Meeting of the Federal Open Market Committee

February 8-9, 1983

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, February 8, 1983, at 2:30 p.m. and continuing on Wednesday, February 9, 1983, at 9:00 a.m.

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

Messrs. Guffey, Keehn, Morris 1/, and Roberts, Alternate Members of the Federal Open Market Committee

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

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

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

1/ Entered the meeting following the action to approve minutes for the December 20-21, 1982, meeting.

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

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

Mr. Coyne, Assistant to the Board of Governors
Mr. Kohn, Senior Deputy Associate Director, Division of Research and Statistics, Board of Governors
Mr. Lindsey, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Dooley, Assistant Director, Division of International Finance, Board of Governors
Ms. Scanlon 1/, Senior Economist, Division of Research and Statistics, Board of Governors
Mrs. Low, Open Market Secretariat Assistant, Board of Governors

Mr. Fousek, Executive Vice President, Federal Reserve Bank of New York

Messrs. Balbach, Burns, T. Davis, Eisenmenger 2/, Mullineaux, Scheld, and Stern, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Dallas, Kansas City, Boston, Philadelphia, Chicago, and Minneapolis, respectively

Messrs. Meek and Soss, Vice Presidents, Federal Reserve Bank of New York

1/ Left the meeting following discussion of the Committee's longer-run objectives for monetary and credit aggregates.

2/ Entered the meeting following the action to approve minutes for the December 20-21, 1982, meeting.

Transcript of Federal Open Market Committee Meeting of
February 8-9, 1983

February 8, 1983--Afternoon Session

CHAIRMAN VOLCKER. It is now time to come to order. We might as well approve the minutes.

MR. PARTEE. So moved.

CHAIRMAN VOLCKER. Is there a second?

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection, we'll approve the minutes. I will welcome Mr. Roberts; I think it may be symbolic or something that he is sitting on the left side of the table. Where is Mr. Balles?

MR. PARTEE. I don't know.

MR. BALLES. There's no policy significance, Mr. Chairman, in my occupying the St. Louis seat.

CHAIRMAN VOLCKER. We do welcome you, Mr. Roberts, if you don't say too much.

MR. ROBERTS. I'm glad to be here but I make no promises.

CHAIRMAN VOLCKER. For the first hour, anyway. We might as well go right to work on the business outlook and the longer-term ranges. We may not get through that this afternoon, but I think we can get a long way. So, Mr. Kichline and company.

MESSRS. KICHLINE, ZEISEL, TRUMAN, and PRELL. [Statements--see Appendix.]

CHAIRMAN VOLCKER. I thought you had another page here showing the directive for the long-term targets over--

MR. KICHLINE. We're holding that in reserve.

CHAIRMAN VOLCKER. Well, that was a very full report. Let us concentrate on what the outlook is. Why don't we divide it into the real economy and prices at this point?

VICE CHAIRMAN SOLOMON. On the real economy, if you remember your chart, although you have a rise in productivity in '83 you have a drop in productivity in '84, right?

MR. ZEISEL. No, not a drop but a slightly smaller rise.

CHAIRMAN VOLCKER. That seems like a very low growth in productivity for a period of expansion.

VICE CHAIRMAN SOLOMON. That's right.

MR. BOEHNE. I'd just like to comment on that for a moment.

I've been impressed by the efforts across the board of big businesses and small businesses to cut costs. And it seems to me that the break-even point of most of these businesses now is significantly lower than it was a couple of years ago. What I keep hearing is that if we ever get a recovery, we will see substantial increases in profits, and I think that means bigger increases in productivity than we might expect. It also may mean that the unemployment rate could be stickier than usual in coming down because there's going to be a great reluctance to offset some of the progress that has been made in lowering the break-even point. So, based on just casual talking to a number of people, it does seem to me that we're in for a period, if we do get a recovery, where we probably could expect a bigger increase in productivity.

MR. ZEISEL. Well, we are faced with a situation in which our forecast is substantially under the average performance of a recovery period--explicitly, about half the rate of growth in the first year compared to that in the average recovery in postwar expansions. Second, we have been through a period in which the trend rate in productivity, at least as best we can measure it, has been very weak. Our feeling is that trend productivity may be in the 1 percent range at this point. Earlier in the postwar period productivity rates normally ran about 2-1/2 percent. So, in a sense, we're operating around a different slope. I think those two factors play rather important roles. President Solomon, we are forecasting a productivity increase of 2-1/2 percent in 1983 and of 1-1/2 percent in 1984. So, the rate of increase shown on the chart does come down a bit.

VICE CHAIRMAN SOLOMON. The reason it strikes me as low is simply based on conversations with many industrialists who have said basically the opposite: They expect relatively strong productivity gains both in '83 and in '84 because they're assuming that the recovery in '83 will not be that rapid and that the expansion will continue well into '84. And they expect to see continued productivity gains in '84 as well as in '83 at about the same rate.

MR. WALLICH. Aren't the swings in productivity in manufacturing larger than they are for the whole spectrum including services?

MR. KICHLINE. That's right. I think there are a couple of other points. That is one of them. I would suspect that the things we hear relate mainly to manufacturing. That's where the cost cutting is taking place and that's where we get the big productivity benefit. But this is for the nonfarm economy in total and I would suspect that there's not as much going on in the services sector, for example, as in manufacturing. The second point is that our view essentially is that, yes, the trend rate in productivity growth is improving. We expect it to improve further. We have a cautious approach. I would also say that some interesting things happened in 1982. One is that productivity started rising very early--well, throughout the whole year but very early in the recession. So, we had some adjustment for the faster trend rate of [productivity] growth that had been taking place with the massive [cost] cutting last year. The bottom line is that there are factors that cut in different ways. I think this is a conservative estimate. If it's wrong, it's probably too low. We might see much better performance than we have here.

MR. PARTEE. In support of more productivity I would also argue that we've got to get a considerable rise in productivity in finance. That earnings squeeze that you expect for the banks, which is only the tip of the iceberg now that we have money market deposit accounts and so forth, is going to force economization there. But it hasn't occurred importantly up to now. When you talk to bankers, by and large they're distressed by the rise in their operating expenses last year but they haven't done much about it; they say they're going to. I think that they will be forced to by events, so that might help. In addition to the industrial area, we might have some productivity improvement as a result of layoffs in finance also.

CHAIRMAN VOLCKER. How do you measure value added in finance?

MR. FORD. Value added?

CHAIRMAN VOLCKER. I'm taking for granted there isn't any to start with.

MR. PARTEE. You can have after--

CHAIRMAN VOLCKER. Do profit margins get squeezed?

MR. FORD. Net interest margins.

MR. ZEISEL. It's probably negative.

CHAIRMAN VOLCKER. Well, that may be going down. We've had comments that productivity is too low. What else is there on the business side?

MR. PARTEE. I wondered if I might just ask a question about the chart showing comparisons of postwar cycles on real GNP. As you commented, Jerry, this is a distinctly less rapid recovery, by a substantial factor, than the typical postwar recovery. You haven't gone back to look at the staff projections of previous recoveries, but I wonder whether there isn't a tendency to understate the recovery that actually occurs because of the obvious fact that there are dynamics in the situation that aren't foreseen at the time we start out on it. Do you have any idea?

MR. ZEISEL. I think you're right. I don't have the numbers at my fingertips but I think in general there is a tendency to understate the vigor of the recovery. One just doesn't see the sources of additional strength. We're still hampered by that particular problem; when one looks at the various components and adds them up, one gets a rather restrained recovery.

MS. TEETERS. Isn't your outlook really heavily dependent on the timing of the inventory cycle? If the inventory [liquidation] ceased as of the end of last year, we could get a very large first quarter which could also push the whole year up to a higher level. I wonder if you have information from the first quarter that indicates anything on inventories yet?

MR. ZEISEL. That is certainly true. And it does appear that the rate of inventory liquidation in the fourth quarter is larger than the Commerce Department estimated, or that we estimated as well, from the data available at that point. And that would suggest that a stronger first quarter--that is, a rebound in activity--would not be unlikely. The question is: What are the fundamental forces sustaining that growth? Essentially, the information that has become available just doesn't suggest to us that there is very much additional [strength]; it is possible that a slightly stronger outlook is in prospect but nothing has changed our view of the forces that are generating income and building activity.

MS. TEETERS. My point is that when the inventory liquidation quits, at that point we could get a quarter that looks very big but is nothing more than the inventory liquidation ceasing. And it could give us a rather nice growth rate even for a year, if we have a couple of fairly jagged up and down quarters as we go through the year rather than a constant growth rate.

MR. ZEISEL. That's correct.

CHAIRMAN VOLCKER. Let me make an observation. With a single exception, everybody in this room has a significantly higher forecast than what the staff has just presented. To the extent that that is only due to what Nancy was just suggesting, that you assumed bigger inventory liquidation in the fourth quarter and presumably a lower GNP in the fourth quarter of last year, I don't think it means anything. But maybe you didn't assume that. Mr. Black.

MR. BLACK. Mr. Chairman, we come out on the high end of most of these forecasts. We're assuming a rate of growth in real GNP fourth quarter-to-fourth quarter of about 5-1/2 percent, and we believe it will be front-end loaded--more growth in the first couple of quarters than in the last two. We're a little more hopeful on the unemployment side; we have that pegged at about 10 percent. But we are less optimistic on the GNP deflator; we are projecting about 5-1/2 percent on that versus 4 percent in the staff forecast. And underlying this is an assumption of a rate of growth of about 6 percent in M1. We are influenced primarily, I think, by two factors: One is that sharp recessions in the past have tended to be followed by a little faster recovery; [the second] is the sharp acceleration in growth of the money supply in the last half of 1982. We are well aware of the inferences that are being drawn from the reported abnormal behavior of income velocity of money and the inferences that are being drawn about the demand for money. But we did some experiments on this; we lagged money by one quarter and by two quarters in computing the rates of change in velocity. If you do that, it really illustrates some rather interesting things--that the drops are not that abnormal by past standards, reflecting the tendency of the money supply's effect to be lagged some time a couple of quarters later. So--

CHAIRMAN VOLCKER. I think we're getting ahead of ourselves. Mr. Axilrod could promptly comment on that at this point in our conversation.

MR. BLACK. Well, okay. This does get to that. But it does affect the velocity forecasted.

MR. PARTEE. What have you lagged it--two quarters did you say?

MR. BLACK. We lagged it one and two quarters. And in either case there were several postwar periods--

MR. PARTEE. Shouldn't you have had a recovery at midyear last year then?

MR. AXILROD. It's hard to [comment] without looking into your projections, President Black. We did the same thing; we lagged M1 and M2 one and two quarters and compared the velocity behavior of the past 5 or 6 quarters with the history of these things measured that way. With, say, M1 lagged 2 quarters--to develop M1 against GNP 2 quarters later--in the 6 quarters ending in the fourth quarter of 1982 we get an average decline in velocity of 1.1 percent even on that basis. And if you go back before 1982, you can't find any negative numbers; you can find an increase of 0.5 percent, but you can't find any negative numbers. If you do it for 5 quarters, it's the same thing. We did this for the same reason that you're bringing it up; the question was raised to us by others. We did the same thing for M2 and it shows a bigger increase in demand, even on this lagged basis. So, it's perfectly true that with lags you don't get these negative relations between money and velocity--that a rise in money this quarter generally gives you a rise in velocity 2 quarters later. But allowing for that over time we have the same kind of change in pattern on a lagged basis that we do on a concurrent basis so far as these data show us.

MR. WALLICH. Aren't these past data very much influenced by interest rate patterns? In the past we've had sharply rising interest rates early in recoveries. We don't assume that this time, so we ought to get rather different--

MR. AXILROD. I was not projecting 1983. I was just looking at the past.

CHAIRMAN VOLCKER. I think we ought to go on to something else at this point, but you might be interested in these charts on lagged velocity, and maybe we can distribute them. You might tell us, Mr. Black, if you have that big an increase in GNP, where it might arise.

MR. BLACK. Well, I hadn't worried too much about the components of it, Mr. Chairman. I would think that it would be mostly in consumer expenditures, government expenditures, a pickup in inventories, and not much improvement in capital and equipment. But we really expect that velocity is going to come back. I'd like to look at those figures of Steve's, because what we did was probably not as sophisticated as what he did. We had a decline in the fourth quarter, if we lagged it 2 quarters, of 1.6 percent in income velocity for M1; and for the third quarter the decline was 2.7 percent.

CHAIRMAN VOLCKER. We can return to that subject when we're discussing [policy].

MR. BLACK. Okay. Anyway, we projected about a 5 percent pickup in velocity and that led us to a greater increase in nominal GNP than the staff has been projecting.

MR. PARTEE. I think anyone with a stronger forecast, Paul, probably would have more consumption. It looks as if the personal saving rate was a limiting factor there, but we have to remember with dynamic properties that if you have more output, you have more income and then you can have more consumption and maybe not change the saving rate very much. And that's how you get a bigger--

CHAIRMAN VOLCKER. The saving rate is going to go down unless we get more investment someplace.

MR. PARTEE. A little, but nothing like a one-for-one comparison if we got the growth in consumption with output to accommodate it.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. I like the staff forecast for 1983 at least. And maybe that's because my numbers, which I put down in advance, turned out to match the staff's almost exactly. I look at the higher numbers that many people are now forecasting--5 percent or more for the four quarters of 1983--and I ask myself "Why?" I wonder if perhaps we are being overly influenced by signs that we got off to a pretty good January, judging by the improvement in nonfarm employment. I think it's quite possible that if we get off to a flying start, a momentum could develop. But I think it's just as possible that quite the opposite could happen: That after an initial burst, real GNP growth suddenly comes to a halt or at least slows down very substantially; industrial output goes nowhere; unemployment begins to rise again; and a new wave of pessimism begins to set in. I think we need to concern ourselves with that a good deal. However, in making a projection and thinking about the course of 1983 as a whole, I really think the same basic factors that led all of us to worry a month or two months ago about whether recovery was going to happen at all, and if so when, are still there. We're still dealing with a business community that is shell-shocked, that is going to play its cards very cautiously on the inventory front, that is going to wait until capacity utilization has gone up, and that is still very worried about the durability of the recovery. We're still dealing with very, very high real interest rates and very little hope that something will be done at this juncture about the deficit further out to bring real interest rates down. We're dealing with consumers who, although they've improved their financial positions, are not going to lead us out of this into a strong recovery; I think the state of the saving rate is one factor that argues against that. And I think the export markets are just very, very weak. All this adds up to a very modest pace of economic expansion. I think the staff has it about right.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. Well, I don't remember what [forecast] I sent in, so I don't have to worry about the consistency with what I say! It does seem to me that Chuck has a point that forecasters tend to underestimate the recovery, but they underestimate the recessions too. I think there are three things that are different about this. One is what Lyle just mentioned about the shell-shocked business community. [Second,] interest rates are still very high and this recovery still needs some nourishing on the interest rate side to make it succeed. That's for later in our discussion but however you look at real interest rates they are very, very high and that puts a damper on enthusiasm. The other thing--and it may be more noticeable in my part of the country than in some of the rest of the country--is that some basic structural shifts are going on in the economy that can have a major impact on the cyclical recovery. For example, even if we get a good recovery, the steel industry just isn't going to be what it once was because of the foreign sector. The automobile sector isn't going to be what it was. We're just not going to get the same kinds of recoveries. It's hard to measure these structural, secular kinds of things that are influenced on the cyclical side. But they do seem to me to tend to put a damper on [the recovery]. Again, I may just be more sensitive about that because of my particular District. But I think there's enough of it in the northeast part of the country that it's bound to have some impact on the national figure.

CHAIRMAN VOLCKER. I misspoke before. I don't know why I only saw one person whose forecast was down with the staff; there are quite a few who are down with the staff, including you.

MR. BOEHNE. So, I guess I'm consistent.

CHAIRMAN VOLCKER. Yes. I have all those with me.

MR. GRAMLEY. There are some that are actually below.

CHAIRMAN VOLCKER. Well, there's one that's below--

MR. GRAMLEY. There have to be at least three: one nonvoting president, one voting president, and one Board member.

CHAIRMAN VOLCKER. There are three.

MR. PARTEE. You're looking at the range there.

CHAIRMAN VOLCKER. Does anybody else want to comment?

MR. CORRIGAN. In terms of the real sector, the number that I have is 4-1/2 percent, as opposed to the staff's 3-1/2 percent, and it's hard for me to get too excited about those kinds of differences. But I'm inclined to the view that the inventory [liquidation] has probably run its course to a greater extent than the staff has [in its forecast]. I also think there's at least a fair potential that the housing sector will be stronger than the staff has projected as well. The area that I find a little more provocative in looking at the range of the forecasts is not so much the real numbers but the price numbers. I have a deflator number that's a little over 4 percent and I struggled a bit to get to that number. But I do agree with the sentiments that were expressed by several people earlier to the effect that productivity will be stronger than the staff forecast. In my own case, I ended up using a unit labor cost number of 2 percent on a fourth quarter-to-fourth quarter basis. Now, what's interesting about a 2 percent unit labor cost number is that if you attack the GNP from the income side, and you assume unit labor costs are going up 2 percent and you assume that unit interest and proprietors' income and all the rest do the same thing, a 5 percent rate of inflation permits something like a 40 percent increase in profit margin measures in terms of the GNP accounts. That, together with the oil price situation and the food price situation, in the context of a 2 percent rise in unit labor costs, leads me rather solidly to the view that we can, in fact, do better than 4 percent on inflation. I think it's important to do it because if we found ourselves with the kind of recovery that's being talked about here and with prices rising at a rate of 5-1/2 or 6 percent by the end of 1983, we'd have one heck of a mess in 1984 irrespective of all the problems financing the deficit is going to cause in 1984. So, I am more optimistic on the price side. I think that's solid. But more importantly, if we don't get that kind of price performance in 1983, it bodes very poorly in my judgment for 1984 and beyond.

MR. FORD. Excuse me, Jerry, but I didn't understand the logic of what you just said. Why are you more optimistic--just because it's a message that doesn't work out?

MR. CORRIGAN. No, I just went through it. I said that I attacked the question of what the inflation rate might be primarily by looking at the income side. I started out with a 2 percent unit labor cost assumption and made a bit of a subjective allowance for oil prices and food prices and then worked through the rest of it. It looks very doable to me to have the inflation rate in the higher 3 percent area--at something like 3.8 or 3.9 or 3.7 percent. I think that's very important.

MR. PARTEE. What you meant to say was that you didn't really think the profits would go up 40 percent.

MR. CORRIGAN. That's right.

MR. PARTEE. He didn't say that, but he meant to say it.

CHAIRMAN VOLCKER. You said they could go up 40 percent with 5 percent or 4 percent [inflation]?

MR. CORRIGAN. No, with 5 percent.

MR. PARTEE. And if you make them, say, 30, that gives you--

MR. CORRIGAN. Again, that assumes basically nothing special about oil prices. Even if you take the staff's estimate of an 8 percent drop in oil prices, then in a sense it's a shoe-in. If we get a larger oil price drop, I don't know. That could get to be a problem too.

MR. MARTIN. On that point, that's the only place where it isn't unit labor costs. In my own case, it is the expectation of a larger oil price drop than the 8 percent, realizing that the natural gas impact is in the opposite direction if you iterate through here a $3.50 or $4 a barrel change rather than a $2 or $2.50 change. I think we tend to underestimate the impact of that iteration. And I think [a larger oil price drop] is definitely in the cards and will produce a slightly lower inflation deflator number than the staff's.

CHAIRMAN VOLCKER. Well, let me ask the question the other way, after hearing you persuasive people. What do you have to assume to get an inflation rate of 5 percent or above?

MS. TEETERS. OPEC gets together.

CHAIRMAN VOLCKER. I'll rule that out. Well, I don't know. Is that the answer? Is that the only way [inflation] gets up there?

MR. BOEHNE. We'd have to have some very bad luck on the food front.

MR. RICE. Some bad weather.

CHAIRMAN VOLCKER. How bad would it have to be on food?

MS. TEETERS. It would have to be pretty bad because the stocks are quite large at this point.

MR. PARTEE. We could also get it if wage rates went up more than the marginal [increase in the] staff projection, which I would assume underlies, say, Bob's higher number. You would have a bigger wage rate, [Bob]?

MR. BLACK. [Yes], and I think there's going to be a big jump in profits. I don't know whether it's 40 percent--that sounds awfully high--but I think profits ought to rise quite rapidly.

MR. PARTEE. More than 12.

MR. KEEHN. I think there's another side to this, which is hard to get a handle on. We've gone through the break-even that Ed talked about--the reductions in the break-even capacity, if you will. There are an awful lot of people I have talked to who, as we get into a recovery, are very anxious to raise prices. And as soon as they sense an environment in which they can raise prices, they tend to go at it with a vengeance. Therefore, we are on the high side with regard to inflation--we were on the low side with regard to real GNP--because I think we're going to see some price increases in '83 and '84 that are a little hard to forecast at this point.

MR. GUFFEY. Yes, but lumber prices are going down.

MR. KEEHN. Really?

CHAIRMAN VOLCKER. If we have a recovery, we're going to see a lot of commodity price increases.

MR. FORD. We already are starting to see some.

CHAIRMAN VOLCKER. One could add up all those commodity prices and none of them equals a small decline in the oil price in terms of impacts on the GNP. We're bound to see increases in volume--

MR. PARTEE. You do hear this interesting comment that we had the other day: That a lot of these prices are being discounted substantially and that businesses don't want to raise prices, they just want to get rid of the discount.

MR. BOEHNE. How do the indexes pick that up? Do they get the discount prices or is that a messy problem?

CHAIRMAN VOLCKER. Poorly, I suspect.

MR. MARTIN. They try, but they don't get them.

MR. BOEHNE. So, there'd be some room for some effective price increases without it getting into the [indexes].

MR. FORD. We've had 3 or 4 of our leading businessmen tell us that [price measures are not properly weighted], when one takes account not just of the price but of the nonprice cost factors, like service and whether or not transport charges are loaded on heavily or lightly and so on. They swear that the PPI has been understating things--that the drop hasn't really captured the full extent of price deflation. There's a big gap in there. So, we have a research project going on because a number of our industrialists have told us we are--or whoever puts out that index is--full of baloney on that.

May I ask a couple of related questions of the staff? Another thing I heard from a number of businessmen is that our capacity number--we put out the industrial capacity numbers that everybody quotes, do we not?

MR. ZEISEL. Yes.

MR. FORD. That tells us that industrial capacity is now running at 67 percent or something like that. I had a number of people, including the principal shareholder of and a number of other major industrialists who really look at this stuff, say to me that our index is really poor--not in the way we're doing the statistical work, but the meaning of it. The argument goes like this: If they really ran mills at 100 percent of capacity in the way they think we measure it, they still wouldn't make any money on some of their mills, especially those that don't have today's oil prices factored in. Any piece of equipment or any plant that's over 10 years old should not be counted as part of capacity is what they're saying. If one made this adjustment, they say that the measured total against which we measure underutilization of capacity would be lower and, therefore, we'd have a higher-than-recorded utilization rate. Related to that, one of the biggest components of our industrial production figures that we report is electricity production and other kinds of energy production, right? I don't know how big a component it is, but the argument is that with the huge jump in oil prices, even considering the recent modification, there's a trend factor toward conservation which is very strongly reflected in things like energy per unit of output overall. If one adjusted for this in thinking about industrial production, probably the last 3 months instead of being down might actually be up, net of the conservation effect. Do any of these thoughts from businesspeople make sense to you, Mr. Zeisel, or Mr. Prell, or any of you?

MR. ZEISEL. They make a good deal of sense and they're a source of considerable concern to us, basically. In regard to the point about effective capacity and the factory that can be used on line, we have been very concerned about this and have been looking at it industry-by-industry. I must add that at this point it's quite a judgment call, but it appears to us that a realistic assessment of capacity that really should be considered obsolete or not likely to be usable would change our capacity utilization figures by about one percent. We'll know more when we get our annual survey. In that survey, we essentially ask businessmen about what they consider their real capacity and, presumably and hopefully, we get a realistic assessment at that point. Nevertheless, I'm inclined to think there's a certain amount of elasticity cyclically in any event--that as things begin to pick up, what was considered obsolete capacity may be brought back on line.

MR. FORD. Just in terms of economic logic, it would seem to me that right at that point when we had that huge jump in oil prices there should have been a substantial increase in the year-to-year change in obsolescence--just a priori.

MR. KICHLINE. Well, that's right.

MR. FORD. It did show up in the survey?

MR. KICHLINE. Parts of it did. I don't think that one would have seen these discrete changes across the board. There is a so-called vintage effect, which implicitly or explicitly obsolesced a large part of American industry by the change in the relative price of oil. Part of that shows up. There are several things; we also look at the McGraw-Hill survey and the Bureau of Economic Analysis data that are direct industry reports. In addition, we have the cyclical problem--and the steel industry is a classic case--where the issue is how much tonnage they are writing off. We've been in contact with steel companies as well as the American Iron and Steel Institute and we have some feeling, we think, about what they are writing off in a permanent sense. Now, the issue about a hundred versus some other number, I think, is a very important one. We have perceived something like 85-87 percent as peak rates of utilization--the point at which we've really had a problem in the past. So, in terms of the current number or some elevated number--adjusted one percent or two or three percent or whatever it may be--we'd relate that to something like a mid-80's range as full capacity utilization rather than a hundred. All of this, of course, is related to prices. One of the issues is: What is the price of that final product that will bring back these mills that are now viewed as outmoded? There is a price at which these facilities are not destroyed or mothballed forever. It's a messy area. The kilowatt hours also are a problem; that was affected by the 1973 oil price increase. We have sent people around to every Reserve Bank in the last 2 years and we have a survey that the Reserve Banks collect for us and it's a mess. That is the final word on that.

VICE CHAIRMAN SOLOMON. Assuming we have 3-1/2 percent growth in '83 and 4 percent in '84, do you have an estimate as to where we end up on utilization of capacity at the end of '84?

MR. ZEISEL. Yes, we end up at about 74 percent as I recall.

CHAIRMAN VOLCKER. Governor Teeters.

MR. ZEISEL. Let me just make a brief comment about the use of electric power. That's really relevant on a month-by-month basis. It's far [less relevant] in the long term because electric power consumption is really used just within a year to [estimate] these figures from month-to-month. Over a longer period of time we drop out the electric power and use shipments and physical measures of activity. So, the version that resulted from the run-up in oil prices in '72 presumably is taken into due consideration by use of other than electric power data later. But to the extent that these figures distort the month-to-month [changes], as you might guess, we do have problems and have to adjust for it.

MR. FORD. Thank you.

MS. TEETERS. Going back to the economic forecast, I added up the numbers in our projections and I must say I was quite surprised to find myself on the high side.

CHAIRMAN VOLCKER. So was I.

MS. TEETERS. Yes, I know. In part I was surprised because it's usually the other way around. Part of it is inventories and, of course, that could hit in any particular quarter or not hit. But the other thing that struck me is that we had a considerable increase in fiscal stimulus in the last 3 quarters of 1982. We've gone from a full employment deficit of $8 billion, or 0.2 percent of GNP, to one of $60 billion in the fourth quarter, or 1.9 percent. It bobs around next year, but it's over one percent all year long. And when I did come out high, at the staff's suggestion I went back and reconciled the income side. I have higher growth in consumption, which does generate a greater increase in output. It doesn't murder the saving rate; you can come up with a fairly good saving rate. But the other thing that jumped out at me is that when you calculate personal taxes for calendar year 1983, there's almost no increase. We forget that there's a tax cut [in the offing] and it's a big one--to the point that taxes will end up in 1983 within $2 or $3 billion dollars of what they were in 1982. And we're going to get the tax cut in a period of rising incomes; it's not going to come in a period of falling incomes like it did this year--a year in which it disappeared. So, I come out on the high side. I checked all my numbers and I could shave 1/4 or maybe 1/2 point off my forecast, given all the uncertainties, but it seems to me that we have a lot of things going for us. I also assumed that the interest rates would go [down] to 7-1/2 percent, which helps considerably on an economic forecast.

