

CHAIRMAN BURNS. Well, if they think that their inventories are top-heavy, why are they ordering at a high rate?

MR. BAUGHMAN. Well, this is their concern. What they are seeing is the orders from the industry flowing to the manufacturing part of their respective businesses and they report that they are in a situation again where the managements of the retail establishments are finding it difficult to hold down the placement of orders from their buyers. And they are concerned that the buyers are setting the stage for a significant inventory problem later in the year.

CHAIRMAN BURNS. Well, I think if that's their problem, they better tighten up their management techniques. I don't follow it.

MR. BAUGHMAN. That's all, Mr. Chairman.

MR. WINN. Could I piggyback on this for just a minute? I wonder if we are not seeing a structural change in the ratio as a result of many of these firms having been burned on the inventory problems. And while we've talked about this for a long time, [a] number of companies have really increased their computer control of their activities, and some of the major retailers [are] among them in this category. [Perhaps we are] seeing really drastic changes in what they consider normal inventory-sales relationships, and following the historical series may be misleading in terms of what they regard as the adequacy or inadequacy.

MR. PARTEE. You think that's really biting? I've been saying that for 20 years.

MR. WINN. So have I. But when you look at what some of these major stores have done, you really get impressed. They are seeing rather dramatic changes--

MR. PARTEE. In the last two or three or four years?

MR. WINN. Yes, well, even the last two years--

CHAIRMAN BURNS. As I have read the statistics over the past year and a half, I think that we have had more prompt adjustments of inventories than previously. I think that's in process at the present time. And I think it's a very healthy thing.

MR. LILLY. The main item in the GAF [general merchandise, apparel, and furniture] area is a thing that's happening--decreasing the number of items available.

MR. COLDWELL. We've been talking about better control for some time, but we still had a pretty good inventory cycle last year.

MR. PARTEE. We sure did.

CHAIRMAN BURNS. Well, we had a very minor inventory cycle. I think we're having one now. These minor inventory cycles prevent the major ones. Or that, I think, is at least a powerful tendency. Mr. Kimbrel, may we hear from you now?

MR. KIMBREL. Mr. Chairman, just a bit curious--in your basic assumptions, what are you incorporating about the minimum wage changes, and do these have any significant implications for your projections?

MR. ZEISEL. Yes, we've introduced the minimum wage change which apparently has been agreed to by the Administration, that is $2.65 as of January 1, 1978. And that will be indexed to straight-time earnings in manufacturing, and that affects our compensation figures in earlier 1978 to the tune of--I don't remember--it's a couple of tenths.

CHAIRMAN BURNS. Somehow, the more we compute, the less we get. And what happens in the economy--we find it makes no difference.

MR. ZEISEL. Well, I may be wrong on that--

CHAIRMAN BURNS. But look, when you raise the minimum wage, what you are doing is applying a lever to the entire wage structure. And every trade [union] leader knows that. And that's why he wants it. Now did you take that into account in your calculations?

MR. ZEISEL. Yes--

MR. KICHLINE. We have the compensation--

CHAIRMAN BURNS. Lifting the entire wage structure as a result of the lifting of the minimum wage?

MR. KICHLINE. We have not explicitly sorted that out in our discussions internally. That was one of the factors that influenced us in showing a drifting up of compensation throughout 1978.

CHAIRMAN BURNS. Well, I was getting at the numerical figure. The more I see the numbers, the less I want to see them.

MR. ZEISEL. Let me correct my figure-- we've jacked up the first quarter of 1978 by 7/10 percentage point as a result of the minimum wage. It isn't quite as bad as I said; 3/4 percent effect of the minimum wage in the first quarter of '78.

CHAIRMAN BURNS. Now we are getting something. My confidence in numbers is rising. Let's move on to Mr. Jackson, please.

MR. JACKSON. I was just interested in the comparative mix proposed in automobile sales, which has been a major source of strength in the economy. And over the next quarter, or [few] quarters, it looks like you are staying pretty much constant about the total. But the mix between foreign and domestic looks like it changes. And I am wondering [whether] you had anticipated the type of exchange rate actions that we have had this week, and [if so], we should perhaps listen to you more often than we do to some of our foreign traders, because you knew more about [that] more fundamental situation that influences that.

My only reaction is that I have had some question about the rate of auto sales that you proposed. Because if you're proposing a 6 percent rate increase in prices here, together with the consequences for foreign sales that are likely to occur as a result of a change in exchange rates, together with the continued high levels of consumer debt despite your low ratios to disposable income--the chances of a lower total auto sales picture seems to me to be substantial. In addition to that, we see a strength in the single-family house sales, and I wonder if we looked very carefully at the rate of sales that have taken place for new houses in the last three months, because it has been down, down, down. Not major, but distinct--

CHAIRMAN BURNS. But just the other way for existing houses.

MR. JACKSON. But, on the point of view of the GNP figures, [unintelligible].

CHAIRMAN BURNS. Yes, but let the existing house sales increase, and the others will catch up a month, or two, or three later.

MR. JACKSON. Maybe yes, maybe no; time will tell. The disparity in prices makes you begin to wonder when you see the price differential now $10,000 on median prices. It will begin to have its impacts, I think.

CHAIRMAN BURNS. What is the differential? I'm sorry, I missed the point.

MR. JACKSON. The differential in price between existing and new houses. Wider and wider.

MR. PARTEE. About $10,000 you say?

MR. JACKSON. My recollection is that it is over $10,000. I have forgotten the figure.

MR. WALLICH. It used to be about 3.

MR. JACKSON. The median price for new housing is so substantially higher than the median price in existing houses.

CHAIRMAN BURNS. Yes, but the two are not comparable. You are talking about different kinds of housing. If you took existing houses of the same quality, I don't think you would get any such differential.

MR. JACKSON. I am suggesting that the capacity of the consumer to continue to pay for the new house is being diminished. And the capacity of the consumer to be willing to pay for the additional price of the new houses is being diminished. And in that way, sales of existing homes may not translate into sales of new ones.

CHAIRMAN BURNS. As far as consumer purchasing power goes, what difference does it make whether he buys a new house or an existing house?

MR. PARTEE. The difference in price.

CHAIRMAN BURNS. Or buying a different kind of house.

MR. PARTEE. So you trade down by buying a used house instead of a new one. That's your point, isn't it?

MR. JACKSON. What I'm really saying is, I think it's entirely possible that, while the psychology will probably offset the increased interest rates that you project, particularly the psychology of inflation in house prices--the consumer will not be as sensitive to increases in interest rates--I believe that the capacity to pay, despite the ratios of debt and so forth, are beginning to influence that, and it looks like the actual sales experience will be sensitive. I wouldn't be surprised if we [saw] an earlier tightening, if not a slight downturn, in new houses under construction--or total value.

MR. KICHLINE. Well, we don't have a very bullish housing market.

MR. JACKSON. I know you don't have a bullish housing market, but I--

MR. KICHLINE. Close to 2 million--

MR. JACKSON. --I'm wondering whether even the slight increase you show might be in more doubt.

MR. KICHLINE. We are not disturbed yet by those indicators, but they run in the direction that you pointed. And [with] the sales of new houses being down, along with the stock of unsold houses or completed new homes rising quite sharply in the last few months, it looks like there is something happening that's quite different than what prevailed over the last year or so.

On the auto market, I think only two key comments that relate to your question. One is, we do assume increasing price competitiveness of domestic models relative to foreign models. One [factor] is the exchange rate impacts in price increases that have gone into our thinking; in addition, we understand that the sales of foreign models have been sustained recently by a profit squeeze on foreign car dealers--that they have been trying to keep down the price effects that they have been absorbing--and over time, domestic models become more competitive. Secondly, we, as you know, assume that the continued strong demand for autos overall can be related to the fact that replacement demand during 1974-75 was very low. The average age of the auto stock is higher than we think is the equilibrium, so this replacement demand that was postponed during the earlier downturn will help sustain auto sales. And those are the two key features.

CHAIRMAN BURNS. All right, Mr. Eastburn now, please.

MR. EASTBURN. Mr. Chairman, my own view of the economic outlook would support the staff view that, if anything, the factors have become less strong than they had been before. This is partly a function of the situation in our own area, which, as the Redbook has indicated, is probably less ebullient than it is elsewhere. It is also partly a function of the fact that, in our staff estimates, we have made fewer judgmental adjustments to the model as the results come off the computer.

Which leads me to a question. Last time, I asked the extent to which you were making judgmental changes and how the judgment compared with the model. My understanding is that generally the experience is that forecasts that are judgmental, well, that judgmental changes of computer printouts are better than a straight model result. Is this the case for the projections that we have had here in the Greenbook over the years? Have you tested the model results compared with the judgmental adjustments to the model?

MR. KICHLINE. I don't know the answer to that question. Jerry, perhaps you are aware of something we have done. I think it's a good question. It certainly hasn't been done recently, and we can do that and provide you with the information without any difficulty. But I just can't answer it at this point.

MR. AXILROD. President Eastburn, on the face of it, unless you ignore the money demand, it depends on how you ask your question. The money demand function in the model cumulatively has been off $40 billion, so it's going to, I am sure, give very different GNP results for the Committee's money supply than our judgment. But of course that could be tested. The other way to run the model is to ignore the money demand function and just put in the interest rates. And so it really depends in part how you ask your question as to what kind of answer you are going to get from this exercise.

MR. EASTBURN. Well, the main thrust of my question has to do with comparing our results as against the Greenbook results, because we have made fewer judgmental adjustments than I presume you have. As a result, our projections are less optimistic.

MR. KICHLINE. That's right. That's what the model is currently showing--

CHAIRMAN BURNS. Well, what is the answer to your own question in terms of the operation of your shop? How good are the model projections, how good have they been?

MR. EASTBURN. Well, I think they've had the same kinds of errors that models have, and we have not--

CHAIRMAN BURNS. Well, have you gotten good predictions from your model, taking it as itself--

MR. EASTBURN. It's essentially the [Federal Reserve] System, not a [Federal Reserve] Board--

MR. PARTEE. You haven't got good projections if it's a Board model.

MR. EASTBURN. No.

MR. PARTEE. Because it has been off for years.

MR. EASTBURN. Well, this might answer the question, then--

MR. PARTEE. Not quite.

MR. EASTBURN. --under the circumstances, since we all are using essentially the same model.

MR. ZEISEL. We'll try to run some very specific comparison, although it is rather difficult since you do have to introduce various assumptions. But we will see what we can come up with. Generally, what we do is evaluate individual sectors rather than the model as a whole, because they involve assumptions--an individual sector--which differ between the judgmental approach and the econometric. But we will do what we can to provide an answer.

CHAIRMAN BURNS. All right. Mr. Winn, please.

MR. WINN. My question has been answered.

CHAIRMAN BURNS. I didn't know that any questions were answered today. Mr. Black, please.

MR. BLACK. Mr. Chairman, I held up my hand back when Mr. Baughman raised his question. I was just going to point out the availability of this constant-dollar inventory-sales ratio figure, so I have nothing more to add.

