TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

November 20, 1979

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

Presentations by Messrs. Axilrod and Sternlight
at seminar on November 19, 1979

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

Meeting of Federal Open Market Committee

November 20, 1979

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, November 20, 1979, beginning at 9:30 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Kimbrel
Mr. Mayo
Mr. Partee
Mr. Rice
Mr. Schultz
Mrs. Teeters
Mr. Wallich

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

Messrs. Baughman, Eastburn, and Willes, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis, respectively

Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. Petersen, General Counsel
Mr. Mannion, 1/ Assistant General Counsel
Mr. Axilrod, Economist
Mr. Holmes, Adviser for Market Operations

Messrs. Brandt, Henry, Keir, Kichline, Scheld, Truman, and Zeisel, Associate Economists

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

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1/ Entered the meeting following the ratification of System open market transactions in Government securities, agency obligations and bankers acceptances.

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

Mr. Coyne, Assistant to the Board of Governors

Messrs. Gemmill and Kalchbrenner, Associate Directors, Division of International Finance and Division of Research and Statistics, respectively, Board of Governors

Mr. Prell, Deputy Associate Director, Division of Research and Statistics, Board of Governors

Mr. Beck, Senior Economist, Banking Section, Division of Research and Statistics, Board of Governors

Ms. Farar, Economist, Open Market Secretariat, Board of Governors

Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Balbach, Boehne, Burns, J. Davis, Eisenmenger, and Fousek, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Philadelphia, Dallas, Cleveland, Boston, and New York, respectively

Messrs. Bakstansky, Broaddus, Corrigan, and T. Davis, Vice Presidents, Federal Reserve Banks of New York, Richmond, New York, and Kansas City, respectively

Mr. Bisignano, Director of Economic Analysis, Federal Reserve Bank of San Francisco

Mr. Miller, Assistant Vice President, Federal Reserve Bank of Minneapolis

Mr. Ozog, Manager, Securities Department, Federal Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting of
November 20, 1979

[Secretary's note: On the day before this meeting, the staff conducted a seminar for the Committee regarding the experience to date with the new operating technique. That session was not an official part of the FOMC meeting and therefore was not transcribed. However, copies of the presentations given by Messrs. Axilrod and Sternlight at the seminar were retained in the Committee's files and are appended to this transcript.]

CHAIRMAN VOLCKER. The meeting will come to order. We need approval of the minutes for [the previous] two meetings. If anyone would like to so move--

MR. MAYO. So moved.

CHAIRMAN VOLCKER. Without objection, we shall approve the minutes of the two meetings. Mr. Pardee.

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

MR. BLACK. Scott, you said that the only thing the foreigners thought we had going for us was our monetary policy. Do you mean in the short run? Do they not see the improvement in the balance of payments that has been projected by the staff?

MR. PARDEE. They see the projections. They've seen the projections over the last few years--the forecast of an improvement on our trade and current accounts and improvement in our inflation picture. And they're still waiting to see when it will come.

MR. BLACK. They don't believe it, in short.

MR. PARDEE. They believe it will come sooner or later, but they're not going to bet on it.

MR. WALLICH. Do you think they're looking beyond the present cycle toward a more distant future in evaluating the improvement in the current account, which is cyclical?

MR. PARDEE. Well, again, there's the oil price situation and the Iranian situation. Any forecast one would normally make would be positive for the dollar, but people are not willing to bet on that forecast given the uncertainties in the oil area and the Iranian situation.

MR. WALLICH. Do you see any important central bank constraint in the use of the dollar for intervention purposes because of not wanting to do damage to the dollar?

MR. PARDEE. They've talked of it a little but I don't see [a lot of that]. The Swiss National Bank has been careful not to sell dollars this time around. Remember, back in August their selling of dollars was one of the elements that triggered the adverse market sentiment. They finally decided that the Swiss franc had gotten so weak that they would start selling dollars; the first time they showed themselves in the market then, the market moved away from them very quickly so they actually did not sell any dollars. But they're being much more cautious this time around than they were back in August in selling dollars.

MR. WALLICH. Thank you.

MR. COLDWELL. Scott, do you see any further rate changes on the horizon abroad?

MR. PARDEE. Interest rates? I would pray that I wouldn't but they face some of the same inflationary pressures we do. The oil price has continued to move up. Many of these countries buy their oil in the spot markets, and to the extent that spot prices have continued to rise this fall it's possible that they will have further inflation feeding into their economies. So--

MR. COLDWELL. Well, I recognize the fundamentals argument. My question was really about the near term. Are you seeing or hearing any noises about changes?

MR. PARDEE. That's why I say I would pray that [the answer is no] for the time being since everybody has raised their interest rates--the Germans, the Japanese, the Swiss, the British, the Canadians, and I'm not sure how many more--since October 6. The Greenbook has a list. I would hope that they're all done for the time being--for the rest of this year. But the fundamentals are still a problem.

MR. EASTBURN. Scott, how understanding would they be of a decline in interest rates here? If the economy weakens substantially, would they understand that?

MR. PARDEE. If "they" is the central bankers, they might understand it or explain it. What has happened so far--the backing off of the funds rates and some moving back of [other] interest rates from the peaks in mid-October--has been taken in stride probably both by the central bankers and the markets. But there is some sort of trigger point where people will begin to wonder whether we have lost our resolve. I don't think that has happened up to this point.

MR. BLACK. Suppose that is accompanied by a clear control over the aggregates. Would they have pretty much the same reaction?

MR. PARDEE. Not everybody has the same perception of what our control over the aggregates is. It's the reading of the economy and the economy is softening. Surely if we could get better control of the aggregates as well, some people would say that's fine, the Federal Reserve is doing its job. As long as inflation remains very high there are still the real interest rate arguments. Most Europeans believe that interest rates have to be positive in real terms in order for monetary policy to have an effect; and many people in the exchange market believe that.

MR. WALLICH. Could I just say a word on this? At the last Economic Policy Committee meeting at the OECD, from which Charlie Schultz and I have just returned, the United States made a long presentation [on U.S. economic and financial developments], including our domestic monetary policy. Charlie and I got just three questions on this. The only subject of these three question was this: What is going to happen when the aggregates and the economy slow? Are you going to let interest rates go down? We, of course, gave the standard answer: that when inflation comes down, the money supply slows and the economy slows and then it will be appropriate for interest rates to come down. I don't know what the reactions were; there wasn't any come-back on that.

MR. BLACK. It sounds as if they accepted that as a reasonable outcome.

MR. WALLICH. They're not stupid. I think they have to accept it as reasonable, but they also figure that it means there will be dollar weakness.

MR. BLACK. They're hoping the aggregates will slow and interest rates will remain high--both.

MR. WALLICH. I think inflation coming down will be the most convincing single thing but unfortunately we're locked into a CPI that has certain lagged features from mortgage rates and from energy. So one can't promise anything.

CHAIRMAN VOLCKER. Do you have any recommendations with respect to operations, Mr. Pardee?

MR. PARDEE. I have two, one with respect to current operations and one with respect to the swap arrangements themselves. Between now and December 28 we have eleven swap drawings for 1 billion 654 million dollars coming due with the Bundesbank. These are all first renewals and need no formal action by the Committee. A second renewal--and this is the first one in all of these operations we've taken since last June--for 88 million dollars equivalent will be coming up in that time span. I will need Committee approval for that now so I can renew it should we not have the opportunity to repay it by that time. That is my first recommendation.

CHAIRMAN VOLCKER. Any comments?

MS. TEETERS. It's 88 million dollars with whom?

MR. PARDEE. The Bundesbank.

MS. TEETERS. All these are with the Bundesbank?

MR. PARDEE. Oh, yes. Those are the only swaps we have outstanding.

MR. MAYO. So moved.

MR. KIMBREL. Scott, you [requested Committee approval of a renewal] in the event you do not have an opportunity to repay it. Are you optimistic on that?

MR. PARDEE. Well, during the last month the Bundesbank has been very helpful in channeling marks to us from their non-market transactions. That's how we have been able to repay the 300 odd million dollars worth of swaps. If the Iranian situation quiets down and we can resume these kinds of operations, the 88 million dollars is at the head of the list to be repaid. We try to repay the longest maturity first, so I would hope by that time we will have repaid it. But [if not], this would be a second renewal and that is always one that requires Committee action.

MR. KIMBREL. I second.

MR. WALLICH. I share Scott's view on the present situation as to how we should proceed. I continue to think that if things quiet down and we get halfway stable markets, we ought to make it a routine to buy a few tens of millions a week or a few million a day, letting the market see that these are routine transactions in order to repay [swap drawings]. So we get [marks] on that basis without always frightening the market when we move in--having the market think that we're trying to cap the rate at that level. But I would agree with Scott that until the Iranian situation settles down, this isn't the time to start such a policy.

CHAIRMAN VOLCKER. Without objection, we shall approve it. Now you have another recommendation?

MR. PARDEE. Yes. Between now and December 28 all of the swap arrangements themselves mature. We have arrangements with 14 central banks and the BIS and I simply recommend that I be authorized to renew them all as they stand. As you recall, last year we entered into extensive discussions with the Bundesbank over eliminating the 50-50 even sharing of risk clause on our drawings. [That was to be done] in exchange for shifting to the use of their interest rates rather than ours on the investment of the dollars that arise out of our drawings. There is still much to be said for the change and we found at that time that the U.S. Treasury agrees in principle, but the Treasury is still reluctant to make the change, particularly now given that we are heavily in debt to the Bundesbank once again. Up to this point the Germans have not pressed the issue this time around. I would hope we can wait for a more opportune time. So I'd rather renew the swaps strictly as they are without any change and review the 50-50 problem at a more opportune time. That is my recommendation.

CHAIRMAN VOLCKER. Any discussion? If not, we need a motion. I guess we need a motion before the discussion.

SPEAKER(?). So move.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Any objections? If not, we will approve it. Having approved recommendations for the future, we better ratify the transactions for the past. Do I have a motion to that effect?

SPEAKER(?). So move.

CHAIRMAN VOLCKER. If there are no objections, we shall approve them. I'd like to say that the question has arisen as to whether the Japanese--the yen has been weak, as you know--may want to draw on their swap [line with us]. We have given them a preliminary indication that in a moderate amount of, say, $300 million that would be all right. I don't know if they will draw or not because the yen has strengthened a bit; I don't know whether there's been any subsequent strengthening. It's the other side of the Iranian situation; I suppose that's the reason it has strengthened. So I don't know what sense of urgency there is now. Do you?

MR. PARDEE. Well, they've seen some turn in their capital accounts. They're hoping that their trade account will turn later this year, just as a sort of very short-term bridge. They are still discussing other measures they might take if they need to on various capital controls. And they thanked us very much; they are grateful that we have agreed in principle on the swap drawing and they will be back to us if they need it. They don't need the money; it's just the question of having this gesture of cooperation from the United States authority at a moment of a little bit of isolation for them. Theirs is the only currency other than the dollar that has been heavily sold in this experience.

CHAIRMAN VOLCKER. They have something like in reserves as I recall, so they're not exactly out of money.

MR. WALLICH.

CHAIRMAN VOLCKER. Well, it has been offered; whether it will be used, I don't know. Mr. Sternlight.

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

MR. KIMBREL. Peter, if those two [dealer firms] are deleted, you'll have a net number of trading firms then of--?

MR. STERNLIGHT. I think that would make it 34 or 35 or something close to that.

MR. PARTEE. You do business with 35?

MR. STERNLIGHT. Yes.

MR. PARTEE. With everyone on the list you have some activity?

MR. STERNLIGHT. Well, there are a couple of firms that have been added to the reporting list with whom we do not yet trade. One that was added several years ago but hasn't quite brought itself to sufficient volume for us to trade with is the Crocker Bank. Also, Smith Barney was added to the reporting list just a few months ago and it is getting very close to the point of having a trading relationship.

MR. KIMBREL. What is the split between banks and nonbanks?

MR. STERNLIGHT. About 1/3 of them are banks.

CHAIRMAN VOLCKER. Any other discussion? Is there a motion to approve the transactions?

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection, they are approved. We have Mr. Truman and Mr. Kichline on the economic situation today--the [extended] horizons of the American economy. Mr. Truman.

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

CHAIRMAN VOLCKER. What are you assuming about the oil price decision in December?

MR. TRUMAN. We are assuming that some of it has already been taken and essentially that we're going to get a 20 percent increase in December.

CHAIRMAN VOLCKER. You said a 23 percent increase or something from this December to next December.

MR. TRUMAN. That's for oil imports. Our actual oil import prices are reflecting the higher spot prices that are now occurring and there will be a convergence--spot prices will come down. So we're getting in the oil import prices in this quarter, as we had even last quarter, essentially the anticipation of the oil price increase reflected in the spot market.

MR. KIMBREL. Ted, the dollar amount then in this last quarter actually would average out to about what?

MR. TRUMAN. This last quarter we have a $23/barrel assumption for the import price. But that's very much higher than the official posted prices, let me say, of the OPEC countries even with the increase that they've had, because of spot--

CHAIRMAN VOLCKER. What are you assuming, say, in February or March for import prices?