MS. HORN. Nancy, what is the price outlook that goes with that?

MS. TEETERS. I'm close to everybody else, or near the median. I think I was at 4-1/2 to 4-3/4 percent on prices. But I do get, as a result, a much bigger drop in the unemployment rate. It pays off.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I think this expansion in 1983 is, to perhaps an unusual degree, a composite of strengths and weaknesses. And from rather modest strengths, a picture of an expanding economy has been put together in the face of some very powerful negatives, especially a weakness in exports and a slowness in business fixed investment. The only unusually strong element that one wouldn't have counted on in other expansions is what Governor Teeters mentioned: We have a very large deficit and we're adding to it, and that is a somewhat unusual feature. Now, if you look at the things that are slow, exports and business investment, there is something in reserve that at some point is likely to kick in--for exports, I guess, with a fair predictability, and for investment depending on interest rates and how businessmen feel and how cautious they're going to be. I think we have at least the makings of getting much more strength on the up side than seems likely. That is, the error, if any, might very well be on the down side. Maybe we are not giving enough weight to the possibilities of a combination of stronger factors. But on the down side I would say we have a variety of small elements that have carried a very modest expansion so far and seem likely to put a base under what we're likely to achieve. I don't see the danger of sagging or falling back, as it were. The caution of businessmen in the investment area to me looks more nearly like an element of strength--something that's going to change. And if it changes more in the upward than the downward direction--if we can get a rise without that happening now--I think we certainly have the makings of a continued expansion.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. I wanted to raise a question on the housing forecast for the second year. Admittedly this is getting to what we here call the long run--2 years.

MR. GRAMLEY. That's the hereafter, I guess!

MR. MARTIN. I thought it was 2 weeks until I read this document. In terms of the second year, Jim, it seems to me that there are some lower ceilings in certain other resource areas. We have had shifts of resources out of the housing [area]--certain of the major supplier firms. I wonder if we won't reach a lower limit this time than 1.75 million. That looked like the good old days to me. Do you have any feeling about that?

MR. KICHLINE. Well, that could be. As you know, our housing starts forecast for 1984 is an average of a little under 1.7 million. That isn't the days of 2 million plus numbers that we had. So, that's one element in our thinking. Another is that we think housing will still be rather expensive in terms of mortgage rates being high and capital appreciation prospects perhaps not being as great as in the past. So, both from the production side and the cost and financing side, it seems to us that there are reasons to believe that housing won't really take off as in "the good old days." But I wouldn't view a 1.7 million number 2 years out as being terribly strong given the pent up demands that presumably are there and the demographic factors. It's pretty much a forecast that I can be comfortable with at this point in time.

MR. MARTIN. And you are on the cautious side with regard to the expenditure growth, I noticed, in the residential area for 1984 and that's a comforting--

MR. KICHLINE. Well, that's part of it too. The argument is that people are building smaller houses and that sort of thing.

MR. MARTIN. Hence your 9 or 10 percent increments quarter-by-quarter.

MR. KICHLINE. Yes.

CHAIRMAN VOLCKER. Mr. Ford. No, you already spoke. Does anybody else want to comment? Let me raise a question, Mr. Kichline. If you look at your forecast beginning now in this quarter of '83 for a year ahead, is that substantially different than the forecast you had in the beginning of the second quarter looking a year ahead?

MR. KICHLINE. Beginning in the second quarter of--?

CHAIRMAN VOLCKER. Of '82.

MR. KICHLINE. I think that's a question that I don't have the answer to here. I'm not sure I want to remember!

CHAIRMAN VOLCKER. It's a point not to be precise about, but my memory is that you had a forecast of a fairly gentle recovery beginning in the second quarter during the year ahead.

MR. KICHLINE. You're talking about our projections of the spring of last year?

CHAIRMAN VOLCKER. Exactly.

MR. KICHLINE. That's right; we had forecast a modest recovery. So, we did not put in the second-half downturn. If that's the question, you're right.

CHAIRMAN VOLCKER. Well, I only raised the question because I detect a quite different tone in this meeting from only a month ago. Everybody is assuming, or has forecast at this point, a recovery. I would point out that I'm not sure that's in the bag; one could have made exactly the same forecast--whether or not you did, I think you did--nine months ago.

MS. TEETERS. I think all the rest of us did too.

MR. KICHLINE. In April and May, I think that's right.

CHAIRMAN VOLCKER. I said one could have made that forecast nine months ago. A lot of people did. What we had at that time as I recall were low automobile inventories and some recovery in automobile production and the beginnings of a housing expansion, following two quarters of large inventory reduction.

MR. PARTEE. There was tax stimulus.

CHAIRMAN VOLCKER. And a tax stimulus coming up.

MS. HORN. Which leads to the question: What is different now that is driving this forecast? Certainly, interest rates are different. What other kinds of--

CHAIRMAN VOLCKER. Interest rates are lower now.

VICE CHAIRMAN SOLOMON. Businessmen 9 months ago were not as cautiously optimistic as they are today.

CHAIRMAN VOLCKER. They were less cautious and more optimistic in my mind.

MR. GRAMLEY. I think so. As a matter of fact they started in July to produce for the upturn that never materialized.

CHAIRMAN VOLCKER. Look, I think we're in a recovery. I just say that one month of upturn does not a recovery make. And the most recent trend in automobile sales--I don't know that it means much, but it's down, not up. Automobile production is now up very close to sales. They have a lot of incentive programs going on. We know some sectors of the economy are declining and there are also plus factors in the economy. We'll see.

MR. GUFFEY. Mr. Chairman, I just want to raise a question to perhaps lay a base or understanding for future discussions. If I understand the assumptions underlying the staff's forecast, an 8 percent M2 growth after the first quarter translates into your figure of 8.8 percent M2 growth for 1983. Is that correct?

MR. AXILROD. Are you referring to the so-called underlying growth rate?

MR. GUFFEY. Yes.

MR. AXILROD. Yes, we now think the first quarter is more like 8-1/4 percent, given the growth rates we got with the new seasonals and the definitional adjustment. So for the year it is somewhere close to 8-1/4 percent, or a little over 8 percent.

CHAIRMAN VOLCKER. We've done a certain amount of talking about the business and the price [picture] and we haven't done any explicitly, except some mention of exports, on the international side or on the credit side. The credit side I think we're going to have to return to in terms of setting targets when we decide what we want to do there. But does anybody have any questions on the international side or on the fiscal side or the credit side? Mr. Balles.

MR. BALLES. If I may, Mr. Chairman, I have a question on each. I would ask Ted Truman, and perhaps you already told us, Ted, and I didn't follow it, so could you tell us again if you did before: What is going to cause the dollar to depreciate in '83 and '84? That's a very crucial assumption in this forecast.

MR. FORD. And it comes down to--

MR. TRUMAN. A month ago I think I would have told you that some decline in U.S. dollar interest rates might do it. And then we've had this marking up. The major [factor] that we have been pointing to for the past year or so, or half year anyhow, is the prospect that the already large current account deficits that we are projecting would be even larger if we didn't have the dollar depreciation and that as a result that would just tend to be unsustainable in terms of the rest of the world absorbing that amount of net claims on the United States over a relatively short period. And the prospect is that [the deficits] will continue. That, I think, is essentially what you have to consider--plus some washing out of the safe haven argument that was more dominant the last part of the year.

MR. BALLES. Well, that's a very tough question to answer and I was really wondering what the international staff here thought and whether there was some assumption or view that they had with respect to relative movements of interest rates here versus abroad and relative movements of prices here versus abroad. Do you care to comment on that?

MR. TRUMAN. On the interest rate side I provided a chart. On the inflation side we think we'll be doing a little better, [which would] build up the attractiveness of U.S. assets. These forecasts aren't that scientific or precise but, if anything, we would conclude that we might get more in the way of interest rate declines abroad than is implicit in the Bluebook forecast, which does suggest that relative real interest rates are going to be higher. We think, if anything, they'd move somewhat higher in the United States which is why, as I said in my concluding remarks, one might argue that there might be something more in terms of financing that would come out of the private capital flows than one could really see in the historical data. That's the basis on which one might argue against [a dollar decline]: That people would be willing to continue to acquire claims on the United States or acquire dollar-denominated claims to such an extent that we would not get the decline in the dollar in 1983 that we're projecting and the much larger current account deficit and drag on U.S. GNP on the export side associated with that. If you took the dollar as it was and kept it at that fourth-quarter level, which is the bottom line of that chart, that [equates to] about 1.3 or 1.4 percent of GNP at the end of 1984. That is a large component, essentially, of the difference between the growth rates that we have in the staff forecasts for 1983 and 1984.

MR. BALLES. Thanks, Ted. The reason I was probing on that point, Mr. Chairman--if I remember my own staff's analysis--is that about 40 percent of the drop in real GNP in '82 came from a deterioration in the net export sector. So, this is really terribly crucial to the outlook.

CHAIRMAN VOLCKER. There is no question that we are in a period, I think, without precedent--Mr. Truman can think of all the precedents while I assert this--in that we have had a big recession here and the foreign [trade] balance is declining instead of improving. Usually the balance improves during a recession. And it is a very large fraction of the share of the decline in GNP. If you want to make horror stories for this year, go along the line perhaps of your reasoning: The exchange rate remains high; the trade balance gets even worse than projected; we get a big government deficit holding up interest rates, let's say; and we have a lot of foreign financing of the deficit. The result would be that we have a mess in the economy: relatively high interest rates, relatively high exchange rates, and for both reasons not a good trade balance and not a good [performance in] other sectors of the economy. Governor Wallich.

MR. WALLICH. I wanted to follow up on this. While I basically share the staff's view about the dollar, nevertheless, one has to bear in mind that our prospective current account deficit is not the kind of deficit that historically has caused currencies to go down. It's not the result of domestic mismanagement, inflation, and so on. It's the result of forces that otherwise strengthen the currency--reduction in inflation and tight monetary management. So it's not quite clear that under those conditions a current account deficit is bound to depress a currency the way it does when that deficit comes from other factors. I still think the chances are that it will, and so I share the forecast. But I think one has to bear the other possibility in mind.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. Mr. Chairman, I have one other question, if I may, and that's related to the financial aspect of the fiscal material. If I could, I'd like to ask Mike Prell a question about a chart in this area, the first chart in his section on the federal government share of total credit flows. This is a technical question, Mike: Does that include or not include off-budget deficits?

MR. PRELL. It covers off-budget items in the sense that it includes all U.S. Treasury borrowings. It doesn't include sponsored agencies, loan guarantees, and other federal credit programs.

MR. BALLES. The other question is, I guess, more analytical and substantive: Is there a risk, not recognized perhaps in our Board staff, Bank staff, or [Committee] members' forecasts here, that we really are sailing into uncharted seas with this huge proportion of the total pool of credit--the bulk of it--absorbed by the federal government? I'd like to know your answer. My hunch, Mr. Chairman, is that that supports your degree of skepticism about whether in fact the recovery is in the bag. There are two things that could upset that recovery: the depressing effects of interest rates that are still pretty high both on a nominal and a real basis compared to historical levels, and secondly what might happen when such tremendous shares of credit get soaked up by Uncle Sam in periods of economic expansion. I'm worried about the crowding out phenomenon. Is that something I should worry about?

MR. FORD. If I may just tack on: On that chart we're talking about, right about now the federal government share of total credit flows is at an historic high. For a few weeks it's zooming skyward and all of a sudden it levels off, while your forecast projects continuing increases in the deficit, including the structural part. How do those things add up in the flow of funds [accounts]?

MR. PARTEE. The other side of this is Nancy's fiscal stimulus. Don't forget that. That's the counterpart of this.

MR. BOEHNE. But does fiscal stimulus mean the same thing if it's financed through monetary policy? One of the reasons we have higher real rates, I think, is the deficit. Whatever dollar you get on fiscal stimulus either results in some higher inflationary expectations or higher real rates.

CHAIRMAN VOLCKER. Would you like to answer Mr. Ford's question, Mr. Prell?

MR. PRELL. There is a complex of things here. In terms of the way the chart looks, plotted as it is, we picked up this sharp rise in the latter part of the recession. The large amount of borrowing that occurred in the latter part of 1982 is at a rate roughly comparable to the kind of borrowing we're anticipating will continue over the next couple of years of financing $200 billion deficits. At the same time we have some slight increase in the overall size of credit flows. Total borrowing by domestic nonfinancial sectors was $413 billion in 1982 and we have it going up to $452 billion in 1983, which is essentially just the increase in government borrowings. And then it's up to $497 billion. So the flow is growing, but its growth is slight. The proportion remains rather fixed.

But returning to the question that President Balles asked, I think our whole projection has to be recognized as being in the context of a monetary policy that we still regard as reasonably restraining on the growth of nominal GNP. We do have continuing pressures sustaining what are, in effect, high real short-term interest rates. And that does lend itself to an unusual type of economic recovery. We have reasonably weak investment in the first half of this recovery. Housing starts do move back up, but it isn't a tremendously robust improvement we see going into 1983 and 1984. So the composition of risk and the credit flows that we have do reflect, I think, this crowding out phenomenon in the context of a restraining monetary policy that's still aiming at, and should achieve, some deceleration of inflation in the context of moderate growth.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. In this flow of funds chart, for example, you don't have the business borrowing by '84 getting anywhere near where it was even in '81. I have the same problem: As I look through this in terms of the sources and uses, it's almost inconceivable to me that you could produce the kind of growth that you have there without putting a lot more pressures on interest rates than--

CHAIRMAN VOLCKER. It's that 40 percent increase in profits!

MR. PRELL. The short-term interest rates in our forecast recede only very slightly at the same time that the inflation rate is edging downward. At current levels one would assess short-term real rates as being rather high. And if it's hard to assess the long rates, then certainly relative to the current inflation rate those too are very, very high. So, we have a rather restrained outlook for capital spending.

CHAIRMAN VOLCKER. Any more questions?

MR. FORD. One other thing, while we're on this page: Given the growing interest of the Committee in credit aggregates as a possible way of tracking or influencing real performance, could you say just a little more about that very unusual divergence between the growth of domestic nonfinancial debt and GNP?

CHAIRMAN VOLCKER. I think that's a good question, but let's defer it until we get to [the discussion of] the targets because it goes right to that question of where a credit aggregate, if we use it, should be in the light of history. Is there anything else just on the general business picture, the international picture, or the fiscal picture? I would summarize my own view on this in a way that John Balles probably [was getting] to: There are a lot of reasons why the price outlook looks pretty good; the business outlook looks pretty good except for the budget deficits ahead and except that the international outlook is a hazard, and except that we still have [potential] problems with real financial disturbances, internationally and domestically, which I'm afraid will be aggravated at some point by too sharp a decline in the oil prices. We have a little problem that has been alluded to here as to how aggressive both labor and business will be in their pricing as the economy expands. I've been relatively optimistic about that but I don't know if there's any basis for being relatively optimistic. If Mr. Keehn is right--I think you were the one who commented on that side--then we have another problem. If everybody's going to be very aggressive [in their pricing] with six months of rise in new orders, I don't know where we are [going]. Only time will tell, I guess. Let us turn to Mr. Axilrod. If you can clarify all this in a statement shorter than the remainder of our available time, my congratulations.

MR. AXILROD. Well, the statement will certainly be shorter.

CHAIRMAN VOLCKER. I'm sure of that.

MR. AXILROD. I might say well in advance, because it relates to a question that was just raised about credit, that throughout this all of our money assumptions and our credit assumptions are in some sense high in terms of rates of growth. It came through in President Black's question about velocity and its lagged effects. They are all, over 1983, high relative to what one might have expected looking back at historical patterns in previous cyclical periods. That carries through to M1. To a degree it carries through to M2, though it's hard to interpret that extracting from the shifts because M2 is such a different animal, given interest rates. For that matter it's hard to interpret M1. It carries through to M3 and it carries through to total credit. So, we're getting a somewhat smaller increase in nominal GNP relative to the increase we're expecting in all of these aggregates. And, of course, that is what happened last year. We got enormous drops in the velocity of all these aggregates last year. We don't have anything like that [projected for] this year, but there's some sense of a little less lift in GNP relative to the aggregates that carries through into this year. [Statement--see Appendix.]

CHAIRMAN VOLCKER. You indeed finished before exhausting all our time. How successful members of the Committee were in following the complexity of your statement, I'm not absolutely certain. As you were talking, I wrote down some observations and questions. I think what Steve has said is right in our traditional framework, with all the appropriate qualifications. It assumes we're going to have targets on these various things, as we've discussed before. And we will look at velocity hypotheses to set them down. Let me just make two assertions to start with--or one assertion with two subdivisions. I don't think we have any escape from an unusual amount of uncertainty --uncertainty in the technical sense--in approaching this subject right now. I will assert, and I think it is true no matter how you lag these things, that velocity is off the map, as Steve indicated at the start, so far as 1982 is concerned and because we have all these uncertainties about shifts. But I also think there's a more basic uncertainty about the economy, which was reflected in our earlier discussion--the international dimensions, the deficit, the "financial crisis" possibilities. [Those concerns] are there.

Against that, let me raise some basic questions and then some operational questions. I suppose the first basic question, which we more or less disposed of last time, but I want to repeat is: Do we need these targets at all either legally or economically? I think we tentatively said yes, we should go ahead with them. And by targets I'm talking about these monetary targets; one can conceive of some other kinds of targets. A subsidiary question is: How firmly should they be put forward and on what basis do we change them as the year progresses? And in evaluating that decision: What do we see as the risks with respect to the economy or to inflation, particularly whether they're asymmetrical, in playing our hand? As part of that I suppose a question is: What concern do we have about interest rates, whether or not we target them? Those I see as general questions on which we have to reach some consensus. And then, assuming we're going to have monetary targets, we have those questions about which one we emphasize, what we do with the shifts, what the base is for M2, how much weight we put on M1, and how we treat this credit aggregate. Probably other questions will arise, but I think those are all operational. This draft directive takes one stab at trying to answer the questions, reflecting pretty much the state of the discussion as I understood it after our last meeting. With that much introduction, I would appreciate some comments on what I characterized as the more basic questions. Maybe we just ought to discuss those a little before we get into which target, which base, and so forth.

MR. BOEHNE. May I ask a question before we get into that? Picking up on the uncertainties, what do you see are the main uncertainties as far as the DIDC is concerned? Do you see a good chance, for example, of a business Super NOW account coming along or other kinds of changes that would--?

CHAIRMAN VOLCKER. Oh, I don't know. I would guess against it, but I'd put the odds at 60/40 or something against. But I tell you, with all the other uncertainties, I see that one as about 18th on the list although it would obviously affect M1 if the DIDC did it.

MR. PARTEE. Yes, it would affect the M1 target.

CHAIRMAN VOLCKER. It's a subsidiary question to "What do we do with M1?"

MR. MORRIS. There is a new development that is relevant to that: The Fidelity Fund is introducing a new money market fund that will offer unlimited checking. There will be no service charge but the cost of handling the checking would be deducted from the revenue. So it will have some [lesser] flow of yields than their present funds. If others follow, then quite clearly they could force the commercial banks into competing, which they haven't done yet, on the Super NOW. That would also force us, of course, to determine how we would treat this new money market mutual fund in M1. Presumably that would be open to businesses and that would give those in the business community a vehicle for having an interest-bearing checking account if they wanted it.

CHAIRMAN VOLCKER. I don't want to impose too much order on the discussion, but I will deem those questions as appropriate when we get to the question of what we do with M1. I'm thinking of the more general questions of how we evaluate the general risks in terms of the very broad strategy of how we play this and what kinds of targets we want and how firmly we adhere to them. Governor Wallich.

MR. WALLICH. I'd like to put forth just two or three very simple propositions. I think the case for money supply targets remains that they are a better protection for the central bank than other forms of targets or no targets at all. Even though the experience we've had in the past year might disillusion one quite substantially, and even though one might have believed all the time that it's interest rates and not the money supply that govern the economy, I think the Congress has given us this mandate to use money supply targets and an opportunity to do something that is publicly much easier to defend than an arbitrary setting of interest rates. So, I would continue with the targets.

I think the uncertainty that has been revealed during the year in terms of the behavior of velocity is so great that we do have to give ourselves more leeway. But I would look for that leeway in a wider range around the midpoint that continues to be whatever we think is the most likely single course for that aggregate. If instead of 3 percentage points we have 5 percentage points [as the width of the ranges], it seems to me that under the circumstances, given what has been observed by the public about the aggregates, that would be acceptable and understandable. Our task, then, would be to arrive at some conception of what the midpoints are of the aggregates on which we want to target. I think we can either put M1 on ice temporarily or make it relatively innocuous by having a wide range around it that gives us flexibility. And we could have additional flexibility by saying that at midyear we may want to review that. That may be a trade-off, so to speak, for a lesser width of the ranges.

CHAIRMAN VOLCKER. Let me just insert an observation here. I don't know how many of you read the Economic Report [of the President], but it went through various iterations before the final version was produced and I didn't read the final version. So, I speak projecting changes that were made in earlier drafts. As originally written, it had a very great retreat from certainty of monetary targeting, without any question, because it recognized the changes in velocity. It basically took the position that you have to blend targets with judgment. In some earlier drafts it came very close to saying what we should do is target nominal GNP, which is something that at our last meeting we pretty much decided not to do. I think that has been toned down as the drafts proceeded but there is still some implication of it I suspect. But that's the way they kind of get out of this box: You have to be reasonably flexible with the targets and look very hard at GNP and inevitably forecast, I think, the GNP in setting the targets or in altering the targets. Governor Partee.

MR. PARTEE. Well, I find myself in substantial agreement with Henry. I think we do need to continue to target the aggregates. I believe it is an opportunity--and also there's plenty of basis for it--for widening the ranges. In addition the tone of the Council [of Economic Advisors] report is that you have to be flexible. They didn't exactly say target nominal [GNP]. I just read that before I came into the meeting.

CHAIRMAN VOLCKER. I'm sure they didn't exactly say that.

MR. PARTEE. They didn't exactly say target, but they said steer by nominal GNP and to the extent that we seem to be achieving a result that is not consistent with what we wanted in nominal GNP, be prepared to change our targets. Well, some notion of uncertainty and of that kind of flexibility could very well [be read] into it. The only thing I disagreed with [Henry on] is that although I wouldn't target primarily on M1, as previously we did, I do believe that M1 so far has stood up a little better than the other aggregates. And, therefore, I see no reason, as he commented, for benching it for the time being or sidelining it. I see no reason for doing that so long as we leave in the caveat that if the DIDC does something big, that target, of course, will have to be changed.

CHAIRMAN VOLCKER. Let me just make a distinction there, as a footnote to what we said. Right at the moment M1 may be standing up better as a technical matter; it's not as distorted by these institutional things. It is at least as far off in its velocity over the past year as the other measures. They all are.

MR. PARTEE. But I don't see that there's an awful lot to choose from.

CHAIRMAN VOLCKER. No, it's probably neither more nor less over the next few--

MR. PARTEE. Even the credit aggregate is way off.

VICE CHAIRMAN SOLOMON. But even if you keep an M1 target, Chuck, you would deemphasize it and say that--

MR. PARTEE. Yes, I wouldn't target primarily on M1.

VICE CHAIRMAN SOLOMON. --basically the reserve path is drawn on the basis of derived M2.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. I think the situation presently is one in which we have to regard our principal objective for 1983 as making sure we do whatever is necessary to permit a recovery. And we have to be awfully careful in defining our financial objectives to make sure that we keep that in mind. Having said that, I still think it's important for us to continue using quantitative targets of some kind. If we go in the direction of trying to target on interest rates, we will be sending signals that we have changed our fundamental long-run objectives of policy. I agree with Henry completely on that. And I think if we start targeting on interest rates, any hope that we're going to make progress on the budget is going to go right out the window because Congress is going to say "Well, if you can do all those good things on interest rates, then what's the point of our being more disciplined?"

In thinking about the targets, I have come to the conclusion that M1 ought to be confined to the nearest waste basket at least for the next 5 years. When I look back at 1982, I don't think this decline in velocity is an accident. The 8-1/2 percent increase we had in M1 over the four quarters consists of a 3-1/2 percent increase in old M1, which is the measure on which we based all of our historical relationships between M1 and GNP, and a 35 percent increase in other checkable deposits. My point here is simply that we have no real idea whether this new composition of M1 will give us a cyclical and secular pattern of M1 anything like the old one or not. And the Super NOWs, of course, make it much worse no matter how much shift adjustment we make for them. So, I think we're in a position in which we ought to give zero weight to M1 and ought to concentrate our attention on the broader aggregates. And I think there's much to be said for using a credit aggregate in some way; I don't think we can use it for a target in the same way we've used the monetary aggregates because we simply do not have the kind of data availability, much less capacity to control it. But using it as an information variable--telling us where we have been, giving us additional flexibility in adjusting our monetary targets as the year goes on--is potentially a very valuable use of that kind of financial variable. Also, if we focus on a total nonfinancial debt variable the way the staff has suggested, it also has the other very substantial benefit of in effect saying to the Congress: "Look, if the number we're shooting for is, say, $450 billion, and the federal government is taking $210 billion, then we only have this much left for the private sector and anything you can do to bring down the deficit will increase private credit availability."

MS. TEETERS. May I ask the staff a technical question? Do we have the same velocity problems with the old M1 that we do with M1?

CHAIRMAN VOLCKER. I will defer that question until we get to setting the targets.

MS. TEETERS. I'm just curious.

CHAIRMAN VOLCKER. Well, restrain your curiosity until we get to setting them up. Mr. Balles.

MR. BALLES. Generally, along with Governors Wallich and Partee, I feel that, yes, we do need to have some kind of monetary targets. The key questions, of course, are what degree of emphasis and what range we should use, etc. Taking a leaf from your book, Mr. Chairman--you mentioned that we could have made the same economic forecast in the spring of '82 that we're making now and that the thing blew up on us--I would caution that the big surprise that we've had since our December meeting may be that M2 was the aggregate that was hugely impacted and that M1 wasn't. That isn't necessarily settled in cement, though; that could change. I'm not sure why or how or when [this might blow up on us] but, frankly, I would reserve judgment as to whether the relative stability that we see in M1, which is a big surprise, is in fact something we can continue to count on. Although I would like to see M1 included--Steve has given us both the pros and cons of doing it--I would be cautious and at a minimum defer judgment until the spring of the year, perhaps in April, about whether we're going to have an M1 target for 1983 at all. I would add another thought--maybe piggybacking, if that's the right word, on Steve's point--that there's a good case to be made for using the first quarter as a base for M2. The same logic that led him to that conclusion would lead me to the conclusion that if we are going to use M1, we perhaps could consider the first quarter also as a base for the year even though there haven't been any big changes, net, so far.

CHAIRMAN VOLCKER. If I can interrupt. I think you're getting a little ahead of this, John. All I'm interested in at this point are broad observations about the targets and how we deal with them.

VICE CHAIRMAN SOLOMON. Well, I don't think there's a need to go around the table. We went over this in great detail.