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

MR. COLDWELL. Jim, on the projection of net exports of goods and services, you're showing a shift from a negative 6 [to a] positive 2.1 between the first and fourth quarter, and then back to a negative 6 in the third quarter of '78. Would you give me a little of your rationale for getting there?

MR. KICHLINE. I'd like to pass that question to Ted Truman, who is more familiar with this portion of the projection than I am.

MR. TRUMAN. Well, basically, as is often the case in the international area, that is an oil-related phenomenon.

CHAIRMAN BURNS. That is what?

MR. TRUMAN. An oil-related phenomenon. You had a big buildup in oil imports in the first quarter. A combination between that buildup, which was weather related, and Alaskan oil coming in, which damps down our rate of growth in imports--in fact, reduces it. It's largely what gives you that swing between the first and fourth quarter.

MR. COLDWELL. What brings you back up then?

MR. TRUMAN. What brings you back is the end of a sort of honeymoon with Alaskan oil, where the marginal supply, as the economy grows, starts coming from imports again. Plus, the [oil] stockpile program. The government stockpile program will add $3 billion to oil imports currently estimated for 1978.

MR. COLDWELL. So you are saying that the entire swing in net exports is an oil-related phenomenon.

MR. TRUMAN. Yes, most of it. Most of it is a swing in the irregularity of it, if I can put it that way. Yes.

CHAIRMAN BURNS. Any other questions or comment. I find myself in a listless mood today. I have not helped this discussion any. I have no clear impression of what we have done or what we have accomplished, if anything, in this morning's discussion. The staff has presented a pretty optimistic picture of the state of the economy and where we seem to be going in the months immediately ahead, and I think the basic question that we ought to be clear about is whether we as a Committee subscribe to that economic projection or do not.

Now, is there a significant departure from that line of thinking by anyone? If so, we ought to hear from members of the Committee. On the other hand, we ought to have an endorsement of the staff's basic view, if that is the thinking. I'm concerned not only about the latter part of our discussion but also what our Secretary is going to report, you see, concerning the thinking of the Committee. On the basis of what I have heard so far, our staff would be in great difficulty. So members of the Committee ought to express themselves on the general economic outlook. Mr. Volcker.

VICE CHAIRMAN VOLCKER. I was about to make an observation on this point. As a preliminary, I continue to find, in the contacts I have with the business community, that there seems to be quite a discrepancy between their mood and what the figures seem to show. We are coming off of a very rapid growth period, but a very distinct mood of caution seems to be prevailing in most of the business community, as nearly as I can see. I think it does bear partly upon the inventory situation, which has been touched upon. You commented that we might be in the beginning stages of a mini inventory adjustment.

CHAIRMAN BURNS. I think we have been for about 2 to 2-1/2 months.

VICE CHAIRMAN VOLCKER. Two months. I don't know. The last figure went up quite rapidly in inventories. That was--

CHAIRMAN BURNS. Yes, but look at the adjustment that has taken place in prices, and it has been taking place in production and employment [in] nondurable goods. You had a run-up in inventories. Retail trade leveled off at a very high level, so the trend is still very strongly upward. The prompt adjustment on the part of the business community [was] reflected partly in prices, reflected partly in production and employment in the nondurable goods sector.

VICE CHAIRMAN VOLCKER. I agree. The last inventory figure we have still shows a rapid increase, but I would expect some decline--

CHAIRMAN BURNS. What was this--

VICE CHAIRMAN VOLCKER. They're responding to that increase, that's right, that's right.

CHAIRMAN BURNS. You had the response, I think, or you are having a response in the sphere of production and employment.

VICE CHAIRMAN VOLCKER. And in that connection, the staff did moderate their projection, I think, with an offset on monetary stimulus or less restraint, however one wants to word it. I think that's in the right direction. I don't think their figures reflect this kind of prospective inventory development that perhaps you have been suggesting and [that] I think is possible.

So, therefore, I just want to record, I would think the odds are--while they have a reasonable-looking projection--there is more chance of falling short of that than exceeding it in the near-term future, and I wouldn't be surprised to see a slower rate of growth in the latter part of this year. I'm not sure that's unhealthy, so long as it doesn't go too far. But I find myself psychologically prepared, anyway, for a somewhat slower rate of growth than what the staff has projected. A more minor fact, following on Governor Jackson--I'm not sure I see quite as much momentum in the residential construction area as they have continuing through the first quarter of '78.

CHAIRMAN BURNS. All right, thank you, Mr. Volcker. Mr. Wallich now, please.

MR. WALLICH. Well, I would like to note first that I believe our staff forecast is relatively high compared to forecasts made by other professional forecasters. Is that right?

MR. KICHLINE. In general, that's right. We are on the high side of the outside forecasts we have looked at.

MR. WALLICH. At the same time, as I look at the details, I'm puzzled why the forecasts are all so relatively low, tapering off toward mid '78. Here we go into a late period of expansion with a very high budget deficit; there's a lot of capital investment to be made up; we're approaching capacity ceilings; and so it puzzles me why the economy shouldn't be accelerating dangerously. However, there seems to be a general consensus of forecasters that the trend is the other way, and I have no particular quarrel with that.

If that is the trend, I think it's the right direction to go. And perhaps what the Committee might want to do is ask itself how--not in just the next half-year or even year, but two years--how we want to accomplish the phasing-in to a full-employment growth path. I don't think we are all that far away from it--as it would seem, from the 7 percent unemployment figure, we think that full employment is somewhere between 5.5 and 6 percent. We might be able to get to something like that in a year and a half or two years, and at that time we ought to be moving at something like 3-1/2 percent if we don't want to hit into the capacity ceiling. Well, that means a gradual phasing down, and in that sense the trend that is projected here of getting to 4.5 percent in late '78 is, I think, a reasonable one. That is the gradual slowdown that we have to have if we want to have a soft landing.

CHAIRMAN BURNS. All right, thank you, Mr. Wallich. Mr. Coldwell next, please.

MR. COLDWELL. Mr. Chairman, I find myself differing in pattern and perhaps in some of the details of the forecast. I have a feeling the second quarter is going to show a higher figure than the staff is showing. I hope the third and fourth quarters show lower figures, because I think we get a more sustainable pattern if you slow this thing down in the latter part of the year. And I think we will slow it down partly by what you have been saying, and I've been saying, for some time. We will have an inventory correction here in the summer and early fall of the year. If so, the third quarter could be considerably less than what is shown in the real rate of growth. I think it doesn't worry me at all. In fact, I would applaud it because we get a more sustainable pattern if we get a slower rate in the fall of this year.

I am also concerned about that net export pattern you are showing. I just don't quite believe it, that's all. I think we are going to show higher deficits, and I'm concerned about the rate at which we are contributing in this deficit package. And while I hear what you are saying in terms of the oil change, I have also done some looking about the relative change in our export-import patterns from a year ago, and oil is not the sole change by any means. In fact, it's only about a third to a half--a little less than that for the total change in the export-import pattern. So if we are going to continue to support a good share of the world with our net import position, this has got some important implications to me in the rate of growth which we aim for in this country.

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

MR. PARTEE. Well, as I look at the projection of quite regular increases in real GNP, I guess I have something of the same feeling that Governor Coldwell does, that the patterns may differ considerably from what's been projected. And I'm reminded, as I often am, of Governor Shepardson's complaint that the lines on the right-hand side of the chart when showing projections are very steady, and on the left-hand side of the chart they are very jiggly. And I think there is some truth to that, that this pattern is undoubtedly not going to materialize over the next six quarters.

But when you look at the average, which is a 5.4 [percent rate of growth] on real GNP over the next year, and a I guess a little less if you put in the last two quarters of '78, I don't find myself able to come up with a figure that I think is a lot more responsible than that. I think the staff correctly has pointed to state and local spending as a source of growing strength in the economy. That has been almost totally neglected by the private forecasters, and I think that is something that will have a real impact in this period to come. I am rather in agreement with Governor Jackson that car sales probably won't hold up. But on the other hand, the staff already has a saving rate rising to around 6 percent, and it seems to me that's a reasonable kind of projection. So all that lower car sales would mean in that context perhaps is less car sales and more soft goods sales, restoring some balance, as often has happened, to the market that is greatly affected when people go out and buy hard goods. And I also think that the outlook for plant and equipment spending is probably one of sustained strength, though how high the figure will go is very difficult to say.

There are some sources of real concern to me in the outlook. I'm concerned about insufficient capacity as we move ahead because I don't believe that a 6-1/4 percent unemployment rate is a satisfactory target. And I think we need to get more capacity on stream, [but] I'm afraid that it's just not going to get there in time. I'm also very bothered by the international picture. I can't quite put my finger on how it's going to affect the U.S., but I feel that the economies around the world are tending to slip, rather than improve. And I think that's going to have some effect on the United States before we are done. The exact path that it will take, I can't be certain of. The traditional path would be that we would import more and export less and thus have a worse balance of trade. In addition, there could be a path that runs through financial relationships that would result from poor business activity abroad. And I'm not sure about that.

So I think there are problems in the outlook farther ahead. But for the moment I'm not concerned about the leveling off of retail sales, about the tendencies, perhaps, to a pause that we are going to have in the economy. I think the basic thrust is still upward, and it's reasonably well based. So I guess that's a long story to say that I guess, on average, I would support the staff's projection.

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

MR. MAYO. Chuck has said what I have in mind very well. I think we are still in a strong recovery, even though it is slowing and we see these various evidences and various problems for which we have no solutions at the moment.

I would merely add one other observation on the capital spending thing from one of our principal capital goods [firms]. This is a [firm] that has decided to expand, but they can't get the people who actually let the contracts to go ahead and do it because not only do they feel restricted by government regulations, environmental and others, but they are also afraid to spend the money that the top management is now authorizing them to spend because they are afraid that the measurement of their success and their productivity will be adversely affected. They have lost a lot of their willingness to take risk in the present environment. It's nothing new, but it's got a cumulative, pervasive effect that could be worrisome.

CHAIRMAN BURNS. Thanks, Mr. Mayo. Yes, Mr. Roos.

MR. ROOS. Mr. Chairman, I find myself puzzled somewhat by our process. Having participated in these meetings for about a year and a half, I have been unable to really define, or have defined for me, the objectives in terms of how we actually quantify what we think to be a satisfactory rate of growth in output. At each of these meetings, to the extent of my recollection, there has always been a great sense of uncertainty even when the recovery was proceeding at a faster level than maybe it is or will be in the immediate future. There [were] expressions of concern, or there were at that time, that the recovery was proceeding too quickly. Then I hear expressions of concern that it's not going to continue at the pace that it was during the earlier phases of the recovery.

And what frustrates me, and I may have totally misunderstood, is that we are trying to carry out our responsibilities of setting monetary policy without having any agreed-upon specific targets that we are trying to achieve in terms of the growth targets. I mean, would we be happy if we saw a rate of growth of output persist forever and a day at 6 percent even if it meant increased inflation? It seems to me we are trying to steer the ship--and I say this not in a critical matter, but I am confused by it--without actually having agreed what we think the rate of growth of output should be. Or at least what we are seeking in that regard as an acceptable rate of increase in prices and these other fundamental factors. I think we peck away at it, we express uncertainties each month, but do we have some real guidepost that we're shooting toward? Or am I terribly off base in not understanding exactly where we are going?