MR. TRUMAN. Well, the price goes up at about a 10 percent annual rate after the first part of the year.

CHAIRMAN VOLCKER. So you're not assuming much impact in December?

MR. TRUMAN. We're assuming 20 percent.

MR. PARTEE. You said after the first part of the year it's about 10 percent. So you have a 20 percent [increase] and then a drifting up from that point.

MR. TRUMAN. As far as the OPEC contract prices, we have a 20 percent increase on the first of January and then 10 percent across the year. When you translate that into our import prices, that translates into a 23 percent increase fourth quarter over fourth quarter. That's because the spot market activity will be [reflecting] some of the OPEC price increase--in effect, the official contract prices--in this quarter as it did last quarter.

MR. COLDWELL. So you're looking at a price of about $30 a barrel.

MR. TRUMAN. About $28 a barrel; we have $28-1/4 in the fourth quarter of next year.

MR. PARTEE. Is your fourth quarter of 1979 price higher than you had before, too?

MR. TRUMAN. Yes, by about 10 percent. Another way of characterizing it, although I decided not to put it into this little story, is that a couple months ago we essentially had assumed that the real price of oil was going to be unchanged in 1980. Now we are assuming, in effect, that the real price of oil will increase by 20 percent. So, for the fourth quarter of 1980 the price is now 20 percent higher than we had assumed. I'm not sure if that helps.

MR. PARTEE. That certainly wipes out any monetary policy effect.

CHAIRMAN VOLCKER. We will be fortunate if it is that small.

MR. PARTEE. Right, that's what he said.

MR. WALLICH. On the other hand, not to seek to achieve a monetary policy effect would just mean that that effect would be all the bigger.

MR. PARTEE. It's a large increase.

MR. TRUMAN. Shall I continue?

CHAIRMAN VOLCKER. Proceed.

MR. TRUMAN. [Statement continued.]

CHAIRMAN VOLCKER. Let me ask a question. You say the current account is essentially in a zero position this year. In the way we used to calculate the current account a couple years ago it would be what?

MR. TRUMAN. It would be minus about $15 billion.

CHAIRMAN VOLCKER. It's a $15 billion difference.

MR. TRUMAN. The improvement between the two years, rather than being $14 billion, is approximately $8 billion. So you still have the significant improvement in the level no matter which way you calculate it.

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

MR. COLDWELL. Jim, suppose your presumption is incorrect--that both you and Ted have misgauged [the oil price outlook]--and the OPEC price goes up something like 40 percent.

MR. KICHLINE. Well, in that case, we'd be talking about adding another quarter or half point to the deflator and I would think taking at least something comparable, if not more, out of the real side. And in the short run I think there is quite a rapid passthrough now of these costs. We'd get some lag effects obviously into 1980 and 1981, but we do get fairly immediately a rapid increase in prices.

MR. COLDWELL. So if there were to be something like a 40 percent increase in the [oil] price level coming out of the December OPEC [meeting], you'd expect this to be hitting the first half of 1980?

MR. KICHLINE. We'd expect a good chunk of it to hit in the first half, but [the effect] carries on. In the current forecast, which has an increase of roughly half that size, we have--

MR. COLDWELL. That's why I doubled it.

MR. KICHLINE. We think our forecast is likely to entail something like a 3/4 percentage point increase in personal consumption prices. That is in addition to the other things going on in the energy area, of which there are many. If we were to assume roughly symmetrical effects, we'd double that, so it gets into the 1-1/2 percent area. So we would see fairly promptly--namely, in the first half--a substantial increase. That is a very bearish outlook and hopefully one that won't come to pass. Even if we have some supply side effects in terms of constraining consumption, it seems to me that you're talking about a poor outcome.

CHAIRMAN VOLCKER. Well, I'm a little confused. Are you saying a 40 percent increase in imported oil prices will bring a 1-1/2 percent increase in GNP prices?

MR. KICHLINE. In 1980, right.

MR. COLDWELL. Over and above what he already has.

MR. KICHLINE. No, that's the total effect.

MS. TEETERS. It's 3/4 point for 20 percent.

MR. COLDWELL. 3/4 point in addition.

CHAIRMAN VOLCKER. What percentage of the GNP is oil now?

MR. KICHLINE. I don't know. The deflators in the energy sector in GNP are about 8 percent.

MS. TEETERS. Ted, am I right that you rather markedly changed your outlook for [growth in] foreign economies, mainly because of the higher oil prices?

MR. TRUMAN. Yes. We have marked it down quite remarkably. We essentially have real growth over the next four quarters of 1-1/2 percent, which is slow growth. Only in one of the major countries do we have what we call a recession, or negative growth. But we have [economic activity in] all the major countries dropping down--essentially growing at half the rate over the next four quarters that they had over the previous four quarters. And the last four quarters have been affected to some extent by the oil prices in 1979. So we have a sluggish outlook abroad. And the improvement in the current account or the trade balance is very small in terms of volume. I don't think there is much increase in the volume of exports from here on in. But the fact is--if I may put it this way--that if our prices are going to go up 10 percent, that means we're going to get something like a 12 or 13 percent increase in the value of exports at a time when the value of our imports stagnates. That's where we get the improvement in the--

MS. TEETERS. But you were counting on [the economies of] our trading partners growing at 3 to 4 percent next year and on that helping our balance of payments.

MR. TRUMAN. Well, that was some time ago. A forecast of 3 percent was reasonable at the beginning of the year.

MS. TEETERS. But now their [expected growth is] down almost to that danger point where they could tip into a recession.

MR. TRUMAN. It is at the point at which it may be somewhat arbitrary [whether we call it a small positive or small negative]. Sluggish growth is the way I'd say it.

MS. TEETERS. So the possibility does exist that we could get a worldwide recession?

MR. TRUMAN. Yes, and if you add in the United States with our forecasts--[unintelligible] others which are less pessimistic, let me put it that way--growth for the OECD area, including the United States, is about zero. It's minus 1-1/2 percent here and plus 1-1/2 percent there; and we're about half or 40 percent of the total, so it's essentially zero.

MS. TEETERS. We've never managed to grow at 1 to 1-1/2 percent without sliding into a recession. Have the others?

MR. TRUMAN. Well, in the rest of the world, other major industrial countries--with the exception of the oil crisis--have not had recessions in the postwar period. They've had growth recessions, but they've not had negative growth or recessions. So there is really no comparable experience with the exception of the United Kingdom.

MR. WALLICH. You know, this discussion does not really reflect what went on at the OECD meeting. The numbers are roughly the same but there was not a great sense of pessimism and not a sense of world recession. Rather there was a mild degree of feeling that it was good to have economies desynchronized instead of having the cycle moving synchronously everywhere.

MR. TRUMAN. Henry, let me correct you on that. Our forecasts are lower than the OECD forecasts in large part because they essentially were dealing with our old oil price assumption of no increase in the real price of oil in 1980. So we have a very different outlook. Their forecast is close to 2 percent for the same G-10 countries, whereas ours is close to 1-1/2 percent.

MR. WALLICH. I know, but by the time this discussion took place the recent increases were known so that was reflected in the conversation.

MR. TRUMAN. True, but I would comment that within the U.S. government, for example, people are only now in the process of focusing on the implications of the [outlook for] oil prices. And I think the same is true for most other countries' forecasts; they have not looked at their official forecasts since July. They're now looking at them and when they finish, I think they will end up with a much more bearish picture than they had a few weeks ago. That's somewhat of a hypothesis but I think that's what is happening. It's fair to say that that is the process that we went through over the last four weeks.

MR. BAUGHMAN. Did I understand you to say that you are expecting essentially an equivalent move in the consumer price index for these countries, from a 9 percent rate of increase to 7 percent?

MR. TRUMAN. This quarter in round numbers it's 9-1/4 percent; a year from now it's 7-1/2 percent. It looks like their consumer price inflation rate peaked last quarter at 11 percent plus. [We expect] some moderation. And they don't have the assistance of housing costs and things like that on their consumer price index.

MR. PARTEE. You've taken into account the higher oil price increase in doing that?

MR. TRUMAN. We tried to, let's put it that way. The forecasts are all supposed to be consistent.

CHAIRMAN VOLCKER. I still don't understand this oil price business. If the weight is 8 percent and you get a 40 percent [price] increase, that's more than 3 percent of GNP. Why doesn't it have a 3 percent impact on GNP?

MR. KICHLINE. What I was quoting was energy prices. We forecast the energy price deflator, which aside from imported oil includes domestic oil, coal, and natural gas prices. When you put that all together, you find that domestic prices would tend to be rising more rapidly as time goes on because of the decontrol. But next year, unless a change is made, it seems that the Alaskan oil will bump against the ceiling. So Alaskan oil will be constrained in its upward price movement. Natural gas supplies are abundant right now. Pricing there is permitted to go higher with increasing inflation, but in fact the market for natural gas is fairly weak and natural gas is readily available, so we have held down the price increases in that area. And the coal market is very weak. So, I don't know right off the top of my head how to translate imported oil into the PCE deflator context. Do you Jerry? We can provide a memo to the Committee, if you like, on the energy sector and its price implications. That might help.

MR. WALLICH. Imported oil is about 3 percent of GNP. Imported oil is half of our total oil [consumption], isn't it?

MR. TRUMAN. Yes. But the point is, as Jim explained, some prices move with imported oil and some prices move partially with imported oil, and one has to add all those things up.

CHAIRMAN VOLCKER. You still haven't included any indirect effects?

MR. KICHLINE. That's right. And in our forecasting exercise they carry well into 1981.

MR. PARTEE. With respect to Governor Coldwell's question, in your additive process you haven't really included any dynamics in the business effects. That is, there must be a point at which another 3/4 percentage point decline in real consumption would have a material impact on inventories and capital spending that would run through the economy in an accelerated way.

MR. KICHLINE. That's right. The 3/4 point effect, for example, this year did not carry through fully to our price forecast. It's roughly 1/2 percent. So we have weaker activity as a result of higher world oil prices and in fact we assume that's going to have an impact in other areas in the domestic economy.

MR. WILLES. Now I'm confused--not that I wasn't before. I thought that when you calculated the U.S. deflator the price of imported goods [always] came in with a negative sign.

MR. KICHLINE. It does.

MR. WILLES. That means that if the price of imported oil is going up relatively fast, that can have a strong impact on the CPI but it's not at all clear that it will have a direct impact on the deflator.

MR. KICHLINE. I was referring to the personal consumption expenditure deflator. It gets measured there directly and subtracted out when we look at the difference in export and import prices. So the deflator will always understate the effect--the price impact--on consumers of rapid increases in foreign prices. When we look at the personal consumption area or the CPI, as you mentioned, we're going to get the full effect.

MR. WINN. My own feelings are perhaps more pessimistic for '80 than yours, for different reasons. I wonder in terms of our current analysis how much allowance we should make for the shock effect aspect [of developments in the energy area]. For example, when we had our [earlier] energy shock, it wasn't really the price but the [concern about] availability that caused people to back off. It then picked up substantially. [I wonder] how much shock effect we'll be getting in behavior for the moment and to what extent that may [erode] because availability is really not affected though price certainly has been in the real sense of the term. So perhaps some of the momentum we've seen will pick up again.

We have the seasonal [issue] of Christmas and then [the question of] how much change in attitudes might be expected out of that kind of [energy price] development. On the other side, we know that the shock effect [from] October 6 caused construction--in terms of new starts--to turn off completely. That doesn't show up for three months in terms of the set up. In contrast to that, of course, is the fact that leasing is just going crazy now because of projected shortages; I wonder how much of that will be reversed if availability is not [a problem]. So availability versus price and its impact may give us a different path than we would get from a normal cyclical type of analysis.

MR. BAUGHMAN. With the rising price of energy--and I'm thinking now primarily of electric energy--and a presumed move by industry to use it more efficiently, is there a possibility that that will give us a lower industrial production index than we might overwise have had?

MR. KICHLINE. We've tried to account for that as best we can. As you well know, a number of years ago we had a fine idea to use for part of the IP index electric power usage as a proxy for output. That was pre-1973. And we've felt very nervous about that ever since 1973, quite frankly. Some of the past data that have come in--this was several years ago now--on output measures from the Census Bureau have given us some hints that perhaps we weren't off that far in the past. We've done some informal checking and we've made downward adjustments, but it's clearly a very hazardous area. We could well be understating output from that side rather than overstating it.

MR. BAUGHMAN. But you're not continuing to use whatever factors were developed?

MR. KICHLINE. No, we have made adjustments since about '72, I guess, when--

MR. PARTEE. You still use electric power. But you have a trend factor that's more--

MR. KICHLINE. Yes, it's about--

MR. ZEISEL. In a sense the productivity factors have been changed.

MR. PARTEE. And then of course you still have output [data]. You still have manhours, too, and you can look at the manhours.

MR. KICHLINE. That's right. And we have physical product data with a lag that accounts ultimately for about half the series.

MS. TEETERS. Jim, you had a model that tracked inventories that ran off industrial production data, which you reactivated again. Is that tracking the GNP data still? Do the inventory numbers in the GNP account look to be correct?

MR. KICHLINE. They do not look out of line.

