Meeting of the Federal Open Market Committee

October 2, 1984

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, October 2, 1984, at 9:30 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman
Mr. Boehne
Mr. Boykin
Mr. Corrigan
Mr. Gramley
Mrs. Horn
Mr. Martin
Mr. Partee
Mr. Rice
Ms. Seger
Mr. Wallich

Messrs. Black, Forrestal, and Keehn, Alternate Members of the Federal Open Market Committee

Messrs. Guffey, Morris, and Roberts, Presidents of the Federal Reserve Banks of Kansas City, Boston, and St. Louis, respectively

Mr. Axilrod, Staff Director and Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Kichline, Economist
Mr. Truman, Economist (International)

Messrs. Burns, J. Davis, R. Davis, Kohn, Lang, Lindsey, Siegman, and Stern, Associate Economists

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. Roberts, Assistant to the Chairman, Board of Governors
Mr. Gemmill, Staff Adviser, Division of International Finance, Board of Governors
Mrs. Low, Open Market Secretariat Assistant, Board of Governors

Mr. Griffith, First Vice President, Federal Reserve Bank of San Francisco

Messrs. T. Davis, Keran, Scheld, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of Kansas City, San Francisco, Chicago, and Atlanta, respectively

Messrs. Broaddus, Burger, Ms. Clarkin, and Mr. Fieleke, Vice Presidents, Federal Reserve Banks of Richmond, St. Louis, New York, and Boston, respectively

Transcript of Federal Open Market Committee Meeting of
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CHAIRMAN VOLCKER. We can start, if somebody wants to move the minutes.

MR. MARTIN. I move the minutes, Mr. Chairman.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection. Let's turn to foreign currency operations.

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

CHAIRMAN VOLCKER. Perhaps you could refresh my memory and that of others as to the nature of this informal limit.

MR. CROSS. We raised the total amount of this limit and the DM amount. The total [informal limit] is now $5-1/2 billion.

CHAIRMAN VOLCKER. What is the operative significance of this informal limit?

MR. CROSS. Well, it is an informal limit. We have a formal limit of $8 billion, which is recorded and registered as the decision of the FOMC and I imagine made public. This $5-1/2 billion is an informal limit, which has been operative for a number of years, under which we seek the FOMC's views about how much we would operate within our total authorized $8 billion. We now have an informal maximum of $5-1/2 billion for all currencies, with [limits of] $4 billion in deutschemarks, $1 billion in yen, and $500 million in other currencies.

CHAIRMAN VOLCKER. Suppose we were not having a Committee meeting and these limits were threatened to be exceeded?

MR. CROSS. I believe you have the authority--

VICE CHAIRMAN SOLOMON. No, there is an Executive Committee--a 3-person subcommittee.

MR. CROSS. The Foreign Currency Subcommittee could authorize it.

MR. GRAMLEY. What are your present holdings?

MR. CROSS. The present holding of DM is $3.9 billion equivalent. Our limit is $4 billion equivalent and I am requesting--

CHAIRMAN VOLCKER. If the mark increased in value, we would exceed the limit?

MR. CROSS. No. These are recorded on [the basis of] historical acquisition costs. We could never operate in this day and age if we were operating on the basis of market value.

MR. PARTEE. We haven't done much with this for a long time, I must say, and I am sure everybody's mind is very fuzzy on it--at least mine is. Why is it, Sam, that we take the interest in marks rather than converting it to dollars?

MR. CROSS. Well, if we converted it into dollars, that would be, in effect, an intervention operation.

MR. PARTEE. But it would be a very regularized small thing that would permit us to get [the interest earnings] back into our own currency.

MR. CROSS. It is not as though we have such massive amounts of these currencies that we need to worry about our balances being too high, it seems to me. As I say, the United States [holdings] as a whole are way below what they were even a couple of years ago.

MR. PARTEE. Well, that is true. It's not even as much as the Continental loan. Nevertheless, a lot of people might consider $4 billion in marks to be quite a holding, particularly when you recall that we got most of it at under 2.

MR. CROSS. Well, the total value of these at today's exchange rate would be less than $3.9 billion. So, I think we are talking about a very modest amount of currencies and it is in our interest to have some of these currencies available.

VICE CHAIRMAN SOLOMON. I assume you are not interested in driving the value of the dollar up any higher?

MR. PARTEE. I don't know what the periodic receipts are, but they certainly can't exceed $100 million. I guess I would have argued that it would not have had any appreciable effect on the dollar had we done this periodically when we get them as a convention. And I don't know why it is--

MR. CROSS. We get about $200 million per year.

VICE CHAIRMAN SOLOMON. I think that's true if you believe that there is a principle involved here, but I don't know what the principle is. You're assuming that all interest on foreign currencies should as a matter of routine be converted to dollars? Is that what you're saying?

MR. PARTEE. I don't know why it shouldn't be. I consider the home currency to be the dollar rather than the mark!

VICE CHAIRMAN SOLOMON. That still is a form of intervention, so I don't understand why you would want to do that unless you had an intervention objective in mind.

MR. PARTEE. Well, I don't remember the basis for doing it this way.

CHAIRMAN VOLCKER. Whether or not it's intervention seems to me semantic. The question is whether we feel comfortable or uncomfortable with the amount of currencies we hold. I personally feel that we hold an uncomfortably small amount.

MR. RICE. Mr. Chairman, it seems conceivable that we may need more than $500 million over the next year, so why not increase the informal limit by $1 billion instead of $500 million?

CHAIRMAN VOLCKER. I'm perfectly happy to.

MR. MARTIN. I certainly support that.

MR. CROSS. I would welcome an increase of $1 billion.

MR. MARTIN. Is there some significance that you didn't articulate to the $500 million?

MR. CROSS. No. It's just that the past couple of times when we raised it, we increased it by $500 million and I did not want to give the impression that there was anything very major involved. It seems to me it would be quite appropriate--and in fact it would be advisable--to increase it by $1 billion.

MR. MARTIN. The inevitability of gradualism! I'd go for a billion dollars. Operationally, I think it makes sense.

MR. PARTEE. Well, I really don't know why we have [an informal limit]. I would move to do away with it altogether. After all, at the rate at which interest is accumulating we will double our money every six or seven years anyhow.

CHAIRMAN VOLCKER. Not at German interest rates or [rates on] Swiss francs.

MR. MARTIN. Let's hope not.

CHAIRMAN VOLCKER. Well, do what you want to do, but it seems to me that this informal limit may be useful within the overall limit of $8 billion. It confuses me a bit as to what it is, but at the minimum it is some kind of Committee checkpoint. It is $5.5 billion presently. I don't think it does any harm and it forces the Committee to review this, though not very frequently. It hasn't been reviewed for however long it has been, but it seems to me it has at least a modest usefulness and I would think we probably would want to keep it. I have no problem with [an increase of] $1 billion. I think that's more appropriate, but that's because my bias is that we don't hold enough of these currencies anyway against the contingencies of an unknown world.

MR. GRAMLEY. Then we'd want to raise the informal maximum for all currencies to $6 billion from $5-1/2 billion too?

CHAIRMAN VOLCKER. Well, it would be $6-1/2 billion.

MR. CROSS. $6-1/2 billion and raise the total for all of them?

CHAIRMAN VOLCKER. Actually, the yen is within $400 million [of its limit]. It's not so far away but the amount is not very large either--not that it is very difficult to change these.

MR. CROSS. Another possibility, Mr. Chairman, if you wanted to consider it, would be to keep the informal limit on the total but to eliminate this difference between how much is in DM and how much is in yen, and how much is in Swiss francs and other currencies. That would provide a little more flexibility.

CHAIRMAN VOLCKER. Well, without taking that major step, I take it this is an understanding and not a formal [vote]. And I take it that what the understanding really means is that these are our foreign currency [limits] but in an emergency I can breach them. But the sense is that the Committee is thinking in terms of these [limits] and if they were breached I would come back to the Committee at some point and I would at least explain why they were breached. Limits of $5 billion [on DM], $1 billion [on yen] and $.5 billion [on other currencies] is the minimum change we're talking about. If there are no widespread objections to that, we will proceed.

We've had a very strange exchange market during this period, as Mr. Cross has described, and he rationalized as best he could why the dollar is so strong. It's not so clear why it's so strong against declining interest [rates], weaker economic activity, and several developments indicating an easier Federal Reserve policy, all of which in days of yore--like two months ago--would have sent the dollar down. They don't seem to have any effect right now.

MR. CROSS. I would certainly agree that there is no very clear-cut explanation. It is amazing how much the attitudes [have changed]; everybody seems to talk about what a good thing the dollar is to get into these days. One can listen to how they talk now and think back to how they talked in 1978 and 1979 when it was going the other way and the United States was [viewed as] hopeless as far as the future was concerned. It's hard to believe they are talking about the same country.

CHAIRMAN VOLCKER. There was very widespread and deep concern about this among European Finance Ministers and central bankers--really for the first time, so far as central bankers are concerned. Certainly the intensity [was great] at the time of the IMF meeting, which was right in the middle of this surge. Various proposals for coordinated intervention were explored and there was very considerable urging that we ease policy much more aggressively to deal with this problem. The intervention that Mr. Cross referred to was coordinated in a rather loose way. It was a general agreement among 4 or 5 central banks, anyway, that upward movements in the dollar would be resisted in our respective markets over the past week. The dollar did stay in a lower range, as Mr. Cross indicated, but when it went up decidedly we had really rather modest intervention. There weren't all that many strong movements in the New York market but there was [unintelligible] intervention on some scale abroad occasionally when the dollar was strong, and that was all agreed to last week.

MR. PARTEE. We intervened in a rising market? Is that right?

CHAIRMAN VOLCKER. In a rising market. The words you used, Mr. Cross, were "a pronounced rising market."

MR. PARTEE. We don't attempt to create disorderly conditions the way the Germans did.

VICE CHAIRMAN SOLOMON. They jumped on the declining dollar.

CHAIRMAN VOLCKER. We deliberately didn't do that. I think it may have been helpful that they did it, but I don't particularly want to be in the posture of doing it.

MR. PARTEE. I wouldn't want to be a party to it. I would like to have the opportunity to register myself against such an operation.

CHAIRMAN VOLCKER. Well, we haven't done it at this point and I have no present intention to do it. We weren't very aggressive, that's for sure. But we need to ratify the transactions if there are no other questions.

MR. MARTIN. Move ratification.