CHAIRMAN BURNS. Well, I can't say you are off base. But I should say that I think of the world rather differently. Now I have been at this for a good many years, and I have found that I can make pretty fair judgments about the direction of the economy and even recognize turns. But as far as magnitudes are concerned, I don't know how to do it. And I have yet to be convinced that anybody in the economics profession knows how to do it. A lot of people are doing it. Generating numbers. But to do it reliably . . .

I think one of our problems is we meet too often. Now it's nice to meet socially, but we meet and then we start worrying. We're like a bunch of hypochondriacs. That's our society now, the world we live in. We follow these little wrinkles in the economic curves. We worry, we get excited, we interpret, and we overinterpret, and we don't learn from our own mistakes.

Now what I find most constructive is that, first, the private-enterprise economy has put out a remarkable performance here in the past two years or a little longer. Since March of 1975 we have added 6-1/2 million jobs in our economy. These jobs have not been created by government; they have been created by private enterprise. It's an extraordinary performance in terms of the past. Or, viewed currently, since October we've generated something like three million jobs. The trend has been superlatively good.

We are in the midst of a social revolution in our country, with women and, to a lesser degree, teenagers finding their way into the labor force. The inflation that we have been having is intensifying the changing role of women in our society, and therefore the unemployment rate remains high. Private enterprise is adapting. And part-time jobs of various kinds are being generated by our business firms but not at a rate that as yet matches at all satisfactorily the rate at which women and teenagers have been entering the work force.

Now businessmen have plenty to complain about. They are paid to complain, they are highly paid men. But watch their actions. Look at this chart--you see, the business capital expenditure which has been lagging is taking hold. Look at what is happening to commercial and industrial construction this year. It's moved to a higher level. The formation of new business is not shown on this chart. A strong upward trend. You know, if we put the little wrinkles aside and look at the major trend, I feel good about the economy.

Where are the imbalances? There is, yes, in the housing field, too much speculation in residential properties. An imbalance in inventory, very small, in process of correction. The one thing to watch is, the cost of business enterprise has been rising of late faster than prices and profit margins are in the process of narrowing. Now, that can go on for a couple of years before you get a turn in the economy. We only have the beginning of that, so I think we have an expansion going. And how fast the economy will expand, I don't know, our staff doesn't know, no one knows, but we are doing pretty well. I'm quite optimistic about the future.

But I share Chuck Partee's concern about Europe and Japan. There are trends abroad in the economy and politically that I find very troublesome; and what to do about it, and what we can do, if anything--it's almost a hopeless situation. And what about our own economy? We are doing quite well. Now, I am not satisfied with what the Congress is doing--the recent trend with regard to the minimum wage.

There is a protectionist wave in our country. Now, let's not fool ourselves. We talk a lot about free trade. You know, there's a quota system--voluntary, we call it--for shoes and now TV sets. Incidentally, Mr. Truman, I would like to have a full report on the trade restrictions that we put into effect in the last five years, which are still in effect. I think the list is disturbingly large.

The government announced an anti-inflation policy. What's happening to it. Where is it? Where is it going? The only agency in government, I believe, that has been doing anything about inflation is the Federal Reserve. And in my judgment, we haven't done enough, though I must say, in the environment that we live in, perhaps we have done as much as we reasonably could, but that's certainly a debatable point. Well, that is my little speech for the day. Who else would like to speak now?

MR. MORRIS. Mr. Chairman, my speech is brief. I don't see any basis for challenging the staff forecast at this point in time. I feel as Paul Volcker does that if there are errors in the forecast for the next few quarters, the reality is more likely to come out on the low side than the high side. And I think that our ability to forecast in this inflationary environment is less than it was before. It seems to me that the implication of that is that this summer we've got to keep very close watch on the numbers and be willing to revise, I think, and to adjust.

For this reason, I disagree with you that we meet too often. I think there are meetings, such as today's, when the caliber of the conversation suggests that we really don't have an awful lot to talk about. But the problem is, we don't know when those months are going to be, Mr. Chairman.

CHAIRMAN BURNS. What I really meant about that is--look, I certainly didn't mean to suggest that we change our practice, and I spoke cryptically. I meant the economy doesn't change that much over the period of a month. I think it is more a matter of the character of our discussion than the frequency of our meetings. I think we pay too much attention to the last little wrinkle in economic curves, which contain a fair margin of error. And one is tempted into that kind of discourse through frequent meetings unless--you see, I think I ought to do my job better and raise certain general questions for discussion so that we get at underlying trends a little more thoroughly, and spend less time in interpreting the latest wiggle of our curves, and working ourselves into either a state of euphoria or a state of depression. No, we ought not to meet less frequently.

MR. MAYO. We have the same problem as the market does in interpreting us--what's a wiggle and what is a trend?

CHAIRMAN BURNS. Mr. Lilly, please.

MR. LILLY. Well, I can't disagree with the staff. I think they're somewhat on the bullish side, but you ask if there are any significant differences. I don't have any significant differences. I do have something that I want to underscore that you mentioned a couple of times--the fact that we may be working very hard here to create the conditions that will lead to increased employment. But whatever we do here can be more than offset by the passage of the minimum wage law with the indexing feature, which is in it for the first time. I think that, in terms of the minority groups in this country and the teenagers, this could be one of the most catastrophic things that could happen.

CHAIRMAN BURNS. That's the 50 percent. What is it, 50 percent of half--

MR. ZEISEL. Starts there, but it gradually moves up.

CHAIRMAN BURNS. Does it, beyond 50? What it is now, around 46 or 47?

MR. ZEISEL. Close to the increase, slightly under 50.

MR. KICHLINE. It moves up to 53 percent by 1980, 1 percentage point a year.

CHAIRMAN BURNS. Oh boy. Well, with the minimum wage, if you leave it alone in an inflationary environment, its bite, you see, will be progressively reduced. But under this kind of legislation, there will be no let-up. There will be cumulative force asserted on the wage structure.

MR. LILLY. It's certainly counterproductive to correct the situation--

CHAIRMAN BURNS. You know, I remember very vividly, one day I got off the plane in New York and--oh, this was some 20 years ago. [David] Dubinsky, who was then head of the [International] Ladies' Garment Workers' [Union]:

"Arthur, can I give you a ride?"

"Oh sure, into the city." So I stepped into Dubinsky's Cadillac, and we had a nice conversation.

And he said, “You know, you’re a professor, you don’t really understand the minimum wage.”

I said, “Well, I probably don’t, you know. I’d like to listen to you.”

He said, “You might think that we’re just interested in the low-income workers.” He said, “Yes, we’re socially minded. Fundamentally, we’re practical people, we’re concerned about ourselves, our own employees. Raise the middle and the whole wage structure gets lifted.”

I’ve heard that from dozens of them since then. That’s what they are after. And, you know, all this is explained to the public in moralistic terms.

MR. WALLICH. And there are more things heard than that, Mr. Chairman. It’s really a defense of the mature and more highly experienced worker against competition from the young, who might otherwise undermine his pay and his job, and also a defense of the stronger Northern unions against the South.

MR. MAYO. It’s akin to the bar examinations.

CHAIRMAN BURNS. See, we defend them against competition from the young, we defend them against competition from abroad.

MR. WALLICH. The South, mostly, in our country.

CHAIRMAN BURNS. Well, gentlemen, I think we’ll take our coffee break now, and then when we get back, we’ll start on long-term targets.

[Coffee break]

CHAIRMAN BURNS. We will return to our deliberations. We want to turn now to the discussion of the longer-term ranges for our monetary aggregates. I will have to testify on that subject next week. The date was originally set for July 26, but there’s been a change, and the testimony will be given on July 29. On July 26, the Committee [on Banking, Finance, and Urban Affairs] will hear testimony from us on the Federal Reserve Reform Act introduced by [committee] chairman [Henry] Reuss.

Now let me make a few remarks by way of introduction. The formal exercise of looking one year ahead was started in March 1975. We’ve met every three months to discuss our longer-range targets. We’ve enunciated a policy and repeated it on every occasion, namely, that we will gradually move our longer-range targets down so that, several years from now, the monetary basis for general price stability may be restored. We’ve been proceeding slowly, perhaps too slowly, but that is a debatable point. If we proceed no faster than we have been going, [unintelligible] in the future, it would take us perhaps 10 years to return the [growth rate of the] monetary aggregates to a [pace] that is reasonably consistent with general price stability.

Now, the performance under these targets has not matched the targets at all closely. While the targets have moved down, [but] in the case of M1, the actual growth rate, if we take the moving 12-month period, has gone up. In the initial 12-month period running from March 1975 to March 1976, the growth was 4.9 percent. For the 12-month period just ended, that is, between the second quarter of 1976 and the second quarter of 1977, the rate of growth was 6 percent. A somewhat similar development has occurred in the case of M2. A gradual increase over successive moving 12-month intervals. In the case of M3, on the other hand, we've had virtual stability; no trend has developed. In the case of M4, the trend once again has been upward. Likewise in the case of M5. M4, you may recall, is simply M2 plus the large-denomination CDs, and M5 is simply M3 plus the CDs. In the case of M6 and M7, which are still broader monetary aggregates, there has been virtual stability.

So the record is somewhat uneven, and if you attach primary significance to M1 and M2, which has been the Committee's practice, we have gradually permitted the growth rates to rise even though our monetary targets have been successively, very gradually, unevenly lowered. Now that's the record to date.

And our question is, what to do today, and my recommendation to the Committee is that we make another very small move toward lowering our monetary growth ranges. I think we need to do that to maintain credibility in the Committee's intention to help restore general price stability in our country, proceeding very gradually, but still having definite goals. Now, in addition to that basic reason, we've had a significant overshoot in the second quarter, and we should take that into account, and that would argue for some reduction in the targets for M1. The inflation rate has been intensifying, and income velocity has been very rapid of late. And I don't think we ought to be deterred from making a modest move by the hesitation that we find in retail trade--actually, even that is uncertain now because, for the last four weeks, if the preliminary figures are right, there's been a significant increase in retail trade once again. That's a very preliminary figure.

I would make the move very modest and simply lower the lower limit of M1 from 4-1/2 to 4 percent. Leave the upper limit where it is so that we have ample elbow room to move toward even a higher rate of growth than we've recently experienced if, in the judgment of the Committee, such a higher rate of growth is desirable. I think that M2 is moving naturally, of itself, in the right direction, and I would do nothing about that. We've made larger reductions in our target figures for M2 than for M1 in the past. An argument could be advanced for lowering the target for M3. But since that has hardly any operational significance, I would be inclined to leave that alone and do nothing about that.