MR. COLDWELL. Jim, as I look over your forecast, you have some fairly heavy negatives on gross private domestic investment in the fourth quarter [and] the first quarter of next year. But in terms of the GNP, I assume that your decline in personal consumption expenditures made the tail wag the dog here. Is that a good assumption?

MR. KICHLINE. Well, I think they're both important. On the investment side, the big mover in the short run for some time has been residential construction investment; business fixed investment is important as well. For 1980 as I remember we have a decline in business investment measured from the fourth quarter of about 3 percent. And durable personal consumption expenditures are down around 4-1/2 percent. So we have placed a major emphasis on the behavior of personal consumption expenditures, principally the durables component. I think it's a fair judgment, but I would weight both of them quite high in terms of influencing the [economy's] performance in this forecast.

MR. COLDWELL. You have government purchases going up and I don't have the [unintelligible] proportions here to balance off but it looked to me as if you might have an offset here between government purchases and gross private [investment], leaving consumption as the swing package.

MR. KICHLINE. In dollar terms, certainly the goods portion of consumption is about twice the size of the investment sector.

MR. COLDWELL. What are the possibilities that the consumer is going to confound you still in this fourth quarter and push off the decline until the first quarter of next year?

MR. KICHLINE. I would not be willing to risk any of my own money on consumer behavior. I think it's possible. Our view has been that the arguments against that strengthen as each month goes by and as consumers have been using financial assets or debt or reducing savings to finance their purchases. But who knows? It's quite conceivable that [consumer spending] will be strong.

MR. COLDWELL. My recollection is that the consumer surveys have been showing a little more strength lately.

MR. KICHLINE. That's true.

CHAIRMAN VOLCKER. You really have to get a pretty big decline in consumption in November and December to make this come out right, don't you?

MR. KICHLINE. No, I think our forecast is that if we get zero to a 1/4 percent increase in retail sales in November and December, we will hit this number.

MR. PARTEE. If you get what? What was the number?

MR. KICHLINE. A quarter of a percent increase in total retail sales excluding autos. We have a separate auto forecast. That's nominal.

CHAIRMAN VOLCKER. In nominal terms.

MR. KICHLINE. That's right.

MR. COLDWELL. Your October figure is preliminary?

MR. KICHLINE. Oh, yes. It's the advance; it's not even the preliminary report.

MR. COLDWELL. The "flash" or whatever you want to call it.

MR. PARTEE. And it could go the other way, too, couldn't it?

MR. COLDWELL. It could go the other way.

MR. PARTEE. I think we could have a very poor Christmas season, which would start out the new year with an inventory clean-up job and that kind of thing.

MR. SCHULTZ. I don't want to be a Pollyanna, but do you have any sense at all of when we will begin to get some very substantial substitution in the energy area? Clearly, we're getting to the point in energy prices where a lot of secondary and tertiary recoveries get to be very attractive. You point out that the natural gas substitution can go on both in homes and industrial use. Coal, as you say, is very weak. Yet there are a lot of energy plants that can be reconverted to coal. At what point does any of this really start to occur with a vengeance? Do you have any feel for that at all?

MR. KICHLINE. No, I don't. We have been getting scattered reports suggesting that some utilities have been switching back. Those that converted under pressure or for price reasons have been switching back and trying to return to the use of natural gas. But there are constraints in these areas. I guess our view is that we don't know enough about the nature of that market to make a reasonable assessment. It's very clear, given price and availability, that the incentives today are there to switch. But we don't have a good feeling for the technical problems involved in this area.

MR. WILLES. Just two things, Mr. Chairman. I wanted to make a comment very much along the lines of the question asked by Phil Coldwell. The national and international companies headquartered in our region who deal not only in the manufacturing area but in the retail area report exceptionally strong orders and backlogs. They're surprised; they can't believe it. So it may well be that the fourth quarter is buying a little from the first half of next year and this quarter will be a little stronger than we expect.

Second, I want to tell the staff how much we appreciate their finally understanding rational expectations because we noticed that in our copy of the supplement to the Current Economic and Financial Conditions the page that is supposed to have capacity utilization on it was blank. And we think they finally understand!

MR. PARTEE. You mean rational expectations are an empty box?

MS. TEETERS. Mark, I think you had the only copy with that particular page blank.

CHAIRMAN VOLCKER. Perhaps we can have Mr. Axilrod's statement and then we'll have a coffee break.

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

CHAIRMAN VOLCKER. Well, you've given us something to chew on other than a donut!

MR. PARTEE. May I ask just one question? Steve, did I understand you to say that you were assuming $2 billion as the initial borrowing on alternative C?

MR. AXILROD. Alternative C.

MR. PARTEE. And $1-1/2 billion on alternative B?

MR. AXILROD. Yes.

MR. PARTEE. And what on "A?"

MR. AXILROD. On "A" it's a little over $1 billion.

MR. PARTEE. All right, that's an important variable that I think we ought to--

CHAIRMAN VOLCKER. That's not saying that that couldn't be changed.

MR. PARTEE. Yes, of course. That's one of the things I think we ought to vote on.

MR. BLACK. Could I ask one brief question, Mr. Chairman? Steve, you mentioned that under "B" you have a 9-1/2 percent increase in M1 from mid-November to year-end. What is the comparable figure for "C?"

MR. AXILROD. For "C," it's between 7-1/2 and 8 percent--1-1/2 to 2 percentage points [less].

MR. SCHULTZ. That's seasonally adjusted.

MR. AXILROD. Seasonally adjusted--no, just in the sense that I took it from week to week.

CHAIRMAN VOLCKER. These all also assume we get a weak number in the next published weekly figure, which we don't know. The preliminary figure shows a decline of $2 billion?

MR. AXILROD. Yes.

CHAIRMAN VOLCKER. If it came out substantially above that, all these growth rates would have to be smaller between now and the end of the year.

MS. TEETERS. But that's following a week in which we had a $3 billion [increase].

MR. AXILROD. It might be fairer to view it as under "B" that we have targeted growth in November of 1/2 of one percent and in December a monthly average of 10 percent. Under "C" in November it's about 1/4 of one percent and in December about 8-1/2 percent. I just want to give a sense that we need to push it up, but the week to week [pattern] can vary just depending on how the weeks turn out.

MR. RICE. Steve, is that 9-1/2 percent growth in M1 over the November and December period what you expect under alternative B or what would be consistent with the 4-1/2 percent?

MR. AXILROD. Yes, that's what we in effect targeted to get the 4-1/2 percent [growth rate from September to December].

MR. RICE. What's the likelihood that we'll get 9-1/2 percent over the period [to year-end]?

MR. AXILROD. If the Committee puts in the reserves--the reserve path we've designed--we believe we will get it. Where we're uncertain is whether that will be with stable interest rates or declining rates. Our general view is that it will probably be with some decline in interest rates, which is the reason we started that path off with borrowing of $1-1/2 billion--a shade lower than we have had in recent weeks.

MR. RICE. But that is the most likely rate of increase?

MR. AXILROD. It is our collective-type projection of what would happen to money. If interest rates didn't change at all, it would be slightly lower than in alternative B.

MR. COLDWELL. Yesterday we talked about the possibility of extending our horizon on this. Are you planning to make any comment on that, Steve?

MR. AXILROD. We did put in the Bluebook--for general guidance--January figures. And I could--

MR. PARTEE. You don't show rates for January.

MR. COLDWELL. You don't show rates; that's my point.

MR. AXILROD. I can tell you what we did there. We assumed you had a 6 percent M1 growth target for the year 1980. So we calculated from the fourth quarter average to the first quarter average a growth of 6 percent. And the figure there for January for alternative B is a level that gets right on that [6 percent] line from the fourth quarter to the first. For alternative A, it's a little over that because [that alternative involves] easing now. And for alternative C it's a little under it. The level that would be implied for alternative B for January gives a January growth rate from December of 5.7 percent, just on a month-to-month basis.

CHAIRMAN VOLCKER. You're saying that if we continue that rate--sort of--for February and March, the first quarter would be 6 percent above the fourth quarter?

MR. AXILROD. It might. I don't know the exact February and March [pattern] but it would be somewhere around there. They could be, depending on how the averages work out.

MR. COLDWELL. Well, comparable to the 4-1/2 percent path that the Committee agreed to for September to December, what would be the rate for--

MR. AXILROD. I don't have worked out a continuation of the 4-1/2 percent path because--

MR. COLDWELL. Well, I didn't mean necessarily the continuation of 4-1/2 percent, but what would be the path you would recommend for November through January?

MR. AXILROD. "B."

CHAIRMAN VOLCKER. "B" is the 4-1/2--

MR. COLDWELL. Through January.

MR. PARTEE. It's a lot higher than that, I think.

MR. AXILROD. From September to January, the growth rate under "B" is 4.8 percent.

MR. COLDWELL. So from November through January you're talking [a bit] higher.

MR. AXILROD. From October to January it's 5.5 percent; there's very little difference between that and 5.7 percent for the month.

MR. PARTEE. How much correction does "C" make on that? What is the growth rate under "C" from December to January?

MR. AXILROD. In "C," from December to January it's 4.4 percent. We assumed that the Committee would be restraining growth a bit below path in the first quarter, so we have it below and then coming back up. So in January M1 is a little below that 6 percent path. These are all things the Committee can adjust, but that's the assumption we made if you went to alternative C.

MR. PARTEE. So you'd have 4.4 percent for January. Then that means you would have something under 4-1/2 percent for the 4 months. And for the 3 months from October to January growth would be about 4-1/2 percent, I guess.

MR. AXILROD. It would be 5 percent because the January growth rate picks up a little relative to the other alternatives to begin [to get M1] coming back on the path.

CHAIRMAN VOLCKER. In the future, as we said yesterday, I think it would be helpful to spell this out with a little more precision over a longer period of time. This is related to when we next meet and we might just think about that a bit. My inclination at the moment is that we might as well meet again in December and consider [our targets for] next year in a preliminary way--not all of next year but I'd look at this in a context of at least through the first quarter. And we can't do that very well without some preliminary notions about what that whole year should be. But then in February, we've got to decide about the year. Now we could change the date of the meeting and make it after Christmas and early in January, I suppose. So, think about that.

MR. AXILROD. Does that mean that at the next meeting, Mr. Chairman, you'd like us to provide paths with alternative longer-run growth rates because the year is starting over and also looking ahead 3 months, say?

CHAIRMAN VOLCKER. By that time I presume we'll have complicated it all by having a new definition of the money supply.

MR. AXILROD. I think the Board is going to make a decision on that shortly.

MR. PARTEE. Certainly in January we will, [ahead of] when we go up to Congress.

CHAIRMAN VOLCKER. So it's going to be a little complicated to say the least. Well, let's have a coffee break.

[Coffee break]

CHAIRMAN VOLCKER. I would like to go around the table and get some general discussion of the economic situation and at least a preliminary statement of policy. Then we will focus hard on policy specifics. I remind you that Steve expressed the dilemma very well. One can argue that from the standpoint of domestic business activity it would be nice to get some fairly early declines in interest rates, to the extent we can do that consistent with the general framework of the money supply decisions we made. On the other hand, [that's not the case] from the standpoint of inflationary expectations--which I don't think have changed so much--and from the standpoint particularly of the unrest in Iran adding to the possibilities of turbulence in the oil markets and an oil price decision that we are not going to like. That is the major risk we are running and not just in a narrow sense. It's a major risk the country is running and the world is running. To the extent we can have any marginal influence on that, it points in the other direction [for policy]. So there certainly is a dilemma in the next few weeks.

Let me say that I think you ought to have in mind this conundrum regarding the [next] Committee meeting. The 18th [of December, our next scheduled meeting date,] is the day after OPEC meets, which is fine if OPEC has made a decision. It's fine in one sense, although it is obviously very early. The chances of OPEC meeting on the 17th and making a decision on the 17th are probably not very high. So it will leave us in a state of suspended animation on that day. Moreover, I don't think we will be in a position then to have absorbed all the distinctions of new and old money supply definitions and all the rest, looking forward to next year. There is the alternative of meeting on Tuesday, the 8th of January. The 8th, 9th or 10th of January [are possibilities]. If we did that, then presumably whatever decision we make here--subject obviously to an interim meeting--is not just for the remainder of November and

December but carries through to the early part of January, by implication, as well. We'll turn to that again later but I think it may have a little bearing on precisely what we do here. The dates are not ideal; at least the December 18th date isn't ideal for the two reasons that I suggested. On the other hand it's not at all impossible; it is scheduled, so we can proceed on that basis, too.

Let's get any general comments you have on the economy and the policy implications you see for it. Would anybody like to offer any comments? Governor Coldwell.

MR. COLDWELL. Mr. Chairman, from my standpoint it seems probable that the economy is going to decline. To me the timing still is a bit [uncertain] as to whether that is going to occur in the fourth quarter or the first quarter. But I think the chances are high that the fundamentals will bring the economy to a lower rate of growth and probably to negative growth. How much of a negative, I'm not prepared to say at the moment. I think there is a good possibility that we might have a fairly sizable negative in the first and second quarters of next year. The place where I would quarrel a bit with the forecast is in the consumption area. I think there is still some resilience out there in terms of the rate of change in consumption expenditures, possibly even by making use of some [increase in] debt, although there it is difficult to see how that can stretch much further than it is stretched. An overriding problem that I see is that even in the staff forecast we are looking at a 10 percent rate of inflation for at least the next nine months and maybe further than that depending upon some other things, including the potential for a very nasty OPEC decision.