CHAIRMAN VOLCKER. Well, we'll find out whether there's a need to go around the table. You can make an observation if you care to make an observation.

VICE CHAIRMAN SOLOMON. Okay. I don't think that there's any alternative to having some kind of broad targetry. There's nothing to put in its place that's acceptable to the Committee, as we know from earlier discussions. Now, if you don't want to get specific, then I have to stop there.

CHAIRMAN VOLCKER. Any other comments on this?

MR. CORRIGAN. In terms of this question of how firmly we put forward the targets, which I obviously think we need, I certainly would favor the direction that I think is implied in Steve's comments and your own, but I'd be inclined to go maybe even one step further. And that is, in your testimony at least, in some carefully construed way, I'd suggest that we might indeed use the GNP as a bit of a steering mechanism. Again, I don't want to get trapped into the business of saying we're going to use it for a target, but I do think there is something to be said for getting a little more flexibility into the approach by saying that we're more willing to look at GNP and be guided by it rather than trying to make the case for flexibility simply on the basis of all these technical arguments about the components of the Ms, which people don't understand or care about. The one other point I'd like to make quickly, in terms of asymmetry or lack of risk, is that at this point I do see a somewhat asymmetrical risk in one sense on the up side. But I can't ignore the fact that if one of the things that you and others have mentioned goes wrong on the down side, while the probabilities of that may be smaller, the implications are much larger and we'd really have one heck of a mess. So, I have some asymmetry in my evaluation of risks; it's asymmetrical in its own right.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. My asymmetry is in the opposite direction. I think a need for an intermediate target will really be important when we get to the point where we have to start pushing interest rates up to prevent an acceleration of inflation. And it seems to me if there's one lesson from the last 3 years, it's that having an intermediate target gives us a good deal of political shelter that interest rate targeting does not. I think the public did have a perception that it was appropriate to decelerate gradually the rate of growth of the money supply and I think we could generate a perception on controlling the rate of growth of credit. But if we suggest [we are] sitting out there managing interest rates, we don't have that public perception going for us.

CHAIRMAN VOLCKER. I'm not sure whether I understand what your asymmetry is.

MR. MORRIS. I understood that Jerry thought the real problem of risk was on the down side. I think in any liquidity crisis this Committee is going to say the heck with the guidelines, we're going to put enough liquidity into the system to take care of it. And politically that will never be a serious problem. The real problem comes when, say, in late '84 or '85 we have to push interest rates up. If we don't have something we can point to that's demanding that we do this in the public interest, I think we're in trouble.

CHAIRMAN VOLCKER. That's why you want to keep targets.

MR. MORRIS. Yes.

CHAIRMAN VOLCKER. Do you also want to make the target relatively tight, whatever that means, at this stage?

MR. MORRIS. I want to make the target meaningful in the sense that I think our problem in the last year or two was that we have been in a situation where we had to abandon the M1 targeting two times out two years. We were presumably following the shift adjusted M1 in 1981. That came in very low and we decided not to bring it within the range. I think that was a sensible decision, but it did mean that we were not targeting at the end of the year what we planned to target at the beginning of the year. [Last] year we also made another sensible decision not to try to force M1 back [down to] within the top of the range, which I think would have been disastrous. But we lose a lot of public [understanding] and strength from having an intermediate target when we have to keep abandoning it because the darn thing is getting the wrong--

CHAIRMAN VOLCKER. Yes, but I guess I'm lost. What do you conclude now for '83 on the basis of all this?

MR. MORRIS. I conclude from this that we should go to targeting some broad aggregate, which is not--

CHAIRMAN VOLCKER. Other than M1?

MR. MORRIS. [Other than] M1 and M2. I don't think we could set a guideline for M2. I think the only one of the Ms that's left that has any validity--and by validity I mean something that is not going to be dominated by financial innovation--

MR. GRAMLEY. What is it you are arguing for--M3 or L?

MR. MORRIS. M3, L, or debt.

CHAIRMAN VOLCKER. You want a firm target for a very broad aggregate, then.

MR. PARTEE. Which we can't achieve.

MS. TEETERS. We don't have any influence on those, really.

MR. MORRIS. I think we can influence them just as easily as we can M1. There's a mythology around this table that we have an extremely tight control over M1. I think it's a lot of nonsense.

MS. TEETERS. We don't have any control over credit.

CHAIRMAN VOLCKER. Governor Rice.

MR. MORRIS. I don't believe that. I don't believe that.

MR. RICE. Well, Mr. Chairman, I agree with a good deal--in fact most--of what has already been said. Particularly, I agree with Governor Wallich and the view that we ought to continue targeting the aggregates and should avoid explicit interest rate targeting for the essentially practical reasons that he set forth. I would like to emphasize, though, that we ought to keep in mind at all times what we consider to be a desirable level of real interest rates and, while we do not make these explicit, I think we ought to continue to look at interest rates and keep in mind what range of rates we think would be consistent with the results we would like to get. I especially agree with Lyle that we ought to keep in mind that the main thing we have to achieve now is to get a recovery going and to try to nurture that recovery. Therefore, as we target aggregates I would favor setting targets for M1, M2, and M3, as well as domestic nonfinancial debt. I would want to remain very flexible in my view of which aggregate was the one to target on at any particular time. I would want to make it very clear in our public statements and in the record that we feel free to shift from one aggregate to another depending on its usefulness. If we find that M3 is more useful than M1 or vice versa, we should feel free to make that shift in emphasis as we have in the past. I would not at this point be prepared to throw M1 in the waste basket. When things settle down six months from now, it may turn out to be a much more useful aggregate to target than it is today. So, I would emphasize two things: (1) we should maintain our flexibility and our right to choose and shift the emphasis from one aggregate to another from time to time; and (2) that we not take our eyes off of interest rates.

CHAIRMAN VOLCKER. Governor Teeters.

MS. TEETERS. I agree with Henry for a change and, Governor Partee, I do like the analogy of the fig leaf you cited last time. I do think that the monetary aggregates provided a very good political shelter for us to do the things we probably couldn't have done otherwise. I don't see that we can move to a very broad aggregate and have any influence on it because I don't know what the relationships are to GNP in these cases and I don't think we have the instruments through reserve management to affect to any marked degree the growth of those very large aggregates. So, I can live with monetary targeting for another year. But I do have one major plea. I agree with all the [comments] about wide ranges and flexibility. I'm not so sure we should hopscotch from one to the other, Emmett, but if we have to we might--

MR. RICE. Why not?

MS. TEETERS. I don't know, but I think it'll break down a little.

MR. PARTEE. But it sounds like we would take the one that we're within [the range].

MR. RICE. I don't know why we can't, if we explain in the record why we are doing it.

MS. TEETERS. Now, that's my major point here. I think we caused a lot of disturbances in the market last year that weren't necessary by not telling people what we were doing. It was pretty obvious by midyear, and certainly by fall, that we needed to change the targets. We have consistently refused to change targets from the original specification of them 18 months in advance. If we had gone ahead and said that due to technical factors and due to liquidity we are going to change the ranges by a certain amount, it would have settled a lot of the uncertainty in the market. I think interest rates would have started coming down in March of last year instead of jumping off a cliff in July. If we do go this flexible route, I think there is an increased responsibility to be very open about what we're doing and to make it public; it seems to me we should tell people exactly what we're doing or what we're trying to do and why we're trying to do it.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, my position probably will not surprise many people, but you may see that I have an unusual degree of flexibility this time. I think we ought to continue to target the aggregates and I think we ought to include M1 in that for a couple of reasons. For one thing, it has been less distorted. That may not hold over the long run; I don't know. We can address that if it doesn't. I think it's important for our credibility that we put M1 in if at all possible, but I do think there's substance in the arguments made by those who say that it's going to be a little different kind of beast than we've had in the past. So, I would widen the range on the up side because it's probably going to contain a larger element of savings and also because it has grown so fast that I don't think we can risk decelerating it that fast without jarring the economy and knocking off any recovery that may be developing. And if we should try to use M1, then I think that ought to be the main basis for constructing our target paths because we found out M2 doesn't work very well. We could, I suppose, use a target shadow reserve requirement, as Steve suggested in the memo last time, of 4 percent or something like that. But the truth of the matter is that even though we've gone through the motions, we really have not been doing any kind of reserve targeting during this period. In fact I argued that we really ought just to admit we were pegging the federal funds rate, which is what I think we've done and I think that was appropriate during this period of uncertainty. But if we're going to get back to reserve targeting, it has to involve something that is to a large extent reserveable.

CHAIRMAN VOLCKER. Mr. Roberts and then Mr. Solomon.

MR. ROBERTS. Mr. Chairman, I'm very conscious, having just left the private marketplace, of the fragile position of commercial banks and also the concern over large government deficits. But I think that another major concern out there is that the Federal Reserve System not sort of operate without any guidelines. I think that the market expects specific guidelines and, if we don't have them, there will be an anticipatory effect in the market that will be negative in terms of interest rates. I would, therefore, strongly favor our maintaining targets for monetary aggregates. It appears to me from my very limited ability to study this matter that M1 has exonerated itself extremely well during this period and, on the assumption that velocity will return to a normal pattern, I would hope that M1 would be very strongly represented in those monetary aggregates.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. In addition to targeting M2 and M3, I have a slight preference for continuing to target M1 but I'd make it clear that we are continuing the present policy of deemphasizing it. If we do not say that, we are going to return to a situation where the markets are mesmerized by the Friday numbers and we're going to have a lot of volatility again and we're going to feel much more handcuffed. I think we do have the need for the kind of flexibility that we have demonstrated in the last few months, so I could live either with dropping M1 or leaving it in. We can leave it in but I think it's essential to make clear that it is going to be deemphasized and that basically there's no perception that we're making a significant shift from the present conduct of monetary policy back to a stricter monetary targeting.

MR. RICE. Would you accept deemphasizing it for now?

VICE CHAIRMAN SOLOMON. Yes.

MR. RICE. "Now" is the emphasis?

MR. PARTEE. How do you answer Bob's point that we don't have any reserve targeting at all? We just target on net borrowed reserves--that is, the funds rate.

VICE CHAIRMAN SOLOMON. Well, we all know what we're doing. The net effect of our monetary policy is still restrictive and the majority of the market perceives it as such because they look at the level of real interest rates.

MR. PARTEE. I do not see the evidence that we have a restrictive policy. I think credit is beginning to flow and flow in very large quantities.

VICE CHAIRMAN SOLOMON. You mean in the first quarter?

MR. PARTEE. Yes.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. I would agree with those who are advocating a continuance of targeting M1, M2, and M3. I would not favor dropping M1. I don't have the exact wording of how to handle it, I guess. I would not be quite as strong as saying that we are not going to pay very much attention to it and rely more on M2, based on the very recent evidence that we have that M1 seems to be behaving a little better in this transition period. I would probably be inclined to look a little more at M1 but I also agree that flexibility is essential because we're dealing in a very, very uncertain time, with the numbers apparently changing with each report that comes through.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. I would join those who support targeting aggregates. My own predilection would be M2 and M3 at this time, with a statement that we would review M1. I would go along with John that we review this in April and not wait until midyear. I think that we need to target aggregates for a couple of reasons and they are important reasons. First, they form a basis for communication; they provide a certain degree of understanding not just on the Hill but in the financial community. Secondly, although this may sound a bit extreme, I think that despite our exceeding the targets by such a large amount they provide a certain amount of discipline internally on ourselves. I believe we must go to wider ranges to reflect the uncertainties, though in so doing it may be appropriate--I would just raise this for consideration--that in communication with the Congress we indicate it will be a rather short-term objective of ours to bring down the rates of growth in the aggregates at such time as the recovery will not be impeded thereby. And I'd say that we would attempt to exercise our best efforts not to have such a turn be abrupt or the method in which it was done itself be disruptive. I certainly support those who believe we should use so-called informational variables. It seems to me that we must mention nominal interest rates, not in the sense of a target but as an information variable, because of the credibility question. If we don't mention that we are monitoring that informational variable, I don't think we will be believed. We should likewise mention as an informational variable the domestic nonfinancial debt for all the reasons that have been advanced here in that it does move us a bit toward the GNP inference.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. I go along with the targeting for all the reasons that have been given, not the least of which is the political sheltering. I do think, however, that we have to look through these targets to the real economy and therein comes the flexibility. It seems to me that the consequences, both social and economic, of not having a recovery this year are so large that we have to look through to the real sector. Not to include M1 seems to me to emphasize the flexibility that we're trying to convey here. If we include M1, there is so much accumulated devotion to that particular indicator--with the Friday afternoon releases and all of that--that to bring it back now is to go counter to what we're trying to emphasize, and that is the need for flexibility. So, in addition to the technical reasons, what we're trying to communicate leads me not to include M1 at this point and go with M2, M3, and with credit as an informational variable.

CHAIRMAN VOLCKER. Mrs. Horn.

MS. HORN. Starting from the premise of targeting aggregates, my preference is to target narrower aggregates both for reasons of controllability and historical relationships with GNP and so forth. Because I favor targeting narrower aggregates, I favor a flexible approach. That flexibility would be on the side of what I think has been referred to as technical reasons--that is, I think we'd have to be explicit that we would be flexible with M1 targets, depending on our fragmented readings of what its velocity is going to be. That's the danger, certainly on the M1 side. With M2, along with the velocity problem, there are also the shift problems. And, of course, the shift problems could develop with M1 as the year goes on. So it's those kinds of flexibilities that I'd like to see introduced into the targeting exercise. I very much agree with Nancy that if we take an approach that is flexible with regard to targets, we must be very open in our communications with the markets. They must believe that we're engaging in an honest flexibility and I think that would be accomplished by frequent and fairly open communication.

CHAIRMAN VOLCKER. Would you like to define dishonest flexibility?

MS. HORN. No, I'm going quickly onto the next subject!

MR. PARTEE. It's sustained upward bias.

MS. HORN. I agree with Frank about the risk question; I think the risk is on the up side. In particular, if we take this flexible approach, I think we will be very sensitive as a Committee to the economy needing more liquidity. Hoping that that doesn't happen, then we're going to need the backbone--and the political protection that we will get from the targets will have to come into play--if we get into a situation where we need to start increasing interest rates. And if we build in too much flexibility, that of course takes a bit of that protection away.

CHAIRMAN VOLCKER. Did I miss you, Mr. Guffey?

MR. GUFFEY. Not yet.

CHAIRMAN VOLCKER. I had your name and I crossed it off without even hearing you, I guess.

MR. GUFFEY. Well, I may not have anything to say that hasn't already been said. If so, I'll just repeat what has already been said. I would join those who would retain the aggregates targeting because, first of all, I don't think we have any choice. Legally, I think we're obliged to do so and it's a question of which aggregates we select. My own preference would be to target M1, M2, and M3, and adopt the debt aggregate. My purpose is twofold. I think Frank Morris said it very well: They may not be used in our implementation process in the immediate period ahead, but they have served us very well as a political shelter. And that wheel is going to turn back around and we're going to need them again. To abandon them now or to dilute them in importance would be a mistake for the future, as far as the public's perception is concerned. I am concerned, however, about the recovery and that we ensure that the recovery takes place. I again agree with Frank that this Committee should look through the aggregates to ensure that recovery does take place fairly early in this year. I hope that's the case, at least. What reinforces my feeling of targeting the aggregates is the fact that the markets are used to looking at them and if we fuzz them up too much without any historical connection with what we've done in the past, we're building uncertainty in the markets. The risk of delayed recovery that I believe is out there is enhanced as a result. This is beyond where you want to go at the moment, Mr. Chairman, but I would set these target ranges in such a way that they can be easily equated to what we have said and have tried to do in the past and move to the lower levels. It bothers me a bit when we talk about a 9 to 13 percent range for M2, for example, and not talk about the 6 to 9 percent range.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. I would join the consensus in favor of continuing with the targeting [of the aggregates]. I've certainly been impressed with the analysis that was done with regard to the shifts that are taking place in the aggregates. Nonetheless, we are in a period with an extraordinary amount of noise and uncertainty. Therefore, I would be in favor of continuing to target M1, M2, and M3, but I would move the bases as far forward as we possibly can to get behind us as much of the shift that has been and is taking place. I would keep a heavy eye, or if not heavy certainly a concerned eye, on interest rates because unless we get the recovery more solidly in place than it is now, we'll have a great deal of trouble. And in all of our public utterances we ought to make it perfectly clear that as we go through the year we are going to be adjusting the ranges, the base, and our whole approach to this to provide for the shifts that are taking place.

CHAIRMAN VOLCKER. Mr. Ford.

MR. FORD. I was listening to you when you said that you wanted to get back to ask if there were any fundamentally different things that the Committee wanted to consider. In listening to what we've all said here, where we are headed--unless somebody does come up with a different approach--is to [take a decision that would] add to the noise in the marketplace. I want to be specific about what I mean. If you take all the things that have been mentioned here today so far, and that a lot of people nodded their heads in favor of, what they come to is this: We haven't voted on it yet but I'd be willing to bet money that by the time we're done voting we will have agreed that there are going to be more aggregates to look at. Specifically, we're going to add a credit variable or two. We're generally in favor of leaving M1 in, although with much less emphasis. There's strong acceptance of the reality that there is going to be more base drift this time than ever before--and if I remember the numbers right--both on M1 and M2. A number of people, at least Jerry, Ed, Lyle, Roger, and a number of others, have said "Let's look through all this to the real economy." That to me is another way of saying we're going to try to impact the economy directly. And I don't think it's too much of a stretch of the words to say we want to [fine] tune the economy in reality. We think we can do it. We've all used the word flexibility. Everyone who has spoken so far has used the word flexibility, which is another way of saying wider bands and more allowance for moving things around. And everyone is advocating the wider bands themselves.

When I take all of these feelings that we've expressed, Mr. Chairman, it raises the question in my mind, in line with your question: Why are we dealing with monetary aggregates at all? If you go back to how we got there, the monetary theorists who pushed this whole concept had as one of the fundamental parts of the concept that we shouldn't try to fine-tune and especially shouldn't try on a short-term basis to be flexible about a lot of things. We should be looking at some aggregate that hopefully has some relationship to what we're really trying to do over a long period of time and just let it go in a steady way and the market will know what we're going to do next. And with these six or seven dimensions of flexibility that we're putting on everything--! There are two or three people down this side of the table who in different ways all stuck to it. Karen almost jumped on the table and then backed off. Nancy said it. What we're doing is we are looking at the real economy, trying to manage it in real terms, and de facto we're using interest rates as the principal variable to attempt to do that. That's what we're doing.

So, my answer to you would be: If we're going to do all these other things, then it would be in the interest of not creating more noise in the markets just to say that we are now going to attempt in our collective wisdom to manage the real economy out of a recession without managing it back into inflation and the principal thing we're going to do is move short-term rates. Because I think that's the truth. Isn't that what we're really doing? It looks that way on the charts to me. So, just in case somebody wants a fundamental alternative--all the rest of the things all of you have said are variations, I argue, on this theme of flexibility, more targets, and wider bands--I'll offer a basic alternative, if for nothing else but the sake of discussion, which is to stop all that stuff and tell people that we're trying to set interest rates that will get us out of the recession and hope that it won't have side effects that will get us back into another round of inflation after it's over. That would be in my view a more fundamental change and one that I don't want to say I'm personally advocating 100 percent; but if the drift of the opinion around this table is to do all these other things, let's at least consider that as an alternative.

CHAIRMAN VOLCKER. I think you've put your finger on a point that I was going to make in summation. I would not carry it to the point that you carried it, but what I hear around the table--with maybe your exception--is unanimity on targeting, which is where we were before, and a lot of flexibility. I think those are fundamentally incompatible in a conceptual sense, if you push this far enough. In one theory of targeting, anyway, you'll go a long way toward undermining what you are targeting if you're very flexible in handling it. I detected a lot of nuances or differences, which gives us a job to reconcile. I wouldn't go all the way to targeting interest rates very firmly because I think there are targets other than interest rates that we could adopt instead of monetary targeting. We can look at a lot of things in addition to interest rates, which I think is probably what we're doing. But I did want to note that I think the Committee is on two horses; I'm not saying wrongly. But there are two horses: One is targeting and one is flexibility. And they have two different names.

MR. FORD. They tend to go in opposite directions.

MR. RICE. It's because of the uncertainty that we were talking about earlier.

CHAIRMAN VOLCKER. Oh, I'm not saying it's wrong. I'm just saying that we better recognize that that's what we're doing. And inevitably, then, you have to put emphasis on other things, whatever they may be at the time--whether it's interest rates or nominal GNP or a number of other things that have been mentioned. As to whether it's reassuring or unreassuring to the markets, I think you could ask a variety of market people and they'd give you different answers to that question depending upon their own predilection. So, that point I think one can interpret for oneself. I have a little strategic decision to make on whether we finish tomorrow or not [unintelligible]. Does anybody else want to comment on these general things in response to what they have heard from others if it doesn't take too long? But I think we are where Mr. Ford suggested. There are a lot of variables and a lot of nuances--or more than nuances--of differences as to what to do with all these variables. And how we condense all that into a directive is the problem. I think this draft that we have in front of us more or less reflects the flavor of the conversation, whether or not it reflects it in the details that everybody would like to see. That's where we are. We can leave it all until tomorrow or we can continue for another 10 minutes or so, I suppose, tonight. If people want to stay for another 20 minutes maybe we could dispose of all these more or less technical questions that I've been deferring about lagged velocity and the question of [the base] that John Balles raised. What else was raised that was more or less discrete? Why don't I just throw open [the discussion] if people are willing to sit here until quarter to six to get more underbrush out of the way.

As I read this conversation--tell me if I'm wrong--we probably can work more or less from the directive that we have before us. I'm not arguing that people wouldn't want to change some of the wording, but I think it very broadly has this flavor of targets with flexibility that I hear around the table. Why don't we deal with this language here, which is fundamental I suppose, on how stable velocity is? On the face of it, it wasn't very stable last year. And the question has been raised: Does it look that much more stable if lagged?

MR. AXILROD. Mrs. Low will pass out some charts that the Committee could look at. [See Appendix.]

MS. TEETERS. What about the velocity of old M1?

CHAIRMAN VOLCKER. It's here. Oh old M1! I don't know whether Steve is prepared to cover that one, but it's a reasonable question.

MR. AXILROD. Governor Teeters, old M1 last year grew 3-1/4 percent; new M1 grew 8-1/2 percent. Our quarterly model equation would have predicted a growth of 5-1/2 percent, given interest rates and GNP. So, [the model result] is in the middle. It was no more accurate--well, the difference is small--on old M1 than it was on new M1. It just underpredicted one and overpredicted the other.

CHAIRMAN VOLCKER. I don't understand it. I would have thought that old M1 was much closer now. What are you calling it?

MR. AXILROD. It was 3-1/4 percent, Q4 1981 to Q4 1982.

MS. TEETERS. That's the growth of old M1.

CHAIRMAN VOLCKER. That was the growth of old M1.

MS. TEETERS. What's the velocity of old M1?

MR. AXILROD. Oh, the velocity of old M1! I'm sorry, I thought you [meant growth]. The velocity of old M1 would have been a little plus.

SPEAKER(?). It went up a little.

MR. PARTEE. A little [plus].

MR. AXILROD. Zero with no change. But I was [addressing] the question of whether our model predicted it. That's another way of getting it.

CHAIRMAN VOLCKER. Well, it's another way of getting to the answer. But I am not sure what your answer is. I take it Governor Teeter's assertion or question--

MS. TEETERS. No, question.

CHAIRMAN VOLCKER. --is: Has not the velocity of old M1 been more consistent than that of new M1?

MR. AXILROD. Well, I can only answer it at the moment for last year. If you get beyond that, old M1 went to pot with the NOW accounts and all that. I still have in mind what happened a lot earlier when there were no differences between old M1 and new M1.

CHAIRMAN VOLCKER. A lot earlier there was no difference, I'm sure.

MR. AXILROD. Last year seems to me the only relevant year.

CHAIRMAN VOLCKER. You're probably right.

MR. AXILROD. One easy way to get at that is to say we have an equation based on the whole history and that the infamous, in a sense, quarterly equation in our model just says there has been a downward demand shift in M1 since the mid-1970s. That equation, given income and interest rates in the last year, said M1 would have increased 5-1/2 percent. The old M1 increased 3-1/4 percent. So, the equation overpredicted for the old M1. The new M1 increased 8-1/2 percent and in that respect the equation underpredicted. I find little to choose by the time I put myself in that framework. Now, of course, Governor Gramley is right that it probably doesn't take into account this special effect of OCDs and NOW accounts and the fact that maybe the behavior is a little different. They have a somewhat different elasticity. The elasticity of M1 with respect to income and interest rates may be changing as the composition changes. We have a problem there, no doubt.

CHAIRMAN VOLCKER. You say the equations are not much different. They're on the opposite side of this. Suppose you take a very simplistic notion and say velocity was averaging 3 or so percent for a long period of time. I take from what you're saying that in 1982 old M1 velocity was about zero. Zero is closer to 3 or so percent than 8 percent was--well, not 8 but--

SPEAKER(?). Minus 5.

CHAIRMAN VOLCKER. Minus 5? Okay, minus 5; that's right.

MR. AXILROD. Mr. Chairman, we on the staff here tend to look at velocity with interest rates taken into account. And there was a sharp drop last year in interest rates. So that's why we tend to look at the model, which enables us to look at both the impact of income and interest rates together. That's why we did it the other way.

MS. TEETERS. Wait a minute, Steve. Let me just see if I [understand]. Given the drop in interest rates you would have expected a drop in velocity, if nothing else changed.

MR. AXILROD. We expected some drop in velocity.

MS. TEETERS. That's what you're saying: a drop in velocity.

MR. AXILROD. There's some--

MR. GRAMLEY. Well, the other way you can interpret Steve's remarks is that what you should do, according to the model, is take the growth rate of old M1 and the growth rate of new M1 and average the two together. Then you get the right answer.

SPEAKER(?). That leaves us another problem.

CHAIRMAN VOLCKER. We're holding an array of charts before us, upon which maybe Steve will make the assertion--I'll make it for him for purposes of testing--that there is no significant difference between lagged velocity and otherwise. I think we can detect a slight difference in the most recent period, maybe only because we don't have another quarter for M1 lagged one quarter in that first chart. I suspect the next quarter would show the lagged relationship with a steep decline. I say that because we had a 16 percent rate of increase in M1 last quarter and nobody thinks that the GNP is going to approach an annual rate of increase of 16 percent this quarter.

MR. AXILROD. Another thing to observe, Mr. Chairman, is shown in chart 5 in the way that we plot the growth rates; they are obviously highly variable for both. The standard deviations are a measure of variability. There is little to choose between the standard contemporaneous and the alternative, which is to use a lag on these. In all cases the alternative is a hair better than the standard, but the difference will not be of any significance. None of this means that velocity isn't going to turn around in '83, lagged, unlagged, or any other way. But it--

MR. BLACK. Could I make at least one observation, Mr. Chairman? Steve, I don't think there's anything incompatible with what we did [in Richmond] and what you did here. You have not used semi-logs on this scale. So, on the vertical scale, an absolute drop there would be comparable to a much smaller drop down here. In the figures that we had looked at back to '54 and '49, the change in velocity lagged one or two quarters was really not that different. So, we were talking about two slightly different things.

MR. AXILROD. A general point I made earlier in the evening, Mr. Chairman, was that whether you look at velocity contemporaneously or lagged, there is a marked change in the behavior of velocity in '82 relative to historical experience. Lagging it doesn't change that. And that's the only point I wanted to make.