And my recommendation or suggestion to the Committee is very simple: to lower the lower limit of the M1 growth range by 1/2 percentage point. It's a very modest move. We'll be criticized, of course, but that is our fate, and we have to do our duty. No matter what we do, we're going to be criticized.

Who would like to speak first? Mr. Coldwell, then Mr. Wallich, Mr. Black, Mr. Jackson, Mr. Mayo, Mr. Balles, Mr. Eastburn, Mr. Kimbrel, Mr. Roos, Mr. Partee, Mr. Volcker, Mr. Guffey.

VICE CHAIRMAN VOLCKER. You have to move fast to get in.

CHAIRMAN BURNS. Mr. Winn. I don't see anyone else.

MR. GARDNER. To speak first--how can I--you have 14 names.

CHAIRMAN BURNS. Oh no. You can speak at any time. Just nudge me hard.

MR. GARDNER. All right.

CHAIRMAN BURNS. Mr. Coldwell, please.

MR. COLDWELL. Mr. Chairman, I'm prepared to move more strongly than you're suggesting. I would like to see us set the M1 target at 4 to 6 percent, knocking a 1/2 percent off both sides. And the M2 target, from 6 to 9 percent. I do this because I think the recovery has moved along well enough. I'm not terribly satisfied with some of the longer-term problems of unemployment, but I'm convinced that some of those are out from under our purview.

I think there's some slowing desirable to sustain this recovery, and I think a level of 6 or 6-1/2 percent rate of real growth is sustainable. We have a very large liquidity level. We have some very heavy purchases in imports as well as domestic consumption. I'm particularly concerned about the dollar's weakness and the large deficit growth. We could let the rate float down and get some help, perhaps, in getting our exports more competitive. It might reduce our import demand. But I think it's time we moved ahead a little bit on tightening monetary policy to reduce the rate of growth in the aggregates and to tighten down to reduce this pressure of higher prices. So I'm ready to take a larger step than you are in the targets--a little bit.

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

MR. WALLICH. I would agree with the proposal, Mr. Chairman, that you've made, with some provisos. First, I would not want to get back on the track [that] alternative D implies, and that would be a much larger move than you've suggested. But as a matter of principle, I think we are maneuvering here somewhat. We're not hitting our targets, and we're using base drift to avoid being confronted with situations where interest rates would rise very sharply. I don't think this is the kind of expansion that can stand sharp increases in interest rates, and so I would like to see us take this action with the understanding that if we overshoot, well then, we'll take another look. We do not absolutely hold to this target.

I think we should bear in mind that what we're trying to do is influence expectations where we've gotten investment in those. People have seen us bring down the aggregates. I think that's very valuable. We should continue it. I think it's wise to do it only on M1. That gives us a chance to do it again next time on M2 or M3. I think one cannot take for granted that we can steadily continue this course without [setting loose] a rise in interest rates that could be very troublesome. So at some point, one has to ask, we may be confronted with a reversal in this steady policy of bringing down the aggregates. But so long as it's possible, and I think it is possible now in the way you suggested, we can and should stick by this course.

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

MR. BLACK. Mr. Chairman, I find myself in complete agreement with your assessment on the economic situation. And I thought we were going to come out with exactly the same figure because you made precisely the same points in developing your suggestion for the long-term targets that I had intended to make. But I come out somewhat closer to Governor Coldwell than to the figures that you put out. I would go ahead [lowering] 1/2 point on each end of M1 to get 4 to 6. Rather than using the 6 to 9, however, that he favored on the M2, I would favor just knocking the 1/2 point off on the top end of M2 to give you 7 to 9, and a 1/2 point off the top end of M3. This would have the effect of lowering the midpoint of the M1 target by 1/2 percentage point and the midpoint of the other two targets by 1/4 percentage point. Now that may be politically pretty hard to do this time, but that's approximately where I believe we ought to move.

CHAIRMAN BURNS. Let's be clear about that last sentence of yours. As far as our doing something, we do what we think is right. Now, there are no political factors that make it hard to reason. To the extent that there are political factors, I think they're of another kind. We have very troublesome legislation in the Congress, and what we do and the way our testimony goes on the 29th, when these targets will be announced, may have some effect on the course of the legislation in the Congress. I think to the extent that there is a political factor here, it's really legislative--legislation involving or affecting the Federal Reserve.

MR. BLACK. And you can get what I want within either set. It's just a question of how wide it is.

CHAIRMAN BURNS. I beg your pardon?

MR. BLACK. I said, either set of ranges would encompass what I really want. It's just a question of how wide it is.

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

MR. JACKSON. I believe the real issue that will face the Committee will not be whether we will accommodate a lower rate of growth in M1 that's suggested by the 4 to 6-1/2, but whether we will move against the higher rates of growth. For that reason I would favor a 4 to 6 range for M1. Having done so, I think the consequences would likely be that a reduction in the M2 range would be appropriate, or logical at least. And for that reason I would favor the 7 to 9 for M2.

Now, I'm embarrassed to admit that I haven't done my homework to see what rates of growth would accrue to the thrift industry as a result of a specified change in the rates of growth between M2 and M3. I haven't done my homework, but my guess is that, here again, the consequences of the first decision would be a lower rate of growth in M3. Only from the point of view of candor with the public would I then anticipate that we're likely to see an 8 to 10 or 8 to 10-1/2 range on M3.

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

MR. MAYO. Mr. Chairman, I come out with a preference for the 4 to 6 prescription for M1. I feel that, again, it would not only continue our basic policy, which you have appropriately announced over time, but this is an occasion where it fits in terms of a period where the economy is growing strongly, and yet where I think we can set an example for the whole free world in terms of our monetary goals, as they are widely publicized. At the same time, I wouldn't change M2 at all. I think it's all right just where it is. This illustrates further our concern about the development of substitutes for M1 that are in the M2 category. And if you again look at our record on M2--and I wouldn't change M3 either--we've really overshot slightly the last three annual periods for both M2 and M3, even though we've been in the target range on M1.

So I would take this opportunity to get a little better realignment of Ms--1, 2, and 3--by lowering to the 4 to 6. That's my preference on M1. I wouldn't be disturbed, however, if the Committee did adopt your prescription of 4 to 6-1/2.

CHAIRMAN BURNS. Thank you, Mr. Mayo. Mr. Balles next, please.

MR. BALLES. Mr. Chairman, I would thoroughly agree with the general proposition about reducing M1, and for the reasons that you mentioned. I would also mention an additional reason. About a year ago the staff did a very perceptive job in estimating the effect of financial market innovations. As I remember, the latest figure shows something like a $17 billion shift of funds into business savings deposits, NOW accounts. The staff, about a year ago, in the face of great uncertainty, estimated about $13 billion; I think it was a darn good guess or forecast.

It seems to me, as I look back on it, that we didn't take that fully into account in our appropriate growth ranges for M1 in view of these financial market innovations. So I think we would have an especially good reason for lowering the M1 range at this time, and for the reason I just mentioned.

Therefore, where I would come out, joining the many others who have already spoken, is an M1 range of 4 to 6 percent. And I would accept your prescription of leaving M2 and M3 unchanged at this time. But with a further proviso that, on the M2 range, we should really aim to keep that growth within the range and preferably not above the midpoint, and avoid the overshoots.

CHAIRMAN BURNS. Thank you, Mr. Balles. Mr. Eastburn.

MR. EASTBURN. Thank you, Mr. Chairman. My view of the economic outlook calls for essentially no change in the intent of policy. I'd be willing, however, to modify this to continue the policy of gradually nudging down as you suggested. But I think there is the question of base drift; the staff figures, incidentally--I think in the Bluebook--were most helpful in this respect. I think this was a big, big step forward in bringing that problem to light.

Now it seems to me we have two alternatives on how to deal with base drift. One would be to adopt your suggestion, Mr. Chairman, and make a small move in M1 and then to work between now and the next quarterly decision time on how we're really going to deal with base drift as it occurs in the future. The other possibility is to begin to deal with it now. And that's the one I opt for, and that leads me to prefer a growth rate for M1 of 4 to 6 and for M2 of 6 to 9, and clearly to explain in the testimony that this is an attempt to deal with this recurring problem of how the base drifts back and forth, so that the [congressional] committee will understand and the public will understand that we're now coping with our problem.

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

MR. KIMBREL. Mr. Chairman, I, too, feel that it's an appropriate time for us to make some lowering of these targets, for the reasons already suggested. There appears to be adequate liquidity in the system, a foreign exchange consideration. The economy, as certainly we read, appears to be moving rather well. I would hope that we could have that continue for some period of time, but with a very strong look at the continuing price problem. So I would feel that we could have the M1, 4 to 6; the M2, from 7 to 9; no particular change in M3.

Having said that, though, I would certainly leave to others the extent to which there is a feeling that the current legislative environment would make it something less than prudent to move in quite that direction. But I would hope that this would be an opportunity; we could begin to make a visible move to restrain inflation, maybe [for] a good while.

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

MR. ROOS. Mr. Chairman, I would echo what has been said by the past two or three speakers. I feel strongly that the upper range of M1 should be reduced, and I would subscribe to the 4 to 6 percent range in M1; 7 to 9 in M2. I personally do not feel that it would avoid some reduction in the rate of [economic] growth, even if we expanded these aggregates ranges, because on the basis of [unintelligible] capacity constraints, we see a reduction in the rate of growth occurring anyway.

But those would be my sentiments regarding the two Ms. And if some reduction in the rate of growth were to occur, I don't think that we should ever accept the responsibility for that having occurred because of this move, if we make it. I think it would occur anyway.

CHAIRMAN BURNS. Thank you, Mr. Roos. Mr. Partee next, please.

MR. PARTEE. Well, Mr. Chairman, I didn't find the staff projection of the economy objectionable. I think the 5-1/2 percent rate of growth over the next year in real terms is about right. I wouldn't mind it drifting off a little bit as we go through the period and into the latter part of '78, and I think, indeed, that that probably is likely to occur. And in the second half of '78, the staff did have a lower rate of growth, and so I think that that's about the proper performance to seek in the economy, given the need to keep as much pressure as possible off of price inflation while achieving some further gradual reduction in the unemployment rate.

And that was based on an M1 expansion expected at 5-1/2 percent, which I guess is the midpoint of what we now have. And that, also, I presume, was based on expansion in M2 and M3 of more like the figures that we now have and some other considerations. So the fact that there was an overshoot in the second quarter, it seems to me, has already been taken account of in the staff projection. However, if you do want, Dave, to consider that there was an overshoot in the second quarter, shouldn't we also consider that there was an overshoot in the first quarter? And you know, where do you stop in putting together these undershoots and overshoots? We've been perhaps fortunate. Perhaps it's the way of the instrument that we tend to have alternating periods of overshoots and undershoots, which brings me to the position I would take.

If it so happened that we now have an undershoot in M1 in the third quarter, and perhaps for the remainder of the year, I wouldn't mind that in order to adjust for what happened in the second quarter. And therefore I can buy the Chairman's proposal that the lower end of the M1 range be dropped to 4 percent. But on the other hand, I think it's very dangerous to reduce the upper end of the range from 6-1/2 to 6 because it's conceivable that we will in fact be developing a good deal of pressure in the system in the period to come and a good deal of upward pressure on interest rates. So I think it would be a shame now for us to be postulating a range of M1 growth that we won't in fact be able to achieve.