In terms of the economy, I would mention one other thing. While we did get some curtailment in the rate of bank credit growth, the curtailment was from a 22 percent rate of increase to 18 percent or something like that. We've missed our guess on that by a very [large] margin. I believe our forecast on bank credit growth was something like 7-1/2 to 10-1/2 percent or some range in that neighborhood, so [actual growth] is almost double that. I don't find, as I wander around, any real stringency yet. There's an awful lot of talk about the price [of credit] bringing things under control [both] in terms of mortgage rates and I think to some considerable extent a usury problem in certain states, but liquidity still seems reasonably adequate for other kinds of [expenditures].

So my preference would be to tilt [policy] a little on the tight side now, given the prospects for next year, trying to make sure that we don't have a further expansion [in the aggregates], which might bring us to even higher rates of inflation. I'd like to keep the Committee's focus on the inflation side for the moment. I do think the chances of [recession] are high next year; and we will have to face the problem of to what extent we allow the rates to go down next year. But I don't like the possibility of those rates going down now, not only because of the potential [effects on the domestic side] for this quarter but also because of the international side.

CHAIRMAN VOLCKER. Mr. Willes.

MR. WILLES. I have to admit that I don't know what's going to happen to the real economy. I'm not sure I even know how to go about predicting that at the moment because it seems to me that it depends so much on what OPEC does and what the Congress does and lots of other things. I will go on to say, which will be no news to some of you, that in terms of policy it's not clear to me that it makes any difference what the real sector does over the next twelve months because I'm not sure that we have any demonstrated ability to have an impact on that--in a predictable way anyway. Therefore, for slightly different reasons, I end up exactly where Phil did in terms of focusing on inflation as the primary objective.

In terms of how we should do that, I have great concern about the process that we are using. It's not that I think we made a mistake in going to reserves. I think that's a tremendous step forward. But I'm not sure we have done that in such a way that we are likely to have a reasonably good chance of being successful. One of the things that we know is that if we change substantially the way we conduct policy, that is going to change people's behavior. Therefore, all of the old statistical relationships that we have been able to look at in the past--relationships between interest rates and reserves and monetary aggregates and so on--might well be in the process of changing because we have changed our focus presumably from interest rates to reserves. So all of the discussion that we have about trying to pick a monetary aggregates target and then backing away from that step by step to figure out what the reserves ought to be and the associated interest rates and so on, just strikes me as being backwards.

It seems to me that the only reasonable prospect we have of really making it work is to start at the other end and say, okay let's fix reserves and then let the system adjust to that. Clearly, we don't know exactly what impact that is going to have because we don't have any functions that are relevant in the new environment. But it doesn't seem to me that a lot of the things we have been talking about--unless we are lucky--are going to lead us to any kind of predictable result either in terms of the aggregates or in terms of interest rates. So I just feel very uncomfortable with the nature of the discussion that we are having in terms of how we hope to reach a policy decision. I can construct, given the kinds of conversations we have had so far, a relatively simple model that would say that what we would end up with are reserves that are totally demand determined. And it seems to me that we are trying to do just the opposite of that. We are trying to make reserves and, therefore, the aggregates supply determined. Yet the mechanisms we have set up would have just the opposite result. So, going back to yesterday's discussion as well as some things we have said this morning, I hope either today or in the near future we can discuss in detail the experiment that we are trying. I say that because it's not clear to me, regardless of what the ultimate objectives we set are, that we stand a very good chance of getting exactly where we want to go unless we just turn out to be lucky.

CHAIRMAN VOLCKER. Mr. Baughman.

MR. BAUGHMAN. Mr. Chairman, I would say with respect to a general economic forecast that I would subscribe to what Mark Willes has said as to the probable low value [any forecast] would have in the present circumstances. It seems to me that the staff projection is a reasonable one. I would not be surprised if [the economy] actually goes down more in the early part of next year than the staff has projected, particularly in the measure of industrial production, for example. But I'm not sure [that prospect] should weigh heavily in our policy posture today.

With respect to our region, of course, we have benefited in terms of local activity from the oil and gas business; the level of that activity is high and is continuing to rise. Notwithstanding that, of course, domestic production of oil is declining and I'm advised that the rate of decline will probably accelerate next year because the Alaskan line will have reached capacity. As it has been moving to capacity, it has given us an increase or has offset reductions elsewhere this year. So the outlook for continued growth of domestic sources apparently is somewhat bleak. With respect to softening in economic activity locally, insofar as there is any softening it seems to be traceable to usury interest rate ceilings. As nearly as we can tell from fragmentary information, the banks are doing a pretty good job of looking across the array of customers, as you suggested they should do, Mr. Chairman, in adjusting to the current situation and they are trying to avoid just lopping off large sectors of borrowers.

Moving from the economic picture to the policy picture, I'm [about] right on track with what Phil Coldwell has suggested. I read [the materials for this meeting] rather carefully, I thought, and I listened rather intently to Mr. Axilrod's comments. Accepting the proposition that we probably should continue the present policy for the time being, it seemed to me that alternative C came a little closer to that than the alternative B prescription. Obviously, there's not a big difference but on balance it seemed to me to come out that way.

CHAIRMAN VOLCKER. Mr. Timlen.

MR. TIMLEN. I must say that in my judgment the consumer has been a great source of strength for a long time and I think finally that is going to turn around. I'm particularly impressed by the fact that the impact of [the cost of] heating homes in the Northeast is going to present quite a challenge to some personal budgets and may affect spending plans. I've talked to a number of savings bankers and country bankers in New York and New Jersey over the past few weeks. And despite the Chairman's urgings, outside of New York City at any rate there is no mortgage money in a savings bank or small commercial bank. The banks in New Jersey and outside of New York City are even changing their terms on consumer loans and are not taking on new business. In the state of New York currently the thrifts are very concerned about their loss of funds outright to other investment outlets. And where they are not losing the money to other investment outlets, they are gravely concerned about shifting money from inexpensive savings accounts into various certificates. Generally that clouds my picture as to the strength of the consumer in the first quarter of next year.

I must say that for the first time we are hearing concerns in New York as to the possible implications for our banking system of either short-term or long-term withdrawals of OPEC monies from United States banks. I haven't heard that too often, but it is a matter of some discussion. I would say that from my standpoint the focus should continue to be on inflation until we get a better reading of the fourth quarter. And I do share the concerns about the position of the dollar in foreign exchange markets. Therefore, I would stand behind some variation of "C."

MS. TEETERS. Mr. Chairman, I think I can endorse a great deal of what has been said. I would like to make it very clear that I don't think we have any more control of the aggregates than when we were operating on an interest rate target. Yet the media and I think some of my colleagues here think that we have run out and put our hands directly on the aggregates; I don't think that's true. I agree with Mark that the fact that we've changed [our approach] is going to change the relationships. I believe we are going to have a great deal of difficulty and there is going to come a time when we are going to fail. We were lucky last month that it turned out the way it did. So, keep in mind as we are making policy that we aren't out there directly determining the Ms. And I'm a little concerned that when we begin to want to expand the money supply we will provide the reserves and there won't be any response in the money supply down the line.

I am also very concerned about the consumer. There is no housing money; [financial intermediaries] are loaned up. I think our policy should basically be steady as you go at the present time. I would not want to force the banks to borrow any more than $1-1/2 billion under alternative B because I do think the economy is going to turn down. And when it does, I think it's going to drop very suddenly. When people get the first monthly bill for heating oil it is going to hit us. I think there is going to be a gasoline shortage again and I feel that people quite possibly are going to be very conservative at Christmas. I would come out in support of alternative B with $1-1/2 billion of borrowings and I would increase the federal funds rate. In other words, I favor a "B-minus" policy.

CHAIRMAN VOLCKER. Increase the federal funds rate?

MS. TEETERS. I want to increase the range. I might combine alternative B and $1-1/2 billion of borrowings with a federal funds range of 10-1/2 to 15-1/2 percent so that when the signs begin to come through very strongly that the economy is weakening the interest rates can drop naturally somewhat more than they could before. In other words, I would like to "unskew" it a bit without raising the top but by dropping the bottom to allow more fluctuations in the rate. And when the rate does start to go down, it will have the space to do that in a natural way.

MR. RICE. Mr. Chairman, I think the staff forecast is a good one and I certainly am prepared to go along with it. It seems pretty clear that the economy is headed for a contraction in the early part of 1980. We see evidence of this already but it's obvious that the increase in energy prices, the prevailing tightness in financial markets, and a continuing [high] rate of inflation will combine to make the contraction in 1980 steeper or deeper than was earlier forecast. So the outlook is clearly for considerable economic weakness in the year ahead.

In the face of that, it seems that our choice is between alternatives A and B; we should be focused more on the effect of such a decision in the year ahead. It was pointed out clearly in the

Bluebook that between now and the end of the year it doesn't really make much difference which alternative we choose. The main impact of a choice between alternatives A and B will in all probability be on the financial conditions that prevail in the early part of 1980. I agree with a good deal of what has been said. I, too, place a great deal of emphasis on the need to continue to resist inflation. However, I feel also that at a time when we expect economic weakness to occur we ought not to put the economy in a situation where monetary policy is exacerbating rather than [helping]. We at least ought not to be operating to worsen the real developments in the economy. So I would much prefer to follow a course that would stand a better chance of providing adequate liquidity in a weak economy--not excessive liquidity, of course, but adequate liquidity at a time when it is needed--rather than being in a posture of having to provide reserves at a time when, as Nancy put it, they will not do very much good.

While preferring to lean in this direction, I would also prefer later on by some months to move more quickly to reverse policy sooner in the cycle and to tighten monetary policy when it's clear that the economy is strengthening rather than risk overtightness in a situation that is clearly weakening. So for those reasons I would lean toward alternative B and I would also be prepared to stay with a federal funds range of 11-1/2 to 15 percent. I think one can no longer be greatly impressed with the argument that real interest rates are negative. They are now positive and the unfolding situation that would be consistent with alternative B would also be one that would lean against inflation.

CHAIRMAN VOLCKER. Let me just pick up on one comment you made. You talked about changing policy and I guess I'd ask you what you mean by "changing policy." The question comes up all the time. What did you mean when you said that--measuring it in terms of the money supply?

MR. RICE. Right, right. In relation to that.

CHAIRMAN VOLCKER. This question is going to plague us, I tell you.

MR. RICE. Now, let me just finish. What I had in mind was late in 1980 or perhaps even early in [1981], whenever the economy begins to strengthen, I would be prepared to tighten monetary policy.

CHAIRMAN VOLCKER. In terms of the money supply.

MR. RICE. In terms of the money supply and at a much earlier point than the Federal Reserve normally does. In this way we'd continue to resist inflation rather than err on the side of maintaining the situation where liquidity would be inadequate [for a] time.

CHAIRMAN VOLCKER. The reason I [raise] the point is that I think it has some relevance unfortunately for this meeting and for every meeting, I suppose. When I appear in public or in private in the first question I get is, "Are you going to stick with it?" So I say what "sticking with it" means. I go through my song and dance about how, particularly with this present technique, we measure it by the money supply and that's not inconsistent at all with a decline in interest rates when the economy declines, particularly if the inflation rate is declining. I have done this a dozen times in public and dozens of times in private. I was at a lunch yesterday where there were some presumably sophisticated people who have heard me say this in public dozens of times, or at least a half dozen times, as well as some unsophisticated types. And an unsophisticated guy asked me "Are you going to stick with it?" I went through my song and dance [about how] we are going to stick with it in terms of the money supply but that doesn't mean interest rates can't come down. I no sooner got finished with this 10 to 15 minute discussion when one of the presumed sophisticates--a member of the Washington economic press--says, "Now, what I want to know is when are you going to change policy?" I said, "What do you mean by changing policy?" He says, "The first time interest rates go down." There we are.

MS. TEETERS. That's why I think we should let them fluctuate.

MR. MAYO. That would be favorable.

MS. TEETERS. We're going to have to break that psychology.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Mr. Chairman, we are still more pessimistic than the staff on the projection for 1980, but they are getting a lot closer to us. We are still looking for a recession, something on the scale of 1974-75, as the result of the three shocks that we have going: the energy shock; what I think now can be called the interest rate shock, which is showing up in Boston in the fact that [a borrower] can get mortgage money from the Boston savings banks--

CHAIRMAN VOLCKER. They can?

MR. MORRIS. Yes. The savings banks are offering it. Money is available, but the demand is falling off very sharply because of the rate--the fact that they are asking 13 percent plus 2 points.

MR. TIMLEN. Frank, what's the usury ceiling in Massachusetts?

MR. MORRIS. We don't have a usury ceiling.

MR. TIMLEN. You see, we do.

MR. PARTEE. You have a particular problem, [Tom].