MR. BLACK. Mr. Chairman, could I circulate a memo to show something differently?

MR. GRAMLEY. Just don't expect us to read it, Bob!

MR. BLACK. Okay. I think there are precedents. Steve is right that nobody knows what velocity is going to do in this upturn. It may come up and it may not; I don't know. I'm just saying that I was surprised to find out, as I read this, that there were precedents to this kind of drop. But they were in periods before this chart begins; they were earlier in the postwar period. And they may or may not be indicative--

MR. AXILROD. Yes. We only went back to where we had quarterly data.

MR. BLACK. Yes.

CHAIRMAN VOLCKER. Interestingly enough--and I think Mike Prell may have mentioned this--on the credit flows we had the same velocity phenomenon. We had something like it in the 1950s for very brief periods. But you have to go back to the 1950s.

MR. PRELL. It is shown on the chart on page 9 in the credit aggregate memo where we did take it back to the 1950s.

MR. FORD. On the credit [memo]?

CHAIRMAN VOLCKER. That was the memo distributed to you earlier. The other question that arose was about basing. There's just a feeling that if you take M2 in the extreme form, if we have a target for the year and use the fourth quarter of last year, we are going to have a big number, whatever the number should be. It's going to be outside the range of anything we've talked about. If we use the first quarter, it still has quite a lot of [that problem] because M2 was rising so fast during January at least. The only way to cure it is by taking as a base some period that we haven't reached yet. It's much less true in the other aggregates. But it's true in spades of M2. So we're left with this simple choice. If we're going to use an M2 [target] and if we use the traditional base, we're going to have a very large number. The pros and cons of--

MR. GUFFEY. One alternative to that, of course, because of the historical significance of the fourth-quarter base is to use that base and for the purpose of your testimony use the underlying growth rate that is assumed and adjust that by the shifts as we go through the year.

CHAIRMAN VOLCKER. Well, we can do that theoretically, I guess. Maybe I just speak for myself but I thought it was the general view around here that it is awfully hard to do that this year because you can't deliver those estimates of the shifts with a straight face and say you have any confidence in them. If you just change one of those percentages a little, you're way off.

MR. GUFFEY. I understand that. But the other numbers don't make any more sense, particularly for the Committee setting its targets. And the fact that we're pursuing the course that's consistent with what we've done in the past is probably the most important message that this Committee could deliver to the public and to the markets in the period ahead.

CHAIRMAN VOLCKER. In that connection, I would only point out--and it surprised me a little--Mr. Axilrod's latest estimate. If I read it correctly in the Bluebook, he is saying the estimate is not a good one in terms of being a reliable estimate. His estimate is presumably the center of some range; I don't know whether he said that or not. If it is the middle of some range, what it says is that we have no basis whatsoever for thinking that M2 was high in the last two months. In fact, it was a little on the low side. I don't think that's the public appreciation. That hasn't particularly been my appreciation. I don't think that has been the appreciation anyplace, but that's what it says.

MR. FORD. Is that going to sell? Can we sell that?

CHAIRMAN VOLCKER. I'm wondering myself.

MR. FORD. I'm serious. I don't mean this as a facetious question.

CHAIRMAN VOLCKER. I don't know. I doubt it, but we--

MR. GRAMLEY. I think we shouldn't try, Mr. Chairman. The idea of shift adjusting--

CHAIRMAN VOLCKER. I don't think it's a question that's fully settled.

MR. GRAMLEY. When the magnitudes are $200 billion in two months it is absurd because if you get a very minor change in that percentage that comes from non-M2 sources, it makes a fundamental difference in your appraisal.

CHAIRMAN VOLCKER. You can't say it is not great. Even if you believe Steve's number as a center of a range, which he says is a very bad estimate, all you can say is that it's not clear that it's high or low.

MR. GRAMLEY. And you ought to make that point. But I think it argues strongly for using a February-March base instead of a fourth-quarter base.

MR. MORRIS. But the problem--

MR. GUFFEY. I'd just like to follow up by saying that I'd rather fuzz up the adjustment than I would the basic underlying growth rate we're shooting for. And I'd assume the 8 percent.

MR. GRAMLEY. You can still argue that from February-March on.

MR. GUFFEY. Well, the historical connection is what I think would be important to the markets.

MR. MARTIN. I think the shock in the market of the very large rates of change that result from using the fourth quarter [as a base] would exceed any kind of side or pseudo analyses that we've shifted the base. I think those large percentage growth numbers would be a shock.

SPEAKER(?). I agree with--

MR. PARTEE. Well, Roger's going to take them out, Paul, as I understand it. He will show a figure that is like the 8 percent from the fourth quarter to the first quarter.

MR. GUFFEY. Absolutely.

MR. PARTEE. And then you've got to [unintelligible].

MR. GUFFEY. Yes.

VICE CHAIRMAN SOLOMON. The markets are so conscious of this $200 odd billion that has moved that I think they would be surprised if we were to base [the target] on the fourth quarter and incorporate this massive redistribution. I think it would be very understandable that we would take the February-March base. Oh, I'm sorry.

CHAIRMAN VOLCKER. No, no, I'm just--

VICE CHAIRMAN SOLOMON. At least I have the clear impression that they would be surprised. They would know the imprecision of our shift adjustment estimates. We'd have to say so quite honestly. And I think they would understand, given this massive movement that's going on, why we would take a February-March base. It's not so much that the size of the numbers bothers me, although I think there are people who don't understand and who will be shocked by the numbers, but I think the market would feel [a February-March base] is a little more accurate way of doing it.

MS. TEETERS. Tony, I agree with you if one thing is true, and that is if the adjustment is slowing down. How fast has it been going the last week, Steve?

MR. AXILROD. The MMDAs?

MS. TEETERS. Yes.

MR. AXILROD. It has been down to about $20 to $25 billion a week.

MS. TEETERS. I like the idea. I want to get a nice stable base, but if the base is--

CHAIRMAN VOLCKER. Let me just try this. Suppose we use something like the February-March base for M2. Is that considered compatible, in terms of whatever presentational objectives we have in mind, with using a fourth-quarter base for the other numbers? Let me say that the reason it's not clear is that M1, we think, was distorted in the fourth quarter and probably not much in January. So that distortion is already largely in the base. Maybe that's bad. We think M3 is on the plus side by some unknown hazy amount in January but not like M2. It's a small fraction of what M2 is distorted by and will probably be less as time passes. So, there's a bit of distortion but not very much if we use the fourth-quarter base for the other numbers. So, we use a fourth-quarter base for those two aggregates, let's say, and for credit, but an advanced base for M2.

MS. TEETERS. What do we do if we get corporate Super NOWs?

VICE CHAIRMAN SOLOMON. We hit that problem--

CHAIRMAN VOLCKER. We cross that bridge when we get to it.

VICE CHAIRMAN SOLOMON. Either way we'll have--

MR. PARTEE. We'd break that series too. That's what we're doing, really--not so much shifting bases as breaking the series and starting out with [a different] M2.

CHAIRMAN VOLCKER. It is a kind of break in the series.

MS. TEETERS. We might as well break all of them and be consistent.

VICE CHAIRMAN SOLOMON. Well, I'm not sure about that, Nancy. We have such an overwhelming case on the distortion in M2 in terms of the numbers one can point to whereas we have a much more modest reason for shifting the base on M1 and M3. I think one could make an argument either way. My preference would be to show that we are maintaining continuity where we can maintain it--where the distortion is not too great. So, I would have some preference for the asymmetrical treatment of the base, which I think just the sheer magnitude of the numbers would justify.

CHAIRMAN VOLCKER. It's getting late. Let me assert, and people can argue against this tomorrow if they want to, that for purposes of putting in numbers in these blanks we will assume that we're going to do what Tony was just suggesting: We'll talk about fourth quarter-to-fourth quarter numbers for everything except M2 where we will talk about some advance date as the base. Whether that should be February-March, I don't know. In saying that, we would have to say that we assume that this [shifting] will slow down drastically. If it doesn't, we will have to look at the number again. So, when we're thinking about numbers, the staff's estimate--which is probably no better than anybody else's--. Or maybe it is better. Let me reword that. It's probably better than anybody else's but that doesn't mean it's very good. But we may have to say something about it in the directive. The staff has already assumed that just using a February-March base for M2 until the end of the year we're still getting some upward bias by an order of magnitude of--

MR. AXILROD. Well, we've assumed, given what's in that long footnote, [the upward bias] to be about a point of growth.

CHAIRMAN VOLCKER. From February-March?

MR. AXILROD. From February-March to the end of the year. And that's assuming that [MMDA growth] slows down to $12 billion a week [on average in February] and to $8 billion a week [in March] and all that.

CHAIRMAN VOLCKER. All right, just keep that in mind as an operating assumption. You are assuming that M3 is artificially pumped up for the year by nothing?

MR. AXILROD. Virtually. It's very hard to read. We assume, though it's hard to make any assumptions, that it was somewhere on the order of 3 points in January and with this slowdown in MMDAs that whatever they want to do with CDs they will do.

CHAIRMAN VOLCKER. On M1 you're basically assuming nothing at this point from a fourth-quarter base?

MR. AXILROD. That's right. But we feel quite uncertain about that because we're not sure why banks have behaved this way with regard to Super NOWs. There is some idea that it could take off once they start competing actively for MMDAs. That's in the back of our minds as a possibility.

CHAIRMAN VOLCKER. Well, unless people take violent exception, let's make those assumptions as operating assumptions. I'm trying to keep the discussion manageable.

MS. TEETERS. May I make just one small plea for the other one? The year that we had the shift-adjusted NOW accounts--

CHAIRMAN VOLCKER. The other one being what?

MS. TEETERS. To put them all on a February-March basis. The year that we had the shift adjustment for NOW accounts, I was almost totally confused as to what our targets were. We had shift-adjusted and nonshift-adjusted [figures]. There's something to be said for having a common base for all three so that we remember which one we're on if nothing else.

MR. FORD. You're going to eliminate unemployment for Fed watchers if there is anything difficult!

MR. PARTEE. I'm not sure whether you addressed this question, but I don't know that I agreed with the point that Steve was making about cutting the range on M3 because there was no reason to think that the institutions will want a larger market share. And, therefore, I think we ought to be careful about that.

MR. AXILROD. It wasn't clear, Governor Partee; they may want a lot larger share than we have in here. We still have a relatively low share.

MR. PARTEE. Yes.

MR. AXILROD. We have an increase of around 8 or 9 percentage points in the market share of banks and thrifts together of total credit and then some cutback in money market funds. If they want a lot larger share, then I think it would be difficult to cut M3.

MR. GRAMLEY. One point we ought to keep in mind in thinking of the M1 target and using the fourth quarter is that we in effect are saying that that horrendous drop in velocity, which largely took place in the fourth quarter, is either going to get reversed or we're going to put it into our targets somehow. Otherwise, you see, we're not going to forgive that big fourth-quarter growth; we're going to make up for it later on. Or to put it differently, if you look at page 15 of the Bluebook and take the first-quarter average for 1983, just for alternative B we have 8.7 percent first quarter over fourth quarter largely because of what happened in the fourth quarter.

CHAIRMAN VOLCKER. You're talking about M1?

MR. GRAMLEY. M1, yes. I think going back to that base of the fourth quarter for M1 is very, very risky. Now, I'm prepared to do that if we're prepared to put a zero weight on the target. To me that's a good compromise: 95 percent weight on M2, 5 percent on M3, and 0 on M1.

MR. PARTEE. [Unintelligible] M2 very stable, yes.

MR. GRAMLEY. You can use any base you want. But I think that's a very, very risky business.

MR. BALLES. Mr. Chairman, if I could have one final shot at this: I could accept what you're proposing but I would again call your attention to the remarks, which I interpret as a warning, that Steve just gave us that M1 could spring to life and the Super NOWs could spring to life. That's why I thought a little while ago and I guess I still feel that a more conservative or safer approach would be to do the same thing for M1 that we've talked about doing for M2--using a first-quarter base--so that we could make sure that this apparent approximately zero net effect in the different accounts will continue through this quarter. I hope it will.

CHAIRMAN VOLCKER. I'm not saying just technically use the first quarter as a base for M2 because I think it falls between stools. It still gives us a high number for the year because it starts at the beginning of January so low. I'm trying to get over that hump so we don't have an artificial, if that's the right word, high number for the year. And we've got to go at least to February to do that. I don't think we have to for M1. But I suppose in terms of symmetry we could say all the targets begin in February-March. But we run into the other problem in that I think it will eliminate continuity where continuity is possible. That's what we have to balance, I guess.

MS. TEETERS. Couldn't we develop a technical relationship between the February-March base and a fourth-quarter base?

CHAIRMAN VOLCKER. Oh, sure. You just have to put in a higher number.

MS. TEETERS. That's right.

CHAIRMAN VOLCKER. But then we'd have this visually high number. Arithmetically, one can reduce it to the same number.

MR. BALLES. Mr. Chairman, for us to try to ponder overnight: Which approach do you find easiest to use vis-a-vis the public, the Congress, and the financial markets--basing on the fourth quarter, basing on the first quarter, or some of both?

CHAIRMAN VOLCKER. Who knows? This is somebody's instinct. My instinct is the same as Mr. Solomon's. We can go back [to the fourth quarter] for M2--but then we end up with this horrendous number and are forced to say that it's so big because we're assuming X percent of it is shifts. And then if asked how we defend that number, we say we can't. It's a guess. That's not a very pleasant position to be in. However, if we [advance the base] for all of them, then people will say: Well, you really took a free ride on everything for a quarter. None of [the options] is totally satisfactory because what we're doing is not totally satisfactory intellectually.

VICE CHAIRMAN SOLOMON. The other thing is that as the media report on our progress or performance during the year they always compare what the rate of growth is compared to what our target was. But they don't go into the technicalities of what the base was.

MS. TEETERS. That argues for one base.

VICE CHAIRMAN SOLOMON. I don't know. You get a somewhat better reading from the media on performance as the year develops.

CHAIRMAN VOLCKER. Well, except that we won't on M1. We were in this trap before because [unintelligible] the facts. We get these changes in the beginning of the year on an M1 target; we'll probably be above the target in the first quarter for the reason Lyle suggested. So everybody says we're above the target and we have to get growth down. We may not have that--

VICE CHAIRMAN SOLOMON. Yes, but if we deemphasize it, then it's not going to--

CHAIRMAN VOLCKER. If we deemphasize it enough, it balances.

MS. TEETERS. We can always raise the targets.

CHAIRMAN VOLCKER. Yes, but if we put it on this silly fourth quarter-to-fourth quarter basis that we do, we can't raise the targets enough. We're always going to start above wherever it is.

SPEAKER(?). At some point we can raise it enough.

VICE CHAIRMAN SOLOMON. Steve, you're assuming for M2 a velocity of circulation of roughly zero in '83?

MR. AXILROD. Right.

VICE CHAIRMAN SOLOMON. And for M1 on your alternative II here you're assuming a velocity of circulation very slightly negative.

MR. AXILROD. No. I would say that we have a fourth quarter-to-fourth quarter growth on the order of 6 percent. So, a slight positive is what's in my mind; it's right here in the Bluebook on M1. That, as Governor Gramley mentioned, would imply a slowdown from here on out, on a quarterly basis, to something on the order of 5 percent or a bit under in growth rates. Our quarterly model, for what it's worth, given the interest rates and income, would predict about a 7 percent growth in M1. That was one of the reasons I thought that a higher growth than 5-1/2 percent was likely; I couldn't see this downward demand shift we've been experiencing occurring this year because we're not ratcheting up interest rates and all that. So, I would say 6 or 7 percent seems to me about the right M1.

VICE CHAIRMAN SOLOMON. Okay.

CHAIRMAN VOLCKER. All these fine velocity assumptions that he made in the Bluebook rest upon a staff forecast that probably has a lower nominal GNP than everybody else's forecast, or is at the bottom of the range, anyway, of everybody else's forecast. If everybody else really believes his or her forecast and believes this velocity business, we ought to have higher--

MS. TEETERS. Higher targets.

CHAIRMAN VOLCKER. Higher targets.

MR. AXILROD. Or, we might get more GNP with the same money, higher velocity, and not much interest rate change, if everyone decides to undo their liquidity. That's a possibility.

CHAIRMAN VOLCKER. Yes, but you're saying if your velocity assumption is wrong.

MR. AXILROD. Yes, that's right.

MR. BLACK. Steve, if we've made our computations right, an assumed M1 growth fourth quarter-to-fourth quarter of 6 percent implies a 1.4 percent rise in velocity of M1 over that year.

CHAIRMAN VOLCKER. With their forecast?

MR. BLACK. That's right, with their forecast.

MR. AXILROD. Yes, that's right. That's why it would be a slowdown from now on.

MR. BLACK. That's the reason I went into that issue awhile ago, Mr. Chairman, and you thought I was premature. I was trying to explain why ours was high and it was based upon an assumption that it would bounce back, which it may well not do.

CHAIRMAN VOLCKER. One percent, historically, would not be much of a bounceback.

MR. PARTEE. No, it's--

MR. BLACK. No, we assumed about 5 percent. That was really the reason I went into what you thought I was going into prematurely: to justify our high forecast.

MR. AXILROD. But it is of interest, Mr. Chairman, that a lot of the slide occurred when interest rates were going up cyclically.

And in '71 when they didn't go up cyclically, the increase was 2.9 or something like that on velocity.

MR. ROBERTS. Interest rates are now going up, however.

MR. AXILROD. Well, we're not projecting [that] as part of this whole projection.

MR. ROBERTS. It could be wrong.

MR. GRAMLEY. In which case the staff's forecast probably also will be wrong--not in the direction of more nominal GNP but less.

MR. BLACK. Well, we know everybody is wrong. We just don't know who is the most wrong.

CHAIRMAN VOLCKER. Well, we'll see you tomorrow morning at when--9:00 a.m.?

MR. BERNARD. 9:00 a.m.

[Meeting recessed]

February 9, 1983--Morning Session

CHAIRMAN VOLCKER. Well, ladies and gentlemen, after listening to our conversation yesterday, it seems to me that this tentative directive is probably a reasonable reflection of our concern to have targets but be flexible. So, I would suggest we assume something like this draft directive will be used. There will be chances for editorial comments, but let me just suggest in the interest of focusing the discussion and expediting things that we put some numbers in those blanks. And on page 3 of that directive I would tentatively suggest that we eliminate the alternative for M2 [that measures the range from] the fourth quarter to the fourth quarter, just for purposes of the discussion at this stage anyway, and assume we're going to [measure it] from February-March to the fourth quarter. If we take the middle course of what the staff says is consistent with their forecast--recognizing that very large amounts of uncertainty exist about that and recognizing also that their forecast for nominal GNP is lower on average than other peoples' by 1 percent or something like that--that says basically 6-1/2 to 9-1/2 percent for that period, allowing for 1 percent or so of shifting from that base.

MR. AXILROD. That's right; it would be about 8 percent plus around 1 percent.

CHAIRMAN VOLCKER. That could be rounded up to 7 to 10 percent, I suppose, or rounded down to 6 to 9 percent, but we're in that range. Turning to M3, for the fourth quarter-to-fourth quarter comparison the staff says 6 to 9 percent, period. That could be pushed; last year it was 6-1/2 to 9-1/2 percent, so I think we're in that range. Whether or not we want to include M1 in the same sentence or make that a slightly more subsidiary sentence or tentative sounding sentence is an issue that we can return to. But the number that they have for M1 is 3 to 7 percent; that could be made slightly higher, I suppose. So, we're around 3 to 7 percent or 4 to 8 percent, I think. And for total nonfinancial debt, which we really haven't discussed much, they propose this rather peculiar result in terms of past cycles of 8 to 11 percent, which they'll have to justify at some point--a little more than I think we've already discussed. It contemplates in their forecast a further decline in credit velocity, which would be unusual during a period of recovery. But I take it they're prepared to defend that proposition. I just throw those out as a focus for your discussion. Let's see what comments we get on them.

VICE CHAIRMAN SOLOMON. I have a question of Steve. I had the impression, Steve, that when you shift the base to February-March from the usual average of the fourth quarter, that 6-1/2 to 9-1/2 percent is tighter than 9 to 13 percent. Am I correct?

MR. AXILROD. Well, for the top in a mild sense it is. Our point estimate [on the fourth quarter-to-fourth quarter range], such as it is, is 11.8 percent, within the 9 to 13 percent range. So, it's 1.2 points from the top of the range. Our point estimate on the 6-1/2 to 9-1/2 percent range from February-March is 8.9 percent. So, relative to the 9-1/2 percent it's 0.6 point from the top of the range. With a 7 to 10 percent range, it would be more comparable in terms of distance from the top of the range.

VICE CHAIRMAN SOLOMON. Yes.

MR. AXILROD. But that's only in that arithmetic sense.

MR. PARTEE. And you've allowed about 1 point for continued shifts?

MR. AXILROD. From February-to-March, that's right.

MR. PARTEE. Well, I don't know about the 1 point; it could be a lot more than that.

VICE CHAIRMAN SOLOMON. The second question I have is: If we want flexibility, shouldn't we aim for a four-point spread in M2 this year instead of 3 points?

MR. AXILROD. Our technical reason for narrowing it when the base is February-March is that just a little more of the year is done and the more of the year that is done, presumably the more you know. So, you could have a narrower range. Also the argument is that the bulk of the shifts is behind us, and the reason for the wide spread was to take account of the uncertainties about the shifts. Of course, it's highly uncertain in any event. But that was the reason for suggesting a slightly narrower spread.

VICE CHAIRMAN SOLOMON. Even though you eliminated January from the base there are still a lot of uncertainties.

MR. AXILROD. Yes. Our thought was that most of the shift would be done. Now, to the extent that isn't true--

CHAIRMAN VOLCKER. But we would have to go back and look at it anyway if most of the shift isn't done. If we get into March or April and M2 is still growing rapidly, or if February and March are distorted, we better go back and look at it again. I think that's clear.

VICE CHAIRMAN SOLOMON. I'm a little worried that 6-1/2 to 9-1/2 percent may be a little tight. I certainly would oppose rounding it off downward.

MR. WALLICH. I feel the same way. It seems to me flexibility appears at all margins, and here's one more--the width of the range--where we ought to allow for it.

MR. MARTIN. I would echo Governor Teeter's comment of yesterday. I'd rather have a narrower range and then at midyear go back. We admit we don't know what the behavior will be and we can continue to reinforce that position and go back in July. If we have to change it, we can change it then.

MS. TEETERS. We may have to change it before then.

MR. MARTIN. All right.

CHAIRMAN VOLCKER. Let's look at them one by one, if that's the way you want to do it. Let's look at M2. Does anybody want to go above 7 to 10 percent?

MR. GRAMLEY. One way of handling the binding aspects of this is to widen the range and make it 6 to 10 percent, extending the upper limit. That has the additional virtue of maintaining the same lower limit as we had last year.

MR. AXILROD. Mr. Chairman, I might say that when we put the ranges that way, they weren't centered on the midpoint. And the reason was that in the previous year the FOMC had established a range and said it expected growth around the upper end. For that reason we simply didn't suggest ranges that were set on midpoints on the thought that the same range would then accommodate lower growth if possible. So, these were not set at midpoints for M2.

MR. PARTEE. Steve, if I read that footnote connected with alternative II correctly, [the consistent range] would be 7 to 10 percent. The footnote says that [the ranges for the three alternatives] would be from 6-1/2 to 9-1/2 percent through 7-1/2 to 10-1/2 percent.

MR. AXILROD. Yes, that's right.

MR. PARTEE. I assume that the middle one, alternative II, is 7 to 10 percent.

MR. AXILROD. That would be leaving that same gap, Governor Partee, of a little over 1 point above the expected--

MR. PARTEE. I just wanted to make clear that we weren't really talking about liberalizing what had been proposed in--

CHAIRMAN VOLCKER. In the area that we're talking about, 1/2 point is inconsequential. There's a certain argument for making it 7 to 10 percent because they are round numbers and why have spurious precision.

MR. PARTEE. I think that's right.

VICE CHAIRMAN SOLOMON. A range of 7 to 11 percent doesn't sound good. It sounds like we're really gambling!

MR. WALLICH. I think 6 to 10 percent would be a little more--

CHAIRMAN VOLCKER. I'm not sure what that gains you.

MS. TEETERS. I get the impression--

MR. RICE. I don't know what it does.

MR. WALLICH. Well, it gains you two things: One is the greater leeway and the other is a lower midpoint.

MR. PARTEE. Of course, we've never been any place close to the lower end of the range in the last several years for M2. And to leave it at 6 percent when we have a new instrument seems funny to me.

VICE CHAIRMAN SOLOMON. Even though I like the four-point spread, I'd like it on the up side.

MR. PARTEE. I'd rather have [unintelligible].

VICE CHAIRMAN SOLOMON. It probably is.

CHAIRMAN VOLCKER. Do I sense 7 to 10 percent as a temporary feeling here? Let me move to--

MR. RICE. Mr. Chairman, could I just ask if this decision relates to the strategy?

CHAIRMAN VOLCKER. This is all highly tentative at this point.

MR. RICE. [Unintelligible.]

CHAIRMAN VOLCKER. Yes, I assume something like that. We'll get to this language, but roughly, yes.

MR. RICE. While I support the decision that was just made on the 7 to 10--

CHAIRMAN VOLCKER. Very tentatively.

MR. RICE. Yes, the tentative decision. I have some concerns about the strategy and the relationship to the alternatives that we select.

CHAIRMAN VOLCKER. Well, let's get to that in a minute and we will reach an iteration. Now, on M3, again just as a starting point, the staff says flatly 6 to 9 percent, for whatever that's worth.

MR. MORRIS. Mr. Chairman, I think you ought to--

CHAIRMAN VOLCKER. A 6-1/2 to 9-1/2 percent range is what we had last year. Is it worth horsing around with the half point?

MR. MORRIS. Yes, particularly because 6 to 9 percent is going to be too tight next year in 1984. We'd have to raise it.

MR. PARTEE. When we start to get some expansion in the [unintelligible].

CHAIRMAN VOLCKER. Why would it be too tight next year?

MR. MORRIS. Well, in the first year of recovery we normally get more GNP for M3, or M3 velocity tends to rise in the first four quarters of recovery and to be essentially flat--no velocity change--in the second year. I think Steve would support me on this: that we would have to raise it next year.

MR. AXILROD. I'm afraid, President Morris, that we have not really worked it out in detail that far ahead. I really don't have any comment on that.

VICE CHAIRMAN SOLOMON. I don't think it's worth cutting it a half point.

MR. PARTEE. I would prefer the higher number, Paul. The banks have been adding a lot of securities and I think they'll continue to do so. And I think the S&Ls will be aggressive. They will pay down some debt but they're going to be looking for places to put their money. So, I'd hate to see that reduced.

VICE CHAIRMAN SOLOMON. If, as we agreed yesterday, they strive for a larger market share and are more aggressive intermediaries, [M3] could easily come in higher. I don't see the point of cutting a half point on the up side.

MR. AXILROD. Mr. Chairman, a partial answer to Governor Partee and President Morris: As a percent of total credit our projections in the flow of funds at this point assume that thrifts and commercial banks together take 35 percent of the market in '83 and 30 percent in '84. I haven't worked that through to M3 as such, which would have to take account of money market funds and shifts from raising money abroad through CDs and that sort of thing. That [share of the market] going back from 1980 to 1952 has generally run in a 40 to 60 percent range. So, [our projection] is well below the norm if the norm can be thought of as the previous 30 years. And, as Governor Partee has suggested, we may be too far below it if the depository institutions get very aggressive.