And that's a distinct possibility, though I can't quote the odds. There are inflationary factors in the economy. We do have an energy program. The staff does have a $3.50 per barrel tax [on oil] going on next January 1. We may wring our hands about the minimum wage increase, but the chances are that there will be a minimum wage increase in the first of the year. And these are things that monetary policy can't very well do away with by running tighter. Indeed, I think that, probably, if you try to run tighter as exogenous factors are causing upward price pressures, you'll just get more upward interest rate pressure, more strain in the system, and a lower real performance in the economy in the period to come.

So I think it would be a mistake to reduce the upper end of the M1 range at this time. I also think a case can be made that M3 should be reduced; it's probably a little too high. But I dislike the idea of reducing M3 all by itself, that is, without changing M2, because that means you now are, in a way, bringing about a lower growth in the thrifts and in home mortgages. I just don't think that that's a very good thing to postulate all by itself, and I think the Chairman is right that [M3] is not operational anyhow, in any real sense of the word. So it seems to me that the cost of reducing the M3 range exceeds the benefits to be gained by the cosmetic purity of having done that. So I would accept exactly what the Chairman proposed in terms of projected growth rates, but I would be very reluctant to accept anything else.

CHAIRMAN BURNS. Thank you, Mr. Partee. Mr. Volcker next, please.

VICE CHAIRMAN VOLCKER. Well, I'd look at this problem in substance. I find myself, in effect, quite happy with what we did last time. And in some sense I'd like to see those numbers unchanged, but we've had this problem of base drift. What I'd really like to see--I know you explained to me, Mr. Chairman, that this is too difficult to explain--that we retain somehow the base of the first quarter and say that we don't see anything very different in the second quarter, except that we had an overshoot. But over a period of a year ahead, we hope to recover that.

I understand that alternative D produces that arithmetic result a year from now, but I must say I don't like that when I see it because it sounds like a more abrupt change in policy than I really have in mind. The difference must be cosmetic, since you end up in the same place, but that way of expressing it is not very happy for me. So where I come out--assuming we have to take a new base in the second quarter--is something like what the staff has for alternative C, which only varies from your suggestion for M1 and M2, Mr. Chairman, in also reducing M2 by 1/2 percent at the lower end of the range, as I understand it.

Mr. Partee has just expressed some of the concern that I would have of reducing the upper end of the ranges. I'm not sure we're going to make it, and I'm not sure we want to act vigorously enough to be sure we're going to make it in the face of what could be a slowdown in the next quarter or so. I'd like to see a little more evidence, anyway. So I'm a little between your suggestion, Mr. Chairman, and those that want to reduce the top end of the range, too.

So far as M3 is concerned, I suppose the logic is to do what the staff has said in [alternative] C, but I also find myself in some agreement there with Mr. Partee, and I don't want to make it look like we're making a stronger change than I think in fact I want to. I wouldn't object to lowering that range to some degree, but I don't think I would go quite as far as alternative C. So I would pick up alternative C on M1 and M2 but moderate the change in M3, and make that only 1/2 percent, too.

CHAIRMAN BURNS. All right, thank you, Mr. Volcker. Mr. Guffey now, please.

MR. GUFFEY. Mr. Chairman, our analysis of the economy is very, very similar to what the staff has already projected this morning. And as a result, we would be happy if the long-range targets were retained very much as was set last time. Further, in view of the fact that we have been missing and we've been in the upper part of our range over some longer period of time now, it would seem that maybe our moving the ranges downward isn't our problem. If you move the top side down, we may have a real [risk of missing] it; as a result, I think we'd be opposed to that. On the other hand, the cosmetic effect, if that's the right term, of continuing to move is very attractive, and as a result, I think we would opt for a solution that you have proposed on the M1 range alone, that is, moving the bottom [down by] 1/2 percent. I don't think it's very meaningful at the moment. I think we've got to begin to focus on the shorter range of getting those aggregates down, and what we do in the longer range is basically for consumption of the public and not for this Committee. So in conclusion, I guess, I would be perfectly willing to buy the cosmetic effect of moving the lower side of M1 but leaving the remainder of the aggregates where they are for the moment.

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

MR. WINN. Mr. Chairman, I'd like to emphasize the point John Balles made. In our area, the banks are actively soliciting the transfer of corporate accounts from demand deposits to the savings account. For example, a company keeping an average $80,000 demand deposit is being encouraged to shift $79,000 over to a savings account, [leaving] a $1,000 demand balance with telephone transfers back and forth to meet the need. And that's a structural change of real magnitude. They're being solicited--as they say, the NOW account is available to the corporation. It may not be available to the individual. But that's a structural change of some magnitude, and I think that that's going to continue here in the period ahead, and so I'd be in favor--[because of] both the base drift and structural change--of going 4 to 6 for the M1. And then following the C category for the M2 and M3.

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

MR. WILLES. Thank you, Mr. Chairman. In part of my attempts to educate myself on what the Committee has been doing, I took a look at the economic outlook that the Committee appeared to agree to in January of this year and then the policy that was decided at that time--the base that was associated with that. And then I compared that with the economic outlook for four quarters hence, and then again with the base that was associated with that. And it would seem that, if the Committee were to, in effect, stay even and not account for the base drift, it then in effect would be saying that it wants more real growth in GNP and a lower unemployment rate and is willing to pay a price of higher inflation to get that than was the case in January. That's a very awkward way of saying [it], I'm afraid. It seems that it will be perfectly consistent with what the Committee did last January, in the face of deteriorating inflation and somewhat stronger economic growth than the Committee foresaw at that time, to simply move down to the 4 to 6 and 6 to 9 that the majority seems to have recommended at this time. And that's certainly where I would come out.

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

MR. GARDNER. I didn't speak to the staff projections, but I do feel that it was very valuable. And I do feel that we still have much to look forward to in this very quiet recovery, gaining ground slowly. That's good in my judgment. There are the obvious points of difficulty that have been addressed here, but on the long-range proposals, I'm entirely sympathetic with what Governor Partee said. I think he stated it too well for me to attempt to add further to his statement, and I would think in the present financial and monetary market situation in which we find ourselves, [it would be] perfectly appropriate to put out a target that is 4 to 6-1/2.

And I listened to Willis Winn, and I'm very concerned with these trends, and they're occurring over time. On the other hand, we haven't really been able to codify and analyze what's happening here. And if I look at where we've been in the last six months or so, I would not feel uncomfortable in not changing M2 and M3 from the present picture. I think dropping M3 has significant difficulties with the extent of private housing that's going on today. I would come out in strong support of your proposals, Mr. Chairman. And I think we have a small luxury of adopting those proposals until we see in further meetings and further developments a more cogent set of reasons for changing. I would support the 4 to 6-1/2 and the M2 and M3 position we're in.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Mr. Morris, we haven't heard from you.

MR. MORRIS. Mr. Chairman, I, too, come out with Governor Partee. My preferred position would be no change at this time. I don't feel that credibility requires that we change our long-range goals every quarter. But I think we are entering into a period of decelerating growth. I like the tone of the economy now. I think it is clear, at least for a couple of quarters ahead, that we're going to have decelerating growth. I think the only question is the rate of deceleration. However, I would accept your 4 percent lower level on M1, Mr. Chairman, if you feel it has symbolic value. I think, in the expansion, the number we've got to focus on most seriously is the upper end of the range. So I really--if we can buy some symbolism with lowering the lower end of the M1 range to 4, I would certainly accept that.

I don't see where we have a base drift problem at this meeting. That reflects my feeling that, at this stage of the cycle, we ought to be coming out toward the upper end of the ranges. And looking at the past six months, we've had M1 growth of 6.1 [percent] and M2 of 8.8, and it seems to me that's about where I think we should have been. I would, however, be opposed to reducing the upper end of the range at this time. I fear that we would not be giving ourselves enough leeway, if we're taking these ranges seriously, and I fear that it might force us into an interest rate policy that might prematurely stifle the economy. So I would come out exactly where Governor Partee would.

CHAIRMAN BURNS. Thank you, Mr. Morris. Mr. Lilly now.

MR. LILLY. I have nothing further to add. I think Chuck pretty well stated my feeling, and I would support your proposal.

CHAIRMAN BURNS. Thank you, Mr. Lilly. Mr. Baughman would say something now.

MR. BAUGHMAN. Mr. Chairman, it seems my views are rather out of step with the group today. I'm rather impressed with the statement on page 6 in the Bluebook.

CHAIRMAN BURNS. Now wait, now wait. Your views are out of step and therefore I want to be sure--I want to hear every word. Would you speak a little more loudly please?

MR. BAUGHMAN. I'm impressed that the staff concluded at page 6 in the Bluebook that alternative D maintains the picture that we've had thus far this year, in terms of long-term targets. And it seems to me that we do have a significant problem of base drift confronting us. It seems to me that that's likely to be perceived as a problem in the public arena. And it leads us to that spot characterized as caught between a rock and a hard place in undertaking to convey what our policy purpose or objective is at the present time. And if we adopt a set of numbers which are essentially unchanged from what we have, that is, the present numbers--and it seems to me we must acknowledge that our base gives us an escalation in the growth rate path of about 3/4 percent--that we are subject to the charge, and will be charged, that we have a policy of drift. In other words, if we just go along with the current--whatever the current happens to be--I see that [charge] as difficult to counter. I can well [anticipate] that, if we were to announce a set of numbers such as are presented in alternative D, [then] what I would call our first-tier critics will charge that we are making a significant tightening of policy. And it will be hard to explain that away in terms of the base drift.

On balance, however, I would rather attempt that explanation than a rationalization that, notwithstanding the higher second-quarter base, we have adopted a policy of essentially no change, and that's reflected in a set of numbers which are essentially unchanged. It seems to me that it would be easier to try to get across the idea that the shift in the base is affecting the numbers, and while the numbers change, policy is not changed. So my preference actually would be for a base which moved along the midpoint of the line of the prior announced path each quarter, which would get away from the fictitious change in numbers. But this may not be the time that we want to make that particular change. So this leads me to a posture of suggesting something close to alternative D, notwithstanding--

CHAIRMAN BURNS. Close to alternative?

MR. BAUGHMAN. D. The last one. The one which the staff characterizes as continuing the current policy posture.

CHAIRMAN BURNS. Well, thank you, Mr. Baughman.

Gentlemen, we're faced with a very hard decision. Speaking personally for a moment, I wish I could join my colleagues who were inclined to move toward somewhat lower growth rates. I wish I could--temperamentally, yes; that's what I would prefer to do. But I do have an obligation to this Committee and to the System as well as to the country. I'll have to testify before the Committee, I will have to defend whatever this Committee decides.