MR. MORRIS. I think we are seeing for the first time real price rationing in mortgage markets. In the past, most of the impact has been on availability but I think we are in a situation now where we could well see a liquidity buildup in the thrifts because the demand is not there at those rates of interest.

The other shock I have in mind is the proposition 13 shock because I have been making a lot of comparisons to the '74-'75 period. One area of the economy that was a great sustaining force in '74 and '75 that clearly is not going to be that way in 1980 is the state and local government sector.

Having said that, it seems to me that the reserve path under alternative C looks quite all right and I would start out with the initial assumption of $1-1/2 billion in borrowing. And I think I'm much more optimistic than either Nancy or Mark about what this procedure is going to yield for us. The figures that Steve showed us yesterday made it very clear, I think, that over very short periods of time the reserves/deposits relationship is very unstable. But as we add [time]--as we go from 2 months to 3 months to 4 months--I think we will see, if we can stick with our guns, that relationship stabilize. I have urged Steve to give us some cumulative totals as we go along and I think they will bear out this relationship.

MR. RICE. Question: You are associating $2 billion of borrowing with alternative C as--

MR. MORRIS. I said initially $1-1/2 billion.

CHAIRMAN VOLCKER. It's a modified "C."

MR. RICE. That's what I was getting at. You are modifying alternative C by reducing the borrowing level associated with it.

MR. MORRIS. But I'd certainly move to $2 billion if the money figures come through strong enough.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Mr. Chairman, we believe the staff's forecast to be a good one, particularly with the caveats about additional oil price increases that may come out of the December OPEC meeting and that would turn the first quarter a bit lower perhaps than our initial forecast would suggest. As to business activity in our area, particularly in regard to housing and autos, autos virtually have stopped selling simply because of credit and prices.

CHAIRMAN VOLCKER. There are different kinds of [auto] credit, [do you mean] consumer credit or dealer credit?

MR. GUFFEY. Both. With respect to housing, we have two situations within the seven states. One is the usury ceiling, which of course has cut off all residential housing. But the same is true in the other areas where usury laws are not a [factor]. The savings and loans virtually have shut their doors. They are not prepared to bid for the high priced short-term money and put it out other than is necessary to meet the commitments they had outstanding before these recent rate increases. Beyond that, retail sales have turned soft and as a result there is fairly good evidence that [they] are going to move to a lower level. What Christmas may hold I suppose nobody knows, but quite likely it will be a bit softer than we would have thought some time earlier in the year.

With regard to the policy we may be considering today, I would say first of all that I, too, would opt for "C" or something even a bit to the right of "C"--and for a couple of reasons that are a bit different than those Governor Coldwell has already expressed. One, it seems to me that if we try to move growth in the aggregates up in the next six weeks to 9-1/2 percent, as Steve has suggested--or if we get zero in November it's 11 percent [in December]--we are going to get a funds rate drop. And [the rate] would be pushing on the lower end of the 11-1/2 percent range that we now have or of some lower range if we were to set it lower today. I think that would be totally inappropriate, not only domestically but also internationally. In the discussions that I had on a trip to Europe recently I got very much the same question that you said was proposed to you. If they see our interest rates drop before they see some [progress] in the fight against inflation, then they are going to believe that we have lost our resolve and, therefore, act accordingly. And the dollar will quite likely come under some pressure.

CHAIRMAN VOLCKER. I understand your international reason, but after your recital on the domestic economy why do you argue that [case] domestically?

MR. GUFFEY. Well, it seems to me that we are going to have the same kind of psychology--

CHAIRMAN VOLCKER. It's a psychology [issue].

MR. GUFFEY. Yes. Policy-wise, it seems to me that it would be appropriate to adopt "C" or perhaps something a bit more restrictive than that. On the other hand--

CHAIRMAN VOLCKER. You still get a passing grade with "D."

MR. GUFFEY. With regard to modifying "C," however, I'd maintain the federal funds range that we now have--that's 11-1/2 to 15-1/2 percent. It seems to me that it would be inappropriate to change that range. If my understanding is correct, the first time the markets or the world will see that 11-1/2 to 15-1/2 percent range will be when we publish our policy record after this meeting. It seems to me that it's important for stability purposes to maintain that range. So what I would propose is that we adopt "C" with an 11-1/2 to 15-1/2 percent funds rate range rather than the one listed for "C." Lastly, I would hope that we would not take action, as "B" would suggest, to try to validate the 4-1/2 percent growth rate that we set in early October for the fourth quarter, simply to try to make that come true if implicit in that is a drop in interest rates.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. Mr. Chairman, I think it's important at this stage of our deliberations [to stand] back and again ask ourselves whether we really are aware of what we have announced publicly that we are going to do. On October 6 we announced that we are going to change our procedures to concentrate more on the control of money growth. Our experience in the Eighth District is that that announcement was received with almost universal approval. And the question that my associates and I get is the same one you do: Is the Fed really prepared to stick with it? One of the things that disturbs me today as I hear the comments is whether we really have a common understanding of what "it" is. My understanding is that "it" does not entail trying on a monthly basis to adjust what we're doing in reaction to what are really short-term economic problems. I don't even think that "it" means doing something the week after OPEC makes a decision--to meet that immediate need. For this process to be successful, we've got to recognize that we cannot operate on a day-to-day or "micro" basis.

We have to set longer-term targets; we have to announce those targets; and we have to avoid the temptation to be nervous Nellies if one week something happens that might frighten us. I don't mean that we blindfold ourselves and blindly stick with [our targets] but I think we have to set longer-term targets and be prepared to do what is necessary to achieve those longer-term targets. One thing that I think would be devastating in this regard is to feel somehow that we will follow this [new procedure] but also worry about whether we ought to reduce the upper limit of the fed funds rate from 15-1/2 to 14-1/2 percent. That sounds as though we have taken a half step but we are not sure where we are going.

Specifically, I would recommend that we choose alternative B, because alternative B--if I understand the staff projections [and analysis]--coincides with what we agreed last month to do. And if for no other reason than the therapeutic value of sticking, in our first month's reactions, with what we decided to do last month, I'd like to see us adopt alternative B and [stay with our plan] to seek M1 growth of 4-1/2 percent by the end of the year. Then I'd like us to project into 1980 a specific long-term target that will be consistent with that. I believe--and if I'm wrong, we're all wrong--that our primary responsibility is not to waffle and to ask ourselves if the aggregates can be controlled. You said, and we ratified this publicly, that yes, we believe the aggregates can be controlled. That was why we did what we did on October 6. In my view our job now is to get the best minds within this System, which I think includes some of our Reserve Bank economists as well as [Board] staff, to work out these processes we talked about yesterday so that we can demonstrate that the aggregates can be controlled. If we fall--if we retreat from what we announced on October 6--I think [it will be] the last straw and any credibility regarding the Federal Reserve's monetary policymaking will be lost. I really think we're on a path of no retreat. I apologize for the length of that statement, but let's understand what we've bitten off; whether it's right or wrong, we've taken that step and the fat is in the fire. Now let's find out the best way to make it work. I think that's our mission.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I have no quarrel with the staff's forecast, though I think there is at least a possibility that the OPEC decision will be less adverse than they think. In Europe there seems to be a feeling that oil is reasonably plentiful and, therefore, that the ability to raise [its price] rather drastically is less.

CHAIRMAN VOLCKER. They only buy it at $40 a barrel!

MR. WALLICH. Well, but at least they've got it. Even so, I think it's clear that we're facing a worsening outlook for both unemployment and inflation. The [situation] seems to be worse on the side of inflation than unemployment and slow growth. So I think we've got to weight our approach accordingly--that is, lean more in the direction of fighting inflation than taking account of the recession.

We have [adopted] a money supply policy for some time into the future and we're really talking here about how to phase into that longer-run path. Admittedly, we're going to review the path in December or maybe in January. But basically we laid down a pattern for the future and this ought to satisfy those who like Larry feel that we ought to have a fairly firm target. I'm quite skeptical of the meaning of this target; I don't think M1 measures what it is supposed to be measuring. If we had the revised aggregates--and revised them the way I would like to see them revised--that [new] M1 would be advancing faster. We see bank credit advancing fast, and it has grown at a very stable rate all through the year, fluctuating in an 11 to 14 percent range. And in the forecast it is not projected to slow down; it's currently projected to increase at its [recent] rate of growth month by month through January. All that suggests to me that we do need continued restraint. I don't see the prospect of another blow being dealt to us by OPEC as a reason for relaxing; it would seem to me a reason for doing more. Otherwise we'll be in the position of the man who was told by his doctor to take it easy because he is badly overworked. And at that moment he has a heart attack so he says, "Well if things are as bad as that, I might as well go back to working a full schedule." It would seem to me that if we are hit harder on the inflation front, then the severity of another blow is a reason for increasing the effort, not for diminishing the effort.

I'd like to say a word about the dollar. I think in the long run we have to adjust to the prospect that we certainly can't keep up with the D-mark. If this inflation is going to go on and on, the differential between the D-mark and the dollar is perpetuated. We are in much the same position as the French are with the franc; they cannot get their inflation down and they're trying desperately to hang on. They've had to take one downward step; they'll have to take others. I don't think we have to yield on our trade-weighted exchange rate, which is the more meaningful measure of the dollar. We ought to be able to hold on and our policies ought to be designed to that end.

Now, I quite share the reactions of the Chairman and of Roger Guffey [regarding] people's statements about our policies. As soon as we say interest rates are coming down as a result of a logical evolution of our money supply policy, they say: "Aha, you're changing your policy." I think there's an obvious logical defect here. One can perhaps differentiate two statements. One is: We're not changing our policy, but the environment is deteriorating as far as maintenance of the value of the dollar is concerned and maybe that's the logical consequence. But we do have to make clear that our policy is the money supply, properly defined, and that interest rates therefore do have greater flexibility. And if inflation comes down, I think that will be fairly acceptable. The problem is that inflation may not come down.

Well, forgive me for that long statement. I just want to say briefly that I lean toward alternative C. The only thing, frankly, that bothers me about it is the prospect that it will bring interest rates down sometime this winter. But I'm aware that we presumably will have a chance to reassess that. If inflation comes down and we have a serious economic situation, the doors are entirely open. But I don't want to prejudice that [policy response] now.

CHAIRMAN VOLCKER. What did you say--"C?"

MR. WALLICH. "C."

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. I don't see any basic reason for changing the posture that we adopted on October 6, Mr. Chairman. With respect to the real economy, the obvious [areas of] weakness that we observe are housing and autos, although I must say that on the West Coast the sag in housing has been offset by what some builders describe as a furious pace of activity in the non-residential construction field. One encouraging sign in the housing situation in our area is that the state's largest commercial bank and its largest savings and loan association recently knocked off a little on their mortgage rates--coming down a half point, though admittedly from very high levels.

CHAIRMAN VOLCKER. From [14-1/2] to 14 percent?

MR. BALLES. No, from 13-1/2 to 13 percent.

CHAIRMAN VOLCKER. Now that is an encouraging sign.

MR. BALLES. But it is encouraging.

MR. PARTEE. I did not know that a savings and loan did that.

MR. BALLES. Home Savings as well as Bank of America. The expectation with respect to the general economy as contained in the Board staff forecast is quite similar to our staff forecast, which I would generally describe as a modest recession by past standards. Obviously, there's a great deal of uncertainty surrounding all these forecasts today. But that's still, I think, the most reasonable expectation. And of course inflation still continues to be the greatest danger here, as many of us view it. I think one of the real problems we are dealing with is the lags that are built into the impact of monetary policy, which we've known about all along. Unfortunately they are not predictable. Those lags are variable but it is typical in a period of restraint that the bad news comes [first] and the good news comes later, in the sense of an observable diminution of inflationary pressures.

The only bad result I see from our October 6 actions is the very sharp rise in long-term interest rates. Maybe the school of rational expectations has an answer to [why that has occurred], Mark, because I can't get an answer from anybody else, including my own staff. To the extent that those rates are influenced by expectations of inflation I'm still wondering why--I'm totally nonplussed--they went up instead of coming down. I think that underscores the point that many people around the table have already made, which is that psychology is so darn important right now. As you so well articulated, the real purpose of our October 6 actions was to get inflation under control by bringing about a deceleration of money [growth]. And we're being observed very, very closely on what's going on there. When there becomes a greater public awareness of what happened in October--that there was a considerable deceleration in the rate of [money] growth--and if the November figures come in as Steve has projected them, that will add still further credibility.

So I think we're right in the midst of a great credibility test right now and I wouldn't want to rock the boat by any major change in the posture that we adopted with respect to the targets for money growth by the end of the year. [I say that] because I think our credibility and hence our impact on long-term interest rates and inflationary expectations in general will be messed up if we don't meet those goals that we've announced. Good or bad we have announced them. They are out there and we're going to be judged by them. When it comes down to the fine strokes between alternative B and alternative C, I think there's not an awful lot to choose; we may be involved in unnecessary or unproductive fine-tuning here. But if I had to choose between them I guess I would lean a little toward "C."

CHAIRMAN VOLCKER. Mr. Mayo.