[SPEAKER(?). Second.]

CHAIRMAN VOLCKER. Mr. Sternlight.

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

MR. BLACK. Peter, do you think that it would work a little better if we used only adjustment borrowing for our borrowing targets and eliminated seasonal borrowing?

MR. STERNLIGHT. I don't know that it would. It could have some different effects. Our experience is that seasonal borrowing does seem to respond to interest rate pressures, and I think that's the logic for coupling it with adjustment borrowing. On the other side, it doesn't have the same pressure to repay quickly that adjustment borrowing has and that's the logic on the other side of it.

MR. BLACK. You'd come out on balance for leaving it?

MR. STERNLIGHT. I'd tend to leave it alone, I think.

MR. BLACK. In the recent period, adjustment borrowing would have given you a better idea of what the federal funds rate was going to do, wouldn't it?

MR. STERNLIGHT. Well, if we had done that in the recent period, I think it would have tended to push rates higher than they went because we had the seasonal component building up.

MR. BLACK. I was thinking you would have cut the adjustment [borrowing assumption].

MR. STERNLIGHT. If we make the suitable adjustments in the borrowing level, which work into the path, we could work with either of those. However, the Committee may not want to do that [kind of] short-run adjusting. I tend to think of the combined total as a better number to work with, but I think it can be argued either way.

MR. PARTEE. It is sensitive to interest rates? Is that right?

MR. STERNLIGHT. Adjustment borrowing?

MR. PARTEE. I mean the seasonal.

MR. STERNLIGHT. The seasonal, yes.

MR. BLACK. I would have thought that it was so much less sensitive that the other conceivably might work better. If you think the federal funds rate--

MR. AXILROD. President Black, we have done some empirical work, and it doesn't seem to show much difference between the two. And I think as Peter mentioned, in the jargon it is essentially an "intercept" problem. You would have a lower level of borrowing on average for whatever funds rate you would be thinking of. As far as the volatility in the relationship, day-to-day, between borrowing and the funds rate, I don't think it makes one iota of difference.

MR. CORRIGAN. Peter, do you think there still is a precautionary premium affecting the federal funds rate right now?

MR. STERNLIGHT. I'm hard put to say what there is right now because after that funds rate [unintelligible] did give some ground, and one could say that there has been evidence just in the last few days of some lessened reluctance to use the window. We've had several sizable banks come in early in the reserve period. On the other hand, the funds rate has been back toward the high side in this current week. It is averaging about 11.21 percent so far in this statement period, which suggests that maybe this is just statement-date pressure--that would be my guess as of the moment--and that there is some return toward normalcy underlying this. But I would have to see another several days before I could conclude that with greater conviction.

CHAIRMAN VOLCKER. Well, it is a very strange period. Every indicator ordinarily would be associated with lower interest rates: The money supply was very sluggish; every bit of business news, I think, came in on the lower side of market expectations; and there was growing evidence of lower reserve pressures. We were in the market every day and the market just didn't react in any consistent way. And now, after all this, the federal funds rate goes up where it was before, with fewer reserve pressures.

MR. PARTEE. We could very well be having that statement-date effect, couldn't we, Paul? As I recall, looking back, we've had that rather regularly now over the last couple of years.

CHAIRMAN VOLCKER. It's a funny statement-date effect, coming after the statement date.

VICE CHAIRMAN SOLOMON. We keep talking about the banks being reluctant to borrow, and many of the banks talk about the Fed having tightened its administration of the discount window. I've had that said to me time and time again even though I know that our discount officers deny that. But I don't know why there is such a strong impression of that around--or there was during this period of time. The fed funds rate was higher than what one would have expected.

CHAIRMAN VOLCKER. That was back during the summer when we had all that other stuff. What I don't understand is this last month. It's the same phenomenon in the exchange market. The same thing is keeping the exchange market higher. It's a refusal to believe that [the numbers are] right--that the economy is slowing and that the money supply has weakened. It has been [that way] in the last two weeks.

MR. CORRIGAN. It doesn't work for the exchange rate, but I keep coming away with the feeling that the only plausible explanation in terms of the domestic market is that perhaps way beneath the surface this precautionary [motive] is still quite operative. It's the only thing I can figure out.

VICE CHAIRMAN SOLOMON. But that doesn't explain why. You are talking about caution [by banks] about borrowing because they might get contaminated.

MR. CORRIGAN. No, not so much on borrowing but that there is just a much more conservative attitude on the part of medium and large size banks in terms on their whole approach to funding and money management, with some implication, obviously, for their willingness to borrow. But I don't know. It's the only thing that makes any sense to me.

MR. MARTIN. To those bankers who are aware of the wildness and the degeneration in the financial position of the thrift industry in their state and their region and their market area, that surely is a factor because it is degenerating rather rapidly.

VICE CHAIRMAN SOLOMON. But if that's the explanation, then we should be in the beginnings of a reversal of that because all the anecdotal reports as well as the reduction in the spread between CDs and Treasury bills show that there has been less anxiety in the banking system and in the markets generally in the last few days. In that case, if we were to continue, let's say, $750 million borrowing, we might end up with a much lower fed funds rate than one would expect at the present time.

MR. PARTEE. I think there is less anxiety about the banking system. I think what Pres was talking about is more anxiety by the bankers about their own situations.

MR. MARTIN. In fact, they are aware that dozens of the S&Ls in their districts are going to fail and fail with a great public splash. And they are aware, if they are operating nationally, that hundreds of them are going to fail. I can see that in the bankers' psychology.

VICE CHAIRMAN SOLOMON. Except that we have gotten reports in the last few days that show so much more relaxation on the part of bank management, particularly now that they feel that interest rates are not going to go up. All I'm saying is: If that's the explanation, then there are [unintelligible] conditions that will reverse that.

CHAIRMAN VOLCKER. There may be some developments in coming days that will increase the anxiety.

MR. MARTIN. Exactly. They will definitely increase their--

VICE CHAIRMAN SOLOMON. Another major bank has to show a big loss or something.

MR. MARTIN. I'm not talking about a bank. I'm talking about thrift institutions. Some of them are in your backyard, good sir.

CHAIRMAN VOLCKER. I'm talking about banks.

MR. MARTIN. All right.

CHAIRMAN VOLCKER. Just read the newspapers. A lot of this may be the commentaries of all these people who make the newspaper every day. They are always predicting every day that interest rates are going to go up. And I think that must be--

MR. BOEHNE. Well, there still is burned very deeply in the minds of people in the country--not just people who watch the financial markets every minute and every hour--the very high interest rates of several years ago when we had a 20 to 21 percent prime rate. The burn scar from that is still very obvious. And the most frequent question that I get when I'm out just talking to people who are running small and middle sized businesses is: We're not going to have 18 and 19 percent prime rates anymore are we?

MR. PARTEE. What do you say?

MR. BOEHNE. It depends on how [unintelligible] interest rates. But the pain of that is still very close to the surface in a lot of peoples' minds.

MR. ROBERTS. I hear a lot of talk from the smaller and medium size banks about how they are more carefully limiting their fed funds sales. Is there possibly a net shrinkage in the market here?

CHAIRMAN VOLCKER. I don't know whether statistically it shows up as any net shrinkage, but I hear that too. They may put less or are prepared to put less with individual institutions.

MR. ROBERTS. They are certainly more selective. Maybe they distribute it out [more].

MR. RICE. Shouldn't that show up in much higher excess reserves?

MR. STERNLIGHT. The nationwide total for excess has not gone up, unless it's changing this very reserve period we're in. In the full reserve periods that we have had, that had not shown any more--

VICE CHAIRMAN SOLOMON. Peter, you told me that there was a tendency in the beginning of these periods for excess reserves to be somewhat higher.

MR. STERNLIGHT. Yes, a tendency within the period for more conservative management but nothing for the period as a whole.

CHAIRMAN VOLCKER. Well, I guess we'll turn to the business picture, which is crystal clear! We have to approve the operations.

MR. MARTIN. Move approval.

[SPEAKER(?). Second.]

CHAIRMAN VOLCKER. Mr. Kichline.

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

CHAIRMAN VOLCKER. Let me raise a question about your initial comment to the effect that no decline or stagnation is ahead.

MR. KICHLINE. I think I said "appears" or "the staff believes."

CHAIRMAN VOLCKER. Okay. That's what I want to raise the question about. You said that things came in a little less strongly--or weaker or whatever adjective you used--than you had expected last time. That was only about 6 weeks ago and you were assuming that GNP was going to rise 5 percent in the third quarter. Now you're down to 2.7 percent. That's a heck of a big difference in six weeks, which reflects the fact that all the news coming in has been very appreciably lower than you were assuming.

MR. KICHLINE. Yes. I would say two things were going on, though. One is that the information that we had at the time of the August meeting generally is weaker today with data revisions. When we had the August meeting, retail sales in July were reported to be down 0.9 percent. With the revised data, they are now reported to be down 2 percent. So, it is true that new information available for August has been weaker, but I'd say the past also looks weaker for consumption, residential construction, business-fixed investment, as well as for the merchandise trade area. It has been very broadly based. I think my briefing did not avoid the issue.

CHAIRMAN VOLCKER. I'm just raising a question. You are amplifying what I am saying. The statistics are quite a lot weaker than you anticipated six weeks ago. We started the summer on a high note and we surely ended it on a low note. GNP couldn't be much higher in September than it was in June. It may be lower. I don't know. As we look ahead, it is very hard to see housing going anyplace; and you say housing sales have leveled off. There was some figure released this morning that I was told last night would show a pretty sharp decline.

MR. KICHLINE. I just received it. The house sales data were revised down for July, and August looks quite a bit weaker.

MR. PARTEE. I should remark that the revisions are an insider's leading indicator. If revisions are downward, that indicates weakness.

CHAIRMAN VOLCKER. Well, we've had a lot of downward revisions. It's very hard to see housing going anyplace. I would think an optimistic projection in the near term is stability. Plant and equipment orders have been down quite sharply over the last few months. Backlogs are obviously up from where they were in the recession, but expenditures are not that much lower than orders at this point. In fact, they are very close, and orders most recently have been weak.

MR. MARTIN. We had the McGraw-Hill survey, too.

CHAIRMAN VOLCKER. I didn't see that.