You take a range of 4 to 6, which is preferred on this first go-round by four members of the Committee; eight members prefer 4 to 6-1/2. I find it difficult to defend 4 to 6. Let me show you why: 4 to 6 reduces the midpoint to 5 percent. The staff projection for nominal GNP is approximately 12 percent. That implies a velocity figure of roughly 7 percent. I would find it very difficult to justify a 7 percent velocity figure. We may get it, particularly at a time when some people will be arguing, "Well, the economy has leveled off, and at such a time velocity tends to fall off." Suppose the velocity figure is lower than 7 percent. If I could argue with conviction that that would put significant downward pressure on the price level, you see, yes, I would be in good shape. But I can't. I can't argue that. It may put some downward pressure on prices, it may put some downward pressure on activity. Over the longer run, yes. I could argue with respect to the effects on the price level.

Moving the lower limit down to 4 percent will subject us to attacks. I don't mind being attacked, but I want to be in a position, really, to answer the attacks in an effective manner. And I find it very difficult to do that at the present time because of the hesitation that some people are going to read into the economic events. I interpret the economy differently. Well, that will influence the thinking of some, and I am concerned about the legislation that we have before the Congress.

A clear majority of the Committee, in any event, favors a range of 4 to 6-1/2 percent for M1, 7 to 9-1/2 percent for M2, and 8-1/2 to 11 for M3. As for bank credit, you have the recommendation by the staff that we do away with the proxy; that change is long overdue. And as to a figure, I think we ought to proceed as we have in our recent meetings and leave it to the staff to supply the numbers that are reasonably consistent for bank credit--consistent with the monetary magnitudes that we decide upon.

MR. PARTEE. I think it would be the alternative C figure, Mr. Chairman; 7 to 10.

CHAIRMAN BURNS. Well, I would really prefer to leave that to the staff.

MR. PARTEE. It might be [unintelligible].

MR. COLDWELL. Why even have it?

CHAIRMAN BURNS. What's that?

MR. COLDWELL. Why even have it?

MR. JACKSON. Why do we have to have it?

CHAIRMAN BURNS. Oh, I think it's quite important to have a credit figure as well as the money figure because we don't want to go completely monetarist at this Committee.

MR. COLDWELL. I happen to be of that persuasion, too, but I still wonder why we just create a figure that we add on to the pack.

CHAIRMAN BURNS. Well, I think that's a--

MR. COLDWELL. It's pure cosmetics.

CHAIRMAN BURNS. Well, I think sometimes, I think they are symbolic. Much of life is based on symbolism. It serves a function. Much of history is based on symbolism. I wouldn't want to ignore it. Well, I don't see any way of compromising readily here, and I think we have to take a straight vote. And I hope we will not be too far apart in the voting.

MR. JACKSON. Could we vote to include the bank credit or not to include it?

CHAIRMAN BURNS. Oh no, I don't think we ought to vote on the bank credit. Leave that to our staff. But to vote on the--

MR. JACKSON. But the implicit vote is to state an objective for bank credit.

CHAIRMAN BURNS. Well, let me repeat what I think we'll be voting on.

MR. JACKSON. Because I don't think there is any indication [in] Governor Coldwell's suggestion as to whether we exclude it completely or include it and have the staff insert the figure.

CHAIRMAN BURNS. Well, let me indicate what I think we ought to vote on, and then we'll discuss that to the extent that there is a difference of opinion. What I'm putting to the Committee for a vote is as follows: an M1 growth range for the year ahead of 4 to 6-1/2 percent; the growth range of M2 of 7 to 9-1/2 percent; a growth range for M3, 8-1/2 to 11 percent; and a figure on bank credit, as distinguished from the bank credit proxy, to be appropriately filled in by the staff. Yes, Mr. Black.

MR. BLACK. Mr. Chairman, you stated there were no grounds on which to compromise, and I see one. I don't think you probably want to consider it, but 4-1/4 to 6-1/4.

CHAIRMAN BURNS. What's that?

MR. BLACK. 4-1/4 to 6-1/4.

CHAIRMAN BURNS. Well, I thought of that, but we have avoided fourths, and I'm a little afraid that we may get to--actually, the difference between 4 to 6 and 4 to 6-1/2 is a small difference.

MR. BLACK. Same midpoint, but--

MR. COLDWELL. It's a meaningful one.

CHAIRMAN BURNS. What's that?

MR. COLDWELL. It's a meaningful one.

MR. BLACK. But I think in this case it really is to knock a little off the top...

CHAIRMAN BURNS. Meaningful one, in the sense that a good deal of meaning may be read into that.

MR. COLDWELL. It also lowers the midpoint.

MR. BLACK. I believe it would give the same, wouldn't it? 4 to 6.

MR. PARTEE. Bob's figure gives the same midpoint--

MR. COLDWELL. *Your* midpoint.

MR. PARTEE. Yours [Mr. Coldwell's] would be lower.

MR. BLACK. Yes, yours would, but 4-1/4 to 6-1/4 would give the same midpoint, I believe, as 4 to 6-1/2.

CHAIRMAN BURNS. Well, we could do that. But I think that--you know, it'd be an exercise in fine tuning that I don't fancy, but if this is what the Committee wanted to do--

MR. BLACK. There's only one reason I would even suggest it, and that is that the upper limit has not really been cut down.

CHAIRMAN BURNS. I beg your pardon?

MR. BLACK. The only reason I would even suggest anything that approximates fine tuning to that point is that there has been no adjustment in the upper limit.

CHAIRMAN BURNS. I think the compromise more practically ought to be along another line, namely, let's bear in mind that several members of the Committee think that the upper limit of 6-1/2 is too high, and, in looking at our short-term ranges, let's keep that in mind as policy unfolds in the months ahead. Mr. Roos, please.

MR. ROOS. Mr. Chairman, just for clarification. I'm just speaking of M1. I am led to believe that if we maintain the upper the limit where it has been--6-1/2 percent--and if we operate from a new base as a result of this base drift, then, even with a reduction of 1/2 percent in the lower limit, this would accelerate M1 growth by approximately 1 percent. Which would have the effect, a couple of years down the road--if there is any relationship between the growth of the M1 aggregate and the price level--of probably increasing the price level predicated on that relationship by just slightly less than 1 percent.

Does the reduction of the lower limit of this range from 4-1/2 to 4 obviate this acceleration of M1 growth and probable acceleration of the rate of inflation at a time when we're trying to inch these things down? I mean, isn't that essentially the scenario that we would be buying if we agree to raise the base and stick with the 6-1/2 percent upper limit?

CHAIRMAN BURNS. It's all a matter of interpretation. You see, the actual growth rates have diverged from the targeted growth rates significantly. And I think that the objective that you seek can be better attained by watching the short-run policy objectives and trying to prevent further upward drifting and try to get, you see, some downward drift. I think that's the operational essence of what we do.

Now, to announce to the world that we are continuing the policy of moving our targets gradually downward is, I believe, a healthy thing. To announce to the world that we're moving our targets down very appreciably when in fact we permit, through our short-run decisions, the growth rate to creep up means that we are inviting trouble for ourselves and [that we] don't do for the economy what we are seeking to achieve. My own inclination, therefore, would be to stay with the more modest reduction but to pay perhaps more attention than we have to the short-run targets. That's the way in which I would seek a compromise of the views that now exist within the Committee.

MR. ROOS. Is it possible, Mr. Chairman, to really convince the world--which I think looks to you, sir, as perhaps the only effective obstacle to continued acceleration of inflation--is it possible to convince them that, [while] we really aren't doing anything with our long-range targets to materially affect this situation--having left the upper part of the longer-range target where it is--that we really are going to achieve this miracle by doing it with our short-range targets? Is anybody going to believe that? Is that going to affect anything?

CHAIRMAN BURNS. I don't know. Well, you know, I look upon the upper limit as an insurance policy. I look upon it also as something that can help us through a difficult legislative period. I can assure you that the statement before the [congressional] committee will stress, even more than preceding statements have, the need to bring the monetary growth rates down. As some evidence of that intention, there is this further modest reduction. Well, you can argue this one, I think, one way and argue it another way. As far as the business and financial community is concerned, I'm not aware of any great dissatisfaction with the monetary policy pursued by the Federal Reserve System. The indications to me are that, by and large, the policy is approved. On the other hand, we do have many critics in the Congress and, for that matter, in a section of the American public.

MR. PARTEE. I might just say, Mr. Chairman--Larry [Roos], the first quarter was an undershoot. It could very well be that the third quarter would be an undershoot. If it is, a quarter from now we'll be meeting, and we'd be looking at how to evaluate an undershoot. I mean, you're basing everything on the second quarter as if that was the exactly right base number. I don't think there's that basis really.

MR. ROOS. I'm really not. I'm taking a five-quarter period, first quarter of '76 to the second quarter of '77, where M1 has grown at 6-1/2 percent--the last three quarters at 6.6 percent, and the last quarter at 8.8. If that doesn't reflect a trend of acceleration, an upward trend, I can't--I'm misreading the figures.

CHAIRMAN BURNS. Gentlemen, I wish we were closer together. Unless there is a further comment or a further suggestion--

VICE CHAIRMAN VOLCKER. Just to add, I think your reasoning is right on this, Mr. Chairman. I don't think we should put the emphasis on lowering an upper limit and not be serious about it, because it's going to get us in all sorts of trouble publicly. I'd put an upper limit that we mean and put our emphasis on the short-range implementation so that we don't exceed it rather than, for public purposes now, put a lower upper limit. At the same time, [it gives] us a leeway on the lower limit; if the numbers do come in weak, we don't have to react in the opposite direction. So I think, in general, that widening the range on the lower side is definitely the right way to go. I might apply that to M2, too, but I think in substance this is the right posture we want to be in.

MR. JACKSON. What better way would there be to convey to the public our determination to operate closer to the midpoint than to reduce our maximum upper end?

VICE CHAIRMAN VOLCKER. Well, I'm not sure we're willing to do that. It's depending on how these numbers come in. I'd be satisfied if we make sure we don't exceed that upper limit. And I think that will be the credibility. We're in danger of losing the credibility by these overshoots.

CHAIRMAN BURNS. Well, you know, as far as the range is concerned, let's not forget the original reason for wanting a range rather than a single figure--namely, our inability to hit the targets, number one; also, the uncertainty of our knowledge as to the relationship between the given magnitude on the monetary side and an economic activity measure one way or another. The relationship is quite loose. Now these were the two reasons we adopted a range rather than a single figure, which assumes, you see, more knowledge than we have and a greater ability to control or to reach our objective than we have.

MR. BALLES. I don't want to prolong this, but I would like to give strong support to the comment you made about looking at the short-run policy in light of the longer-run policy. I think that's very important, and we haven't always done that as well as we might have. But that's something to strive for as we go.

CHAIRMAN BURNS. Well, that's something that Mr. Balles in particular has reminded us of repeatedly. Well, gentlemen, I think that we are probably ready for a vote now.

MR. BROIDA.