MR. MAYO. I'd say a couple of things. I have no fault with the staff forecast except that my elbow--which doesn't quite have the problem of Nancy's elbow but maybe it will get that way--tells me that the economy will be weaker than in the forecast. The chances are greater that it will be weaker with greater unemployment and unfortunately maybe even a little more inflation. I still feel very strongly that the Fed's job is to concentrate more on the inflation in our economy now than on the real sector, again partly because we are the only game in town. Even though our effectiveness may be limited, psychologically it is far more effective than anybody else's. My answer to John Balles on the reason why long-term interest rates have gone up is that there has been, even among sophisticates, an almost complete turnover and disillusionment as to whether inflation can be controlled. This is reflected in long-term rates and it makes our job even more of a challenge.

I welcome what we did yesterday, Mr. Chairman, as well as Steve's additional input this morning. But I think we may be engaging in a bit of self-flagellation here that is over and above the call of duty. We made a giant step on October 6. As we sit back and look at it, it isn't that giant a step in terms of what I would call an evolution of monetary policy and its strategies and techniques. We have been concerned with reserves before; we just were too timid to let the system work. We have freed the reserve control concept now of its interest rate bounds to a considerable extent. And yet we must grant that we have found no magic formula as to additional ways of making this process of monetary policy as simple as some of our academic friends believe it can be made. We still have lags; we still have multiplier effects that differ; and we still have disputes as to how to do our seasonal adjustments. We can go right down the line, and we still have basically the same problems we had before. This has been a very important step, but I would rather view it more as an evolutionary step than a revolutionary step. The press has taken it up as a revolutionary step and we can live in the glory of that in the short run. I don't think that it is understood yet what we are doing apropos of the Chairman's statement about [being asked] when is policy going to change.

I welcome Larry's speech on defining "it" as having a longer-term span than many people had argued before; I certainly agree that that is true. And it's for that reason that I don't share Roger's worry that a big December number is going to get us into any trouble. I prefer "B;" I would not object to the Morris formulation of "C" with the $1-1/2 billion [on initial borrowing]. I do not see anything particularly wrong with that. I would take us at our word, though, on the releasing of the federal funds constraint and go with 11 to 16 percent. I would broaden it by 1/2 percentage point on [each] side to indicate again our willingness to see the rate fluctuate a little more. I see nothing wrong with that. But I come back to the point that I think is terribly important: Although I welcome the soul searching [and the attention] we are giving to the change in technique and the way the Board staff and the Desk have approached it, we are still dealing basically with the same animal that we did before. We have a chance here to sharpen things up--and we have sharpened things up--but certainly there is no way to make this process as simple as perhaps some of us would like.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I think it's pretty obvious that the Iranian crisis has potentially great implications for the domestic outlook--[more] than the mere availability of petroleum supplies. But absent that problem, I would think the staff's forecast would be about right. If I had to guess which way the error might be, I would think the economy might be somewhat weaker than they are projecting. It's certainly true that the economy has shown amazing resilience up until now. I guess inventories are in better shape than they were this time in the 1973-74 downturn. But when I look at the weakness in housing and hear a talk like Frank Morris gave us on the resistance to rates and about the lack of availability of funds, I think housing is going to be quite weak.

I think the consumer is pretty well over-extended. I gathered an interesting observation from the chief executive officer of He said that consumer loan demand had virtually dried up at is their consumer financing company, but was still present at the bank. I asked him if this related to the type of customer the two institutions have. He allowed as how he didn't know but said that might be part of it.

And finally, I would think that if we made an error on the [forecast] of net exports, they would probably be weaker than we had guessed because of the increasing restrictiveness of monetary policy abroad and the generally unsettled international climate.

Turning to the policy side, I think the most important task is for us to hit our long-run targets. I agree, as someone said earlier, that we can probably do that pretty well with any of these alternatives. Certainly we ought to hit the M1 and M3 targets with any of them and I believe we'd come pretty close on M2 with any of them. Bank credit I guess we are going to miss altogether. So I don't think that there's a lot to choose from in view of the short period left, as Emmett Rice mentioned. I have a marginal preference for "B." My only concern with "B" is that the lower limit on the federal funds rate range might be a little high at 11-1/2 percent. Now, last time I argued that we ought not to put that below 11-1/2 percent because I thought we had a credibility problem. And I felt that if [the funds rate] came down before we demonstrated any control over the aggregates, we'd have a real problem. But I do think we have gained considerable credibility at this point and also the economy looks weaker. So against that background, although I'm somewhat concerned over what Henry and Scott said earlier about the foreign reaction, I think the reserve growth needed to achieve alternative B may well entail more federal funds rate movement on the down side than some might expect. I think the rate might have to go below current rates by a fairly significant level so I would want to lower that lower limit to 10-1/2 percent. I guess I'd stay with 15-1/2 percent for the high end, but I surely wouldn't object to raising that. I might be wrong on this and I would suggest that maybe we ought to have a telephone conference if the funds rate approaches either of those limits.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, we are plotting a path [for the provision of reserves], and there never will seem to be much difference in the short run in the paths that we plot because they only work out over the long run. But I think there is a difference between alternatives A, B, and C. There's a different implication for the shape of monetary growth in the first quarter that transcends the very precise [short-run] period we are talking about. In a coming recession, whatever its shape or size--and it may be quite different than we are expecting right now--I think it is important that we continue to say that it is our job and our intention to provide for a reasonable amount of money and credit growth. That's really about all we can do. [And we need to do so] as safely [as possible] with inflation on the one side and unemployment, which I would point out to you is projected by the staff to be as high as 8.4 percent for next year, on the other side. About all we can do is to have that kind of ambition. I would, of course, as we have sacrificed the mortgage market, sacrifice the foreign exchange market at the right point in the battle to maintain moderate growth of money and credit over the period to come.

Now literally it seems to me that we would stay with alternative B here because we have had some shortfalls in monetary growth rates in October and some are projected--perhaps [they will occur], perhaps not--for November. Remember, all we are doing is talking about the path of our provision [of reserves], not what will actually develop in monetary growth. But I dislike that a little because it seems to me that it implies providing too many reserves in December. I think we have to have a strategy for making up shortfalls and overshoots, and we haven't really quite developed one yet. Although we have had a shortfall, I don't like the idea of running too strongly in December for fear that it will extend over into the early part of next year. So my view is that we ought to try to make up a little, but not the full amount, of the shortfall. I think that puts me between alternative B and alternative C. The path I would propose for the Desk and Steve to work on is 5 percent for the 2-month period in M1 and 8-1/2 percent in M2; and I don't think M3 has any great significance in path setting in that time frame. To be fair, it also requires the setting of an initial borrowing level and my view of the matter is that we should stay with $1-1/2 billion. I was thinking that perhaps it ought to be a little higher, but then I was reminded that the reason the borrowing is [currently] above $1-1/2 billion is that we've had a few misses so to be absolutely even-handed we perhaps should have the $1-1/2 billion initial assumption.

On the funds rate range, I certainly wouldn't want to narrow it. I agree with Larry Roos. We have announced to the world that we've changed the way we do things. And to appear to be constraining [the funds rate] again or to seem to be moving toward a constraint is unnecessary and hardly makes worthwhile the anguish that the market has gone through in adjusting to our announcement of the change in policy. Now, if we open it up a little, I really don't care. I think for this particular period I would leave the range at 11-1/2 to 15-1/2 percent; we're just about in the middle of that right now and I believe there probably won't be any need to raise it on the top end in the period to come. We can open it up later by reducing the lower end if in fact the performance of the monetary aggregates comes in below our expectations. I guess that's it.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. To start I'd like to commend Steve and Peter again for their performance yesterday. I hope that we can have the second verse of modulations on the theme, whether we meet in December or January, with the same group. I thought it was an extremely productive meeting. As I indicated earlier, I am still concerned about the shock impact versus the economic impact.

First, in the mortgage market I think there will probably be more funds available; people are being sold on the idea of paying the present prices because these mortgages can be refinanced. Unlike our long-term Treasuries, which have call protection, the possibility of paying a high price temporarily or at least the prospect of [the house] being sold may lead to somewhat more mortgage money being advanced than we contemplate at the moment.

If I were to guess on the outlook for next year--and we have not talked about fiscal policy and what that may mean--I'd say the prospect of our forecast, as good as it may be, [materializing] is not a very high one. I don't know whether changes will occur early in the year or late in the year but I suspect we will see big deviations as economic conditions unfold.

Second, I agree with Bob Black that the Iranian situation, the Cambodian situation, and others portend shocks that are outside the energy area but could be quite significant as we look down the road. So I'm really uncertain as to what the outlook may be. Another shock we face is the fact that we are going to change the [definitions of the] aggregates and that's going to introduce another uncertainty into the picture. In view of that, I would be inclined to go with alternative C on the aggregates measures because of the phase-in or transitional stage. I'd stay with the present federal funds range, as in alternative B, and keep the $1-1/2 billion in borrowing.

CHAIRMAN VOLCKER. Mr. Eastburn.

MR. EASTBURN. Chuck Partee has given the precise description that I was prepared to propose, though the route by which we arrived at that might be a little different. I start with the comment that you made, Mr. Chairman, about your sophisticated and unsophisticated audiences, which I think is very much to the point. We have many non-economic factors that are going to be at work here for some time. That's the real world and I think we have to recognize that. I believe the recession is going to be at least as severe as the staff has projected and possibly worse than that. And I think the

Fed is going to come under a great deal of pressure as we move through the first half of next year. I believe we are going to be in a good deal of difficulty with our policy. Given that I think right now we should avoid making the recession worse than it's likely to be, I think primarily we should [aim to] meet the targets that we have specified. We do have a credibility situation that in my view takes first priority. I'm not sure "B" will assure that in the short run, partly because of M2. On the other hand, I am concerned that "B" may produce a decline in interest rates too soon. "C" is more restrictive than I would like to see so this leads me to somewhere between "B" and "C," which is where Chuck comes out. I would leave the funds range where it is and continue to assume the $1-1/2 billion of borrowing.

CHAIRMAN VOLCKER. Mr. Kimbrel.

MR. KIMBREL. Mr. Chairman, we too have considerable appreciation for the staff projections but I guess we would assign a higher priority for some [possibility] of a tax cut next year than the Greenbook seems to suggest. Also, the South and the Sun Belt are frequently characterized as areas that will not suffer [in a recession] to the same degree as the rest of the country. But I happen to have a slightly different view. I think anything occurring in the rest of the country is going to happen there. And the same [logic] flows to the fact that real price movements and inflationary expectations are so deeply entrenched at the moment that I think we simply must do something to try to dislodge that. Added to that is the significant concern and influence of the foreign exchange markets; the unsettled [conditions] there at the moment are an added dimension that I think requires [concern] on our part. We recognize, too, that there's almost a belief that we will relax [our policy] too early. And that leads me to feel that the realities of our existence suggest that a continuation of our present policy may be easier now than possibly in 1980 when unemployment or other outside pressures are being brought to bear, even if inflation continues unacceptably high.

So reading these numbers slightly differently from some of the others, I feel that alternative C is pretty close to where we are at the moment. I'd be happy to see that continue, even the 11-1/2 to 15-1/2 percent [federal funds range]. And I'd prefer to see the borrowings more in the $1.8 billion [area] where I believe they are at the moment. So I prefer "C" with those [specifications] I'd add.

CHAIRMAN VOLCKER. Governor Schultz.

MR. SCHULTZ. I think the only economic law I believe in at this point in time is Murphy's Law. I don't know how human beings are going to behave in this particular period, so I'm torn. It seems to me that autos and housing are very weak and the rest of the economy continues to hang up there. I have a feeling that at some point that's going to change. Consumer attitudes are going to change and things are going to get pretty weak rather quickly; and I would like to be responsive when that occurs. On the other hand, it seems to me that we have some real dangers from oil and other exogenous shocks over the near term. I wonder what shape we'd be in if we hadn't taken the steps we took on October 6, in view of what is happening in Iran. It seems to me that we'd be in pretty bad shape. So my feeling is that we have to continue to hold on to this [policy] a while longer and that puts me somewhere in between "B" and "C." I feel that Governor Partee's approach is a very reasonable one.

CHAIRMAN VOLCKER. You've disappointed me, Governor. If you had come out for "B," we'd have among the Committee members an exact split of 5 "Bs," 5 "Cs," and one in between "B" and "C."

SPEAKER(?). How about that!

CHAIRMAN VOLCKER. Noncommittee members are irresponsible! At one point in looking at this I didn't think there was much difference between these alternatives. But I think Governor Partee and others are right that there probably is a real difference when you compress this into a narrow period of time. Obviously the consensus, whether it's the whole group or the voting members with some exceptions, is a weak "B" or a strong "C."

MR. MAYO. The other way around--a strong "B" or a weak "C."

CHAIRMAN VOLCKER. It depends on how you define "strong." If you would prefer, it's a strong "B" or a weak "C." There is a question of how to phrase this and reach a maximum consensus here. I might say in a general way that it would scare me if the federal funds rate went up toward the 15 percent area again, considering all that is happening. I don't detect any strong "sentiment," shall I say, to lower that upper limit. But I don't like it because I do think it would be very disturbing in terms of psychology in the markets. And our chances of getting long-term rates down in an orderly way I think would be damaged.