CHAIRMAN VOLCKER. What was it in 1982?

MR. AXILROD. We have it rising from '82, which was 27 percent; and in '81 it was 30 percent. Those were all low years.

MR. PARTEE. Thrifts were really squeezed.

MR. AXILROD. But before that, numbers in the 40, 50, and 60 [percent area] are what you would have seen. That's [higher] because we think much of that money is being raised through the bond markets--

CHAIRMAN VOLCKER. Well, I don't know. Again, I do not have a strong degree of conviction in the area of a half point.

MR. GRAMLEY. I think we gain nothing by cutting it a half point. We allow ourselves a little more flexibility by leaving it where it was.

MS. TEETERS. There is some advantage in making it the same as M2.

MR. MARTIN. Except that we're going to sound like the United Kingdom.

VICE CHAIRMAN SOLOMON. When we shave off a half point like that, we imply a level of precision in our thinking that seems to me inconsistent with all the uncertainty we keep talking about. I would just stick with the provisional target we set up.

CHAIRMAN VOLCKER. Do I hear any other comments? Hearing no other comments, we'll put it tentatively at 6-1/2 to 9-1/2 percent.

MR. BALLES. May I ask a question, Mr. Chairman? Could I just ask you to review quickly what you said on M1? I'm not sure I--

MR. PARTEE. We haven't done it.

CHAIRMAN VOLCKER. We're getting to M1 right now.

MR. BALLES. I thought you had already passed it.

CHAIRMAN VOLCKER. No. M1 is now before the house. The staff says 3 to 7 percent for the middle course on their forecast.

MR. AXILROD. Again, Mr. Chairman, that range is not centered on the midpoint [of our forecast]. We left everything along [the lines of] the Committee's previous decisions that growth would be running toward the upper ends of the ranges.

MR. PARTEE. What was the midpoint?

MR. AXILROD. In my view, the midpoint [for M1] consistent with the 8 percent underlying M2 growth would be in the 6 to 7 percent range unless one thinks in some model sense that there's a downward demand shift.

CHAIRMAN VOLCKER. You assume, though, no change on business demand deposits?

MR. AXILROD. And that assumes that the DIDC doesn't do anything on the business demand deposits.

CHAIRMAN VOLCKER. And that doesn't assume much on Super NOWs, I take it.

MR. AXILROD. It doesn't give much room for Super NOWs and assumes that we don't experience again the downward demand shift that we had from 1974 on.

CHAIRMAN VOLCKER. We can make it 4 to 8 percent.

MR. BALLES. Mr. Chairman, I would like to make a pitch for the 4 to 8 percent for several reasons. As I understand the Board staff's projections for the first quarter, Steve, M1 is expected to grow at a 5 percent rate, roughly, for February and March. Our San Francisco money market model, which we started with last year, is projecting about a 10 percent growth in those two months. Time will tell which projection is--

CHAIRMAN VOLCKER. 10 percent growth in what 2 months?

MR. BALLES. A 10 percent average growth in February and March. And I would hate to see us get trapped in a posture where too low a range would force tightening and produce a premature rise in interest rates in view of the uncertainties that I feel about the solidness of this business recovery. Therefore, I would hedge my bet and go for 4 to 8 percent on M1.

MR. GRAMLEY. I would strongly support that. An additional argument for the ones that both John and Steve have given is the fact that we're looking at responses to Super NOWs which at the present time are being conditioned by the fact that the banks and the thrifts are just being flooded with money on MMDAs. I think a very logical possibility is that, as the MMDA rates settle down, interest in Super NOWs is going to build up, and none of us knows exactly how much allowance to make for that. I think we ought to provide flexibility on that score.

MR. MARTIN. Yes. I would add to that. It seems to me that the thrifts still have a competitive device that they have not exploited. My conversations with many of their representatives this week in Washington go to that conclusion. This is a vehicle which can get them into a side of the financial markets that they're very interested in. And I think this is one of the arguments for separating the [M1] comment here and not making it pari passu with M2 and M3. We really don't know what is going to happen when certain financial institutions begin to exploit this in this calendar year.

CHAIRMAN VOLCKER. Yes. The editorializing is something I want to return to when we get beyond the numbers. And maybe I'd make this range sound a little more tentative.

MR. PARTEE. May I ask a question? Steve, your own [M1] projection for the first quarter is an increase of 8.7 percent, isn't it? So, you must be projecting substantially lower growth rates as the year goes on.

MR. AXILROD. It's about 5 percent for the rest of the year. It's roughly the same as in February-March. I should add that our monthly model would say around 9 percent at current interest rates, somewhat similar to what President Balles mentioned. Our quarterly model at around the current interest rate gives the quarterly average that we have here, around 8-3/4 percent. Take your choice on which model you go by. We put a little more weight in this case on the quarterly model, which gives this slowdown. Of course, it could be somewhat higher in the coming months.

MR. WALLICH. But the uncertainties are so great on M1 that if we don't want to express them by some qualification of it as a target, then I think we need a wider range.

CHAIRMAN VOLCKER. We'll come back to that question on qualifying it as a target. It's a question of how strong it's implied, right? It's not implied in this sentence but it's implied in a later sentence.

MR. BALLES. Mr. Chairman, there's one other--

VICE CHAIRMAN SOLOMON. I hate to say it but it seems to me that all it does, even with 4 to 8 percent, is move us slightly away from the upper end of the range without even allowing for the growth of Super NOWs later in the year, etc. In the course of conversations with some key market people, in general I've noticed that they give the advice that according to the market it's much better to project higher targets and hit them during the course of the year than it is to worry about the initial effect of the higher targets. That is just the general advice I heard from one of the key people in the markets. So, even though we will have deemphasizing language, I assume, I'm not sure that 4 to 8 percent does anything more than move us slightly to a more realistic range. And it still doesn't allow for any Super NOW growth.

MR. PARTEE. I rather like 4 to 8 percent, though, because it's less than we had last year. We had 8-1/2 percent last year?

MR. AXILROD. Yes.

MR. PARTEE. It's a little less at the upper end. I think if we went above 4 to 8 percent, we might as well forget it. Already it seems to be quite a liberalization of our previous targeting.

MR. MORRIS. I think if we forgot it, it would be a big step forward.

MR. PARTEE. I realize you feel that way and probably Tony does too. But I think there are others who would like to keep it, including myself.

MR. BLACK. Then you'd have to [marry] alternative II into alternative I.

MR. PARTEE. Well, except that I think their [unintelligible] figure is too tight.

MR. BLACK. Well, I mean that we've taken a couple of the figures out of alternative I and set them into alternative II.

MR. PARTEE. And we do have to remember that we have a higher forecast than the staff for the GNP. So, I would move 4 to 8 percent, Paul.

CHAIRMAN VOLCKER. I haven't heard any contrary view expressed strongly.

MR. BLACK. Mr. Chairman, I didn't express it very strongly but I feel it very strongly. I wouldn't go as high as that. I think 7 percent is as much as we dare risk. And the only reason I'd be willing to go as high as 7 percent would be that I think there is probably going to be a higher element of savings in M1 than we've had before. Otherwise, I'd say 6 percent is as high as we ought to go.

CHAIRMAN VOLCKER. Does anybody else have an opinion?

MR. WALLICH. The previous midpoint was 4 percent, with the 2-1/2 to 5-1/2 percent range. We can achieve that midpoint by the admittedly rather extravagant range of 1 to 7 percent. Then we haven't raised our target any time.

MR. BLACK. One percent is too low even for me. Even three percent is too low.

MR. PARTEE. Seven is too low.

CHAIRMAN VOLCKER. I will assert that when the width of the range gets to be 6 percentage points, we might as well not have one.

MR. ROBERTS. Mr. Chairman, I'd like to be associated with a 4 to 8 percent range, with the hope that the midpoint of the range is what we'd be working toward. I think we have to come off a rapid growth rate slowly instead of abruptly.

CHAIRMAN VOLCKER. Does anybody else want to speak to this point? I seem to have a considerable opinion for 4 to 8 percent. Well, let us pass on to total domestic nonfinancial debt. You have some more or less elaborate analysis suggesting that total domestic nonfinancial debt is the [measure] we ought to be using. I guess what it shows is that on these growth rates it makes a trivial difference, so I'm not sure it's worth an elaborate discussion. I'm just talking about the definition now--whether we use total nonfinancial debt, total domestic nonfinancial debt, or total domestic nonfinancial debt [plus net stock issues]. They all seem to have more or less the same [projected] growth number.

MR. ROBERTS. May I ask why we're establishing such a target at all? It doesn't seem to relate to anything, as I read the material. There seems to be an assumption that we're going to use a target like this. I don't understand what the purpose of it is.

CHAIRMAN VOLCKER. It's not exactly a target, but this has a certain history. We can do what we want to do, but we have been requested to provide such an associated range anyway.

MS. TEETERS. What do we do with it?

CHAIRMAN VOLCKER. We're dropping out the bank credit here--and whether we want to do that is another decision--so, it fulfills the role that bank credit used to do. I think what we do is look at this [sort of range] to see if it confirms a contrary indication of what is going on as time passes.

MR. GRAMLEY. There's a very good reason for looking at what happens to debt growth in a year in which the monetary aggregates may well be developing a new kind of relationship with GNP that we don't fully understand. I would hope we'd use this seriously. And I do want to say something about the numbers at the appropriate time.

CHAIRMAN VOLCKER. Why don't you go ahead right now.

MR. GRAMLEY. I think another way of getting a perspective on it--and none of us really has looked at this number very closely--is to look at the flow of credit implied and how that relates to the level of GNP forecast for the year. We're starting with a range that in my judgment is too low. The 8 percent lower limit would imply a growth of credit equal to 11.7 percent of forecast GNP. And that would be the lowest ratio we've seen since 1970 in a ratio which has a secular tendency to go upward. Furthermore, if you take out the $210 billion the staff is forecasting that the government will borrow, that leaves $171 billion for private domestic nonfinancial borrowing. That ratio is 5.3 percent of GNP. You have to go back to 1950 to find anything similar.

CHAIRMAN VOLCKER. This is if we took 8 [to 11] percent.

MR. GRAMLEY. Yes. The midpoint is 9-1/2 percent and is also in my judgment very, very low. It leaves a ratio of private credit expansion to GNP of 7-1/2 percent. There's only one number since 1961 that was that low: 1975. So, we're talking about recession levels of private credit expansion relative to GNP.

MR. PARTEE. The height of the number is accounted for by government.

MR. GRAMLEY. Right. Of course.

MR. PARTEE. But even the aggregate number in Appendix IV in the Bluebook is 13.9 percent, which is not up much from last year and is well below what it was running earlier.

CHAIRMAN VOLCKER. What page do you have?

MR. PARTEE. Appendix IV gives this. I'm looking at the far right hand set of numbers in the middle column.

MR. GRAMLEY. To put Chuck's point in a different way: There is a secular upward movement in this ratio. We get in the 13 to 14 percent range, as a portion of GNP, for the first time in 1972-73. We're talking about a very, very stringent set of credit market conditions that would lead to that kind of ratio of credit expansion to GNP. I think 9 to 12 percent would be more appropriate in terms of the kind of credit market situation we all want.

CHAIRMAN VOLCKER. I'm not sure I understand this table that Mr. Partee has called to our attention. What column are you looking at?

MR. PARTEE. The last set of numbers is the ratio of the flow of credit to GNP. The middle column--these abbreviations are such that it's hard to make it out--is the private debt, isn't it?

MR. AXILROD. Yes, that's the domestic nonfinancial debt.

MR. PARTEE. That is the domestic, right.

MS. TEETERS. That includes the government?

MR. PARTEE. That includes government, yes.

MR. AXILROD. Yes, that includes the government.

MR. PARTEE. And we certainly ought to include government.

MS. TEETERS. We know there was an increase during the 1970s. As we came out of the '75 recession, the ratio went up to--

MR. PARTEE. To 17 percent.

CHAIRMAN VOLCKER. The nearest equivalent here is 1975, if the forecast is right, and it's 1.4 percentage points--

MR. MORRIS. But we're not targeting the flow; we're targeting the percentage growth.

MR. GRAMLEY. But that's a flow.

MR. MORRIS. We're targeting this first set of numbers.

MR. PARTEE. I know; but they have to relate.

MR. GRAMLEY. I'm just looking at it a different way and one that to me is a more familiar one. And I think what it says is that we're targeting on growth rates of private credit relative to GNP that are [comparable to] the ratios of 10 years ago.

MR. FORD. But Lyle--Mr. Chairman, may I address this? It seems to me one should think about the overall balance sheet. Now we're talking about the other side of the balance sheet than the one we normally talk about. Isn't your argument tantamount in some sense to saying that there's a low saving rate in our economy, which we have in our forecast and which affects the flow of funds overall plus other things? You're suggesting we take it as a given--as something that we implicitly accept--that there's going to be a huge bite of federal sector borrowing as projected in the nice charts we had yesterday, even with the cheery assumption that it's going through the roof right now but it immediately levels off for some reason. I still don't understand the chart from yesterday's presentation. Another way of saying what you're saying is that if we choose these numbers we're talking about now, we're not leaving room for the private sector. Doesn't that translate into saying "Let's monetize the federal debt"?

MR. PARTEE. Yes. I wouldn't have put it that way, though, Bill. I think Lyle is the one who made the point about the private sector. I'd look at the total, including the government, and say it ought to be in reasonable relation to the kind of growth in GNP that we hope to achieve.

MR. FORD. Why not? It would be nice if you could have it. It depends on the policy guide.

MR. PARTEE. And I think Lyle is right that the number is a little too low.

CHAIRMAN VOLCKER. If you look at this other column on velocity, however, you get a different answer it seems to me. I have a little trouble seeing how we're going to justify all this debt expansion. We will have as low a velocity number as we have ever had except for last year.

MR. PARTEE. That is to say that the debt number is pretty low.

MR. AXILROD. Well, another way to look at it would be that GNP [growth] is very low. We have a bigger percentage increase in this debt aggregate than we do in GNP. And our past experience in recoveries was that that wouldn't take place. So, one other way to look at it is that your GNP number might be a little low. Of course, that would then lower that ratio that's troubling Governor Gramley.

MR. MORRIS. Our analysis of debt indicated that a 7 to 10 percent range would be adequate for 1983. So, I think 8 to 11 percent is going to be plenty.

MR. GRAMLEY. We're talking about a ratio of private credit expansion to GNP that we last saw maybe in 1954-55 or somewhere around there. You'd think somehow--

CHAIRMAN VOLCKER. I don't understand this, Lyle. This number you're looking at is this last column, isn't it?

MR. GRAMLEY. I'm looking at the middle column of the last row. And then I'm saying: What if we took out the government component of that and got to the private ratio?

CHAIRMAN VOLCKER. All right. You're looking at private. If you look at the total, this number is high relative to the 1960s and a little low relative to the 1970s.

MR. GRAMLEY. You will note that this ratio has a secular upward trend to it. It started out in the 6 to 9 percent range in the early 1960s and got up into the 12 to 14 percent range in the early 1970s.

CHAIRMAN VOLCKER. Showing credit inflation.

MR. GRAMLEY. Well, that's part of it.

MR. MORRIS. And it has been declining since 1978.

MR. GRAMLEY. We don't need to roll back the world that fast.

MR. PARTEE. You certainly don't want it to be 16 or 17 percent.

MR. GRAMLEY. No. I wouldn't suggest anything of the kind.

MS. TEETERS. Lyle, may I ask what you did? Did you take the $413.3 billion in the middle column in the third set of numbers and subtract out $145.6 billion for the federal and then on the $452.3 billion did you take out $218 billion?

MR. GRAMLEY. Yes. Well, from the $452 billion I took out the staff's [projected deficit] number, which I think was $210 billion, and I got a figure--I don't have the numbers--whatever 452 minus 210 is. And I divided that by the GNP and got 7-1/2 percent. I looked at my own tables here, which I happen to have with me, to compare that 7-1/2 percent. And when I went back, I thought: Well, in 1975 we had 6.9 percent. And then I went all the way back and had to go back to 1961 to find any comparable ratio.

MR. BALLES. You know, 1976 was 11 percent.

MR. AXILROD. Mr. Chairman, we don't feel extremely confident about all of these numbers--and Mr. Prell may be able to make some comments on how he got to here a little more elaborately--but if we attempted to have a lot more private credit, we believe that interest rates would be a lot higher in that process and we wouldn't get the GNP because the rise in interest rates would begin to cut it back. So, this is where we came out with a consistent set of relationships. We didn't think that there was room for any more private credit within the monetary targets and given the government's [needs].

CHAIRMAN VOLCKER. But to state it the other way around, you are also saying, if I understand it correctly, with this relatively small amount of private credit you think interest rates would decline and the GNP would rise as you projected.

MR. AXILROD. Yes, [with rates] stable and maybe edging down.

MR. FORD. That comes out of this chart show.

MR. GRAMLEY. But let's get this causation straight. You do not put interest rates up, if you were targeting on credit aggregates, by having high credit aggregates. The reason that credit expansion declines is precisely because interest rates go up. We want a target here, I think, that accommodates a sufficient expansion of credit at something close to prevailing interest rates. That's the way one would have to look at it.

CHAIRMAN VOLCKER. That's what they say they've done.

MR. GRAMLEY. I think the argument almost came out the other way around. That is, that you could have low credit aggregates because there may be sufficient restriction on the economy with present interest rates so that private credit demands are not going to be strong. I say that may well be, but we may be misappraising the level of interest rates necessary to hold credit expansion down this low. And I want to make sure that our credit aggregates are not that tight. It's because I'm taking these numbers seriously--and I hope we use this number seriously--that I'm arguing this strongly. Maybe we're not going to, but maybe--

MR. MORRIS. The velocity of debt in the first year of expansion tends to be about 2 percent. So, if you had an 11 percent rate of growth in debt in the first year of expansion you should be able to finance 13 percent nominal GNP [growth].

MR. GRAMLEY. That 13 percent could be used to set the monetary aggregates very low. Typically what we have had in the early period of recovery is a marked increase in interest rates from very low levels, which leads to economization of money and credit use. But that's not the situation we're in now. We're already starting from real interest rates that are very high and we're worried about whether or not interest rates are going to go up enough to choke off the recovery. And one way to guarantee it is to set both monetary and credit aggregate targets that are too low.

MR. FORD. I would say the opposite. You're talking about long-term rates when you're talking about capital. What we have to worry about in the marketplace, if we do some of these things--set the aggregates too high and throw in this credit aggregate with it--is that the bond market, which seems to have flattened out and is starting to tick up now, could take off on us and we could get the exact opposite of what you just said. I'm still trying to figure out where the bottom line of the paper is that the staff did. But I read one thing over and over again. In terms of comparison with money measures, M1 performs as well as the best of credit measures. Look at this chart that was given out yesterday, which shows the huge increase in velocity there. That's the same thing you guys are complaining about--the monetary velocity.

CHAIRMAN VOLCKER. A huge decrease in velocity.

MR. PARTEE. A decrease, yes. That's the same thing.

MR. FORD. It was a dramatic change.

MR. PARTEE. One does see the same effect running through all these numbers.

MR. FORD. So why add another obfuscating factor to the set of already imperfect measures? What Lyle is saying--if we were to state it in [our targets] and then take it seriously--could be interpreted in the money markets as saying that we are worried about adequately financing the federal deficit. Another way of saying what he's saying is: Let's monetize the debt.

MR. WALLICH. I think that's the right way of looking at it. The question is: How much credit expansion can the economy stand without inflation? And the sad fact is the government limits the amount that the private sector can have. We have to recognize that by limiting the total credit expansion.

MR. FORD. And you can't say: Let's take the government part as a given and then add on and make sure there's enough there for the private sector, which is what I hear Lyle saying. That's another way of saying we will monetize the debt no matter how big it is.

MR. GRAMLEY. Monetizing the debt in that sense, Bill, would mean taking off all limits and I'm not arguing that. It's a question of what particular numbers are appropriate, and there can be disagreement on whether or not 8 to 11 percent or 9 to 12 percent is appropriate. Arguing that raising the limits by one percentage point means monetizing the debt seems to me to be a bit extreme.

MR. WALLICH. Well, we have the other targets that would prevent that anyway. But I think what you're saying, Lyle, is that the deficit really is cutting very deeply into permissible private credit expansion. There's no way of getting around that by saying that we will have more private credit expansion anyway. That would let the total become excessive.

MR. GRAMLEY. All I'm arguing is that we're dealing with a new ratio that none of us really knows too much about. I'm saying, in my judgment, 8 to 11 percent is just too tight. It's as simple as that.

MR. ROBERTS. Is the question, since we can't control this measure, what it will turn out to be if we set the aggregates? We don't control this measure, do we?

MR. PARTEE. If the aggregates run off [track], we may use this to look to see whether we--

MR. ROBERTS. But it's just a monitoring device.

MR. PARTEE. It's more a monitoring device; I think that's right.

VICE CHAIRMAN SOLOMON. It can influence one's decision.

MR. PARTEE. We want to have the right setting if we're going to use it as a monitor.

MR. ROBERTS. When you say influence your decision, Tony, do you mean that if it were running differently than you expected, you would do something differently in terms of the aggregates?

VICE CHAIRMAN SOLOMON. Let's say that we had a very difficult decision to make. This is just one more straw on one side or the other--whether it's running tight or running easy--that we would look at. To some degree we also are influenced by the exchange rate and by a lot of other things. I think it would have some influence.

MR. ROBERTS. So, it should be consistent with the aggregates, if there is any relationship.

MR. MORRIS. Another way of looking at it is to look at the first column where you see that the highest rate in the whole period since 1960 was 13-1/2 percent. So that 11 percent historically is--

CHAIRMAN VOLCKER. 12-1/2 percent.

MR. FORD. It was 13-1/2 percent in 1978.

MR. MORRIS. 13-1/2 percent in 1978. First column.

CHAIRMAN VOLCKER. We're looking at the middle column.

MR. PARTEE. That's total [debt]. You want to look at domestic, which is the second column.

MR. MORRIS. All right; then it's 12.9 percent. Therefore, it seems to me that in the first year of expansion, when business credit demands are not going to be all that strong, 11 percent is plenty high.

MR. WALLICH. But those were years of much higher rates of inflation, weren't they?

MR. MORRIS. That's exactly why I think we don't need 12 percent.

MR. MARTIN. Those were also years in which the criterion of business managers for financing was leverage, leverage, leverage without any expectation that leverage would ever work against them. There will be some tendency to try to shift toward equity and try to reduce debt. We are leaving out the equity sector, and we know we are, for the reasons that were given in the paper.

CHAIRMAN VOLCKER. I must say that Mr. Morris' point looks pretty persuasive to me, Mr. Gramley. What do you say to that?

MR. GRAMLEY. When you look at the 3 years we've just completed and see that we got away with 9-1/2 to 10 percent expansion in total credit, you say to yourself: Well, maybe that's enough. What I want you to recall is that in those 3 years we have had no growth in economic activity at all. None. We've had extremely high real interest rates. It is no surprise that debt expansion assumes a very low--

CHAIRMAN VOLCKER. We had inflation 5 percentage points higher on top of it.

MR. GRAMLEY. This relates to nominal GNP and how fast credit grows overall. Nominal GNP figures clearly were much higher in the latter part of the 1970s.

CHAIRMAN VOLCKER. What was nominal GNP growth in 1980 and 1981?

MR. KICHLINE. Fourth quarter-to-fourth quarter in '81 it was 9-1/2 percent.

MR. GRAMLEY. No, you need year-over-year figures for these.

MR. KICHLINE. Year-over-year in '81 it was 11-1/2 percent. I don't have the number for '80.

MR. AXILROD. These are sort of fourth quarter-to-fourth quarter.

MR. GRAMLEY. Oh, I guess you're right. These are kind of fourth quarter-to-fourth quarter.

MR. PARTEE. Yes, I think it is fourth quarter-to-fourth quarter.

VICE CHAIRMAN SOLOMON. Frank, the fellow who has been pushing this is Ben Friedman. I don't remember when I talked to him what his numbers were. Have you had a conversation with him?

MR. MORRIS. To my knowledge, I don't think he's recommended a target for it.

VICE CHAIRMAN SOLOMON. I have an instinct that not very many market people would be familiar with this and spend a lot time analyzing whether this is easy or tight with the exception possibly of Henry Kaufman and Ben Friedman. I'm sure Ben will be commenting on it. I was just wondering.

MR. MORRIS. But a 12 percent rate of growth will not look very tight to those guys.

MS. TEETERS. Even more important, the way the sentence is worded is terrible.

MR. PARTEE. I would like to make it 9 to 11 percent, Paul. I think that would take care of all our problems. That range is awfully wide; a 3-point range in a number as large as this is awfully big. I think 9 to 11 percent would take care of the problem of the very low number; Lyle looks to the bottom end of the range. The high number wouldn't be as high and wouldn't bother [other] people. And for my purpose, the midpoint would be 1/2 point more and I think that is about what it ought to be.

MR. GRAMLEY. I think that's basically [unintelligible].

MR. MORRIS. 9 to 11 percent.

MS. TEETERS. May I suggest in addition that we change the wording of that sentence? It says: "And the associated range of growth for total domestic nonfinancial debt has been established at...." It sounds as if we know what we're doing.

MR. PARTEE. That is too serious.

MS. TEETERS. We think it may be in that general neighborhood.

MR. BOEHNE. I think the word "estimated" is a good idea.

MR. BALLES. "Estimated" is good, yes.

CHAIRMAN VOLCKER. Well, it's a little odd that we have a very narrow range for the figure we don't know much about.

MR. PARTEE. The difference between the high and the low ends must be around $100 billion when it's 9 to 11 percent.

MR. MORRIS. It's a more reliable number, so we don't need a wide range.

MS. TEETERS. Yes, but I think we should also--

MR. PARTEE. The number we're talking about is around $500 billion.

MR. GRAMLEY. You're right. When you add one percentage point to the flow, you get an extra $4.8 billion. An extra $4.8 billion of credit is a lot.

MR. MARTIN. Let the record show.

MS. TEETERS. Shouldn't we also add a sentence?

MR. FORD. You sound like Everett Dirksen--a billion here, a billion there!

MR. PARTEE. It adds up to [real] money after a while!

MR. WALLICH. It's the percent that counts here and not the dollars.

MR. PARTEE. Well, I'm talking about the dollars because a lot of people look at those flow of funds numbers.

CHAIRMAN VOLCKER. What's the total of this figure?

MR. PARTEE. It's around $500 billion.

MR. GRAMLEY. It was $4.8 [trillion] at the end of 1982.

MR. AXILROD. $4.8 trillion is the stock.

MR. FORD. Think of it as 50 percent more than GNP. Right?

MR. AXILROD. Ten percent of $4.8 trillion is $480 billion.

MS. TEETERS. Mr. Chairman, I would also like to add a sentence after this.

MR. FORD. How can you miss a target that's 50 percent--?

MR. PARTEE. When you have a 2-point range that's a hundred billion dollars.

MS. TEETERS. I would like to add a sentence in here that indicates that we have not bought Ben Friedman 110 percent--that we're looking at this as something we would follow rather than use as a strict target.

CHAIRMAN VOLCKER. There already is one in there.

MR. WALLICH. To give it a 2-point range when the others are mostly 3 points I think gives it a special status that will be regarded as being particularly confining when we really mean it's particularly loose.