MR. KICHLINE. It's dated as of yesterday. They are tabulating the October survey. The first reading for 1985 will be available late in October. They have a little under half of the respondents in and the total is running around an 8 percent increase in nominal terms, which is substantially weaker than the staff forecast. The survey is [still] fragmentary; we don't know how to make a lot of sense out of it, but it is indeed a weak number.

CHAIRMAN VOLCKER. This is all accompanied by a great surge in imports, which certainly is eating into U.S. production. The however many percent increase in the exchange rate recently can't help that situation in the future; there was an enormous surge in the exchange rate. I don't know what consumption is going to do but it wasn't very good over the summer. The auto sales look all right. But that's the only thing that looks pretty good. All of these other things raise some question about the vulnerability of inventories in the sense of continuing large accumulation, which is the only thing going on now. So, why can't you make a pretty good case for no growth in the fourth quarter?

MR. GRAMLEY. How many times in the past have we seen periods of economic expansion interrupted by a quarter of pause and then it goes on? I would bet that over the postwar period you could find ten of those.

MR. MORRIS. I think the pauses typically come about two years after the beginning of an expansion. We normally go into a little slowing period.

MR. WALLICH. I find it hard to believe that with this budget deficit--even though we have very large negative net exports--we could have the economy sagging. There is just so much purchasing power put in. There's also the stimulation of [business] investment, which surely dominates housing. It's about 3 times as big as housing. So, as I look at the underlying factors, it seems to me it's a picture of continued [unintelligible] pressure--not certainly strength.

MR. RICE. We're talking about the fourth quarter and this would be a quarter of pause and it could be a big pause.

MR. WALLICH. Well, that I could see. The things I'm talking about don't point to any particular quarter, but I do try to look a little further ahead and ask myself: Where are we going?

MR. GRAMLEY. Jim, have you looked at previous cycles to see whether--

MR. KICHLINE. There are many. A classic case is 1976 where we had a slowdown, particularly in consumer spending, and it looked at the time as if the economy were perhaps falling apart. But it was really just one of these pauses that subsequently led to very sharp growth. I have an answer to your question from the model. We have all sorts of things in the model, and the probability of negative GNP growth occurring in the fourth quarter of 1984 according to the Board's econometric model is 25 percent.

MR. PARTEE. It's what?

MR. KICHLINE. It is 25 percent. That probability has been rising because of the factors you've been citing.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. I wonder if we have an example here of central bankers finding something going along about the way it ought to be going along and finding a whole lot to worry about. It seems to me that several months ago we were concerned about the economy overheating. We were going along well into a recovery and the concern was that we were going to go off the ledge and that it wasn't sustainable. We get some slowing over a period of several months and now some concern about a recession. It seems to me that what is happening is exactly what a majority of the Committee wanted to happen just a few months ago--that we are seeing this adjustment to a slower economy. My own region happens to be a region that's fairly sensitive to what is going on in the [overall] economy and historically it has tended to come down earlier than some other regions. I must say as I talk with people in various sectors that the evidence suggests some slowing [in the expansion] but there's not very much that would suggest that we're heading into a slide. There is less strength in manufacturing but the retailers report that things are going along really rather well. We've had some weakness in tourism largely because of the dollar and the fact that Canadians are not coming into the District. There is weakness in residential housing but commercial construction is going along reasonably well. The bankers report some slowing in C&I loans but not as a forerunner of a recession.

So, where I come out is that the economy is doing exactly what we wanted it to do. We wanted [the expansion] to slow down some so that we could have a more sustainable growth. It seems to me that we are not as recession prone as I would have thought at this point in the recovery. I think inflation is under much better control and I think monetary policy has been conducted on a better basis this time around. We tightened earlier in a recovery than any time I recall since being in this room and I think we have begun to ease earlier than we normally have; so I think policy is considerably less pro-cyclical than it has been historically. I would come out thinking that what has been happening is pretty good for the economy.

CHAIRMAN VOLCKER. Mr. Rice.

MR. RICE. Well, Mr. Chairman, the staff's revisions to the forecast for 1985 seem to be more than usually sensitive to the dollar exchange rate. We know what the various possibilities are there and we also know the difficulty of assessing the probabilities associated with forecasting the exchange rate. But I don't think many people would argue that the basic long-run strength in the economy is being threatened. I don't know of many people who have forecast a recession in 1985. I think the central question for us right now is: What is going to happen in the current quarter and possibly the next quarter? The question is whether the economy is going to continue to decelerate below the current level of activity estimated for the third quarter or whether it's going to stabilize at levels around those of the third quarter or whether it's going to rebound as projected by the staff. I think the scenario outlined by the staff for the fourth quarter is a very plausible one and I certainly hope that it is realized. If it is realized, we'll have pretty much what Ed Boehne was hoping for--that is, we will have the kind of situation that we want.

However, I think we have to recognize and pay some attention to the kinds of factors that the Chairman pointed to just a moment ago: that there is evidence of considerable weakness and that the staff forecast is based on pretty wobbly foundations--primarily consumer behavior and the expected rebound in consumer spending. Now, at a time when investment spending is also decelerating somewhat, this rebound in the current quarter seems to me crucially [dependent] on a substantial rebound in consumer spending. And from past experience, I think we have found that predicting consumer behavior in the short run on a quarterly basis is a very hazardous business. In other words, it seems to me highly possible that, in light of the very rapid deceleration that we've seen in the last quarter, this could carry forward to very low levels of expansion. I would expect positive rates of growth, but conceivably fairly low rates of growth--marginally positive rates of growth--and that, in my judgment, would not be a desirable outcome. And I think we have an opportunity now to forestall that without any risk of threatening a sustainable expansion.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. I appreciated Jim's comment on the 25 percent probability from the model of zero growth in the fourth quarter.

CHAIRMAN VOLCKER. Minus.

MR. KICHLINE. Zero or negative.

MR. MARTIN. It seems to me that when we refer to the slowdown in growth we're talking about a change from 10.1 percent real GNP growth in the first quarter to 2.7 percent in the third quarter. I suppose that's a slowdown rather than a jamming on the brakes, but it is reasonably significant. Henry's point is well placed with regard to consumer behavior and the probability of the consumer coming back, particularly in the durables area. The other side of that coin is the consumer coming back to a saving rate that might reflect the news that I expect to occur with regard to failing thrift institutions and commercial banks as the year wears on. [When] the November 14 report of Financial Corporation of America comes upon the media and other institutions show difficulties, it could even be that the consumer will feel that saving may be a little more desirable. I don't know what the probability of that is but there is some probability. Of course, then the question is raised as to saving into what. As to the notion of a return in the nondefense capital goods area to a much stronger rate of spending, I think there is a great deal of uncertainty there and that uncertainty stems from the very point that the Chairman underlined previously, which is that interest rates are still relatively high and profit margins, due to foreign competition, are the narrowest in many, many industrial categories that they have been in several decades. And that certainly tends to weigh a bit upon a board of directors realizing that because of the financing gap they have to go outside. They can't do as they did in the earlier stages of the expansion and finance from internal sources.

So, it seems to me, though I don't know what the probability is, that there is a risk--not the risk that we will have such a bad fourth quarter or first or second quarter going forward, but the risk of an earlier end to this expansion than would be desirable considering the need to face fiscal policy decisions in '85. And those are decisions that can best be made in [an environment] of a trend rate of real growth or even a 3 to 4 percent rate of growth rather than an expectation that the recession is around the corner and, therefore, it's too late to do anything in the fiscal policy area. I reiterate my concern about financial institutions and their lack of financial soundness and the vulnerability that the expansion has to the fact that this will be developing later this year and into next year. So, it seems to me that the Chairman needs to have flexibility and that we need to build into our thinking quite a bit of flexibility so that we can move, particularly to offset downward pressures, in the short- or intermediate-term future.

CHAIRMAN VOLCKER. Miss Seger.

MS. SEGER. As someone who was pessimistic rather early on, I guess I'm pleased to see the statistics finally supporting my woman's intuition in that the statistics across the board are certainly looking much weaker than they did back in July when I arrived here. I'm also viewing this as a good sign, as are people in Philadelphia, and not a bad sign. I think it's healthy that we are looking at some downward revisions in our forecast for the rest of this year and for 1985 because it's important to keep inflation under control and having these signs takes some of the heat off here to jam on the brakes. So, I'm pleased to see that this is happening. Also, I'm optimistic--maybe more optimistic than most people here--about some of the fundamental changes going on in the economy. I have mentioned these before, particularly those things that are influencing productivity favorably. There are other [developments] that influence the management of companies and increase their commitment to doing things efficiently, which of course is tied in to productivity. Their stronger moves in labor negotiations, some innovations, and more emphasis on R&D are the kinds of things that I think will pay big rewards longer term. I'm also concerned, though, about the problems of the thrifts. Maybe it's because I just gave a talk a week ago to some treasurers of savings and loans and I'm carrying those cards, but there are big problems there. There are big problems there even if interest rates don't rise, but the numbers I heard with even a modest increase in interest rates in the future are terribly scary. I think a very large group will be going down the chute rather than a somewhat smaller group. So, those are my concerns. But, as I said, overall I'm rather pleased with what is going on.

CHAIRMAN VOLCKER. Mr. Forrestal.

MR. FORRESTAL. Mr. Chairman, I too am rather pleased about the ways things have gone. I don't really see the risks being on the down side either for the fourth quarter or for 1985. I was a little surprised at the 2.7 percent staff projection. I would have thought it would be a little higher. I think the Commerce flash report of 3.6 percent is probably closer to the mark and, in fact, market watchers are expecting that to be revised upward somewhat. Also, the numbers that I've seen for September, in my District at least, are indicating some rebound in the economy from the slowing in the summer.

Speaking specifically about my District, we are seeing the slowdown, but in all areas the strengths are still outweighing the weaknesses in the economy. So, I would think, Mr. Chairman, that the risk is that we will have a rebound in the fourth quarter and that that will carry over into 1985. I say risk not because I think it's going to be terribly significant but because the numbers will probably be lower. But I certainly don't see any negative growth or even zero growth in 1985. I think the institutional problems certainly will have an effect on consumer attitudes and consumer expectations but, at the moment at least, I sense a less nervous attitude on the part of people with respect to the banking system. I don't think the thrift problems have really surfaced very well in peoples' consciousness. Now, if FCA or some other thrift were to go belly up, we might have a different situation. But, for the moment at least, I think the market nervousness and consumer nervousness about the banking system has abated to some extent.