MR. WILLES. Why is that, Mr. Chairman? Why would that scare you if in the short run [the funds rate] went up?

CHAIRMAN VOLCKER. Because I think it would lock in these long-term rates and raise great concern about credit availability in the short run.

MR. MAYO. Paul, that doesn't bother me for a change. It seems to me that we've demonstrated that we're willing to let that rate go up to 15 percent and if it does a second time--if it should happen--I think less attention would be paid to it.

MR. WALLICH. I think that's very likely.

CHAIRMAN VOLCKER. I think that's right if we weren't in a phase of declining economic activity. Then we could get a little excitement in this city of ours!

MR. PARTEE. We've got this concept of a crunch in mortgages, which would probably be exacerbated.

MR. COLDWELL. How would you feel about an 11 percent rate?

CHAIRMAN VOLCKER. On the down side?

MR. COLDWELL. Yes.

CHAIRMAN VOLCKER. Well, I do think we have this problem internationally so I'm not all that gung ho on the down side either.

MR. WILLES. It sounds like you're talking about an interest rate target.

MR. MAYO. I object.

CHAIRMAN VOLCKER. You object to what?

MR. MAYO. I feel the same way as Mark does, that the Chairman is getting too close to [targeting] interest rates.

CHAIRMAN VOLCKER. Now, I agreed with your whole lecture, Mr. Mayo, that we didn't have a revolution but an evolution.

MR. MAYO. That's right.

MR. PARTEE. He also said a giant step, I believe.

MR. MORRIS. But he didn't say whether it was forward or backward!

CHAIRMAN VOLCKER. That remains to be seen, I think. In any event, I believe there is something to be said for not changing these [specifications] unless there's a reason for changing them, just in terms of consistency with what we did earlier. That's a point that several people have made. And I think literally what we did earlier is that we said what is the equivalent of "B" but that we would not be very disturbed if it came in somewhat below that. So we would not ease [if the aggregates were coming in] between "B" and "C." in that sense. I think that's where the center of gravity is here. It's just a question of how to express it. From the standpoint of consistency in posture for a very brief period, I put to you a proposition that we stick with the "B" specifications but with the clear understanding that we had last time--namely, that if [the aggregates] come in a little low because that's the way the cards fall in the next few weeks, we don't have to exert ourselves too greatly to make it all up in December, although we'd obviously be [leaning] in that direction. In that case we would presumably have a decline in the federal funds rate of some significance.

On the other hand, if November [growth] were high, higher than is currently being projected, it would be a straightforward "B" type of approach I would think. And just what that means for interest rates may be a little less clear but probably still the chances are for a small decline if the overall projection is correct. I guess "B" and "C" should be split from the standpoint of M1 and M2, too. M2 is pretty much on target; it's just slightly high in terms of the yearly target. For M1 it looks as if we're going to make the yearly target all right.

Let me just try that out on you. Mainly in the interest of not appearing to fiddle around at this stage, the specifications would be those of "B," as we had before. But if [monetary growth] comes in lower than "B" and between "B" and "C," that's not a source of concern. As for the initial borrowing, we've had suggestions running from $1.5 billion to $1.8 billion. Going along with "C," I'd be inclined to put it somewhere in between, at $1.6 or $1.7 billion to start with. I think that expresses a bit that bias toward coming in between "B" and "C." And let's leave the federal funds range where it is, if that's the consensus. I don't think we're going to hit either end of that range. The lower end, I think, would probably require a decline in the discount rate, so that's a separate decision.

MR. COLDWELL. Mr. Chairman, I did not attempt to specify [particulars] because I thought we were going around a second time, but where you come out is not far from where I would suggest. I'd split this borrowing [range] at $1.7 billion. However, if I heard you right, you're taking the monetary growth rates of "B," and I would much prefer the growth rates that Governor Partee suggested of 5 percent and 8-1/2 percent [for November-December]. I believe that's what you said, Chuck.

CHAIRMAN VOLCKER. Well, we can do that. I think that's expressing very much the sense of what I am saying, too. But your proposal has what I would see as a disadvantage--I don't know whether it's a major disadvantage--of having to write a policy record that says six weeks after we made the decision [on October 6] we're now fine-tuning it for another six weeks. It seems to me, to avoid a sense of fine-tuning over a six-week period, we'd be better off expressing it the way I expressed it. But the substantive difference, obviously, is close to negligible.

MS. TEETERS. What will be published [in the policy record for October 6] is just the 4-1/2 percent for M1 in the fourth quarter, Phil.

MR. COLDWELL. All right.

MS. TEETERS. And I think the language to be released this week is 4-1/2 percent [but that] somewhat less than that [would be acceptable].

MR. COLDWELL. Well, if we take alternative B, it's 5-1/2 percent on M1.

MR. PARTEE. For the two months.

CHAIRMAN VOLCKER. For the two months. But I think the record would say that we're confirming what we did last time.

MR. COLDWELL. But that's exactly part of my problem because--if I heard Steve right--if we confirm that, we've got to hit roughly 10 percent [for M1] in December on the basis of his present projections.

CHAIRMAN VOLCKER. If November comes in as low as he's talking about.

MR. AXILROD. If November is close to zero. If it comes out at 3 or 4 percent, it's 6 or 7 percent [for December]. It's that sort of thing.

MR. PARTEE. If I might just tag on, Phil, I think I'd also like to extend the projection into January.

MR. COLDWELL. I would, too.

MR. PARTEE. That was sort of my notion of going in between "B" and "C" and then saying we'd continue that for January until we have a meeting and can review it again.

CHAIRMAN VOLCKER. Well I think the difference here is, as I say, substantively a nuance.

MR. COLDWELL. Well, you [may] want to call a meeting of the Committee if the aggregates did come in at that high a level, but I think a 10 percent rate of growth in M1 in December would be unacceptable.

CHAIRMAN VOLCKER. What I am saying is that if November comes in as low as we're now estimating, we probably wouldn't hit the 10 percent in December. I'm not saying we can't hit it because we know we get these things.

MR. MAYO. We provide reserves.

MR. COLDWELL. Well, we would provide the reserves for 10 percent and that presumably would force the federal funds rate down sharply.

CHAIRMAN VOLCKER. I'm not sure we'd provide [the reserves] for 10 percent, as I see it. I'd say we'd come in at 5-1/2 percent or lower.

MR. PARTEE. Well, all right. I think maybe you want to say that it's 5-1/2 to 4-1/2 percent, you know. That's one way of doing it. But it is a path that we're setting here, or telling the staff to set, regardless of where the money supply actually comes out. This is the rate at which reserves would be provided, as I understand it. Am I right about that?

MR. AXILROD. That's right. Whatever numbers the Committee picks, it's a path; it's difficult to work with a range in this kind of thing.

MS. TEETERS. Steve, what would be the annualized rate of growth on, say, alternative "B" or "C" from October through January?

MR. AXILROD. For "B" it's 5-1/2 percent essentially.

MS. TEETERS. And for "C?"

MR. AXILROD. For "C" it's 5 percent. And it's 5.9 percent for "A."

MR. WALLICH. I think we ought to avoid the prospect of needing a 10 percent rate of growth and having to force in reserves in December to achieve that.

SEVERAL. I do, too.

MR. WALLICH. I think December would be much too early for a decline in interest rates in line with trying to say that this should go hand in hand with [what is happening with] the economy and with inflation.

MR. AXILROD. Mr. Chairman, I hate to suggest the possibility of moving these numbers and set forth another option. But one way to meet your point and the point other members of the Committee are expressing is to leave M1 at alternative B as you have--have no change there--but to lower the [associated] M2 because that's clearly higher than the Committee intended. Then in constructing the reserve path there would be somewhat less reserves. And if it does turn out that M2 tends to grow higher than we allowed in there, it would put a little downward restraint on M1. That is, the policy record would have the M1 [range] unchanged, the M2 essentially unchanged, and our reserve path total will be a little lower than what is shown here for alternative B.

MR. WALLICH. But the non-M1 component of M2 doesn't absorb a very large amount of reserves, so the impact would be slight.

MR. AXILROD. Yes, but for whatever it absorbs if M2 grows at a higher rate, there will be less for M1. So it would go in the direction of reducing M1 below 5-1/2 percent in practice if, in fact, M2 was growing as strongly as projected.

MR. PARTEE. What did we specify for M2 back in October?

MR. ALTMANN. 7-1/2 percent.

MR. PARTEE. It was 7-1/2 and we now have 8-3/4 percent?

MR. AXILROD. Yes, we can't really get 7-1/2 percent. In alternative C, M2 growth, as you can see, is 8-1/4 percent over the two months. [Adopting] "C" would get [M2 growth] down to 8-1/4 percent. If that were substituted, that might reduce the reserve growth a bit.

MR. COLDWELL. I would much prefer to specify this out rather than to adopt something that then is going to be interpreted midstream because none of us really knows what the projection is going to be or how [growth] is going to turn out. So I would prefer that we use 5 percent and 8-1/2 percent with a $1.7 billion borrowing assumption and hold the fed funds range.

MR. MAYO. I would support that, Mr. Chairman.

MR. PARTEE. How does the $1.7 billion compare? How would you interpret that 1.7, Steve? Would you interpret that as a neutral initial borrowing assumption or is it a little restrictive, or what?

MR. AXILROD. The way borrowings have been running very recently, that is about [consistent with] where the present federal funds rate is, really. It's in some sense neutral in that it's starting out about where we are.

MS. TEETERS. But suppose November doesn't come in as low as we think it's going to.

MR. PARTEE. Well, we don't know.

MS. TEETERS. I'd rather do it Steve's way and lower the M2 target--to have some flexibility for the numbers as they come in--and leave the target for M1 where it was on a quarterly basis.

MR. MAYO. We basically have that flexibility, though, either way we do it.

MS. TEETERS. Yes, but there's an awful big advantage in being able to say we looked at it--that we're part way down the road and we're not going to change our objective at this point. I think there's a lot of just good public relations in that.

MR. COLDWELL. Then we ought to stay at 4-1/2 and 7-1/2 percent instead of going to 5 and 8-1/2 percent.

MS. TEETERS. I'm talking about just releasing quarterly [targets] and that's all.

CHAIRMAN VOLCKER. Where were we before on the M2 rate for the quarterly period from September to December?

MR. AXILROD. The Committee had specified 7.6 percent.

CHAIRMAN VOLCKER. 7.6 and it's way up to 8-3/4.

MR. AXILROD. We are at 7.6 percent to date and our projection is that the growth in time deposits will be high relative to M1, so we raised it. But of course M2 growth may not come in that high. It has been running high relative to M1 as compared with expectations, so we continued [that pattern for November-December].

MR. WILLES. That's because of large CDs.

MR. AXILROD. Yes.

MR. BALLES. May I ask you a question, Steve? You are still, I assume, giving equal weight to M1 and M2?

MR. AXILROD. No.

MR. BALLES. That disappeared?

MR. AXILROD. Oh, yes. The Desk is looking at the reserve path.

MR. STERNLIGHT. We've got reserves that are generated by deposits in the aggregate and [we look at] other factors that generate reserves.

MR. AXILROD. If M2 is running slow, it will release some reserves to support M1 and vice versa. But they're not going to be [weighted] equally because of the differences in reserve [requirements].

MR. BLACK. I don't think that's responsive to John's question, really.

MR. BALLES. What I was trying to get at is what you would plan on doing if M1 came in below the 4-1/2 percent we targeted on and M2 came in higher than the 7-1/2 percent. How would you balance those out in trying to construct your reserve path?

MR. STERNLIGHT. We'd be guided by how reserves are coming out in relation to path, President Balles.

MR. PARTEE. You sort of weight it in relation to the average reserves, as I would see it. That is, the components of M2 have less reserve requirements so they don't get equal weight any more.

MR. TIMLEN. But you start with the estimate of required reserves for M1 and M2.

MR. AXILROD. Well, President Balles, when M2 was coming in about on track, I don't believe that the staff felt that it had to make a special effort to push up M1 because the Committee had decided that the aggregates [could grow at the target rate] or a little lower. Similarly, if M1 were coming in on track and M2 were running very high, given the stress that we interpreted the Committee to be putting on M1, it would have been a question as to whether we would want to adjust the reserve path down for something like that.

CHAIRMAN VOLCKER. Simply refresh my memory. I thought M2 was coming in more or less on track.

MR. AXILROD. Yes.

CHAIRMAN VOLCKER. Then why is your projection higher than the track we estimated last time?

MR. AXILROD. Because M1 is coming below. It's the relationship that seems to have changed.

CHAIRMAN VOLCKER. M1 is coming in below but M2 is coming in on track. But your current projection for the quarter now is above the track.

MR. AXILROD. Because we're pushing M1 up.

CHAIRMAN VOLCKER. Because you're pushing M1 up.

MR. AXILROD. M2, therefore, would be running even higher. That's the--

CHAIRMAN VOLCKER. But M2 is only going to go off track in the second half of the quarter.

MR. COLDWELL. Because M1 is going to be pushed up.