CHAIRMAN VOLCKER. I don't know. Who the heck knows what this figure should be, but I'm a bit bothered by a lower figure than 9 percent which is where it has been running roughly. Presumably, we're disinflating during this period. We haven't had a figure--

MR. PARTEE. We haven't had a figure as low as 9 percent--

CHAIRMAN VOLCKER. That's right. During the inflationary period, we haven't had a figure as low as 9 percent.

MR. PARTEE. We're talking about all this financing by the government, which is a part of it, and we have a low end that's below anything we've had.

MR. FORD. The last time it was below 9 percent the economy was a lot healthier than it is now, gentlemen. That's what we're trying to do, isn't it? I'm not kidding about this. That is the other way of saying it.

MR. PARTEE. 1970 was the last time it was below 9 percent and that was a recession year.

MR. FORD. There was accelerating inflation in that period.

CHAIRMAN VOLCKER. It got down to about 9 percent in '74 and '75 when there was more inflation than there is now.

MR. WALLICH. Well, the aggregate responds very little to inflation. Otherwise, it should be 5 percentage points lower now than it was at its peak.

CHAIRMAN VOLCKER. Well, it's 3 or 4 percentage points.

MR. MORRIS. It's responsive to nominal GNP, Henry, not just inflation.

MR. PARTEE. The chart looks pretty good until the last couple of years.

MR. GRAMLEY. [Unintelligible] economy from the liquidity position of businesses and individuals. And it clearly has a very strong secular upward trend. It always has; that went on before there was an acceleration of inflation [unintelligible]. If you go back to the 1950s, you'll find there was an acceleration in the growth of debt relative to GNP.

CHAIRMAN VOLCKER. I don't think that's true. The velocity has been unchanged for 20 years.

MR. AXILROD. I think, Mr. Chairman, we have a very modest growth in nominal GNP here and we're getting [rising] economic activity only because we have very low growth in prices. Our problem, we thought, was to explain why total credit growth was so small with this kind of nominal GNP, given--

MR. KICHLINE. So large.

CHAIRMAN VOLCKER. So large.

MR. AXILROD. I meant so large, pardon me.

CHAIRMAN VOLCKER. That's where I start out. De novo, the question I have is: Why is it so large? Why is credit in the first period of expansion expanding faster than nominal GNP?

MR. PARTEE. Maybe because a dollar government bond doesn't have the kick that a dollar Carter bond does.

MR. AXILROD. Part of our answer was that we weren't getting enough strength in economic activity to generate a substantial cash flow to businesses, so we weren't getting them able to finance as much, relatively speaking, internally. The character of this expansion is somewhat different from the character of earlier expansions. It's slower. It's dominated by government.

MR. CORRIGAN. That's the problem. It is totally dominated by government. And I don't know how you can walk away from that.

MR. FORD. Remember, if you don't like the crowding out argument in that we're taking the government's share as given, another thing that's implicit in what Lyle is arguing is that you will increase financial leverage of corporations. Because what you're talking about providing them adequately with is debt, which as Governor Martin noted, has to be related to equity. And what he just said is that there's not going to be equity forthcoming for whatever reason. That's in the forecast. I'm not arguing with it. But the logical conclusion is that if we put a high number on the range and if we make the credit available to the private sector after the government gets its share, the net result will be an increase in the debt/equity ratio of corporate America. And that ratio, if I'm not mistaken--I'd like to ask the staff--

MR. PARTEE. You can't reach that conclusion, Bill, because one of the biggest sectors in here is the consumer--mortgage debt and consumer debt.

CHAIRMAN VOLCKER. Well, I hate half points [in the ranges], but the arithmetic resolution of this problem would be a range of 8-1/2 to 11-1/2 percent.

VICE CHAIRMAN SOLOMON. I thought of that, but it seems to me that implies some precision. I wonder if it's wise to make that--

CHAIRMAN VOLCKER. We just did, under your urging, for M3.

VICE CHAIRMAN SOLOMON. Maybe we should just stop with what we had already set up before.

MR. PARTEE. I would buy 8-1/2 to 11-1/2 percent.

VICE CHAIRMAN SOLOMON. I would like to make one suggestion. I don't feel that strongly about it, but I'd like to point out that there is an advantage in addition to this associated [debt] target of leaving in our traditional associated bank credit target for two reasons. One is that we always hit it for some strange reason, and that's very nice to have happen. [Laughter] The other one is that there are a lot of people in the markets who aren't going to understand [the debt aggregate]. If they do, it's very--

CHAIRMAN VOLCKER. Of course their argument is that we get that [bank credit] figure on a much more up-to-date basis.

VICE CHAIRMAN SOLOMON. And it seems to me that there would be some sense of continuity. If people see that same bank credit target of 6 to 9 percent or whatever it is that we've had every year--and we always hit it rain or shine--they're going to tend without doing any independent analysis, which will be limited to a very few people, to feel reassured about the higher numbers on this broad credit measure because they'll assume it's consistent.

CHAIRMAN VOLCKER. Do you have the number for bank credit?

MR. AXILROD. Well, the number for bank credit that falls out of this whole consistent set of data is 7.8 percent.

VICE CHAIRMAN SOLOMON. It's still within 6 to 9 percent; it's still the same thing.

MR. MORRIS. Keep 6 to 9 percent.

MR. PARTEE. It really ought to be depository credit, but we don't have a number for that.

VICE CHAIRMAN SOLOMON. Maybe we wouldn't hit it that way.

MR. BLACK. If we vote on these, as I've figured it, we've now substituted all the specifications of alternative I and the rate of growth from a February-March base for M2, and we're calling it alternative II.

CHAIRMAN VOLCKER. That's correct, I guess. One could argue, however, that these are all based upon a somewhat lower GNP than everybody is calculating.

MR. MORRIS. Furthermore, the M2 number is based on sheer speculation on the part of the Board's staff that after the end of March--

MR. PARTEE. So are the other numbers.

MR. MORRIS. --M2 is going to grow 8 percent.

MR. BLACK. I was just thinking on the mechanics of voting. I might say I favor old M2 and you might say you favor the new M2. I was just pointing out that a transposition has sort of taken place, rightly or wrongly.

CHAIRMAN VOLCKER. You are right. Well, what do you think about this bank credit issue? We could write a sentence in here saying that this would be consistent with a bank credit range of ___ to ___ percent. That gets another number in there; I don't know whether that's good or bad. I don't mind saying that at some point. We could use it as a transitional device but not monitor it, or put it in parentheses.

MR. BALLES. What advantage would there be of that, Mr. Chairman? I thought initially we were aiming at substituting a broader measure of credit than the narrow bank credit measure which had been affected by the degree of intermediation or disintermediation or whatever. I suspect we might be getting too many targets.

CHAIRMAN VOLCKER. Obviously, it adds another number and that's a disadvantage. I think we ought to say some place, though we don't necessarily have to say it in [the directive]--we can say in the text of the [policy record]--that we have this range and it was pointed out that this was the practical equivalent of the 6 to 9 percent range for bank credit.

MR. PARTEE. That's all right.

MR. GUFFEY. I think that's attractive.

CHAIRMAN VOLCKER. Well, why don't we do that. Take a note of that somebody. Why don't we go back over this and look at the language, paragraph by paragraph. I had a very minor change back in the boiler plate part. In line 20 it says "Growth of M2 surged to an extraordinary pace in January." That's certainly right. Then it says "largely reflecting...." If I understand it correctly, it's more than largely reflecting. It misimplies that it's only partially [the reason]. So far as we know it may be the whole [reason]. We don't know. I would make a big change and substitute the word "apparently" for "largely." Somebody says it's just an arithmetic thing; I guess it's what you're measuring from. In lines 12 and 13 it says "In recent months the advance in the index of average hourly earnings has slowed appreciably further." I guess that depends upon precisely what month you're comparing it with.

MR. GRAMLEY. We could say "slowed further, but not appreciably."

CHAIRMAN VOLCKER. I don't remember exactly what the numbers were. I thought the January figure was a little lower, but I just figured--

MR. GRAMLEY. If you take the period from last September to January, you get a 5.3 percent rate of increase. The third quarter was 5.5 percent, measured from June to September. There has been a tiny further slowing, but not a lot.

CHAIRMAN VOLCKER. Just take out the word "appreciably." Is that okay?

MR. GRAMLEY. I definitely think that would do it.

CHAIRMAN VOLCKER. All right. Does anybody else have anything on the boiler plate part?

MS. TEETERS. I do. On page 2, line 37--

CHAIRMAN VOLCKER. That's not the boiler plate.

MR. PARTEE. It never changes.

MR. MARTIN. This is the armor plate!

CHAIRMAN VOLCKER. That first sentence is certainly boiler plate, but I--

MS. TEETERS. It was the first sentence that I had trouble with.

CHAIRMAN VOLCKER. Now we are down after line 33. What do you have, Nancy?

MS. TEETERS. First of all, the word "sustainable" is used twice and I don't know what it means to say "a sustainable pattern of international transactions."

MR. PARTEE. We never did.

CHAIRMAN VOLCKER. The only virtue that it has is that we have an unsustainable pattern. We've had it for years and we haven't changed the sentence.

SPEAKER(?). Steve, what was the--

CHAIRMAN VOLCKER. I think the question is whether we want to change something--this particular sentence--which has in fact been boiler plate. I raised the same question. Actually, it may be more relevant now than it was before in terms of the exchange rate. I would be inclined to leave it. But nobody's going to notice it because it has been there forever.

MR. WALLICH. It's very hard to say anything about the balance of payments; still, something should be said. And then we'll in effect have to say something about the dollar.

CHAIRMAN VOLCKER. Is there anything else in that first paragraph? Anything down to line 49?

MR. GRAMLEY. Mr. Chairman, in line 44, I would prefer to put the lower market rates of interest after declining inflation because it sounds as if the declining inflation is what is causing the lower market rates of interest. It would read then, starting at line 43, "...and that the availability of interest on large proportions of transactions accounts, declining inflation, and lower market rates of interest...."

CHAIRMAN VOLCKER. Anything else in that first paragraph? Let me go to the next paragraph, which is bracketed. It seems to me that that ought to stay in, but I wonder whether we shouldn't reverse this somehow. I don't have any [precise] language, but something like "In establishing growth ranges for the aggregates for 1983 the Committee felt that M2 might be more appropriately measured after the period of highly aggressive marketing of money market instruments has been completed. The Committee also felt that a somewhat wider range is appropriate for M1." We need some language in there, I think, to make that range sound a little more tentative, consistent with the rest of it.

VICE CHAIRMAN SOLOMON. "For monitoring M1."

CHAIRMAN VOLCKER. Well, that would be all right with me. And that would be explained a little later, if that's--

MR. WALLICH. I think we ought to say something here to indicate that these ranges are more uncertain than in the past since we haven't quite said that except for M1.

CHAIRMAN VOLCKER. Well, it says that right now. That's the last sentence. I think the whole thing conveys that. The first paragraph says something about that and then this paragraph concludes with it. I'd make it "Those growth ranges will be reviewed in the spring and altered, if appropriate, in the light of evidence" etc. Then what this is saying--let me just be clear--is that we may look at M2 [after] we see what happens in February and March and see whether we like that as a base or whether it [should be] changed. And we'll see whether we have any stronger feeling about M1 at that time, which is before the normal period [for our review of the ranges]. Okay?

MR. AXILROD. Did you want the narrowing to apply to the M2 range as well?

CHAIRMAN VOLCKER. No.

MR. MARTIN. Altered.

CHAIRMAN VOLCKER. No, we're changing the word "narrowed" to "altered."

MR. KEEHN. Maybe it's a minor point, but in lines 53 and 54 we use the phrase "after the period of highly aggressive marketing of [money market deposit accounts] has been completed." We are implying that by using February and March as the base that the aggressive marketing will be over then. I'm not sure we can say that.

CHAIRMAN VOLCKER. [We could say] "subsided." It depends upon what one means by "highly."

MR. KEEHN. I'd give it a more temporary--

CHAIRMAN VOLCKER. The distinction is between highly and not so highly.

MR. PARTEE. "Subsided" is a lot better word.

CHAIRMAN VOLCKER. "Subsided" is all right.

MR. KEEHN. Yes.

MS. TEETERS. Should we add "hopefully"?

SPEAKER(?). Perhaps.

CHAIRMAN VOLCKER. We just talked about the tentative numbers for the next paragraph. I think Governor Martin raised some question about how M1 is stated. Let me suggest this. It would read as it is except for putting an "and" after M2 and before M3. "For the period from February-March to the fourth quarter a range of 7 to 10 percent ...taking into account the probability of some residual shifting...." Well, there's a question right there. Do we attempt to quantify that residual shifting? I would say we ought to quantify it very roughly in the earlier discussion [in the policy record], but we don't have to do it here. Then just make it "and for the period from the fourth quarter of 1982 to the fourth quarter of 1983, M3, which appears to be less distorted by the new accounts...." And then say something like "A tentative range of 4 to 8 percent"--if that's what we have--"has been established for M1 assuming Super NOW accounts are not vigorously pursued and that the [proposal before the DIDC for] business demand deposits isn't adopted."

MR. PARTEE. Is not adopted?

CHAIRMAN VOLCKER. Is not adopted. It's not "business demand deposits," but put in whatever the right language is.

MS. HORN. The implication of that is that M1 is receiving substantially less weight than M2.

CHAIRMAN VOLCKER. We say that specifically in the next paragraph, I think. It comes up again in the next paragraph.

MS. HORN. You'd like me to wait until discussion of that?

CHAIRMAN VOLCKER. Well, we can't determine this paragraph independently of the next one; I think it does have that implication. So, whether or not you like the language in the next paragraph, it's designed to make it consistent with the next paragraph.

MR. GRAMLEY. Mr. Chairman, that language about the Super NOWs--if it says we assume nothing happens on that--may compromise your position at the moment with the DIDC. Does it bother you at all?

CHAIRMAN VOLCKER. I'd just say that we had to make some assumption one way or the other.

MR. GRAMLEY. But you used the wording that this range makes no allowance for any marketing of Super NOWs for businesses. It would be a little difficult--

MR. PARTEE. Not marketing. It's the possibility of them.

MR. GRAMLEY. The range makes no allowance for that.

CHAIRMAN VOLCKER. Well, I didn't mean to give definite language. I haven't any language here, but I don't mean to make it read as though that decision is prejudiced; it's just a factual statement of what our assumption was in establishing this range. We can accomplish that.

MR. PARTEE. We have to be a little careful, I think, with the phrase we have about Super NOWs too. Of course, they're being marketed now to households.

CHAIRMAN VOLCKER. I haven't any language written down.

VICE CHAIRMAN SOLOMON. Maybe "assume no unusual..."

MR. PARTEE. Yes, some institutions would say they're pushing them pretty heavily.

CHAIRMAN VOLCKER. Why don't we say "assuming Super NOW accounts do not draw a substantial amount of funds from outside of M1" or "draw only modest amounts of money from outside of M1." And I think we could say "assuming that interest payment on transactions accounts is not extended beyond the present eligibility."

MR. PARTEE. Or "extended to corporations and other businesses" or something like that.

CHAIRMAN VOLCKER. Either "corporations or other businesses" or "beyond the present eligibility." It's just meant to be a factual statement of what our assumption was in establishing a range.

VICE CHAIRMAN SOLOMON. What will you answer if some member of the [Congressional] Committee said: Does that mean then that in the DIDC you are going to oppose the extension to corporations?

CHAIRMAN VOLCKER. It just means that's the assumption that we made.

MR. PARTEE. [Unintelligible.]

CHAIRMAN VOLCKER. I probably will say yes, anyway, but that has nothing to do with this.

MR. PARTEE. I do believe the comment [on the DIDC proposal] has run pretty much close to this, hasn't it?

CHAIRMAN VOLCKER. I'm not sure, but that's my impression. I haven't looked at it myself.

MR. CORRIGAN. On the following paragraph that deals with the question of emphasis on--

CHAIRMAN VOLCKER. We're not quite to the following paragraph yet until I make sure there are no more comments on this one.

MS. TEETERS. Should the range of bank credit go with this?

CHAIRMAN VOLCKER. No, I think we agreed to put that in the [policy record] text earlier, not here. It will go in the summary of the discussion or whatever we call it but--

MR. PARTEE. It's not a specified target.

MR. AXILROD. In the summary we could indicate what the total credit would be of which we think bank credit would be about so much. That would take care of it.

MR. BOYKIN. The only question I would raise as far as numerical sequencing is: Why not address the M1 situation up front--address it first? I realize it's being downplayed.

CHAIRMAN VOLCKER. I think that's the reason. Again, I think that is dependent upon what we say in the next paragraph. I just think it's better this way if it has a little less emphasis precisely because it does have less emphasis.

MR. BOYKIN. I guess my basic problem is that I wonder if I would give it quite that much less emphasis.

CHAIRMAN VOLCKER. Well, that's going to come up in the next paragraph. Let's turn to the next paragraph, which starts out by saying "[In implementing monetary policy,] the Committee agreed that substantial weight would be placed on behavior of the broader aggregates."

MR. CORRIGAN. I do have a bit of a problem in terms of this question of emphasis on M1. As I look at it, we're talking about targets in general that at least strike me as being toward the high side in a context in which there's at least a 50-50 chance that we are going to get some recovery, if not a fairly robust recovery, in velocity. Now, if we find ourselves in that situation, M1 with all its imperfections and everything else is really the only device to use, in terms of the way we run monetary policy, to be able to snug up. That may develop out in the year some time, but I--

MR. PARTEE. But, Jerry, that's a pretty good sentence there at the top of page 4.

CHAIRMAN VOLCKER. Why do you say that? I don't understand.

MR. CORRIGAN. Why do I say it? I guess I have at least a degree of concern that we could run into a problem on the up side.

CHAIRMAN VOLCKER. Yes, but why is that only going to be reflected in M1 and not the other Ms?

MR. CORRIGAN. Well, in terms of open market operations, the fact of the matter is that--take the extreme case where it's not even a question of emphasis but we have nothing there on M1--as a practical matter our ability to react in a reasonably effective way to what is happening with M2 or M3 or credit or whatever is limited.

CHAIRMAN VOLCKER. I don't understand that. If they're running high, we tighten up.

MR. BLACK. Mr. Chairman, let me see if I may help on this point. We would lose the automatic adjustment mechanism to a large degree.

CHAIRMAN VOLCKER. Less automatic--

MR. BLACK. The Committee sets the initial borrowing target and after that all the Committee has is the automatic part because we don't participate in any ad hoc adjustments. I sure would like to have that automatic part fairly strong.

CHAIRMAN VOLCKER. I think it's less automatic; I agree with that. I think the Committee does participate; it's less automatic but it's there. If we want to use it, it's there.

MS. HORN. Jerry's point that we're going to need M1 later on for the upside possibility is one that I agree with. And it seems to me that while we have uncertainty about economic activity and the macro outlook, one of the things we could do as a Committee is say that we will react to M1 going above the target. We will react less quickly than we did historically; historically we tried to get it back in [its range] over a 10- to 12-week period between discount rates and reserve movements. We could say we will react less quickly as a Committee. I'd like to see M1 receive more emphasis than this directive puts upon it.

MR. GRAMLEY. Well, we're talking about long-range targets for the moment. And if Jerry's problem becomes a real one, the way we can deal with that is in the short-run directive in May or June or December or whenever the date is by providing more weight to M1 because then we'd get the more automatic response. So long as we haven't thrown it out, as I suspect [we may have], we're all right.

MR. BOYKIN. But the fact that we are talking long term is why it seems to me that just the sequencing of it gives a little more weight to [its deemphasis]. I'm not arguing about the qualifying language but since we are looking out for a year, if what Jerry says does materialize, it seems more logical to be consistent and address M1, M2, and M3 as we traditionally have. I think it would leave the impression at least that M1 is not as abandoned as it apparently is right now.

MR. BOEHNE. I think you have to look at where we've come from, though. We have deemphasized M1, in fact, in recent months. And while we may feel a little better about putting M1 back in a monitoring sense, what really has happened over the last 6 weeks that would make us jump from essentially not using it at all to putting it back up there?

MR. BOYKIN. I'm not arguing for jumping that far; I'm just arguing for acknowledging that there is such a thing now.

CHAIRMAN VOLCKER. Just to put a little balance on this discussion in that direction, my concern about that sentence on the top of page 4 was that it was too strong. I'd ease it slightly and say "While the behavior of M1 will be monitored, the weight placed on that aggregate over time will be dependent on evidence."

MR. FORD. What kind of evidence may I ask, Paul? Remember, if you go back not 6 weeks but back to last fall when we were arguing about M1 in a discussion like this, we were saying that we were worried about what would happen when the all savers [certificates] matured and we were worried about what would happen with MMDAs. But we had double-digit growth of M1 before October and after October,

CHAIRMAN VOLCKER. My answer to that is that there's no question M1 is running high relative to targets. We can make these technical adjustments, but it's running high when you look at that whole period. But the relationship between M1 and the economy I don't think has settled down, to say the least. And my problem is that I don't know how soon I would have the intestinal fortitude, if that's the right term, to say that I have any conviction on what the velocity is of M1. I'm not [just] assuming that it's distorted by these technical things. If we had an undistorted M1 figure, I'd say: Okay, it's undistorted, but what its relationship is to the economy, I don't know at this point.

MR. FORD. But what Jerry is saying is: Why should we start out by assuming anything except that velocity is going to make a comeback? And the weaker language we put in now will probably be--

CHAIRMAN VOLCKER. The target assumes velocity is going to make a comeback and I assume it's going to make a comeback, rightly or wrongly, to some degree. But on the question of whether the velocity is going to be 1 percent up or 5 percent or 6 percent up, I will tell you I'm a complete nihilist. That's my problem.

MR. FORD. All I'd say, along the lines of what Jerry thinks, is that the farther we let this horse out of the corral, the harder it's going to be to jump back on it when we think we need it.

CHAIRMAN VOLCKER. I suffer from the disability--I'm sorry--of not understanding Jerry's point in the first place. I don't want to jump back on it if I don't have any confidence in the darn thing.

MR. CORRIGAN. Let me try to make the point a little differently, then. I am thinking out perhaps well into 1983. I'm not worried right now and I probably won't be worried for at least a number of months. But I could be worried come the summer or sometime when I see the velocity rising 4 or 5 percent and we're at the top of the M1 range. We'd have a mess on our hands at that point to suddenly be in a position where we have to reemphasize M1 because we want to be able to live with the automatic mechanism in a more direct way. I think that is a very difficult position.

VICE CHAIRMAN SOLOMON. You would agree, though, that by definition if we went back to that situation of giving it that much emphasis, we would then have more confidence that velocity was telling us something.

MR. PARTEE. I think that's right.

VICE CHAIRMAN SOLOMON. So, therefore, one would handle it the way Lyle Gramley suggested: that if that situation does arise, then it's perfectly consistent with this. Right?

CHAIRMAN VOLCKER. Well, you have two parts to your statement. The first part I understand--that it's running high and by implication nominal GNP is running very high and you want to tighten up. I think that's separable from the automaticity issue where you just say M1 is running high, let's tighten up.

MR. CORRIGAN. My question is that I'm not sure the extent to which, in fact, it might be separable. That's what I worry about.

MR. PARTEE. I guess I'm somewhat sympathetic with that too. I think this is tending rapidly to become an argument between those who like M1 and those who like money market conditions.

MR. CORRIGAN. Actually, I don't like M1.

MR. PARTEE I would have thought that we might say here "Some weight will be given also to M1, depending on the performance of velocity"--that is, velocity coming back. It's a shading.

MR. GRAMLEY. Is this simply added weight? If we're setting any kind of target for M1 at all, we presumably are putting something other than zero [weight on it].

MR. PARTEE. Well, this doesn't say; it just says it will be monitored.

CHAIRMAN VOLCKER. Because it says now "monitored closely," you see.

MR. PARTEE. Some weight, with the amount depending on the extent to which it resumes a predictable velocity relationship. That way, you see, we'd be in a position as velocity comes up to give it more weight. We would have positioned ourselves for it.

MR. CORRIGAN. That's the point I was trying to make. You just made it much better than I did.

CHAIRMAN VOLCKER. Well, I don't know where we are. I'm a bit bothered by the word "closely." That's my only problem.

MR. MARTIN. Yes, let's delete "closely."

VICE CHAIRMAN SOLOMON. I don't think it helps any, but if you want to get your point in, instead of saying some weight we could say "with the degree of weight placed on that aggregate over time being dependent on...." Is that all right?

MR. CORRIGAN. That helps me.

MR. PARTEE. It's the kind of thing we can more easily change and give more weight to it as time goes on.

MR. GRAMLEY. We could monitor it "carefully" instead of "closely," Mr. Chairman.

CHAIRMAN VOLCKER. Let's just monitor it.

MR. MARTIN. Well, we do everything carefully.

CHAIRMAN VOLCKER. We have it now reading: "The behavior of M1 will be monitored, with the degree of weight...." Now to this credit flow issue. We're on that sentence.

MR. BALLES. The more I listen to this discussion the more I wonder whether we are on the wrong foot here. Is it really the degree of weight that we want to emphasize or is it the appropriate range of growth that would be the thing to concentrate on?

CHAIRMAN VOLCKER. I would argue that appropriate growth, which is obviously relevant here, is covered in this other sentence that says we're going to look at that again anyway. I think they are two different points and I guess it's just a question of where we discuss the two different points.

VICE CHAIRMAN SOLOMON. The [appropriate] range of growth is going to depend on what velocity is.

MR. BALLES. Well, that's right; the two are opposite sides of the same coin in a way.

CHAIRMAN VOLCKER. They both are relevant. My sense, as a matter of drafting, is that this paragraph is directed explicitly to the degree of weight. In the paragraphs before we said we are going to have to look at it again in terms of the range.

MR. BALLES(?). True.

MR. PARTEE. Just in the interest of being clear with my suggestion--since you didn't adopt it, maybe you didn't understand it.

CHAIRMAN VOLCKER. The other possibility is that I didn't like it!

MR. PARTEE. Well, that's possible. I assume this is a democratic matter and, therefore, let me be clear. I would say "Some weight will be given to the behavior of M1 also, with the degree of emphasis dependent on the extent to which that aggregate over time shows velocity characteristics resuming more predictable patterns."

CHAIRMAN VOLCKER. I will tell you why I don't like it. [Unintelligible] is that I think right away the market is going to say: What's going on with M1 beginning right now in February? And it's going to put us in a box; they're going to be looking at those weekly figures very closely.

MR. MORRIS. That is precisely the danger.

VICE CHAIRMAN SOLOMON. It's a real danger. Oh, they love those numbers, that action!

MR. MARTIN. The Reuters tape on Friday afternoon--

MR. ROBERTS. Well, you can't assume that's irrational either, if the marketplace judges it to be important. I think the market is concerned currently about the rate of expansion in the money stock.

VICE CHAIRMAN SOLOMON. Yes, if we return to the kind of weekly volatility that we had before, it would seriously impede the recovery. And I don't think it adds anything to our anti-inflationary posture to have that kind of weekly volatility.

MR. ROBERTS. No, but I think we should stay hinged to a rate of growth in M1, and we've done that. And the assumption, as I understand it, is a resumption of normal velocity. I don't see anything wrong with that. I think this wording looks all right.

CHAIRMAN VOLCKER. I'm not sure I see anything wrong with it in the future, which is what I think this wording conveys. I don't like the implication that in the next few months we're going to be at that mercy.

MR. GUFFEY. Does what you just said imply that if velocity returns to some normal pattern based upon historical experience, we'll go back to targeting M1 as the single aggregate as we did at some time earlier?