Basically, as I look at the situation, I think we are in a pause. I expect the fourth quarter to come in a little better than the staff has projected and, as I said earlier, I think that will carry over into 1985. The wild card in all of this is the question of the dollar. And I would just like to raise at this point--if it's appropriate, Mr. Chairman--the question of how significant in our discussions today the question of the dollar should be. Perhaps we can talk about this later, but I wonder with respect to the dollar what might happen if this significant decline in the dollar [were to occur] whether this situation should be reflected in some way in the directive. I just throw that out as a point of discussion. What happens to the dollar can obviously affect these projections very, very significantly. If anything were to happen soon in terms of a marked change in the dollar, it could affect what happens in the fourth quarter or certainly in 1985. But with the exception of the dollar consideration, I would think the economy is on a pretty good track and I would be more concerned about inflation in 1985 rather than slow growth.

CHAIRMAN VOLCKER. You refer to evidence of a rebound in your District in September. What is that evidence?

MR. FORRESTAL. Well, retail sales have come back in early September. Housing is back a bit more. It is still down from earlier levels, but better than the July numbers had suggested. Consumer spending generally is a little better.

CHAIRMAN VOLCKER. Well, I don't know. I heard a lot of stories about retail sales improving late in August and in early

September. More recently I hear stories that they disappeared again. I don't know whether--

MR. ROBERTS. That's what I am hearing also--that they have become sluggish again after a little pickup in late August and early September.

MR. MARTIN. They could come back, [given] the discounting techniques to move the merchandise. I've heard [that their approach is]: Never mind what the price is; [unintelligible]; let's do something else here to move the merchandise.

MR. FORRESTAL. One of the interesting things that I find is that the retail sales reflected in the statistics are not borne out by the retailers that I talk to. We see evidence in the numbers of relatively weak retail sales, for example, yet when I talk to various retailers they say they are doing great. There is some discrepancy.

CHAIRMAN VOLCKER. You must have been talking to different ones than I was talking to or I wouldn't have [unintelligible].

MR. PARTEE. Well, that's one thing about retailers: You can always find a retailer to support your position!

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. In the Eleventh District, Mr. Chairman, we are seeing some slowdown. Primarily what we see is a climate of weakness in the energy industry, particularly the processing portion. Refining and [unintelligible] actually are showing absolute declines both in employment and production. This summer drilling also declined on a year-over-year basis, although very recently there has been a little pickup there. Housing is ebbing. Non-residential construction is flattening out, and I really don't think that's too bad down our way. We do have a number of areas of strengths. On unemployment, of course, we're below the national average, which really still suggests to us a fairly tight labor market. This is borne out at our own Bank where we continue to see our turnover rate increasing. It's always fairly large, but it is picking up again. The excessive inventories in oil field equipment are being worked off and production and employment as a matter of fact are beginning to increase there. Defense contracting is helpful as is electronic equipment. In retail sales, we continue to make gains but anecdotally some retailers we talk to seem a bit pessimistic. The told me that they were getting increases of 17 and 18 percent and now it looks like 7 or 8 percent and he's not too sure what will occur as we go through the year. On the agricultural side in our District, while prices aren't that good, increased production has pretty well offset that. At least for this year, we think the District agricultural situation is not going to be all that bad overall, although it's not uniform. The drought areas, of course, are severely hurt. My bottom line is that this seems to me more of a pause right now, and I agree with those who think that maybe that's not too bad a development. I would anticipate that the fourth quarter might be a little better and that 1985--barring all these really terrible things that have been mentioned--shouldn't be all that bad.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. Well, in the words of one of my associates: "The Middle West has dropped out of the economic expansion." But as I hear the comments, maybe we aren't the only ones to have dropped out. I think it's now clear that overall economic activity in the Middle West has been at least leveling off since the early part of the summer. Steel production is down and down significantly. Imports are taking a very much larger part of that market. The heavy capital goods sector continues to be relatively weak. One part of that sector, indeed, has turned around: Orders for large trucks, which had been very strong, have now turned around and are on the way down. Residential construction is down, the result of high interest rates. Our gains in employment rates have slowed down. Our unemployment rate is down, but it's probably more a factor of people just dropping out of the work force and not the result of higher employment numbers. Retail sales are uneven. There was a pickup during the back-to-school period. Nonetheless, the September numbers, according to what we're hearing, are again on the soft side. In the agricultural sector, the outlook continues to be relatively poor and the land values are continuing to go down. The outlook for farm incomes is not positive and that is backed up even more in the farm equipment sector where production is being further curtailed. Some major manufacturers are continuing to lay off workers. Broadly, the news is a bit more modest. I would not suggest by any of this that we are heading back into a recession. I think it would be far too early to suggest that. But certainly, at least in our area, the expansion has faded. And I think we are going to have to watch the numbers pretty carefully in the upcoming period.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. In general, Mr. Chairman, I have a lot of sympathy for what Mr. Boehne said. At the same time, there is no question that the tone of things has changed. From my own perspective, two months ago I would have put about a zero probability on a fourth quarter of zero or something worse than that. I'm not sure where my own mental calculus would take me right now--maybe to the 25 percent the model has, or maybe a little less than that. But I still think the best bet, by a comfortable margin, is that we will see a pattern of economic growth emerge in the fourth quarter and in early 1985 along the broad lines suggested in the staff forecast. Having said that, there is no question that right now it's darn hard to read through the numbers. Clearly, for example, the way that imports are working their way into the economy is just off the charts in terms of our appreciation of what it means for domestic income, employment, and all the rest of it. On the other side, it's awfully hard to know what the underlying demand for automobiles is. We get reports through our directors and otherwise suggesting that the supply constraints in the automobile industry are very real and that the cars that people want simply are not available. The inventory situation is a very, very tough call. It could go either way. Again, the general attitude we seem to run into everyplace among business people is that they are being very aggressive and they are not terribly uncomfortable with their inventory situations even right now. On the housing sector, I think the general view that it's going to stand still is probably right. But there's one potential little problem there. I get the sense that these adjustable rate mortgages that were put out in such enormous quantities earlier in the year and late last year could be a potential problem in their own right that could possibly have some unsettling influences on the mortgage market, leaving aside the problems of the thrifts. The inflation outlook, I think, is clearly a plus, both in terms of attitudes and psychology as well as reality. While we may be a little surprised by the business numbers, in some way the biggest surprise is the continued very, very satisfactory showing on the inflation side, which is reflected in recent [wage] settlements as well.

Just a word on the agricultural situation: The credit side is no better than it was in May; it's probably worse notwithstanding the fact that production yields are going to be pretty good. On balance, I think the credit side is probably worse. But all in all, as I said, I think the best bet by a comfortable margin is a rebound along the lines of the staff forecast. The biggest wild card by far is the financial situation, despite the progress that was made with some of the LDC debt problems and so forth. I think the real wild card is the possibility of some more uncertainties or unsettling events in the financial situation quickly spilling over into a question of confidence about dollar-denominated assets in general. It could have very adverse implications for the dollar. That would be the worst of all worlds.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. I want to agree strongly with Ed Boehne. In fact, I would underline his comments by saying "Thank goodness we have had a slowdown," because throughout 1983 the expansion was more rapid than we expected. We certainly didn't have in mind anything like that 10 percent increase for the first quarter; that was several percentage points above what we expected. The second quarter was also considerably stronger than originally forecast and than what we thought appropriate. Finally we have gotten a quarter on the low side. It's the first quarter I can remember in the recovery that's on the low side of the projection and it's about time that we start to see some balance. Somebody earlier was talking about putting some risks back into the situation. Well, I think that's necessary for the business situation as well as the foreign exchange value of the dollar --that there be a two-sided view as to what may be occurring. I'm inclined to think that this is temporary. Despite Emmett's comments that consumer spending is variable in the short run, I would say that there tends to be an equating of spending with income streams, and income streams are still good. So, the chances are very, very strong that there will be a recovery in consumer spending in the fourth quarter. Whether it will be as strong as the staff has projected, I don't know, but I would say the chances are good that there will be a larger increase in GNP in the fourth quarter than in the third.

I'm a little more concerned about 1985. I noticed particularly the tremendous rate of increase in imports, and I think that is beginning to sap the economy. If that continues in 1985--which, incidentally, the projection doesn't forecast--we could get a considerably weaker year than has been forecast from the standpoint of domestic activity. But that's some time in the future and a lot will depend on the value of the dollar. And who knows what that may be? Just to take a figure, it may be 40 percent lower by the first of the year. Who can say where the dollar will be? I do think that our greatest threat, looking ahead over the next couple of years, is the possibility that we may find ourselves in a position where interest rates have to be substantially higher than they are now. And that's because of the thrifts, Martha, and the farmers, Jerry, and the small businessmen who have been referred to, and the LDCs, and the condition of financial institutions generally. A repetition of the 18 percent rate level that we saw before would be very, very destructive on the economy. As I see it, that need may still develop in the course of this cycle as we get farther out, and it's very important to try to keep the pressure off so that won't occur. That's the big thing we have to watch out for, and that's why I say "Thank goodness for the slowdown!"

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I feel very much the same way. Of course, I am in some way impressed by the immediate events, but we can't influence them very much. In other words, what we do now is not going to have any immediate effect even on the fourth quarter except maybe for housing. And looking at the longer run, it seems to me that inflation continues to be the main problem. I know it's boring to talk about inflation since it is finally doing so well. But really, that is to be expected. Here we are well above the natural rate of unemployment and inflation is going down, and that's what it's supposed to do. What puzzles me is that so many people expect rising inflation at a time when we have a very high level of unemployment. Maybe these expectations are [related to a view] that the dollar will go down or maybe to the fear of financial calamities. But basically we seem to be taking 5 percent [inflation] for granted. If it stays that way, then the problem is out of the way. I think we're living on borrowed time here with respect to the dollar. We don't know when it will come down. It's very unlikely to me that it will always stay at these levels. We have had remarkable wage moderation; it's hard to explain. Most expectations were for very high settlements, and surely that underlying feeling of "restore and more" must still be there. I am grateful to have had such good settlements. If you look at our money supply target, we have pulled that down on average 1/4 or 1/2 point at most for 1985. Nominal GNP is likely to go from about 10 percent growth to about 7.5 percent. So, if this change in the relationship of money to nominal GNP isn't going into output, maybe it will go into slower velocity but maybe it will go into higher prices. At least the makings of that are there. As I look at the outlook, I look more at mid-1985 and later in 1985 than at the fourth quarter [of 1984]. I think there's enough reason to believe that the fourth quarter isn't a cause for immediate alarm and to allow one to take this longer-run view. Thank you.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Mr. Chairman, I came into this meeting feeling very optimistic because we've been able to move the economy to a slower growth mode without pushing interest rates higher than we did. I was afraid a few months ago; I didn't know what level of the funds rate would be required to slow down the economy. I have no concern about a prolonged period of stagnation, much less a recession, simply because I think the fundamental underpinnings to the economy are strong and I think the economy would be very responsive to even a modest downward movement in interest rates, which any prolonged stagnation would tend to generate. The main thing I've been concerned about in the near term is the foreign exchange market because it seems to me that there is a speculative bubble in that market. It's just like the tulip bulb mania. Whenever you see a market defying all the fundamentals, which it is doing now, you have to think the time is approaching when a correction has to be made. And, obviously, I'm concerned about the interest rate effects of a decline in the dollar. So, I think it is very fortunate that if the dollar should start declining fairly soon, it will do so in an economy that is moving ahead at a more reduced rate and the strains on the financial markets will not be as great as they otherwise would. I see that as our major problem coming up--how we respond in policy to the financial strains caused by a weaker dollar.