MR. AXILROD. Yes, as I say, banks may not get all that [projected increase] in time deposits.

CHAIRMAN VOLCKER. Well, I really think we are talking about narrow differences at this point. We just have to reach a consensus on how we phrase this. In listening to all the rest of you, there's a slight predilection for my way of phrasing it. I'd be perfectly happy to phrase it the other way if that's the way people want to do it. I think it amounts to--

MR. PARTEE. Why don't you take a couple of tests on expressions of preferences. I think it would be very desirable, if we could, to have a large number of people voting for whatever [the decision] is.

CHAIRMAN VOLCKER. As I understand it, we have basically two [alternatives] on the table. And we have the Axilrod alternative, too, so we have three options on the table. We have one that is a straight compromise between "B" and "C," and $1.7 billion on initial borrowings. That's one way of doing it. Another way of doing it is to specify "B" with the understanding that we're not unhappy if it turns out to be "C," if November monetary growth is as low as projected.

MR. TIMLEN. Does either give you a better assurance as to what M1 will do in December?

CHAIRMAN VOLCKER. I think there's equally little assurance in either case. And the third alternative is staying with "B" on M1 but lowering M2 to something like "C." That's a different compromise between "B" and "C."

MR. PARTEE. For path purposes.

MR. MAYO. But Steve's point could be accomplished, couldn't it, by weighting the average of "B" and "C" on M2 toward "C?" Just have it 8-1/2 percent, say.

CHAIRMAN VOLCKER. Well, let's not make any more--

MR. MAYO. I'm trying to simplify it.

CHAIRMAN VOLCKER. One is a straight compromise right down the line between "B" and "C."

MR. MAYO. What do you mean? Is it 8-5/8 percent for M2?

MR. COLDWELL. It's 5, 8-1/2 and [borrowing of $1.7 billion] and the same fed funds range.

MR. MAYO. 8-1/2.

CHAIRMAN VOLCKER. 8-5/8, I suppose, is a straight compromise.

MR. MAYO. My whole point on all of this is that 8-1/2 percent works in the direction of Steve's suggestion. Why don't we make it 5 percent, 8-1/2 percent, and 7-1/2.

MR. COLDWELL. That's what we have.

CHAIRMAN VOLCKER. 8-1/2 and 7-1/4 percent, I suppose.

MR. PARTEE. M3 is not--

CHAIRMAN VOLCKER. And $1.7 billion on borrowing.

MR. COLDWELL. And the fed funds range the way it is.

CHAIRMAN VOLCKER. All of these leave the fed funds range where it is. The alternative is alternative B with the understanding that [the specifications in "B"] in some sense are the maximum, within the limits that we can maneuver these things anyway. If November comes in weak, we'd probably be satisfied with "C." And we'd also start out with a $1.7 billion initial borrowing assumption. Let's just take those two at the moment.

MS. TEETERS. I don't think Steve's alternative is well specified. It would be 5-1/2 percent for M1 and what would M2 be?

CHAIRMAN VOLCKER. M2 I think would be 8-1/4 percent. That's a straight compromise.

MR. PARTEE. No, it would be less than that, I think. It would be an impossible construction.

CHAIRMAN VOLCKER. Well, he's not taking it literally to get it within the target, I take it. I'm just compromising between "B" and "C." I suppose one could say technically--if the staff's estimate is any good--that that is the most awkward one. It's not going to happen. But their estimate may be no good, so--

MR. WALLICH. Well, I could take the second.

CHAIRMAN VOLCKER. We have alternatives 1, 2, and 3. The borrowing level is the same in all of these for simplicity. So all we're talking about is these other numbers. One is an arithmetic compromise between "B" and "C," half way between "B" and "C" straight out. The other is a more flexible interpretation between "B" and "C" and would depend in practice presumably on what happens in November, which we can't control any more.

MR. WALLICH. That would probably protect better against unexpected drops in the funds rate because we can go all the way to the "C" specifications.

MR. COLDWELL. Not necessarily.

CHAIRMAN VOLCKER. It goes in that direction, certainly. It might depend, I think, on how low November came in.

MR. COLDWELL. And how rapidly we recognize it.

CHAIRMAN VOLCKER. Then we have this--instead of saying bastardized version, I'll say "hybrid"--which is 5-1/2 percent for M1 and 8-1/4 percent for M2. I myself am not sure that M2 isn't going to fall off. My instinct is that it may fall off and [the 7-1/2] may turn out to be consistent [with what we have for M1]. Now the only trouble with voting on 3 alternatives is that you can't make a second choice, apparently. But let's see whether there is an overwhelming consensus for one of these. The first one, the arithmetic compromise. Just members, indicate if that is your preference. Eight.

MR. ROOS. You're only asking Committee members?

MR. COLDWELL. Yes.

CHAIRMAN VOLCKER. The next alternative is two. Four with myself. And the other one is the Axilrod version, which I guess is not [anyone's first choice.] Well, it looks like it's 8 to 4 [in favor of the first one].

MR. PARTEE. Do you want a "can live with" indication?

CHAIRMAN VOLCKER. Yes. I suppose the next question is can everybody live with one, with its arithmetic purity. [Unintelligible] but nonetheless pure. Everybody can live with that?

MR. WALLICH. Well, would you be willing to raise [the initial borrowing assumption]? This gives us a little more opportunity for fine-tuning and sharing because we've got the borrowing. Would you be willing to raise that a little?

CHAIRMAN VOLCKER. I thought you voted for it in the first place?

MR. WALLICH. I wanted two. Yes, if you made [borrowing] $1.8 billion.

MR. PARTEE. But that's tougher. The choices were between "B" or "C." You're trying to make it tougher and move it toward "C."

MR. WALLICH. Yes, that's what I'm trying to do.

CHAIRMAN VOLCKER. You people all realize that if you vote for this compromise, this straight arithmetic compromise, and November really comes in low, we're going to be much easier in December than in the other alternatives.

MS. TEETERS. I think that might be appropriate.

CHAIRMAN VOLCKER. It would balance--

MR. MAYO. That's why we can live with it.

MR. WALLICH. That's what I don't like.

CHAIRMAN VOLCKER. Well, have we got a consensus for the arithmetic purity?

MR. MAYO. Sure, let's vote.

MR. BLACK. If I understand what it is.

CHAIRMAN VOLCKER. It's halfway between "B" and "C." It couldn't be simpler.

MR. RICE. Mr. Chairman, how does this look when it's written up? Does it look like--

MR. BLACK. Better than it sounds.

MR. RICE. Will it look as if we've departed [from our original decision] in any meaningful way?

CHAIRMAN VOLCKER. Well, I would suggest that we write it up so that it doesn't. It depends upon how one interprets what we said before. It's slightly tighter in some sense, if you interpret it literally [compared with] the number that we gave before. But if you put it in the context that we said we weren't going to be unhappy if growth came in a little below, we're accepting that [lower growth] as we said we would accept it.

MR. PARTEE. Do we just write it up as November, December, and January and then it would be 5 or 4-1/2--

CHAIRMAN VOLCKER. Well, I think we ought to assume for the moment--we'll decide about the meeting date in a few minutes--that if we decide that the next meeting will be in January, obviously we carry this forward into January. That's the implication; it is until the next meeting.

MR. AXILROD. I would assume, Mr. Chairman, that this is roughly the sentiment that the Committee decided before--that it has got a hair less M1, and a hair more M2. This to me is essentially what it--

CHAIRMAN VOLCKER. I think what we're talking about is [the period] until the next meeting.

MR. COLDWELL. Or unless things fall out of bed and you call a special meeting.

MR. PARTEE. Yes, we can always have a meeting.

CHAIRMAN VOLCKER. Okay, let's vote. We are voting for a straight arithmetic average between "B" and "C."

MR. BALLES. This is for November-December?

CHAIRMAN VOLCKER. Until the next meeting, whenever that meeting shall be.

MR. TIMLEN. But that would be no later than January.

MR. MAYO. We're not going to do it for February and March.

CHAIRMAN VOLCKER. In the normal course of events I think that's expected. We will decide upon the meeting date in a moment. So, it's until the next meeting.

MR. ALTMANN.

Chairman Volcker	Yes
President Balles	Yes
President Black	Yes
Governor Coldwell	Yes
President Kimbrel	Yes
President Mayo	Yes
Governor Partee	Yes
Governor Rice	Yes

Governor Schultz	Yes
Governor Teeters	Yes
First Vice President Timlen	Yes
Governor Wallich	Yes

Unanimous.

CHAIRMAN VOLCKER. We have another action to take which, if I understand it correctly, involves me delegating to Governor Schultz and in his absence Governor Coldwell the authority to answer all requests under the Freedom of Information Act, I guess.

MR. ALTMANN. No, the appeals from any turned down by the Secretary.

MR. COLDWELL. Appeals [of any requests] turned down by the Secretary.

MR. ALTMANN. Of which we have had none, I think, since 1975.

CHAIRMAN VOLCKER. Is there a motion to accept that delegation? Without objection, it is so delegated.

The next meeting is the remaining item of business. What I would suggest is that we tentatively keep it on December 18, but that you clear your calendars for whatever date seems best among January 8, 9, or 10. Are there preferences [with regard to those dates]?

MR. WINN. The 10th is a [board] meeting date.

CHAIRMAN VOLCKER. It's a Thursday.

MR. WALLICH. And the 8th is the date I'll be returning from the BIS meeting.

MR. COLDWELL. You'd be gone on the 7th too.

MR. WALLICH. The 7th and 8th I'll be gone.

MR. ROOS. What did you say about December, Mr. Chairman?

CHAIRMAN VOLCKER. Keep that on your calendars, with a presumption that the meeting will be held on December 18th. But I want the freedom to move it to--let's say the 9th of January if we can be that specific, which is Wednesday. The meeting might be moved because of various developments of an unforeseen character but particularly it may be convenient in terms of the new money supply figures and all the rest. If nothing is happening that suggests that we need to review things with urgency and if the [new] money supply figures will be in better shape and clearer with two weeks more [of work on them]--and we will have the advantage of knowing the OPEC decision and we won't have that on December 18th--then I'd be inclined to change it. But if something comes up [and things are] not going according to Hoyle in some sense, I'd be inclined to keep it [as scheduled].

MR. ROOS. While we're all here, could I address a question to Bob Black? We have a Conference of Presidents meeting scheduled in December.

MR. BLACK. We could reschedule that.

MR. ROOS. Would we if we move [the FOMC meeting date]?

MR. BLACK. Yes, sure.

MR. BALLES. I might suggest, Mr. Chairman, the possibility of having this meeting on January 8 if that's agreeable. If we're going to follow it with the Conference of Presidents, that takes another day. Is something wrong with January 8th?

CHAIRMAN VOLCKER. Only for Governor Wallich; I think that's all.

MR. COLDWELL. How about the 4th?

MR. PARTEE. Not the 4th; I won't be here.

MR. WILLES. Could we not precede [the FOMC meeting] with our Conference of Presidents.

CHAIRMAN VOLCKER. Yes, I wonder whether you could do it in the opposite order, with the Presidents' conference first.

MR. BLACK. Yes; we could shift it to January and Ernie could preside instead of me.

MR. ROOS. So if we did that, it would be the 8th and 9th.

CHAIRMAN VOLCKER. You'd have the Presidents' conference presumably on the 8th and the FOMC meeting on the 9th instead of vice versa.

MR. WILLES. Your preference at the moment is to have it in January. So in terms of our planning we should be thinking more of January than December, right?

CHAIRMAN VOLCKER. Again that's my preference if nothing goes wrong, but you know that seldom happens in this business. So I'm not sure what the most likely [date] is. I guess my preference would be to move it later because the money supply numbers will be in better shape and clearly we'd have the OPEC business behind us. But if things get disturbed, my preference would be the other way around.

MR. WILLES. It would just be easier in planning if we could fix on one or the other as the dominant one. I'm happy to go to January. I think that makes a lot of sense, but I would prefer to fix on one date rather than two.

MR. PARTEE. I think that's true. Why don't you turn it around?

CHAIRMAN VOLCKER. Well, let's state it the other way around. Let's have a presumption that we will have it on January 9, but keep the other date open just in case things go wrong.

MR. MAYO. Sold.

MR. BLACK. Let me ask the subcommittee chairmen to get their reports in as if it were going to be in December.

CHAIRMAN VOLCKER. That means they'll be on time for the 9th anyway! All right, let's presume it's on January 9th, but keep December 18th open in case we're hitting the federal funds [limit] or something is going on internationally or whatever.

MR. BALLES. Does that assume, Mr. Chairman, that we'll still meet on February 5?

CHAIRMAN VOLCKER. Yes. On February 5 we'll still have to make the final decision on the targets. So I would expect to have a preliminary discussion of them on whatever date we meet before then. It won't be until February 5 that we will know the budget and some other things anyway, but we are going to have a preliminary discussion whenever we meet next. And that preliminary discussion will have some substance because presumably it might affect what we do in the short run. Do we have a motion for adjournment?

MR. COLDWELL. So moved.

CHAIRMAN VOLCKER. We are adjourned.

END OF MEETING