CHAIRMAN VOLCKER. It doesn't foreclose that. It doesn't say we're going to target it as the single aggregate; I don't think we ever did.

MR. GUFFEY. Primary is right. I think I would oppose getting back--

CHAIRMAN VOLCKER. We say that, but I'm not even sure how true that is. Look at 1981. M1 was running low and we said: Well, let it run low because the other aggregates are running high. That's explicitly what we said.

MR. GUFFEY. We were also working against inflation then and were all willing to see M1 run low to try to achieve lower prices.

CHAIRMAN VOLCKER. That was certainly a factor in it, but that's not what we said.

MR. GUFFEY. My point is that if this is taken to mean that if the one condition is met--that velocity returns to some normal pattern--

CHAIRMAN VOLCKER. A predictable pattern.

MR. GUFFEY. --a predictable or historical pattern--then M1 assumes some importance, as I think it did before, then I think some additional language might be appropriate. In fact, I rather like Chuck's language of emphasis rather than characterizing it as is done here in this sentence.

MR. MORRIS. My only problem with it, Mr. Chairman, is that I don't see that we have a basis for differentiating M1 and M2. That is, M2's velocity is certainly as unreliable in this situation as M1's.

CHAIRMAN VOLCKER. Let me ask a question. I just don't know. I guess we're saying the opposite.

MR. GRAMLEY. All we need is a sentence here that keeps our options open. I think we're arguing much too hard about details of the language. We want to keep the options open.

MR. BOEHNE. What about an approach something like this: "The behavior of M1 will be monitored closely. Should evidence [emerge] that velocity characteristics are resuming more predictable patterns, the Committee will reopen the issue of the weight that it will place on M1." I'd suggest something like that, which pushes to some future point a discussion of where M1 fits, depending on what the evidence is. I think that connotes the idea that it's not being given a whole lot of weight in the very current period.

CHAIRMAN VOLCKER. I don't have any particular problem with what you're proposing. It seems to me it is virtually identical to what we have here. I would, frankly, take out the word "closely," which I think maybe confuses the issue at the moment. But in substance what you said is the same as what this sentence says. It's a drafting preference.

MR. BOEHNE. I think, though, that my approach does give a coloration to it that the Committee is keeping open the whole issue of the weight that it's going to give to M1. This [wording] gives an automaticity to it that if certain preconceived conditions arise, then the Committee will automatically go back to M1. My wording pushes that decision into the future, should that evidence exist.

CHAIRMAN VOLCKER. You interpret it as a diminution of M1 at the moment.

SPEAKER(?). Postpone it.

VICE CHAIRMAN SOLOMON. We have a clear split here between those who want to imply a stronger possibility of a return both to an emphasis on M1 and a greater degree of automaticity and others who simply want to be neutral about keeping the options open. I guess that's what the argument is about. I tend to agree with the second view. And I had thought that was the thrust of the consensus view generally--that we don't want to imply to the market that we are being extremely sensitive and that there is a near-term probability. I do want to be neutral on M1. The big question in the market is: How long is the Fed going to continue its current approach to monetary policy as opposed to at what point do they [return] to some more automatic emphasis on M1? It seems to me that in the face of that, we ought to be carefully neutral.

CHAIRMAN VOLCKER. As I interpret it, the sentence as modified by Mr. Partee suggested a stronger M1 and I guess Mr. Boehne interprets his suggestions as being weaker on M1. And what we have is in the middle. So, I guess I'm left in the middle. If I don't hear violent objections, I'm left with the question of whether the word "closely" is in or out.

VICE CHAIRMAN SOLOMON. I would hope it would not be in.

CHAIRMAN VOLCKER. I would [too].

VICE CHAIRMAN SOLOMON. I happen to agree, as I said earlier. I just think that the market is extremely sensitive to the question of whether we are leaning back toward M1 again.

MR. PARTEE. If we don't put it in, it sounds as if we're paying about the same amount of attention to M1 as we are to the total credit flow. We are also saying that we are monitoring that.

VICE CHAIRMAN SOLOMON. We can say "carefully," though.

MR. PARTEE. Carefully, as opposed to our usual sloppy--?

MR. FORD. You can intentionally monitor your speedometer while going 85.

MR. GRAMLEY. You can even monitor it while--

CHAIRMAN VOLCKER. That's right. We have all the options. We can not look at the speedometer, we can look at it, or we can look at it very closely or we can look at it carefully.

MR. WALLICH. No, I think this states that--

MR. FORD. The question is where you put your foot!

MR. WALLICH. Where we ought to be guided in choosing these options is that for a while we'd just be looking at it and it may be very high. It can't go on very high indefinitely.

CHAIRMAN VOLCKER. I think the word "monitored" assumes that if you look at the speedometer you pay some attention to it now and then. It's just the degree of attention you want to pay to it.

MR. FORD. It depends on whether it's a governor on the motor.

MR. WALLICH. Yes, the degree changes over time.

CHAIRMAN VOLCKER. Well, I think the issue is whether "closely" is in there. We can substitute "carefully." How many want "closely" in there?

MR. MORRIS. I would suggest "casually."

CHAIRMAN VOLCKER. I interpret that as a vote against "closely." Who wants "closely" out? You want it out.

MR. MORRIS. I don't have a vote.

CHAIRMAN VOLCKER. Well, everybody will vote in this general [poll]. Who wants "closely" in? I guess we have a majority to take it out, but that was not the most overwhelming vote I ever saw!

MR. BLACK. Could we say that some members will monitor it fervently?

SPEAKER(?). Closely.

CHAIRMAN VOLCKER. Let's go on to credit flows for the moment.

MR. CORRIGAN. Is the word "degree" in that sentence or not?

CHAIRMAN VOLCKER. Yes, I assume that we're using "degree of."

MR. CORRIGAN. "With the degree of weight," okay.

CHAIRMAN VOLCKER. That implies, I guess, some weight right from the beginning. Well, I now have it without the "closely" but with "the degree of" in there. On credit flows, this question has arisen before, and here is the sentence that's supposed to answer the question: "Credit flows, while not directly targeted, will be evaluated in judging responses to the monetary aggregates." That's one of the more declarative sentences, I think.

VICE CHAIRMAN SOLOMON. It's nice and straightforward.

CHAIRMAN VOLCKER. Any comment on that sentence?

MR. BLACK. Shouldn't we spend a couple of hours discussing whether [evaluated] carefully or not so carefully?

CHAIRMAN VOLCKER. Last sentence.

VICE CHAIRMAN SOLOMON. I think we ought to leave in what is bracketed.

CHAIRMAN VOLCKER. If what is bracketed is left in, just in the interest of clarity, it ought to say "including evaluation of conditions in domestic <u>credit</u> and foreign exchange markets."

VICE CHAIRMAN SOLOMON. We are doing that.

CHAIRMAN VOLCKER. Do you want to leave that? I think we are doing it now. Is that the consensus?

MR. MARTIN. It would be incomplete without it.

CHAIRMAN VOLCKER. Well, that completes the long-term ranges. Let me go back after all this discussion [to the numbers]. We put in tentatively: 7 to 10 percent for M2, with a February-March base; 6-1/2 to 9-1/2 percent for M3; 4 to 8 percent for M1, with a note at the end of that. I take it we're using "estimated" instead of "established" for the 8-1/2 to 11-1/2 percent range for credit. And in the text of the discussion [in the policy record] that will be rationalized with the present range for bank credit. And that does, as a matter of fact, correspond pretty much--maybe exactly--to alternative I. I note again that most of you at this point have a slightly higher GNP [forecast], nominal and real, than the staff estimated in establishing the alternative II ranges. Unless anybody has a further question, we ought to vote.

MR. WALLICH. I find confusing the reference to credit flows. Is that specifically what we mention as total--

CHAIRMAN VOLCKER. Where are you?

MR. MARTIN. Page 4.

MR. WALLICH. It's on page 4. We have "Credit flows, while not directly targeted, will be evaluated." Are these credit flows the total domestic nonfinancial debt? If so, then I think we ought to repeat that because the way it is stated in the earlier paragraph, it looks like a quasi-target. And here we are saying we are not targeting it directly.

MR. GRAMLEY. But we use "associated range of growth" on the previous page. I think it's just a reiteration, making clear that this--

MR. WALLICH. But the distinction is that "associated range" is the same as "not directly targeting."

MR. PARTEE. You would like to use the same title.

MR. WALLICH. Yes. It's only known to this group.

MR. BALLES. There's a different problem too. On page 3 we talk about total domestic nonfinancial debt and on page 4 we talk about credit flows. We know that we mean the same thing; I wonder if readers will.

MR. WALLICH. Exactly.

CHAIRMAN VOLCKER. I don't really care, but I don't know when those data come in. Presumably, we'd be looking at credit flows against the background of that range; we get some clues without having that precise number [for total domestic nonfinancial debt] in front of us. It sounds awfully technical to me to repeat total domestic nonfinancial debt. But if that's what you want to put in, I'm perfectly happy to put it in.

MR. WALLICH. That leads to this--

MS. TEETERS. Why don't we put "credit flows" as the title?

MR. BALLES. We could just call it "debt expansion."

CHAIRMAN VOLCKER. "Debt expansion." That's fine.

MR. PARTEE. Yes, it's closer.

CHAIRMAN VOLCKER. Rather than getting all that technical about it, "debt expansion" is fine. If there are no other comments, I guess we can vote.

MR. BERNARD.

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

Four against.

CHAIRMAN VOLCKER. All right, we will go to the immediate [policy]. I don't know whether we need any more discussion from Mr. Axilrod at this point or whether we need a coffee break.

SPEAKER(?). Yes, I think so.

SPEAKER(?). [I need] a lot of that coffee, Mr. Chairman!

CHAIRMAN VOLCKER. Why don't we have a brief coffee break.

[Coffee break]

CHAIRMAN VOLCKER. We live in a wonderful world where setting short-term targets is affected by the last figure we have. We live in a world in which we've just changed all the seasonals and patterns and all the rest. As a preliminary, Mr. Axilrod ought to discuss without the latest numbers, which we'll tell you about in a minute, what all these revisions did to last year's numbers and [this year's numbers] to date.

MR. AXILROD. Mr. Chairman, the benchmark revisions, which were put in the appendix to the Bluebook, lowered the growth in M2 from 9.8 to 9.2 percent, largely because of the exclusion of IRA/Keogh accounts for the year; they had no effect on M1, which grew at about 8-1/2 percent, and reduced M3 growth for the year as you see from 10.3 to 10.1 percent. However, for M1 within the year there were very sharp changes in the seasonal pattern, which changed the months and quarters to a substantial degree. The growth for Q4, which on the old seasonal pattern had been 16.1 percent, changed to 13.2 percent. The January growth for M1 was reduced to 9-1/2 percent from the higher number, 12-1/2 percent, that it had been before the seasonal revision. These changes in the seasonal pattern were reflected also in the weekly data. You may remember that the last week published, the week of the 26th [of January], showed an increase of $2.7 billion for M1. Now it has a decrease of $2.6 billion but the preliminary data we have show substantial increases thereafter for the weeks of February 2nd and February 9th, suggesting that we're on track toward a higher M1 in February whereas we had revised down the January growth by 3 points and thought it would continue at the lower growth rate. The data for early February on the revised benchmarks and seasonals suggest that we're on a higher track for February than the estimate of around 6 percent we had in the Bluebook. I don't have additional data.

CHAIRMAN VOLCKER. There are several points. The growth in M1 in the last quarter of last year has been revised substantially down. It's still high, but instead of 16 percent it's 12-1/2 percent.

MR. AXILROD. 13 percent.

CHAIRMAN VOLCKER. It's something like that, if I remember. January, with the radical revision of data for the week of the 26th, which may or may not be right, is now less than 10 percent instead of over 10 percent.

MR. AXILROD. 9-1/2 percent.

CHAIRMAN VOLCKER. But you show, [if] one can believe it, that the radical revision is promptly offset the following week, which goes into February, with a further increase the following week of some substantial size. That now makes February look higher than January. The data are subject to equally radical changes in the rest of February. What to make out of all of this, I don't know.

MR. AXILROD. It makes it difficult, Mr. Chairman, on the face of it to think that M1 is going to slow substantially in February and March on average from January.

MS. TEETERS. Do you have a revised M2 for January, Steve?

MR. AXILROD. Not at this point.

CHAIRMAN VOLCKER. Well, we return to what we want to do. When do we meet again?

MR. BERNARD. The end of March--March 29th.

CHAIRMAN VOLCKER. March 29th. A period of--

MR. MARTIN. Close to seven weeks.

CHAIRMAN VOLCKER. Seven weeks exactly. I don't quite know what numbers to put in here. And the question is whether we need any numbers.

MR. WALLICH. I would agree with that.

MS. TEETERS. Mr. Chairman, maybe Steve could explain to us how he intends to operate. It might help us decide what kind of numbers we put in.

CHAIRMAN VOLCKER. Well, how he intends to operate depends upon what we decide here.

MR. PARTEE. Bring in borrowings.

VICE CHAIRMAN SOLOMON. Basically, thinking back to the amendment we adopted at the last conference call, we talked about seeking to maintain existing reserve conditions and not increasing the restraint. That comes closest to what we are really doing, assuming that we continue with the $200 million borrowing assumption. If it were our judgment that we wanted to press toward some more easing, we should adopt something lower, say, $100 or $150 million. If we want to defer that easing, okay, we can defer it. But it seems to me that the operation is best summed up either in the first sentence of the paragraph the way it is now or we could go back to the language adopted in the amendment in the last conference call.

CHAIRMAN VOLCKER. Without numbers, you're saying?

VICE CHAIRMAN SOLOMON. I have a very mixed feeling about the numbers. I realize that we really can't drop the number for M2 and leave one in for M1 and M3 without confusing people; they'll think we are paying more attention to M1 and M3 than we are. So, I suppose we really either have to drop them all or leave them in. But we have to make clear that they will not govern and won't override what is basically an intention to continue with the existing degree of restraint or, if the aggregates slow down sufficiently, to ease. So, even though I realize that the word "contemplated" that has been put in achieves in a certain sense what I'm talking about, I'm not sure that "contemplated" is quite the right verb. Perhaps "were expected" or [unintelligible] "experienced"?

CHAIRMAN VOLCKER. Well, let me just put on the table an alternate proposal for the first sentence and at least explore what we want to do in substance. Suppose we just say "For the more immediate future, the Committee seeks to maintain the existing degree of reserve restraint expecting that that will be consistent with some slowing of the aggregates." If we want to go further and consider what would be very nice if it happens, "Lesser restraint would be acceptable in the context of appreciable slowing of growth in the aggregates." It leaves open the question of how we quantify this or whether we quantify it at all in the directive. I think what that says is that we don't want to tighten up in this next seven-week period as we see it now and we don't want to ease up unless the aggregates turn in a favorable direction. I would make that view fairly explicit. We can put in the numbers or not put in the numbers, I guess.

MR. PARTEE. What was the alternative you suggested? I understood the first thing and then you suggested something else that I didn't quite understand.

CHAIRMAN VOLCKER. The other thing is not an alternative; it just takes care of another possibility--a further [action] not for today. The first one says we will maintain the existing degree of reserve restraint; the second one says lesser restraint would be acceptable in the context of appreciable slowing of growth in the aggregates. That would not be for today but if the aggregates came in low in the next three or four weeks, we would ease.

MR. PARTEE. Your first sentence was "[existing degree of] reserve restraint expecting that this will..."

CHAIRMAN VOLCKER. Expecting; that's not promising, but expecting. Just to be clear, I think the second part would reflect a view that right now we don't want to tighten, which is implied by the existing language but is not quite as clear. If we're putting in both sentences, it says we don't want to tighten right now but we do contemplate easing if the aggregates are noticeably, or quite visibly, soft.

MR. ROBERTS. Is that soft relative to those earlier targets?

CHAIRMAN VOLCKER. Well, we have to decide whether to put in the numbers.

MR. PARTEE. What is soft?

CHAIRMAN VOLCKER. What is soft?

VICE CHAIRMAN SOLOMON. Well, M2 is bound to be slower.

MR. PARTEE. It'll drop from 30 percent to some lower number.

VICE CHAIRMAN SOLOMON. [Unintelligible] flows, yes.

MR. PARTEE. We certainly do want to be concerned about the possibility of a relapse. That was mentioned a couple of times yesterday, by Lyle and I think by you, Paul. And I agreed that it's conceivable that after this goes on for a month or two there could be a relapse in the economy. And we want to guard against that.

CHAIRMAN VOLCKER. I think the probabilities are that we are beginning a recovery. But I would not discount at all the [other] possibility; the atmosphere changed radically from the last time we met. If something so simple as car sales were to come in at between 5-1/2 to 6 million, the third consecutive month of decline, and suddenly production schedules are no longer increased in the automobile industry but decreased, and housing doesn't do much more in the next month, people's moods will change rather sharply, I suspect.

VICE CHAIRMAN SOLOMON. I would opt for the second sentence in addition to the first. I think it makes our intention clear. And then we leave open the degree of appreciable slowing and how we interpret that.

CHAIRMAN VOLCKER. Any other comments? There must be some comments. Mr. Guffey.

MR. GUFFEY. Well, I'm not sure I understand what you've done to this language. If we retain the language consistent with the current degree of restraint, that suggests that there isn't any flexibility for easing and achieving a discount rate decrease, for example, because we would provide reserves in such a way as to maintain the current interest rate levels unless we saw the aggregates coming in much, much slower or at least slower than now. That seems to me in the period ahead to be somewhat unlikely to any appreciable extent. I come out on the side of wanting to ensure recovery and thus, although [a discount rate action] is the Board's prerogative, wanting to see some additional downward movement in short-term rates to ensure that.

CHAIRMAN VOLCKER. All right, look: I think the issue should be clear. The alternative language that I propose says, I think, what you said it says. It says that we will maintain the existing degree of restraint unless the aggregates come in lower in some sense than we now expect. And that doesn't give room, probably, for a discount rate cut to the extent that that's [not] consistent. If I understand you correctly, you're saying this is a little tighter than you would like to see it.

MR. GUFFEY. Yes, indeed it is. I'd like to see language that would permit us, without regard to what the aggregates do, in some period ahead when a window comes open again to move rates to a somewhat lower level, whether it be 50 basis points--. It doesn't sound like much, but it has a psychological impact.

CHAIRMAN VOLCKER. You say regardless of what the aggregates do. You are in effect saying, if I understand you correctly, that what we ought to say in this first sentence is that we will ease reserve pressures a bit right now.

VICE CHAIRMAN SOLOMON. Or leave open the possibility.

MR. GUFFEY. Leave open the possibility; that's correct.

CHAIRMAN VOLCKER. Leave it open on the basis of what criteria? How does it differ from doing it--

MR. PARTEE. Well, we've left it open in Paul's language--that is, if we get weak aggregates.

CHAIRMAN VOLCKER. If we get weak aggregates, it is left open, but I think really what Roger is saying is do it now.

MR. PARTEE. I would want to communicate my position as not agreeing with that.

MR. GUFFEY. It seems the only thing that we can control at the moment is interest rates. Our biggest objective, as far as I'm concerned, is to ensure a recovery. And if we're all hung up on waiting for the aggregates to show us some diminution in their growth, then we've given up the only thing we can do to aid the economy.

CHAIRMAN VOLCKER. Well, that's a clear point of view.

VICE CHAIRMAN SOLOMON. Then the implication, Roger, is that you wouldn't put in numbers.

MR. GUFFEY. I think that's correct. And I'd maybe not put any language in that suggests that we'll continue this restraint until we see the aggregates growing at some lower rate, because that also would--

CHAIRMAN VOLCKER. Well, yes, I think you're forced to that. Just to be clear: I'm not arguing for or against it at this point. I think you have to put in some language that says we would seek to reduce--or I suppose you could live with this language if the discount rate is reduced, which isn't your decision.

MR. BLACK. [Unintelligible] true, but it's--

CHAIRMAN VOLCKER. Well, I think technically in the first sentence or two it could be maintain the reserve restraint but we'd do it with a lower discount rate. We would just go ahead and reduce the discount rate on some bright day. I think that would satisfy Roger's position, as I understand it.

MR. GUFFEY. Yes, I think that's right.

MR. WALLICH. I think it would take a real collapse of the growth rate of the aggregates to justify reducing interest rates under present conditions. That could happen; we shouldn't preclude it. But if the aggregates remain half-way strong and the economy expands moderately, I don't think that's the time to reduce interest rates.

VICE CHAIRMAN SOLOMON. I wouldn't go quite as far as Roger, myself. But what we might do is to say that lesser restraint would be appropriate if justified by monetary, credit, and other conditions.

CHAIRMAN VOLCKER. In fact, what we could say is that lesser restraint would be acceptable in the context of appreciable slowing in the growth of the aggregates or signs of more business weakness, or words to that effect.

VICE CHAIRMAN SOLOMON. I don't think we have to be that explicitly honest. All we're trying to do is not lock ourselves in or not close the door to the possibility that we might want to cut rates in some way or other even if the monetary aggregates were not appreciably slowing.

MR. GUFFEY. I would go one step further and suggest that we do want to cut the rates without regard to the aggregates because we have no control over those. Our focus should be on the economy and the recovery. I, at least, would have cut the discount rate two to three weeks ago. But the Board didn't.

VICE CHAIRMAN SOLOMON. The only thing I disagree with here is that I think we can't make too sharp a break. If we get too explicit in disregarding the monetary aggregates, I think it's going to cause adverse market reactions.

MR. GUFFEY. Well, I understand that point.

VICE CHAIRMAN SOLOMON. And, therefore, I think we ought to be a little more generalized in our language.

MR. GRAMLEY. I certainly agree with Roger's objective that we want to ensure a recovery. But I would argue that 50 basis points on short-term interest rates is not going to do the job. If we don't have interest rates low enough now to provide reasonable assurance of a recovery, then let's forget about 50 basis points on short-term interest rates and knock them down 200 basis points; I would agree with trying to go to a 50 basis point reduction only if that were a first step in a substantial further easing of interest rates. And frankly, I don't think that's necessary. The best thing we can do now is to provide some assurance that interest rates are not going to rocket upward. To provide a signal that we're going to knock them down now and then maybe knock them up again a week from now is going to shake markets much worse than leaving them where they are.

MR. BOEHNE. I have a lot of sympathy for what Roger is saying. I think the recovery is at a very fragile point. I don't think it's a fact yet, though we probably will have one. But expectations about what is going to happen are very important. And while there may be some risks of a perverse reaction in long-term bond markets, I think the business community needs a bit of assurance, a ray of hope, a signal, that interest rates certainly are not going to go higher. A little tilt downward at this point, including a discount rate [cut], would provide that signal. I don't think that necessarily means a commitment to go 200 basis points further. This recovery is at a very critical stage in terms of psychology in the business community, and the consumer community needs a little psychological lift. I think a tilt toward ease would serve that need very nicely.

CHAIRMAN VOLCKER. Let me put the question more modestly than that, without disregarding that question. Do we want, in effect, to foreclose a tightening in the coming weeks?

SEVERAL. Yes.

MR. PARTEE. For the next seven weeks, yes, I would.

CHAIRMAN VOLCKER. Is that the general feeling? If we know that much, we know quite a lot. If we want to do that, I'm inclined to think some variant of this alternative language I suggested, which says that fairly plainly, is probably right. That leaves open the question of whether we want to go further, but it says that much at the minimum. So, if I judge you correctly, that's agreed. Now we have this Roger Guffey-Ed Boehne kind of approach. Let's have more discussion.

MR. ROBERTS. I think that's just dead wrong, Mr. Chairman, because if we just control interest rates without consideration of the aggregates, the markets will take over in terms of expectations--I think it's already happening in the long market--and raise interest rates and that will be self-defeating and abort the recovery. We'd get exactly the reverse of what we want. The Board could lower the discount rate to zero, but if it has nothing to do with market rates, it doesn't mean anything.

MR. PARTEE. Without being quite that strong, I would remind you that we just had a chart show that gave us a reasonably respectable performance for the economy. I believe it was said that almost everybody here had [projected] growth rates somewhat above what the chart show indicated. January certainly is a strong month. It doesn't seem to me obvious at all that rates need to be lower to bring on a recovery. It may be that they will have to be lower but it doesn't seem obvious that they have to be. In the meantime, I agree with Ted that the market is becoming pretty apprehensive about these aggregates. And for us just to abandon them altogether I think will be certainly a featured comment in the market and could give a counterproductive result.

CHAIRMAN VOLCKER. I doubt it, but I'm confused. Just now I thought I didn't hear any objection--I just heard one, Mr. Roberts--on not tightening in this period.

MR. FORD. Well, I disagree with that. But I think you're right that the consensus is there. I thought you were asking "Is that the consensus?" And I think it is. But I personally disagree with it because I think we face the possibility of a very vigorous [economy]. Suppose these events continue and all these things--the real things that we lack such as housing starts and auto sales--start to take off coupled with all the aggregates, however defined, continuing to grow at scary rates. Then what would you do?

MR. GUFFEY. But we're only talking about between now and the end of March.

MR. FORD. That's quite a critical period. At the risk of embarrassing John, who may want to refute what I'm going to say, he was just showing me some research that he likes, which seems to indicate that the traditional problem the Fed has faced in the past is overstaying ease because we're always talking about what is happening in the economy today when the decisions we're making will impact with a lag--in the summer, the fall, and the end of the year. So, I don't agree with the consensus, but I think you correctly identified it.

CHAIRMAN VOLCKER. Let me make sure I correctly identified it. Let me have a show of hands of all those who as we sit here right now making the best judgment we can--we're not talking about [forever] because if something radically different happens we can always have another meeting--don't want to put in an automatic tightening. Well, I guess it is the consensus; let's stop talking about that aspect. I understand there may be some opposition to that.

MR. FORD. That's why I didn't bring it up.

MR. BALLES. Just to make my own point clear, in response to Bill's comments: I agree that that has been the strategic mistake we've made in the past, but I don't agree that we have already overstayed ease. I think we need a little more ease; that's where our judgments differ.

CHAIRMAN VOLCKER. All right. Barring another meeting and reconsideration in the event things change from the way people now see them, it looks like we're not going to tighten on reserves. So, presumably we say that. Now we still have the question: What do we say beyond that, if anything? We can just say that.

MR. BALLES. Mr. Chairman, I'd be worried about not putting in the aggregates at all, although in some ways it's tempting not to do so. But in not putting in any short-term targets it seems to me the discontinuity between what we're saying for the year as a whole and what we would say for the two months ahead would just be far too great. And I suspect the market would be very concerned, upset, and worried, speculating about what we were really up to unless in some loose way at least we continue to pay some attention to growth of the aggregates.

CHAIRMAN VOLCKER. We've got to get to that. Let me just see whether we can get to that faster if I am a little more explicit and say I interpret the consensus that was just stated as being basically the first alternative sentence that I proposed: "For the more immediate future, the Committee seeks to maintain the existing degree of restraint, expecting that would be consistent with some slowing of the aggregates."

MR. PARTEE. "Restraint in reserves."

CHAIRMAN VOLCKER. Yes, "restraint on reserve positions" or "reserve restraint." "Restraint on reserve positions" would probably be more accurate.

MR. PARTEE. I think that's better. Then "expecting that would be consistent with--

CHAIRMAN VOLCKER. --some slowing of the aggregates."

VICE CHAIRMAN SOLOMON. Well, we may find that the slowing is only in M2.

CHAIRMAN VOLCKER. That is right.

VICE CHAIRMAN SOLOMON. We may very well find the slowing is not in all the aggregates.