CHAIRMAN VOLCKER. That's what we all have been saying for a year or more. Governor Gramley.

MR. GRAMLEY. I'm very much in the Ed Boehne/Chuck Partee camp. I do think something rather fundamental has happened to the basic expansion and I think we should be thankful for that. I would note again that we've been through a lot of periods of economic expansion--Jim mentioned 1976, which was one, but there have been many others--in which the growth of employment, industrial production, and real GNP slowed for awhile and then picked up again. Jim was asked what the probability of negative GNP in the fourth quarter was and he gave the answer .25. A more meaningful question in my judgment would be: What is the probability of two successive quarters of negative GNP growth? And the answer the model cranks out on that is .05, which is negligible. And that agrees with my own perception.

MR. PARTEE. At this time? Did you have that run?

MR. GRAMLEY. Yes. That's a regular output run of the model and I get the model forecast.

MR. PARTEE. One in 20?

MR. GRAMLEY. Yes. If you look over the basic factors that have been driving the economy, and many of them have been mentioned here, they all seem to me to be conducive to continuation of economic expansion. Budget policy is expansive. Monetary policy has not been unduly restrictive--we're looking at a growth of real money over the first three quarters of around 2 percent, which is quite high by historical standards. Consumer confidence is high. Consumer balance sheets are in quite good shape--income ratios have gone up but to nowhere near where they once were. Net worth has improved recently with the pickup in stock prices. As for incentives for business investment, surely we can't expect to see 20 to 25 percent rates of real business fixed investment taking place, but profits are high, the tax incentives are still there, and capacity utilization is up. As for the inventory situation, one can see problems in some areas like chemicals and fibers, textiles, and metals, but overall inventory sales ratios are quite low. My perception is the one that Jerry mentioned--that most businesses are quite comfortable with their inventory positions. So, I think the staff has it about right. I think we will see a pickup in the fourth quarter, and if not then, we will see it in the first quarter. And then if we can see growth stay in the range of 3 to 3-1/2 percent, it's certainly going to be quite beneficial in terms of the impact on interest rates and aspects of financial markets and the problems we have there.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. Focusing on our regional economy, it's not unlike what has been described in some other areas, particularly where there is a fairly dramatic division between urban and rural areas. In the urban areas, retail sales have leveled off; the housing starts, not unlike what has already been described, are falling off somewhat. On the other hand, commercial construction, particularly in Omaha, Kansas City, and Oklahoma City is booming. It started late and it will continue on for another couple of years simply to complete the projects that are underway. In the energy area, as Bob Boykin has indicated, there's been an uptick in rig count operations. In Oklahoma, Colorado, and Wyoming, the numbers are reasonably substantial as a matter of fact.

CHAIRMAN VOLCKER. I thought he said the oil business was depressed.

MR. BOYKIN. I said during the summer there was an uptick in Texas; the actual rig count was still down a little in New Mexico and parts of the country he's talking about. There have been rather substantial increases over the last month and we have begun to get a little uptick even in Texas. But comparing now to a year ago, it's still down a little.

MR. GUFFEY. I think our numbers would reflect something modestly different from that; the uptick compared to a year ago would be somewhat greater than Bob has just described. In auto production, they are working very near capacity on the auto assembly lines. Aircraft, on the other hand, is almost a dead industry at the moment. They can't sell aircraft, particularly business aircraft. That is one of the things that businesses apparently defer and there's an overhang on the market of used aircraft. And that's rather an important part of our industry in the Tenth District. The agricultural scene is not unlike what already has been described. It's bad now and the prospects of it getting better any time in the near future are not bright--non-existent as a matter of fact. Russian grain sales are taking place now, but they're taking place in [the context of] an inventory overhang and as a result the prices do not reflect it nor does it pass through to the producer. And that, of course, has a continued impact on the financial side; the agricultural banks are sort of hanging on. The question is what they will do with collateral that supports those loans when the loans cannot be serviced--interest cannot be paid. As a result the best estimate is that if there is a bottom to be reached, it won't be reached until perhaps the first quarter of 1985. The question of what will happen from now to then is uncertain. But I think it should be important to this Committee to understand that unless we have a dramatic decrease in interest rates there will not be any salvation for the agricultural sector. The current rates, or modestly lower rates, will not be an answer to the financial problems in the agricultural sector.

With respect to the staff forecast, I would agree with Ed Boehne and others who have expressed the view that we ought to be happy with the slowdown. As I look into the fourth quarter and particularly into 1985, I have some question about the staff forecast in that I think the economy will be somewhat weaker than they forecast. In the numbers that they used, retail sales are very important; auto sales, for example, are extremely important in 1985. The staff is looking at an 11 million unit rate for auto sales in 1985. The fourth quarter of 1985, for example, is in the area of 11.2 million--greater than any time in 1983. That suggests to me that if there is any retrenchment because of problems in the financial sector or otherwise, that forecast is more expansive than I would feel comfortable with. With respect to the dollar's strength, it's anybody's guess. But as it relates to inflation it would seem to me that so long as the dollar is strong imports are strong, and we could look at lesser real growth and lesser inflation and, thus, the forecast for nominal GNP in the period ending in the fourth quarter of 1985 would be somewhat less than the staff is projecting.

CHAIRMAN VOLCKER. Mr. Roberts.

MR. ROBERTS. Mr. Chairman, in the Eighth District, economic activity is still strong--I think a little stronger than the national average--but we are clearly seeing signs of a slowdown. Building activity is high but housing starts are declining. Builders are comfortable with where they are but are worried about what will happen in the fall and generally are anticipating that the high interest rates will severely and adversely affect them. Consumer spending is strong in our District; sales of consumer goods haven't really slowed down. We have gotten a lot of information from national retailers that sales, after flattening out in the summer, picked up in late August or early September and, as I said, have become sluggish again. Locally, there is less of that sluggishness. Except for in the northern part of our District, the agricultural situation has improved; there is some reduction in the financial pressures that the farmers have been feeling for the last two years.

I made a comparison here of weak points and strong points and what I ended up with is that the same industries and the same activities are on both the weak and the strong side. For example, in agriculture we have a very weak situation in northern Missouri. In the case of soybeans, it costs more to produce them than they can be sold for at the moment even though we are getting a lot of production --in the area of 50 bushels an acre. The value of the dollar is an adverse factor in exports, and cotton and rice are export crops in part of the District. On the other hand, they have the biggest production in history--greater than 1982. So, how that will come out is a close call in terms of the effects on them. Construction is at a high level but the outlook is for a weakening. In production, generally we're at a very high level. Automobile sales are characterized by the major dealers as red hot. They can't handle the demand, particularly for some of the larger cars. So, that looks good. On the other hand, we've had some plant closings in the District. International Harvester, a producer of farm implements, just closed a plant with 1500 workers; a small foundry closed; we saw the first AT&T effect in telecommunications with a small plant closing. In terms of the confidence factor, there is considerable concern about the thrifts. I had an interesting coincidence of three visits in the last two weeks by bankers who are concerned about the condition of thrifts. Now, why they are [concerned] may be a product of industry discussions, but they foresee major failures without identifying them. As I talk to the thrift people, they are concerned about the negative interest arbitrage but they haven't seen any deterioration in quality, including in the variable rate loans. The consumer's confidence is reflected in our District in rising consumer loans; the consumer is still borrowing. All in all, what I see is a slowing at a high level--not a lot of imbalances around that we could really do anything about. Agriculture is an example. There is some effect of the high dollar, but no big inventory problems that haven't been resolved. Our expectations are that nationally we'll probably see a continuation of about 3 percent growth next year but with inflation rising, probably on the order of 5-1/2 or 6 percent.

CHAIRMAN VOLCKER. Mrs. Horn.

MS. HORN. As for business conditions in our District, the anecdotes would support an economy that is levelling off but not declining. And we would view that as basically a good development. I would like to comment on inflation. A couple of speakers have commented on it and, in my opinion, it is an ongoing problem. There is, of course, a good side of this. We hear a number of anecdotes on productivity as well in our District--that it may be increasing and there may be some significant changes. On the negative side, leaving off fiscal policy from the discussion and turning to the exchange rate, I think there is a genuine concern that if the exchange rate were to be reduced significantly, that would show through to prices very quickly. In the Cleveland District we have a large number of the types of firms that are finding themselves subject to import substitution. And it's that pressure that has kept their margins in an area where they are just completely uncomfortable with them. They are just waiting for the moment to move [prices higher]. We hear many, many stories of these types of firms being poised to move the instant they can. So, that adds to my concern about inflation as the longer-term problem.

CHAIRMAN VOLCKER. Does anybody else want to comment at this point? Mr. Griffith, if you want to, we'll give you 30 seconds.

MR. GRIFFITH. Well, I can't add anything other than to say that we support the Ed Boehne concept. We think things are going really well. There's nothing wrong with sitting here right on target. Our staff forecast has, as does the Greenbook, fourth-quarter growth more in the 4 percent range. And we're optimistic about 8 percent nominal GNP growth next year. I would only add to two things that have been talked about earlier. In our District we also have agricultural problems, and I concur with Roger that these problems are going to show up in the first quarter of '85 and later. And, of course, the thrift industry problems--and it seems we must have half of them, all arising at one time--are, as I think Jerry pointed out, in fact causing great concern in the financial community. Bankers are huddling for strange reasons. They have strange views about borrowing; they have strange views about a lot of things; and they're very nervous about the thrift industry.