Chairman Burns	Yes

Vice Chairman Volcker	Yes
Governor Coldwell	No
Governor Gardner	Yes
President Guffey	Yes
Governor Jackson	No
Governor Lilly	Yes
President Mayo	Yes
President Morris	Yes
Governor Partee	Yes
President Roos	No
Governor Wallich	Yes

Nine to three, Mr. Chairman.

CHAIRMAN BURNS. All right now, we want to turn--but I wonder about the hour, how much we can--how do you feel, would you like to continue, or take a break and go to lunch? I'll tell you, let's do this. We'll have Mr. Sternlight's report and perhaps also Mr. Axilrod's, and then we'll break for lunch. Mr. Sternlight, we're ready for you.

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

CHAIRMAN BURNS. Thank you for your report, Mr. Sternlight. Any questions to Mr. Sternlight?

MR. PARTEE. Most everybody made payment the next day, didn't they?

MR. STERNLIGHT. Payments went through the next day; there's the question of what interest rate adjustments to make, if any, because of the nonday--we skipped a day.

CHAIRMAN BURNS. Mr. Black, please.

MR. BLACK. I think Mr. Sternlight pretty well took care of my question, Mr. Chairman.

CHAIRMAN BURNS. Mr. Wallich.

MR. WALLICH. Last time we had a money market directive, do you feel that this made any difference in why things went--for instance, would the funds rate be significantly different from now had we had a corresponding aggregates directive?

MR. STERNLIGHT. I think there was sufficient strength in the aggregates toward the latter part of this interval so that, if you'd been operating on an aggregates directive, there might very well have been a need to firm slightly. I think we just barely avoided such a need, and one of the factors working in that direction was the fact that there was a money market directive.

CHAIRMAN BURNS. My guess would be that the federal funds rate would be a little higher now.

MR. WALLICH. I would have thought so, too.

CHAIRMAN BURNS. Any other question? Mr. Axilrod, how many hours do you need for your report?

MR. AXILROD. Approximately 3-1/2 minutes, Mr. Chairman.

CHAIRMAN BURNS. All right. You'll be timed precisely; please proceed.

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

CHAIRMAN BURNS. Well, thank you, Mr. Axilrod. I think it's a very helpful statement. Mr. Wallich.

MR. WALLICH. You say that there's much less relation between velocity and interest rates; is that the case also if you try to allow for the clear upward trend of velocity that we have as a result of technological changes, such as you have specified before?

MR. AXILROD. This is the velocity of M1, and I think you'd have to allow for more than the technological changes, and we're working on that. The next thing I'm going to say, I think you might have to allow for a large increase in corporate and state and local government holdings of very short term assets, like the federal funds and RPs [repurchase agreements]. And if you began including that in M2, then this relationship may become a little strong again. But we're still working on that, Governor Wallich.

CHAIRMAN BURNS. Any other questions to Mr. Axilrod? Yes, Mr. Jackson.

MR. JACKSON. Just one question. To what extent do these short-term projections include the possibility that, for brief periods, the wild-card maturing deposits will be deposited in the M1 demand deposit figure before they're rolled over?

MR. AXILROD. We did not make any specific allowance for that, Governor Jackson.

MR. JACKSON. Do you think that would be a material factor?

MR. AXILROD. I think there would be some possibility. But I would believe that most of the holders, knowing the time of maturity, would probably arrange their transaction to minimize the amount going through demand deposits. I think there could be some effect if you go out of the wild card into a market security in the transaction process, but I think that would be a rather passing phase. We have assumed, in fact, that there is, under current conditions, enough scope between the ceiling rate on longer-term time certificates and current market rates for institutions to hold these deposits.

MR. JACKSON. You don't think that [any] of [the] alternatives here would pose the likelihood of substantial disintermediation then?

MR. AXILROD. Well, I think alternative C might put banks a little bit closer to the margin than [it] would thrifts, so, a little more room. I don't think alternative B would pose any problem; alternative C would begin to, a little bit, for banks, but not significantly over the next four weeks.

MR. PARTEE. Did you allow for any shift from M2 to M3 on account of the wild card?

MR. AXILROD. No, we did not make any specific allowance for that, Governor Partee, but as rates got higher, it would become more of a possibility.

MR. PARTEE. You did not make any allowance. Well, I'm not [unintelligible] that these people were great buyers, that they were shopping for the best way, if they can get a better way than this.

MR. AXILROD. If you got up to the ceiling rate at banks, then there would be much more of a possibility of shifting.

CHAIRMAN BURNS. How much do you have outstanding in the wild card?

MR. AXILROD. I believe it's $18 billion in thrifts and $8 billion in banks between about now and October.

CHAIRMAN BURNS. Yes, Mr. Balles.

MR. BALLES. One quick question for Steve. Laying aside the possibility of nationwide NOW accounts--which, of course, is quite uncertain as we sit here--but just considering NOW accounts in the states where they are presently permitted and possible further shifts of business deposits into savings--and alluding to my earlier compliments to you and Mr. Paulus on the guess you made a year ago of what would happen to M1 as a result--what are your feelings with regard to the period ahead as to what further shifts there might be out of M1 into M2?

MR. AXILROD. Well, President Balles, I would really--we have not investigated that in any detail. And I would propose that we do that and report back through a memo.

MR. BALLES. Fine, thank you.

CHAIRMAN BURNS. Well, you better get started on that because my own guess is that if we get nationwide NOW accounts, we would want either to shift entirely to M2 or give it a significantly larger weight. That's my guess.

MR. AXILROD. Do I interpret you right, President Balles--you are asking for our estimates of shifts to NOWs, to savings, as well as [to] these other instruments--telephone transfers--

MR. BALLES. Right. The whole package.

CHAIRMAN BURNS. And also its implications for our monetary procedures. Because, you know, we've been able to live with our present definition; well, we've made an adjustment, giving as much weight to M2 as we do, or approximately the same way as we do, to M1. But with nationwide NOW accounts, I doubt if we could retain the present procedure.

Gentlemen, it's time to break for lunch, and we'll be back at--what would you prefer, 2:15 or 2:30? Let me have a show of hands for 2:15.

[Lunch recess]

CHAIRMAN BURNS. Gentlemen, we are late in gathering once again, but there were some legislative problems that a number of us had to talk over at lunch. And we want to turn our [attention] to the directive to the Desk and our decision with regard to monetary policy in the weeks immediately ahead.

I think no matter what we do today, under that head we ought to have a monetary aggregates directive, in view of the decision that we reached earlier in this meeting. My own inclination, which I will put forward to the Committee as a target to accept or reject, is to have a monetary aggregates directive, to accept the figures under alternative C for M1 and M2 on page 6 [of the Bluebook], and to accept the federal funds rate range under alternative B. Mr. Mayo.

MR. MAYO. I was with you through the M1 and M2, Mr. Chairman. I think that is the right course to go. I would expand the federal funds range, however, to 5-1/4 to 6 percent on the grounds that I think we need a little bit more freedom. I think it is in line with what we have just talked about on our targets on the longer term, and that's why I also subscribe to your formula for M1 and M2, because I think that 3-1/2 to 7-1/2 effectively covers the 4 to 6-1/2 that we were just talking about, realizing that you need a wider range in the short run. So that's where I would come out. I would see us moving toward maybe 5-1/2 to 5-5/8 as the central point only if we are pushing that upper limit of 7-1/2 percent on M1.

CHAIRMAN BURNS. Well, I thank you, Mr. Mayo. Who would like to speak next? Mr. Coldwell.

MR. COLDWELL. Mr. Chairman, [we're] not too far apart; actually I have gone a little step further, with M1 of 3 to 7 and M2 of 6 to 10. But the federal funds rate--if we are going the monetary aggregates route, I think we ought to return to the full 1 point, and I'd take 5 to 6 percent.

CHAIRMAN BURNS. All right. Thank you. Mr. Black, please.

MR. BLACK. Mr. Chairman, Mr. Mayo has made all the points I'd wanted to make. I would be right with him.

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

MR. EASTBURN. I would agree with that position too.

CHAIRMAN BURNS. Thank you. Mr.--

MR. KIMBREL. And so will I.

CHAIRMAN BURNS. Thank you. Mr. Guffey.

MR. GUFFEY. Contrary to what Bob Mayo said, I would rather support your proposal in the fact that, so long as the aggregates [are] performing and appear at the midpoint, we stay right where we are in terms of the fed funds rate. And only if they push up [to] the upper range do we move it. I believe this other contemplates that we will indeed move the fed funds rate a little earlier than might be under your proposal.

MR. MAYO. My proposal was that you didn't move the fed funds rate until you get very close to the end of your M1 range.

MR. GUFFEY. I guess I would prefer that if we are going to have an aggregates target, if you do, we use--

CHAIRMAN BURNS. Gentlemen, I don't think we want to change our rule, you see. We are changing the rules of operation, Mr. Mayo. And I think we will work ourselves into trouble if we change our rules from meeting to meeting. We ought to stay with a given rule until we decide that some other rule is better. Stay with that for a while.

VICE CHAIRMAN VOLCKER. Can I just qualify this, Mr. Chairman? Is [it] your implication that we should go above where we are now, right away, if we were at the midpoint in the aggregates? We're below the midpoint in the range you propose.

CHAIRMAN BURNS. Well, you know, our rule is that, when we have a monetary aggregates directive, we use the full range. The full range first. That's rule one--full range is available for use. Rule two is that there is a zone of indifference. And that zone of indifference, instead of being equal to 4 percentage points, is equal to something like 2-1/2 or a little more than that. That's our second rule. And rule three, of course, is, if we start hitting against the boundary lines, we then have the special intervention by the Manager and the Committee Chairman. Those are our basic rules.

VICE CHAIRMAN VOLCKER. But we're not at the midpoint of the federal funds range you now propose.

CHAIRMAN BURNS. Well, we're at 5-3/8

VICE CHAIRMAN VOLCKER. And the midpoint of the range is 5-1/2.

CHAIRMAN BURNS. The midpoint is 5-1/2, yes, but I don't think there ought to be an arbitrary move to 5-1/2. There ought to be a move based on some evidence concerning the aggregates. But the full range being available for us in contrast to the money market directive.

VICE CHAIRMAN VOLCKER. But you wouldn't move right away, and there, as a practical import, you say until some aggregates evidence can then--

CHAIRMAN BURNS. Yes.

MR. MAYO. As a practical matter, Mr. Chairman, it seems to me what I was saying, it conforms to rules 1, 2, and 3.

CHAIRMAN BURNS. Well, then our discussion has been helpful. That is, the meaning that you sought to convey, which I didn't get in the first instance, has now been clarified. That's helpful. All right, then, Mr. Jackson, please.

MR. JACKSON. Mr. Chairman, I would support the aggregates proposed for M1 and M2. I would also support the federal funds range, while normally, I think the wider range of latitude would be desirable. In view of the unknown consequences of financial shifts as a result of the wild-card expirations that we may be experiencing, of which we don't know the ramifications, I think a narrower federal funds [rate] would be a better course of action while keeping the monetary aggregates. I would move with deliberate speed to the midpoint of the ranges. Which means 5-1/2--not instantaneously, but with deliberate speed in that direction.