MR. MARTIN. But I think that language, Tony, would be well received in the market. Just the mention of [maintaining] restraint and the [expectation of a] slowing [in monetary growth] I think will be well received.

CHAIRMAN VOLCKER. Yes. Now, if we have a sentence of that sort, a question still remains in that it says nothing about any easing at all under any contingencies. The second sentence I suggested says we might do that if the aggregates are slow enough. We have had some expression of opinion that we ought to be doing that anyway.

VICE CHAIRMAN SOLOMON. Might.

MR. PARTEE. See if there's agreement on that.

CHAIRMAN VOLCKER. I just find it hard to see how to write this unless we say we want to do it. I don't know what other criteria--

VICE CHAIRMAN SOLOMON. The only other way of doing it is something like I suggested earlier: that some easing might be acceptable or appropriate in the light of monetary, credit, and economic conditions. So, we would be leaving open what will trigger that and yet we would not be ignoring the monetary aggregates.

MS. HORN. Mr. Chairman, it seems as we sit here today that the obvious thing that would create the window to allow for more easing would be a substantial slowing in the aggregates. So, for that reason, I support that wording. If something unusual were to happen in the next two months, then in fact a move on the discount rate could [be taken] into consideration in this period. But as we sit here today it seems to me that a slowing in the aggregates that would permit--

CHAIRMAN VOLCKER. Let me give you two alternatives. I think the second sentence as I gave it to you does what you want to do.

MS. HORN. That's right.

CHAIRMAN VOLCKER. "Lesser restraint would be acceptable in the context of appreciable slowing of growth in the aggregates." We could just leave it there or add something after that, such as "in the context of appreciable slowing of growth in the aggregates, or further evidence of low velocity, or further evidence of unusual demands for liquidity, or evidence of unexpected weakness in the economy." We could put in any of those things.

MR. BLACK. I'm with Karen, Mr. Chairman.

MS. TEETERS. I would like to add "unexpected weakness in the economy" because it could be that the January numbers are a fluke. I think that's what we're basically aiming at anyway: to restart an economic recovery. And we need a window to do it with, if it turns out that way.

MR. GUFFEY. That doesn't really satisfy the objective that I have because we would have to wait for this evidence to come forth. I agree with Lyle that 50 basis points isn't going to make a lot of difference except for the psychological impact that that 50 basis points may have in the market. And we need it now, not at the end of March.

MR. MARTIN. It could have the same psychological impact we had the last time we made that move.

MR. GUFFEY. That's a risk. I'm just saying the risk is on the up side.

MR. BOEHNE. The last time it was done, it was done before the funds rate was dropped. I think we have to ease the funds rate down to around 8 percent before a discount rate cut.

MR. GUFFEY. And we can do that by our borrowing level.

MR. FORD. How can we do that? We already have it down to $200 million.

MR. GUFFEY. Go to less than $200 million.

MR. FORD. Make it a minus?

CHAIRMAN VOLCKER. Let me approach this in baby steps. Given the consensus we already have on the first sentence, would members of that consensus object to the first part of the second sentence? That part, in other words, is that we ease if we were to get further appreciable weakening in the aggregates.

MS. TEETERS. What do you mean by appreciable?

CHAIRMAN VOLCKER. Well, we'll get to that later.

MR. PARTEE. That's a word we've used--appreciable.

CHAIRMAN VOLCKER. Well, it's a word I have here at the moment anyway.

VICE CHAIRMAN SOLOMON. Which is more or less--substantial or appreciable?

CHAIRMAN VOLCKER. We will get to the discussion of what the numbers are and whether to put them in here in a minute. Is the sense of that agreeable?

MR. ROBERTS. Do you mean about weakness in the aggregates or unusual liquidity?

CHAIRMAN VOLCKER. I'm just talking purely about weakness in the aggregates now. I'm going to get to the other question next, but I'm just asking: Is going that far desirable?

MR. WALLICH. If we can find language to define the aggregates.

CHAIRMAN VOLCKER. All right. So, tentatively, we go that far. Now we take the next step. Do we put an "or" in there which may be "high liquidity," "low velocity," or "unexpected weakness in the economy"? How many want that additional step? We're now getting close.

MR. GRAMLEY. If after four or five weeks' evidence on the state of the economy or the monetary aggregates they are too fast instead of too slow and we decide we ought to change our policy, we're making decisions based on last week's numbers, not on a well-reasoned view of where the economy is going to go. So, I would stop with the slow growth of the monetary aggregates.

MR. PARTEE. I just can't recall a directive that had a reference to the economy directly in it. Steve, do you remember any? Peter?

MR. AXILROD. I can't in the operating paragraph.

MR. PARTEE. [I can't recall] in the operating paragraph where weakness in the economy would bring a change in policy.

MR. AXILROD. We've had weakness in bank credit.

CHAIRMAN VOLCKER. We never did anything so sensible as that.

MR. PARTEE. I must say the velocity reference strikes me as ludicrous because we can't really say what velocity is until more time passes.

VICE CHAIRMAN SOLOMON. Again, why can't we cover the same stuff in more general terms by saying "if monetary, credit, or economic conditions so justified."

MR. PARTEE. That just sounds so wide open.

MR. ROBERTS. Doesn't it just say that regardless of the movement of the aggregates, you're going to do what you want to do?

VICE CHAIRMAN SOLOMON. That's true also of these other formulations with liquidity or the weakness in the economy, etc. If there is a consensus for that, all I'm saying is that it ought to be worded more generally. I don't like the phrase "weakness in the economy."

MR. ROBERTS. It seems to me it's implicit. If we have an international crisis or liquidity crisis we're going to deal with it ad hoc.

MR. PARTEE. We certainly could always have a conference call.

CHAIRMAN VOLCKER. Let me just ask the voting members at this point, and I won't try to pin down the exact wording: Who wants to go beyond what we've just tentatively agreed to--that if the aggregates are weak enough we ease--and add another phrase referring to the economy or liquidity or something? Five. How many clearly do not want to add any other phrase? Just to make sure, we'll see how many mugwumps there are on that side. Five. Five to five and one person who didn't express an opinion apart from myself.

MR. FORD. In doing this, you're still limiting it to those in consensus with the whole thing, right?

CHAIRMAN VOLCKER. I guess that's right.

MR. PARTEE. But for somebody who is voting he asked for a vote on whether you wanted that phrase in or not.

CHAIRMAN VOLCKER. Well, I asked originally for those who are [members of the consensus].

MR. PARTEE. Oh, I see, Paul.

MR. FORD(?). Well, I'll go with the five if you need another vote. I [don't] know who the other one is. Oh, it's you. I'll go with the five who are concerned about easing for too long a period. Whichever direction that five is, that's mine. There you have it.

CHAIRMAN VOLCKER. We're obviously rather evenly split on that point.

VICE CHAIRMAN SOLOMON. I'm not sure, if I may say so, that we're really achieving what Roger intended at all.

MR. GUFFEY. No.

CHAIRMAN VOLCKER. We're not.

MR. PARTEE. I'm actively opposed to it.

VICE CHAIRMAN SOLOMON. Even with the five who have expressed some support for these other conditions--. I'm going to retract my view on this. The more I think about it, we can always have another meeting if there is a problem, and if we go further than saying that there will be less restraint if the monetary aggregates slow down appreciably, then without achieving very much on the other side we may be inviting some risk of a market reaction.

MR. MARTIN. I agree.

VICE CHAIRMAN SOLOMON. I think I'll reverse my vote.

MR. MARTIN. We appreciate your vote.

MR. WALLICH. If the issue is posed "Do we look at the economy or do we not?" we have to say we look at the economy and not just at these aggregates. So, that's why when that issue comes up I can't vote any other way.

MR. PARTEE. But not in the operating instructions to the Desk.

CHAIRMAN VOLCKER. Well, I'm not sure it adds a lot to include it, knowing we can always meet again. I will tentatively leave it off. Where we are is with the first sentence as I gave it to you and the second sentence with the aggregates in there and nothing else. That leaves us with the question of how and whether we quantify this in the directive or how and whether we quantify it outside the directive in explicit words. I think we can leave the numbers out of the directive, but it's a matter of choice. I don't know what numbers to put in here at this point with these very preliminary new numbers we got. We don't know whether they are going to show a different [M2] over the quarter but they show it lower in January and at this point higher in February, which changes the pattern anyway.

MR. GRAMLEY. I appreciate the difficulties of putting in any numbers at all given the prevailing uncertainties. But to put out an operating paragraph which says, in effect, that we have some numbers and we're going to act in accordance with them but we're not going to tell you what they are, doesn't seem like a reasonable way to proceed.

CHAIRMAN VOLCKER. We don't tell them until after the period is over anyway.

MS. TEETERS. I'm not sure, Lyle, that we even have any numbers.

MR. GRAMLEY. Then we ought to use different language.

MR. PARTEE. Well, it says we expect [monetary growth] to be lower. If it's appreciably lower, we might ease some.

MR. WALLICH. I would not put numbers in here because it's so uncertain, but I would refer to the longer-term ranges and say if the actual numbers fall significantly below most of those and we have a collapse in the aggregates then, yes, [we would ease]. But if they are just more or less in the ballpark, I would want easing precluded.

VICE CHAIRMAN SOLOMON. We're expecting a minimum growth of around 15 percent in M2.

MR. PARTEE. Yes, but you can't even do the M2 in relation to the longer term because we're establishing the base for the longer-term in February and March.

CHAIRMAN VOLCKER. One thing we could do is make that [relative to the] longer term, if it weren't for the distortion of M2.

MR. PARTEE. We could do that; it makes sense.

VICE CHAIRMAN SOLOMON. Yes, but it doesn't make sense with M2, which is the key aggregate we're looking at. And even the 15 percent may turn out to be an underestimate in view of the way February [seems to have] started off.

MR. RICE. Is the problem with indicating numbers that M2 is too high and you don't want to mention it? I don't think that's a good enough reason.

CHAIRMAN VOLCKER. Well, the trouble is that we haven't the vaguest idea, I guess, what M2 is going to be. It depends upon how fast these MMDAs continue their rise during--

MS. TEETERS. If we take the attitude that we don't want any increased restraint in the period immediately ahead and have interest rates go up, it seems to me that the real decision is on the level of borrowing because we don't know where the growth is going to go or what M2 is going to do. Now, whether we want to open that up in the directive, I don't know.

CHAIRMAN VOLCKER. I think maintaining the existing degree of restraint means that we keep the borrowings where they are now.

MR. PARTEE. It's a question of under what conditions would we ease.

SPEAKER(?). I'm not sure.

MR. MORRIS. That could be specified in terms of M3, I think, but I don't know about M1 or M2 for this period.

MS. TEETERS. But M3 is being affected by the growth rate in M2 also.

MR. MORRIS. But relatively little. We could pick--

VICE CHAIRMAN SOLOMON. We don't want to spell out a target for M3. That would be pretty--

CHAIRMAN VOLCKER. That's the difficulty we're in.

MR. WALLICH. If we refer to the totality of our many targets in a broad way so that M2 can be seen as being exempted if necessary, one gets a sense of what I think we ought to aim at amongst the aggregates.

CHAIRMAN VOLCKER. There's a great sense that these aggregates are rising rapidly. M1 I think is. For M2 and M3 it is not at all clear. There were very low numbers in December for both of those aggregates. They were very low. And liquidity was practically nothing in December. I am just wondering whether we can get some language along the lines that Henry has suggested here. But M2 is a real problem. "Lesser restraint would be acceptable in the context of appreciable slowing in the growth of the aggregates to or below the paths implied by the longer-term ranges" or something like that.

VICE CHAIRMAN SOLOMON. If I were reading that literally--

MR. MORRIS. I think that's too [unintelligible]. What we're saying is that we're not going to allow them, even for a short period, to fall below the long-term ranges.

CHAIRMAN VOLCKER. No, no. We can't prevent them from falling below. We'd be delighted if they fell below. What we'd say is that we would ease in those circumstances.

VICE CHAIRMAN SOLOMON. Yes, but some people when they see our long-term targets would read that as meaning that unless M2 gets all the way down to 7 to 10 percent or something like that, we're not going to be easing.

CHAIRMAN VOLCKER. Well, I'm not so sure. But we can put in a sentence on M2 to describe that. If we literally took this language "to or below the paths [implied by the] long-term ranges," we would say in the policy record that we don't expect M2 to revert immediately, given all these things, to whatever we said up above--7 to 10 percent. We'd say we know that M2 growth is going to be high for a while.

VICE CHAIRMAN SOLOMON. Yes, we'd have to say that.

MR. MORRIS. I don't see how we can quantify this without causing more trouble than we have already.

CHAIRMAN VOLCKER. We could say, "taking account of the distortion of new accounts." I'm not so sure that's so bad.

MR. PARTEE. That does take care of it, technically. That would take care of it.

CHAIRMAN VOLCKER. "Lesser restraint would be acceptable in the context of appreciable slowing of growth in the aggregates to or below the paths implied by the long-term ranges, taking account of the distortions related to the introduction of new accounts."

MR. MORRIS. That sounds good.

MR. FORD. What you really mean, don't you, is assuming that the real economy is going down at that time. It's possible that the nicest thing that could happen would be that that would happen while the economy is still going [up], meaning that velocity has turned around. And would you still want it in there?

CHAIRMAN VOLCKER. Well, all that it says is lesser restraint would be acceptable. I can imagine circumstances in which we wouldn't want to do it because the economy looks so strong. I agree with that. But I don't think this binds us to ease if suddenly the economy were taking off and these aggregates came in low for a few weeks.

MR. ROBERTS. Don't these sentences in lines 82 to 85 [of the draft directive] take care of the qualification and make it unnecessary?

CHAIRMAN VOLCKER. I was just looking at that. If we took the sentence the way it's written here tentatively, I'm not sure we'd need that. We don't need any of that bracketed material I see.

MR. ROBERTS. We don't need them both; that's for sure.

MR. PARTEE. Yes, I think this is a substitute for that proviso that we were talking about. I think the way you put it is acceptable, Paul.

CHAIRMAN VOLCKER. Is that all right?

MR. BALLES. Could you please read that again, sir?

CHAIRMAN VOLCKER. I'll read the whole thing to you. "For the more immediate future, the Committee seeks to maintain the existing degree of restraint on reserve positions, expecting that will be consistent with some slowing in the aggregates. Lesser restraint would be acceptable in the context of appreciable slowing of growth in the aggregates to or below the paths implied by the long-term ranges, taking account of the distortions related to the introduction of new accounts."

VICE CHAIRMAN SOLOMON. Do you want to add at the end of the first sentence "slowing from their recent pace"?

MR. AXILROD. That was meant to refer to December-to-January.

CHAIRMAN VOLCKER. The trouble with "some slowing in the aggregates" is that when you look at all this through a microscope that's certainly true of M1, but it's not true of M2 or M3. M2 adjusted and M3 raw, if you take December and January together for instance, are already low.

VICE CHAIRMAN SOLOMON. But some people might not understand what "slowing in the aggregates" means.

CHAIRMAN VOLCKER. Well, I'm wondering whether I know what it means now that I look at it closely. Why do we need that part?

MR. AXILROD. That only refers to January, because of the problem you raised. So, if that isn't clear--

CHAIRMAN VOLCKER. We would have to put in January. It's just based upon one month there? As I look at it now, I wonder whether we need that. "For the more immediate future the Committee seeks to maintain the existing degree of restraint on reserve positions. Lesser restraint would be acceptable in the context of appreciable slowing of growth in the aggregates."

MR. BLACK. Mr. Chairman, it seems to me that we have to compare that slower growth to something. If we don't, somebody might conceivably think that we're referring to the last part of '82.

CHAIRMAN VOLCKER. But I think the second sentence conveys what appreciable slowing is: It's to or below the paths implied by the long-term ranges.

MR. BLACK. Oh, I thought you took that out.

CHAIRMAN VOLCKER. No, I'm taking it out of the first sentence for the reason that you suggest. Now that I look at it, we're not really looking for any slowing, except in M1, from December-January. We are obviously looking for slowing in M2. Because of that, I guess that doesn't add anything. So let me read the two sentences over again at this point. "For the more immediate future, the Committee seeks to maintain the existing degree of restraint on reserve positions. Lesser restraint would be acceptable in the context of appreciable slowing of growth in the aggregates..." That may be ambiguous in itself, but once we add "to or below the paths implied by the long-term ranges," it tells someone what we're talking about, it seems to me. Then "taking account of the distortions related to the introduction of new accounts." Maybe we should say there "particularly in M2."

MR. AXILROD. Well, as to the strength of M1, Mr. Chairman, I'm not sure how much is Super NOWs at the moment. I don't have any added data. It might be desirable to leave it more general.

CHAIRMAN VOLCKER. All right, I won't add that. Does that catch the flavor of what we're talking about?

SPEAKER(?). Yes.

CHAIRMAN VOLCKER. Quite explicitly we're saying we'd be very reluctant to tighten during these next seven weeks.

MR. PARTEE. As a matter of fact, it says we won't tighten.

CHAIRMAN VOLCKER. I think as it stands it says we won't; that's right.

MS. TEETERS. And if we have an opportunity, we'll ease.

CHAIRMAN VOLCKER. Right. And not tightening means something around $200 million [in borrowing].

MR. BLACK. Does it leave open the possibility, Mr. Chairman, that if there is an unusual strengthening in the aggregates, we would consult?

CHAIRMAN VOLCKER. It leaves open the possibility of consulting just as, if the economy weakens or something, we'd consult on the other side. But clearly it says, barring any further decisions, we will not tighten. Then I guess we leave out all the bracketed material. And then we have to fill in the blanks presumably in that last sentence. We currently have 6 to 10 percent. Is that where we want to leave it? I'm talking about the last sentence on the federal funds rate.

VICE CHAIRMAN SOLOMON. Oh, I see. It's hard to move it down, I think. It's about 8-1/2 percent. If we made it 6 to 9 percent, it shows that we [unintelligible] problems or we could have 7 to 9 percent in an attempt to show that. It's consistent with the first sentence to move it down to 6 to 9 percent.

MR. PARTEE. Yes it is.

CHAIRMAN VOLCKER. It might be consistent with the first sentence to move it to 7 to 9 percent or 7-1/2 to 9 percent or something.

MR. GRAMLEY. Or 8-3/8 to 8-5/8 percent!

CHAIRMAN VOLCKER. Well, I don't think that.

VICE CHAIRMAN SOLOMON. I don't care whether we leave it alone.

CHAIRMAN VOLCKER. Well, unless somebody has a strong feeling, we might as well just leave it where it was. Are there any other comments? I guess it's clear in everybody's mind what we mean to convey by this. In fact it's pretty plain, I think, in the main.

MR. PARTEE. It is.

CHAIRMAN VOLCKER. Shall I read it again just to make sure? "For the more immediate future, the Committee seeks to maintain the existing degree of restraint on reserve positions. Lesser restraint would be acceptable in the context of appreciable slowing of growth in the aggregates to or below the paths implied by the long-term ranges, taking account of the distortions related to the introduction of new accounts. The Chairman may call for Committee consultation if it appears...federal funds rate...of 6 to 10 percent."

MR. GRAMLEY. Is the word "introduction" the right word in that phrase "introduction of new accounts"? Maybe it is.

CHAIRMAN VOLCKER. This is all part of the introductory period.

MR. PARTEE. When you refer to "aggregates" I would make that "monetary aggregates."

CHAIRMAN VOLCKER. "Monetary and credit aggregates"?

MR. AXILROD. Well, the credit aggregates aren't slowing, Mr. Chairman.

CHAIRMAN VOLCKER. Leave them out. Okay. We understand. We can vote.

MR. BERNARD.

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

CHAIRMAN VOLCKER. I guess we have nothing else to do. Is that right, Mr. Secretary? [Secretary's note: Mr. Bernard replied in a whisper to the Chairman.] Oh my gosh, I forgot to do that earlier! We have our Managers down there [with their transactions] unconfirmed.

MR. CROSS. We've been waiting patiently for two days.

CHAIRMAN VOLCKER. Mr. Sternlight, proceed if possible. Somehow we made our decision before we heard from our Managers!

MR. STERNLIGHT. Shall I proceed, then?

CHAIRMAN VOLCKER. Proceed, please. You may say something so radical we may want to reverse all our decisions.

MR. BLACK. We have to promise we're not going to!

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

CHAIRMAN VOLCKER. Comments or questions?

MR. GUFFEY. I just have a question for Peter: How will you interpret the language we've just adopted here with respect to the current level of restraint when borrowings have been at $110 to $150 million in the last two weeks? Are we talking about a $200 million borrowing level or are we talking about a $150 million borrowing level? Maybe it's a question to you, Mr. Chairman.

MR. STERNLIGHT. Well, $200 million is what we were aiming for. As I mentioned, the last two full weeks have come out at about $150 million. This week so far it's at about $110 million, although I wouldn't be surprised if it got up a little higher than that with Wednesday's borrowing.

CHAIRMAN VOLCKER. I haven't been following this very closely, but I assumed we were aiming at around $200 million.

MR. AXILROD. That's right.

MR. STERNLIGHT. We were aiming [for that].

MR. AXILROD. Any time we've constructed a reserve path it has been with $200 million of borrowing [consistently].

MR. GUFFEY. But the current level of restraint is something less than that, as evidenced by the borrowing level.

MR. AXILROD. I would say not, President Guffey. The funds rate has averaged between 8-1/4 and 8-1/2 percent steadily, which is what one would expect aiming at $200 million of borrowing. There have been variations around it, but they haven't been accompanied by much variation in the overall constellation of money markets.

CHAIRMAN VOLCKER. And they're really aiming for reserve provision consistent with $200 million of borrowing if their excess reserve assumptions come out correctly. And it's the excess reserve assumption that has been a bit off in recent weeks. You can't expect to hit the borrowing on the nose because of that variation and because of other reasons. But if the excess reserves calculation itself has been off what they had been expecting, there may have been errors in the actual calculation of the factors too. I don't know how they contributed, but--

MR. AXILROD. What I meant, Mr. Chairman, is that unless told differently we would construct a nonborrowed path based on the required reserves that are evident that week, assuming that borrowing will satisfy $200 million of the total of excess and required. And that's how it will be constructed until we're told differently.

MR. CORRIGAN. Peter, do you have a sense from looking at the last six weeks or so what the underlying growth in reserves is--in other words, extracting from the reserve impact of all the shifts in deposits and so on?

MR. STERNLIGHT. I'm not sure I'd know how to answer that because the shifts have had a big impact, most recently slowing the growth of reserves quite a bit. With the shift out of the reservable big time deposits into the MMDAs that are reservable and extracting from that, I'd say maybe you're looking for the underlying M2 growth or something, which--

MR. CORRIGAN. A rough estimate.

MR. STERNLIGHT. I think the staff has been estimating fairly moderate growth--in the 8 percent area.

MR. AXILROD. It depends, as Peter said, on what you thought anything would have been doing otherwise. Our rough estimate was something like 10 percentage points in January. It had been reduced by that amount because of the CD drop--

MR. CORRIGAN. Right.

MR. AXILROD. --and the 1 percent out of the saving deposits. But that has some rough assumption of what it would be otherwise.

MR. PARTEE. The actual figures on reserves are showing very little expansion.

MR. AXILROD. Yes, largely because of this sharp drop in required reserves because of shifting into the--

CHAIRMAN VOLCKER. Actual reserves figures are showing a decline in January, as I remember.

MR. AXILROD. I'd have to look it up, but I think it's February where we are going to have a decline.

CHAIRMAN VOLCKER. Any other questions?

MR. BALLES. Yes. Just so we'll all know, Mr. Chairman, has the date of your testimony been set yet?

CHAIRMAN VOLCKER. February 16th.

MR. AXILROD. We have a total reserve growth of 1-1/2 percent roughly at this point for January. A sharp drop is projected for February.

CHAIRMAN VOLCKER. If there are no other questions, Mr. Cross.

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

CHAIRMAN VOLCKER. Before we proceed, I am reminded that I forgot to request ratification of the domestic transactions.

MS. TEETERS. So moved.

VICE CHAIRMAN SOLOMON. Second.

CHAIRMAN VOLCKER. Without objection the domestic actions are completed. Now we will go to the international [intermeeting transactions].

MS. TEETERS. So moved.

CHAIRMAN VOLCKER. And we have to ratify anything we have to do on those proposed [swap] renewals if they prove necessary, as they are likely to be.

VICE CHAIRMAN SOLOMON. So moved.

MS. TEETERS. Second.

CHAIRMAN VOLCKER. No objection. We will do that. I might say that the Mexican commercial bank loan has been delayed beyond all conscience I guess, partly by the hassling over the precise terms of the loan agreement, which runs to 175 pages. There are some substantive questions and the banks are trying to get all they can out of this agreement. Of the $5 billion of commitments that they were seeking, the last I heard was that they had $4.8 billion approximately, which is close enough, I think, to close the gap. It may not be closed in the ordinary course but somehow it'll be closed. I don't think that's essentially what is holding it up. It's getting the agreement on the loan agreement. It's running more than a month after it should have been done and I [unintelligible]. The remaining repayment on the swap has to be out of that money, which is why that has been delayed.

MR. FORD. Any doubt that it will jell?

CHAIRMAN VOLCKER. Well, there's always a doubt when it's delayed and, of course, the new uncertainty put in the situation is what happens to Mexico if there is a real oil price decrease. That is a question to which I do not know an answer. If it's small, I guess we can paper it over a little more and get a little more money someplace. If it's large, I don't know what we would do.

VICE CHAIRMAN SOLOMON. In the view of the key people who are negotiating all this, of the four remaining substantive areas being negotiated there is only one really difficult one. And that is the question of what foreign exchange assurances the central bank will give in regard to the ultimate repayment of what will be the rescheduled private debt, [unintelligible] debt. The other three are resolvable. I was surprised to find that the people who are running this operation feel that the $4.8 billion in commitments they have are solid even if there were, let's say, further erosion in oil prices. Even if there were further concerns, they seem to think that they can depend on that. In the meantime, they have agreed to try to speed up their discussions as much as possible. But the Mexicans also share some of the blame in not getting the rate [unintelligible] up there regarding this foreign exchange position.

MR. KEEHN. Tony, are they going after the other $200 million or are the participants about where they're going to end up?

VICE CHAIRMAN SOLOMON. I think that their formal posture has to be that they're going to continue pursuing this until they get full pari passu $5 billion. But I agree with Paul that there may be ways of handling this so that we can still go ahead and still appear to have gotten the full $5 billion while we're still striving to get it. We're probably not going to get very much more money but I think the leading banks would probably help make up a part of that $200 million debt. So, there are different ways of handling it.

CHAIRMAN VOLCKER. Carefully. I think the Open Market Committee meeting is over unless somebody else has anything. There are a couple of other things I want to mention. But we're finished with the meeting with the date set for the next meeting, [March 29th]. Let me say what is obvious. I see no excuse for any leaks whatsoever from this meeting. And I see no need for anybody to talk with anybody in the press between now and February 16th, period.

MR. FORD. Do you mean about monetary management?

CHAIRMAN VOLCKER. I'm looking at all parts of the room. I think you can just avoid any confusion by deferring any discussion with the press until a time not very far off, a week from now.

We have these [individual] GNP forecasts. I would hope you would get in any revisions that you want to make on those forecasts in the light of any additional information, including this meeting, by the close of business tomorrow so we can incorporate that in my report. I presume that we will pick out some central tendency, or mode, or something, in presenting those forecasts.

END OF MEETING