CHAIRMAN VOLCKER. Maybe you can give us a quick recital, Mr. Axilrod, and we'll [have coffee.]

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

[Coffee break]

CHAIRMAN VOLCKER. I might say that I don't have all these figures precisely in mind, but the latest indications on the money supply suggest that September is going to come in lower than was assumed. And the quarterly figure for June to September will be in the neighborhood of 2 percent or a little more, right?

MR. AXILROD. It will be below 2-1/2 percent and could be as low as 2 percent. The numbers are variable.

CHAIRMAN VOLCKER. October will start off appreciably below the September average. It's rather a very sluggish ending. The other figures for the 3 months are without any clear change.

MR. PARTEE. That is, growth from June to September would be 2 percent instead of 2-1/2 percent?

MR. AXILROD. September could be as much as 1-1/2 points lower than we had, so that takes off 1/2 point for the quarter.

MR. PARTEE. I see.

CHAIRMAN VOLCKER. It may be worth pointing out that reserves have done nothing over the summer. A question was asked about the dollar earlier, and I'm not going to deal with all the questions of what happens if the dollar declines because I don't know. I've been worried about that for a year and it hasn't happened yet. Instead, it has been going up and going up very rapidly recently, as you know. That is a factor in my thinking at least. I suggest that something is the matter here in terms of some notion of longer-term equilibrium and is a factor in the business picture and, as I indicated earlier, a source of some alarm abroad. I certainly put that in my thinking as a factor to supply more reserves rather than less during this period. That factor alone is not the only factor, but I think at this stage it is not an insignificant one. Well, with that much introduction, who would like to say something?

VICE CHAIRMAN SOLOMON. It seems to me that we ought to maintain the present borrowing level of $750 million. I do think it's worth commenting here, though, that I've been surprised that you have brought borrowings down from $1 billion to $750 million without any consultation with the Committee. Even though I think that was the correct thing to do and a certain amount of discretion is indicated in the directive, it seems to me that at some point you would want to check with the Committee to make sure that others share that view on how to use that discretion. The question could arise again, possibly, over the next few weeks: If we were to start with a borrowing level, let's say, of $750 million, at what point would you feel that you should check with the Committee if both money and the real economy turn out weaker and, therefore, you were reducing the borrowing level or increasing the nonborrowed reserve path?

Turning to the decision for today, I'd start from the assumption that even though there may be weakness in the fourth quarter, that just does not mean an incipient recession. It seems to me that we already have been perceived in the markets as being fairly aggressive in easing and I think we ought to be somewhat cautious, particularly between now and the election period. Unless there are very clear economic reasons to do otherwise, we ought to continue to be fairly cautious rather than move toward a pronounced easing. As far as the targets go, alternative B strikes me as fine. I would leave the funds rate range where it is. There is one last point: It's not too likely, but if we were to get a restoration of confidence in the banking system in a way whereby the management of these banks began to follow a somewhat less cautious policy in reserve management, then with a borrowing level of $750 million, we might find fed funds dropping to as [low] as, say, 10-1/4 percent. And a question I think the Committee ought to consider is: Do we want that much of a drop? If this contingency were to arise--though I don't think it will--would we want to see that much of a drop? There could be an understanding that the Chairman would be in touch with the rest of the Committee at that point.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I would support alternative B with the understanding, as during the last period, that the borrowing limit could be lowered if the aggregates come in extremely weak. But I think an 8 to 12 percent fed funds range is no longer appropriate. When interest rates were moving up, the lower end of the funds range didn't have much relevance. When they start moving down, then it seems to me the lower limit becomes the more relevant one. And to me an 8 percent lower limit is simply too low, certainly at this juncture. I would hate to see us make the sort of mistake we did in 1981 of pursuing vigorously an M1 that was showing some weakness and pushing rates down and getting an enormous surge of response from the economy again. I think that would be very unfortunate. It seems to me that we need to probe down on interest rates and not let them move down too sharply.

CHAIRMAN VOLCKER. What are you referring to in 1981?

MR. MORRIS. Well, in '81--

VICE CHAIRMAN SOLOMON. In '80 when we had an 18-1/2 percent funds rate in June.

CHAIRMAN VOLCKER. That was an entirely different situation. A drop in the economy and the money supply decreased [unintelligible]. It was a mistake in retrospect, but I don't think we have anything like that now.

MR. MORRIS. The context is different. What I'm trying to say is that I don't think in the present context we ought to vigorously pursue a sluggish M1 if it means pushing interest rates down very sharply. And, therefore, I think it would be a mistake to have the directive give the Manager leeway to move interest rates down that far. I would suggest a 10 to 12 percent range on the funds rate as being much more realistic, and that would require the Committee to make another formal judgment before we went below ten percent.

MR. RICE. I would just like to point out that even alternative A contemplates a funds rate no lower than 10-1/4 percent.

MR. PARTEE. Well, assuming that the aggregates come in that way.

MR. MORRIS. It just seems rather silly to me in this situation to have a number as low as 8 percent when the lower limit is the relevant one.

CHAIRMAN VOLCKER. You say 8 percent. This is a piece of the framework that I hadn't even considered--that the funds rate might be down around 8 percent.

VICE CHAIRMAN SOLOMON. Or even 10 percent. I would have problems with 10 percent in the next few weeks. I assume you would.

MR. MORRIS. I'm not sure I would have a problem with 10 percent, but certainly anything below 10 percent I think would be a little precipitous right now.

CHAIRMAN VOLCKER. It's a question of what kind of signals we want to give. After all, we're very close to the 12 percent and we're nowhere near the 8 percent at this point. Governor Martin.

MR. MARTIN. Mr. Chairman, I think that the growth in M1 and the growth in M2 over the last 4 months or so deserve some underlining here. The lack of growth in the monetary aggregates and the flat configuration of the curve of reserve growth argue, as one of our colleagues here indicated, for probing in the direction of restoring M1 and M2 to a somewhat higher configuration over the next weeks. It also seems to me that the slowing of the economy's rate of growth and the uncertainty with regard to nondefense capital spending suggest a probing in that direction. I would join Governor Gramley in his assertion that a 25 percent annual rate of growth of capital spending is not appropriate at this stage of the cycle, but I would also point out that we've had some minus figures in the nondefense capital area for two months and that the purchasing agents indicate strongly that this continued for a third month in September. I'm not sanguine that the consumers are going to come back that quickly. On top of the rationale stemming from the aggregates and from the reserve growth pattern you add the high uncertainties with regard to a possible growth recession--whatever that is--in the fourth quarter or the first quarter or both. We can certainly have two quarters of very, very low growth with the implication that says to the Congress when they come back--after all, we're talking about policies that will have some impact four or six or eight months from now just at the time when the Congress is back--and the question of taking some responsibility for fiscal policy is in the offing. If we have 1 or 2 percent real growth at that time, what prospect is there for some degree of responsibility for fiscal policy?

And finally, it seems to me that the behavior pattern that Steve described with regard to borrowing, with regard to fed funds provision, and with regard to excess reserve positions on the part of the banking community will probably be reinforced. This aberrant behavior, if you will, that has kept the fed funds rate where it is despite almost daily intervention by us, despite the reserve position, and the borrowing position of the banking community, is going to be reinforced by the bad news that's going to come out of commercial banks and thrift institutions instance after instance. And we know this bad news is coming and that it is certainly not going to build confidence. It seems to me we should probe from the current level of $750 million of borrowing, from the current 11 to 11-1/2 percent level of fed funds, and from the current level of excess reserves carefully down toward the levels specified in "A." In other words, I recommend we start at the current levels and move very carefully toward "A," consulting as you will with this Committee, Mr. Chairman. But, certainly, a $600 million level of borrowing is not out of the question; and if it takes a $500 million level of borrowing to get to that 10 to 10-1/2 percent range for fed funds, then so be it. A third reason for probing and moving in that direction is, of course, the dollar situation, which has been thoroughly discussed here and which is giving our central banker colleagues in Europe and Japan difficulties. To me, the aggregates, the economy, and the dollar argue for a careful probing movement in the direction of whatever it takes to bring the rate down in the direction of the level specified in "A."

CHAIRMAN VOLCKER. But not necessarily the money supply numbers specified?

MR. MARTIN. But not necessarily the money supply.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. Tony Solomon has stated a position that I would like to join, with just a modest change for maybe different reasons. Rather than adopting "B" as proposed in the Bluebook at a 6 percent M1 level--and I'm not talking about either M2 or M3 or the federal funds range--I would prefer that the Committee adopt a shading toward "C," to the 5-1/2 percent level, the same level we adopted for the third quarter. In other words, as the record is published it would reflect that there has been no change in the objective of the Committee with respect to money growth. The difference, obviously, is that we did not achieve 5-1/2 percent growth in the third quarter, but only 2 percent on a quarterly basis. It would give us the latitude to move down. My concern is, much as what has already been expressed, that the fed funds rate range have some flexibility in it but that within the next six weeks there not be any major move to a lower level. I think the chance of moving to lower interest rate levels is quite likely consistent with the comments that I made earlier in that I don't believe that the economy is going to be quite as strong as the staff is forecasting for the fourth quarter. I think we'll see some easing. But for the record I would like to see us re-adopt the same money targets that we had in the third quarter and try to achieve that 5-1/2 percent growth for M1.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. I like the specifications of alternative B. I would neither want to raise the M1 number above 6 percent, which I think is a good center number to have in mind, nor to reduce it, especially following on the shortfalls that we already have had, which I think would signal a more restrictive stance. I like the specifications and I would leave the funds rate at 8 to 12 percent. It comes as somewhat of a shock to me that anybody would consider the 8 percent a relevant number. I see the point about not going to 8 percent in the short run, but I think the public relations effect of raising it from 8 percent to 10 percent would be too difficult for us to deal with, so I wouldn't do that. Now, I must say that I don't think there has been anything very aggressive about monetary policy in the last 6 weeks when you remember that we are significantly--significantly by several points--short of the targets we set just 6 weeks ago for the third quarter. We are three points short in the case of M1, 2-1/2 points or more short in the case of M2, and 2 points short in the case of M3. I'm surprised that policy didn't flex more toward an easier money market stance than it did over this period. So, far from wondering why there wasn't a conference call to see whether we should go that far, I'm wondering why there wasn't a conference call to see if we should have gone further in this period than we did. As I said, there's nothing wrong with these targets, but the trouble is that our most recent record is that we don't meet the targets. It may be that we will meet them readily or it may be that we won't meet them readily in the quarter to come, since we have just received this news about M1 perhaps falling even further short.