CHAIRMAN BURNS. Who would like to speak next? Mr. Gardner.

MR. GARDNER. I have no difficulty with the ranges of M1 and M2, but if you will forgive me for appending an additional comment on your comment this morning, I don't want a 6 percent federal funds rate without further deliberation. So I would support the narrower range in the federal funds rate because I think this would be a most significant point in all of our processes. And I see no reason to move that midpoint up, adopt a higher limit. Particularly in this--and I suppose this is always true--sensitive time. So I would support the 5-1/4--the alternative B federal funds rate range--very vigorously.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Yes, Mr. Kimbrel?

MR. KIMBREL. In our [Treasury] financing, if we are going to move, would we need to do this very quickly?

VICE CHAIRMAN VOLCKER. This is the question--

MR. KIMBREL. Treasury financing.

CHAIRMAN BURNS. I don't know what the financing schedule is, precisely.

MR. STERNLIGHT. They will be announcing a week from tomorrow, Mr. Chairman, in terms of the quarterly refunding operation. So, from that standpoint, if there were any significant rule [unintelligible], the midpoint would probably be [unintelligible] making its presence in the market early. I don't know that these smaller rules that [unintelligible] are contemplating--

CHAIRMAN BURNS. How much will the Treasury be--

MR. STERNLIGHT. They are refunding just over $3 billion, and they might add $2-1/2 billion or $3 billion before or on top of that. So it's a sizable--

CHAIRMAN BURNS. And that means that the only new information that we'll have will be Wednesday and Thursday of this week.

MR. AXILROD. That's correct, Mr. Chairman, but I ought to add that there is some thought that, because of the blackout in New York, the additional data that we get for the week ending the 20th may be subject to some more doubt than they usually are--the preliminary data. There may be some technical problems in interpreting and getting that data. So that what I'm saying is, the additional information we'll have Wednesday and Thursday will be subject to more doubt than it usually is.

CHAIRMAN BURNS. When will those doubts be resolved?

MR. AXILROD. I would assume they would be resolved within a week afterward, when we get the final data for that period.

CHAIRMAN BURNS. Wait, now the final data, are you referring to the preliminary data that you normally get on the Thursday?

MR. AXILROD. Yes. I'm referring to the data for the week ending July 20, which we would normally get on a Thursday.

CHAIRMAN BURNS. Well, the data are always a bit cloudy--

MR. AXILROD. That's right; I'm told they'll be cloudier.

CHAIRMAN BURNS. This time they will be somewhat more cloudy?

MR. AXILROD. That's right, because it covers the period in which we had this power failure in New York.

CHAIRMAN BURNS. We'll get to this point a little later--that is, we'll have to clear that up. Yes, Mr. Kimbrel; no, you have spoken, that's right. Mr. Volcker.

VICE CHAIRMAN VOLCKER. Well, I am at about the same place I think that Steve Gardner is. I can use the C and D aggregates projections or also go along with Mr. Coldwell, and maybe one or two others, who even went a half a point lower than that. But I agree with Governor Gardner that we should not increase the federal funds rate to 6 percent without careful further deliberation. So I also feel strongly that we ought to keep this range 5-1/4 to 5-3/4 and be prepared to use it up to 5-3/4. But I think the common sense way of expressing it, I guess, is to retain this asymmetrical midpoint so that we don't move without some further provocation or confirmation on the aggregates, which might delay us until after the financing.

MR. LILLY. That was my question. Our normal procedure would be to move deliberately toward the midpoint, wouldn't it, unless you were given other instructions?

CHAIRMAN BURNS. I think that that would be the normal procedure, but starting from an asymmetrical midpoint there is a special question as to how fast we move. And the suggestion that I made was that we move on the basis of new information rather than move mechanically.

MR. LILLY. The staff would create [unintelligible] good reason to move, then I would support your proposal.

CHAIRMAN BURNS. Thank you, Mr. Lilly. Who is--yes, Mr. Winn.

MR. WINN. I can [associate] myself with that, too.

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

MR. PARTEE. Well, Mr. Chairman, I would have rather done it the other way around. That is, I think it is time to have a monetary aggregates directive because the special circumstances of early July are over. But I think there is some uncertainty about what the aggregates are doing and certainly about what aggregates tend to do. I note that we have a July projection of 7-1/2 percent, which would require, with your suggested range, a quite low August in order to stay within. I note also, [with] Governor Jackson, that we don't know quite what the wild-card experience is going to be. And so we might consider using this occasion to broaden the ranges for M1 and M2. In particular, I would have suggested 3 to 8 for M1 and 6 to 11 for M2, and then I think we could use the whole 1 point funds range, 5 to 6. I would like to see us begin to have a little wider funds rate range when we use a monetary aggregates target.

The other point, the reason I reduced the lower end of both those ranges, all the way down to 3 [for M1], is that I think the sense of the Committee, as I got it this morning, was that we would welcome some weakness or some undershoot. We wouldn't really want to move as much as we would against strength on the other side.

CHAIRMAN BURNS. Well, then, why would you want the federal funds rate to move down to 5?

MR. PARTEE. Well, that's only 3/8 from where it is now, and we would only be [moving there] in the case you were validating a 3 percent M1 for July-August. And you're going in with a 7-1/2 percent estimate for July; if that were realized, what would that mean--a minus for August.

CHAIRMAN BURNS. But a move of the federal funds rate [down] 3/8 would be regarded as a very significant easing move by the Federal Reserve

MR. PARTEE. But if we have a negative August--in a situation where the economy seemed to be flat or weakened, well, I just--I can live with what you proposed, but I would have thought that this might be a time to broaden those ranges.

CHAIRMAN BURNS. All right, thank you, Mr. Partee. Mr. Morris hasn't spoken yet.

MR. MORRIS. Mr. Chairman, I accept your proposal.

CHAIRMAN BURNS. Thank you, Mr. Morris. Mr. Roos, we haven't heard from you.

MR. ROOS. Mr. Chairman, I would support the M1 and M2 ranges under C. I'd like to express support for a federal funds rate of 5-1/4 to 6.

CHAIRMAN BURNS. Thank you, Mr. Roos. Mr. Wallich, we haven't heard from you yet.

MR. WALLICH. I think we're in some danger of mixing the two directives. I think, if we want an aggregates directive, we ought to have a wide funds rate spread. The narrow spread is appropriate for the money market directive. So I would go for 5 to 5-3/4 with a midpoint of 5-3/8, and otherwise, the specifications of B

CHAIRMAN BURNS. All right, anyone else like to speak?

MR. BALLES. Mr. Chairman.

CHAIRMAN BURNS. Yes, Mr. Balles, and then Mr. Baughman.

MR. BALLES. In the interest of brevity, Mr. Chairman, I would support your proposal, assuming the asymmetrical midpoint, in view of the sensitive conditions we have right now.

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

MR. BAUGHMAN. I would find your suggestions on the aggregates quite satisfactory, but on the fed funds, I'd be inclined to the 5 to 6 range.

CHAIRMAN BURNS. Thank you, Mr. Baughman. Anyone else? One thing is perfectly clear: the Committee is inclined to accept a monetary aggregates directive. And a clear majority favors a growth range for M1 of 3-1/2 to 7-1/2 and a growth range for M2 of 6-1/2 to 10-1/2. As for the federal funds rate, there is a distribution, a wider distribution. Six members of the Committee favor a range of 5-1/4 to 5-3/4, and--oh, something wrong. Our secretary never makes a mistake, but today he's made a mistake, and I don't know what it is. Mr. Guffey, we don't have you recorded--

MR. GUFFEY. I am in support of your proposal, Mr. Chairman.

CHAIRMAN BURNS. Well, that makes for the majority, just what I've been waiting for. Any further discussion?

MR. COLDWELL. Mr. Chairman, I have no problems with your [5-]1/4 to 3/4. The only question, I think, is the asymmetrical side. You might test to see whether the Committee wants the asymmetrical or the move to the 1/2 point [midpoint].

CHAIRMAN BURNS. You mean the prompt move to the--

MR. COLDWELL. Well, reasonably prompt.

CHAIRMAN BURNS. Well, all right, let me put the question as it was worded by Mr. Coldwell, and each member of the Committee will interpret that for himself. Members of the Committee who seek a reasonably prompt move from 5-3/8 to 5-1/2 will indicate that by raising their hands.

MR. PARTEE. Regardless of any information we have received?

CHAIRMAN BURNS. Well, every member of the Committee will interpret that for himself.

MR. BROIDA. Three, Mr. Chairman.

CHAIRMAN BURNS. Well, then, I would say that the move ought to be made on the basis of new information. But we don't sit on new information, we use it. That is [what] the monetary aggregates directive always means.

Well, unless there is further question, let us vote on the following: A monetary aggregates directive; an M1 range of 3-1/2 to 7-1/2; an M2 range of 6-1/2 to 10-1/2; a federal funds range of 5-1/4 to 5-3/4, with the understanding that the range is to be used depending on how the information comes in; and that a move be made to the midpoint of 5-1/2 when and as new information points in that direction.

Now, some special attention will have to be given to the Treasury financing problem, and I don't quite know what should we say about that, if anything, at the present point. Mr. Holmes.

MR. HOLMES. I think some reference to the Treasury financing might well go into the directive for a change.

MR. AXILROD. We've haven't had that reference for a long, long time, Mr. Chairman, and we have taken account of financial market developments, which I believe might be satisfactory. I don't know that we need to make special mention.

MR. HOLMES. I think if the Committee understands that we do have to keep an eye out on the financing, that's all that's needed; nothing specific is really needed.

CHAIRMAN BURNS. Well, I think the Committee does understand that. Well, if we are ready for the vote, let's proceed.

MR. BROIDA.

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

Unanimous.

CHAIRMAN BURNS. What else do we have to do, Mr. Secretary?

MR. BROIDA. Set the date for the next meeting.

CHAIRMAN BURNS. Yes, Mr. Baughman?

MR. BAUGHMAN. [In] appendix III, page 2, in the Bluebook, [there is a] reference to the computation of the bank credit measures and [a] suggestion at the very bottom of the page that the staff could develop a monthly average series for the components of that measure as well, if desired. I assume the reference here is simply to the broad break between loans and investments, rather than the detailed loan rate?

MR. AXILROD. No, we could develop on a weekly average basis the same breakdown we had on the end-of-month series. We have the same lack of information in both cases.

MR. BAUGHMAN. It would seem to me that it might be helpful, with the bank credit measure being brought into the picture, that we have at least some of the broad categories

MR. AXILROD. We are working toward that end, but it will be at least some while, and of course it will be some while further to seasonally adjust them.

CHAIRMAN BURNS. Mr. Baughman, I'm sorry, I haven't been attentive, but has your question been properly handled by Mr. Axilrod?

MR. BAUGHMAN. Taken care of as far as I'm concerned.

CHAIRMAN BURNS. All right, good.

SPEAKER(?). Mr. Chairman, can I ask the Presidents to remain?

END OF MEETING