MR. AXILROD. Please remember this is Tuesday and borrowing on Wednesday--

MR. PARTEE. Well, I know. That's why you're proposing Wednesday meetings, which is a very good reason for Wednesday meetings. But I am remembering that it looks as if we are going to have a shortfall [in M1] and it might carry through into M2 also; I don't know. I've been a little unhappy about an initial borrowing level as high as $750 million and it strengthens my view that we ought to cut it to $650 million to start with. I see nothing wrong with a 10 percent funds rate, although I guess I would have to agree that if it goes significantly below 10 percent for a period of time, that signals something new and I would want to talk about it before it got below 10 percent. But if reducing the initial borrowing number to $650 million happened to give us [a funds rate] moving down toward 10 percent, I wouldn't be at all concerned about it. Maybe that's the problem we're going to have, Mr. Chairman: that we all will choose alternative B but we all will have different ideas as to where [that may lead].

CHAIRMAN VOLCKER. Mr. Forrestal.

MR. FORRESTAL. Thank you, Mr. Chairman. Looking at the GNP I'm a bit more optimistic than some of the comments that I have heard. I think the third quarter may very well wind up stronger than the 2.7 percent that the staff has projected and that the fourth quarter, and indeed most of 1985, will be a little stronger as well. Also, I think the money supply is about where we want it, notwithstanding some of the recent weakness. There, too, I think we will have a bit of a rebound, as suggested by the Bluebook. So, the policy consideration that flows from those hypotheses would indicate to me that a status quo policy is appropriate, and for that reason I would opt for alternative B with a borrowing level at $750 million. I think it would be appropriate for consultation to occur if the fed funds rate were to drop below 10 percent. I have some sympathy with the remarks that were made earlier about the range of the fed funds rate. I really don't know what 8 percent means except for public relations purposes, but it doesn't seem to me to be very relevant in this environment. If the dollar were to surge again, I would assume that that would cause a different policy direction, and again perhaps a consultation would be appropriate.

Mr. Chairman, the question that I raised earlier about the dollar in terms of any significant deviation upward or downward really went beyond consideration of policy at this meeting. I have a concern that we're all expecting at some point some decline in the dollar--and hopefully it would not be a precipitous decline--but nobody really knows and nobody knows when it's going to come down. I suppose we could say we'll have a winner one day--that it probably is going to come down. The question in my mind is: Is anyone looking at what our response should be if there is a precipitous decline or do we deal with this on an ad hoc basis? Maybe some planning is going on that I'm unaware of, but I raise the question of whether there is a contingency plan and, if not, should we be looking at some kind of contingency plan.

CHAIRMAN VOLCKER. Well, if you specify the conditions that you are imagining, I will develop a contingency plan.

MR. FORRESTAL. I don't know what the--

CHAIRMAN VOLCKER. Neither do I. That's the problem.

MR. FORRESTAL. [Unintelligible.]

SPEAKER(?). The Secretary of the Treasury takes care of it.

MR. FORRESTAL. Well, two things occur to me: One is intervention and one is a change in policy.

CHAIRMAN VOLCKER. I don't know what the conditions would be. I suspect it will go down some day. I don't know whether it will be in 1984, 1985, or 1986. I suspect when it comes down it will come down precipitously. You tell me whether the economy is vigorously expanding at that point or whether it's weak and what the inflation rate is then and what the budgetary situation is and I would be glad to develop a contingency plan. But I named three variables, none of which I know about at this point, and all of which would affect my contingency plan.

MR. FORRESTAL. Well, I guess if I were doing it, I would lay out various scenarios.

CHAIRMAN VOLCKER. Well, I invite anybody who wants to engage in that exercise to engage in it. Mr. Black.

MR. BLACK. Being more confused than usual about the economic outlook, which is a state I imagine most people around this table find [themselves in], it's hard to contemplate but I didn't say very much during the first part of the meeting. [Unintelligible] Boehne, Partee, and Gramley axis, for lack of a better term. But I think a point that Henry made does deserve stressing and that is that if we are fortunate enough to get the 4-3/4 percent inflation rate that the staff is projecting for next year, that would look good only in relation to the late 1970s and early 1980s; in any other time that would have been considered a major economic problem. So, in formulating our short-term objectives, I think we need to keep that longer-term objective in mind and try to hit our targets for what would be the 18th month in a row right on the button. If we could come out near the midpoint of the target, I think we would do something that would be very beneficial from the standpoint of the whole economy.

To get to the bottom line: Like Chuck, I would go with all the provisions and specifications of "B." Unlike Chuck, though, with M1 growth picking up in September albeit not as much as I thought, given [the report] this morning that it's apparently somewhat more elastic with respect to interest rates than we thought earlier, I think it's unlikely that we've seen the full response to this decline in the fed funds rate that we had earlier. So, I would be inclined to let it sit there for a while or maybe move it down a tad at most and then wait and see what happens.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. I would buy the specs of "B": $750 million on borrowing, 6 percent for M1, and leave the fed funds rate range where it is. Basically, I want to try to stay where we are. I would agree with Chuck that what we have done couldn't be considered aggressive easing, but I think we have eased significantly. The principal concern on my mind is that if I'm right and the staff is right on the outlook, the greatest danger at this point is that we might inadvertently ease too much, which would then give rise to the need for higher interest rates later. In this connection, it seems to me that none of us knows for sure whether or not this pause, if it is a pause, is going to continue through October or through the first part of November or exactly how long. That may mean that we're going to be looking at some rather weak money numbers for a while and I don't think we ought to panic. We ought to move gingerly toward a lower level of adjustment borrowing, if that's necessary. I would be quite reluctant, for example, to see us move down to $500 million, given that we've moved to $750 million within the past few weeks.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. Well, Mr. Chairman, I agree pretty much with what Pres Martin said. It seems to me that all of the recent developments point to a need to ease monetary conditions somewhat--the behavior of the aggregates, the level of the exchange rate, the level of the dollar, and the outlook for inflation. Hardly anyone expects an inflation rate next year above 5 percent. The consensus outlook among economists, as I read it, is between 4 and 5 percent. We ourselves revised our inflation forecast down. So, from almost everybody's point of view, the outlook for inflation is improving and is much better than it was just a month or so ago. If you add to that the condition of the thrifts, I think this is a time when we could reasonably hope for a somewhat lower level of interest rates. I think the case is as strong as it has been in recent years for some easing. Call it a probing easing if you like, but I think we ought to try to ease some. Now, the good thing about the present combination of circumstances is--at least it seems so to me--that we can do it with very little risk. If the economy surges in the fourth quarter or early next year--we expect it will not, but if it does--we are in a very good position to reverse without any damage to the economy to speak of. So, it seems to me that we can at this time think very much in terms of reducing the reserve pressures somewhat. I would go for a position somewhere between alternatives A and B, although Governor Partee's specifications for alternative B are very close to what I would be willing to go along with. We could call it "B" with Governor Partee's specifications. But I would like to see a level of borrowing around $600 million and I'd leave the funds rate range pretty much where it is.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Mr. Chairman, in my view, it's a little premature to try to do any further easing right now. The status quo has a lot of appeal to me. Therefore, alternative B as specified in the Bluebook, with a $750 million dollar borrowing assumption, would be very acceptable to me.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. I would go along with the specifications of alternative B, including an initial borrowing level of $750 million. However, it seems to me what is really crucial in this decision is how we--how you, Mr. Chairman--respond to incoming information over the next several weeks. I would respond more quickly to a continuation of weak aggregates and a weaker economy than I would the other way around. So, if we got surprised with stronger aggregate growth or a stronger economy, it would take more evidence to respond than it would if they continue to be on the weak side, just simply because of the accumulation of information that has come in on the weak side. With this kind of approach, we are more likely to end up a month from now with lower rates than we have now, but I think it would depend on incoming information as we proceed through the period, much as has occurred during the last 6 or 7 weeks.

MR. PARTEE. Would you change "would" to "might" to have an asymmetrical directive?

MR. BOEHNE. Well, I suppose that is more literally what I'm saying. I could live with a symmetrical directive as long as we had a slightly asymmetrical interpretation.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. I would take the specifications of "B" as is, with borrowing at $750 million. That view is partly conditioned on my view of the economy and partly conditioned on my thought that the trajectory we are facing going into 1985 with money growth is important. It's also based on a belief that if incoming developments did warrant some further easing, we could get a pretty quick response in the real economy. On that I happen to agree with Frank Morris. But it's also based on not very scientific observations that suggest that the law of averages with regard to the money supply is now working against us. We have gotten surprised on the down side for several months running and I have this fear that one of these months, for no necessarily obvious reason, we could have a big surprise on the up side. And, in that kind of circumstance, I think there is a very great risk of interest rates moving down much too fast--the risk of the whipsaw effect. I'd hate like the devil to find ourselves in a position later this year or early next year, for whatever reasons--the economy, money supply, the exchange rate--where we had to reverse quickly. Indeed, I would argue that that might be more damaging to the thrifts than staying where we are in the intervening weeks and months. So, I do see a real risk of a whipsaw effect that could be very damaging if we get too far out in front of this thing.

I'd like to think that there was something that could be done with open market operations to facilitate a soft landing of the dollar, but I guess I don't. I do have an open mind as to what kind of contingent language, symmetrical or otherwise, might be in the directive that would permit some further reduction in the borrowing level if the economy and so forth warranted it. But I would be very much on the side of a gingerly response rather than any very aggressive probing. I would draw that distinction.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. Well, I would go with Alternative B. I'm puzzled by the behavior of the aggregates. There has been more than the usual variation in very short-run velocity. I know that short-run velocity doesn't mean anything, but it is puzzling to observe the ups and downs over the first half. So, the specifications seem all right to me and borrowing of $750 million seems all right to me. On the funds rate, I would like to put a lower limit on it. I recognize that doing this in the public record might have adverse repercussions. For instance, it might affect interest rate expectations adversely. So, perhaps we could have an understanding that we would have a telephone conference. As for symmetry, I would prefer to stay symmetrical.

CHAIRMAN VOLCKER. Miss Seger.

MS. SEGER. I'm leaning toward the A alternative, with my first reason being the performance of the monetary aggregates in the third quarter. When I look at what the various alternatives are expected to produce in the way of monetary growth in the fourth quarter and for the 12 months in 1984, it looks as if even with alternative A the results would be within the longer-run targets with the exception of M3, which would be just outside by a very small amount. Also, as I mentioned earlier, the economy is definitely slowing. I don't believe we are heading straight for a recession but I think there has been a significant slowing. I happen to agree that it's going to continue to be on the moderate side of the spectrum and that would suggest that some easing, as in alternative A, is appropriate. To repeat what a number of people have mentioned, the strong dollar is a consideration here and I hope that we can do something to maybe at least stop its strong advance.

Finally, I repeat my continuing concern about the thrifts and the health of the financial system in general. When I look at where the fed funds rate would likely go based on alternative A, as I read the statement here, it looks as if it would go somewhere between 10-1/4 and 10-1/2 percent; and I don't see that as a precipitous drop in interest rates. Maybe it's my bias, having seen a lot of volatility in interest rates, but from where the fed funds rate is now I would say that's on the modest side. Also, I am thinking of the signals that we sent to money market participants this summer when many of them assumed that the Fed had in fact tightened. I don't remember sitting here and voting for tightening. [That was] the conclusion that many of them drew from asymmetrical language. Consequently, I think we got an upward movement in the fed funds rate that in fact exceeded what we were talking about here at the time--at least what I thought we were hoping for. Having said all that, I would prefer to go with some easing and in general what is shown here in alternative A.

CHAIRMAN VOLCKER. Mr. Roberts.

MR. ROBERTS. I would prefer that we use alternative B but make certain that we do everything possible to accomplish the M1 growth projected for the fourth quarter. I think the recent experience has demonstrated that when we have too many targets we can get inconsistencies in borrowing and interest rates and money and it probably is too big a pot. I would concentrate on money and if that caused us to lower the borrowing level or lower interest rates in order to accomplish that, I would be in favor of that. It seems to me that we have a broadly based economic expansion that has reached a high level and is turning a little sluggish but still doing all right. Price [increases] have slowed down. Interest rates have come down significantly. And we're dealing here with lags. What we have at the moment reflects the past monetary growth and what we do now will affect the future. And contrary to what Emmett mentioned, my observation is that people at the Conference Board, Chase, DRI, Morgan, and Citicorp, all are looking for 4-1/2 to 6 percent inflation next year in the projections that I see. And that's the range that I see also. We're right in the middle of the ranges on the money supply and I think we ought to try to stay right there.

MR. RICE. The Association of Business Economists, an organization of 200 people, is looking for an inflation rate somewhere between 4 and 5 percent. I also noticed yesterday that our shadows expect an inflation rate between 3 and 4 percent.

CHAIRMAN VOLCKER. It's a little dangerous that they said they were content with policy!

MR. GRAMLEY. They also said that underlying policy is consistent with 6 to 7 percent inflation and that unless we bring money down, we might get worse results.

MR. PARTEE. And they were talking about 10 percent [on the funds rate] by the end of this year, weren't they?

VICE CHAIRMAN SOLOMON. I also heard that they approved what we have done this year.

CHAIRMAN VOLCKER. That's what it said in the paper. Mr. Griffith.

MR. GRIFFITH. Mr. Chairman, the Twelfth District supports the specifications of "B" and very much what Ted just said and what Bob Boykin said. We think it's premature to make any change right now. We don't [know] exactly where the stop point is. And the point that Jerry Corrigan made our staff thinks is very important: that if [rates] were to go down too much too quickly, we could find ourselves starting off 1985 with the whipsaw effect. And for that reason we feel very strongly about the specifications of "B" as written.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. For reasons that have been well stated, I think alternative B would be the most desirable alternative at this point. Clearly, there has been a moderation in the rate of economic growth. I think there is a disagreement around the table as to whether or not we are headed toward a more negative environment or indeed just down to a more sustainable rate of growth. But it does seem to me that from a monetary policy point of view, things are lined up awfully well at this point and the fundamentals are really right and that it would be premature to be making any kind of significant change. We are in a period where we would want to watch it pretty carefully but, fortunately, we have another meeting coming up in a fairly brief period of time. As a consequence, at this meeting alternative B seems to me to be the most appropriate alternative with borrowing of, say, $750 million, but I'd have a high element of flexibility on that borrowing. And I would attempt very hard to achieve a growth rate of M1 in the 6 percent area.

CHAIRMAN VOLCKER. Mrs. Horn.

MS. HORN. I support alternative B and I share very strongly the concerns that Jerry expressed and that were expressed by some other people around the table. Maybe I will just state it in a slightly different way. I would not like to give the market the wrong signal through borrowing and the fed funds rate. Now, if I only knew what the wrong signal was--.

CHAIRMAN VOLCKER. Exactly. We could all share that.

MS. HORN. But, since I don't, moving slowly seems to me the best approach. And I would support "B."

CHAIRMAN VOLCKER. Well, I think you have identified the right question. There is clearly a strong consensus for "B" with a couple of exceptions. That is not surprising when we are talking about numbers for the money supply, which look nice. Most people have suggested not changing the fed funds rate [range]. That sounds right to me too; I don't see how we can raise the lower limit without getting peculiar interpretations. I thought we had a very full discussion at the last meeting of what to do in terms of contingencies and I must say I don't ever remember being in a position [during an intermeeting period] when every indicator that I looked at appeared to be in the same direction and neatly fit the directive for moving down. Whether I looked at M1, M2, M3, reserves, the exchange rate, the economy--what else have I left out here?

MR. PARTEE. Prices.

CHAIRMAN VOLCKER. Prices--except for that last consumer price index number. That was the only fly in the ointment. But the producer price index and everything else seemed to fit exactly in a contingency that we considered and discussed at some length at the meeting as to how we would react under those circumstances. The one thing that was really surprising and added a little edge to the way we operated was the exchange rate. One could have argued that we should have been a little more aggressive in our monetary policy [response]. At least that's my thinking. In any event, that's behind us.

We seem to have votes for "B," which I interpret as including both the funds rate range and the aggregates. There are some differences of opinion on how that is to be dealt with. I would remind you of what Si Keehn just said. We meet again in 5 weeks; it's a relatively short period of time. I didn't hear anybody talking about a higher borrowings number. Some people were talking about a lower one and a number of people were talking explicitly or implicitly about not being too slow to move lower, if the evidence suggests that. Someplace in this area we ought to be able to reach some kind of consensus operationally. I don't like the directive as Mr. Sternlight and Mr. Axilrod wrote it, I must say. It starts out by saying policy is unchanged. I'll be more correct in my words; it says the "implementation of policy has been unchanged" when it obviously was changed in the last month. If we were to read all of our directives in succession, they would never say anything was changed, although in fact they were changed.

MR. PARTEE. That's traditional.

CHAIRMAN VOLCKER. Well, I recall we had an argument about this once before. But it seems to me that the first sentence ought to acknowledge that we have somewhat less pressure on reserves than we did at the time of the last meeting [when we adopted a directive] that said no change unless something happens. Well, something happened. That's a more or less technical point. The real question is what we do thereafter. I certainly share the view that some have expressed that if things continue coming in on the low side and/or the exchange rate continues very strong, we shouldn't be very reluctant to ease further in the kind of range that has been discussed here. I, myself, am somewhat indifferent as to whether or not we do that right now. I don't think it is necessary [to take action now]. We have a very peculiar technical situation now where the funds rate is very high--and borrowings have been very high just in the last few days--relative to what one would think it would be with this borrowing level. The actual borrowing level we're going to publish is going to be way above our target. It's going to confuse people. And we are looking toward a great excess of reserves later in the week that may or may not be reflected very promptly in the funds rate. How we will handle that I don't know, but we are well above any borrowing number--about twice--that anybody has been talking about for the first week of this two-week period. And getting it down to any of these borrowing numbers in the course of this week is inconceivable. It would have to go to zero right away. So, during this period, we're going to have a much higher level of borrowing than any of these numbers we are talking about. Whether there was anything that could have been done about that, I don't know, but it's too late now. We are going to start off the first week of this five-week period with a very high level of borrowing relative to what we're presumably aiming at, which may mean that the funds rate temporarily will go quite low later in the week. In that case we obviously will be selling--not necessarily this week, but later in the two-week averaging period.

MR. PARTEE. Is this the first week of a two-week period?

CHAIRMAN VOLCKER. Yes, this is the first week of the two-week period. Just as a guess, the funds rate isn't going to decline all that precipitously later in this calendar week but the banks may have such an accumulation of excess reserves by the early part of next week that it may plunge. And they will be even further confused by what we're trying to do. I have my doubts about these two-week averaging periods the more experience we have with that; the banks don't seem to have a very good idea of where the funds rate should be and it moves all over the lot.

MR. GRAMLEY. Maybe we should go back to lagged reserve accounting.

CHAIRMAN VOLCKER. I don't know how much that affects it. It may be that the contemporaneous reserve accounting makes them so much more uncertain about their reserve positions that it contributes to it. It may be a combination of the two.

MR. PARTEE. [Unintelligible] uncertainty.

CHAIRMAN VOLCKER. In any event, in substance I will attempt to interpret what people are saying or some mean of what people are saying. We start where we are, or close to where we are, and are pretty prompt to move lower if the money supply weakness is further confirmed, if the dollar is strong, and if economic weakness is relatively further confirmed. All these signals would have to be pretty strong to carry us to borrowing as low as $500 million, I think, but not so strong to carry us down to $650 million or $600 million. The signals would have to be clear, but not extreme. Before I talk about language, how does that sound?

MR. GRAMLEY. I for one would repeat my own concern about moving too far too fast because I don't think we know when the economy is going to start picking up again. I thought I heard a fair number of people share that concern; maybe not. There were a number of people who were worried, as I am, about the possibility that if interest rates come down too much and if the economy then recovers rates would go bouncing back up again. And that's not a desirable development, in my judgment.

CHAIRMAN VOLCKER. Well, what we want to examine is how much is too much too fast. I would remind you, we now have a borrowing level that is down by $250 million, presumably, in terms of the previous target, with the fed funds rate as of the last few days down practically not at all. A lot of other things are going on. I don't know what you're thinking of. Putting it in terms of interest rates is easier to describe.

MR. GRAMLEY. Yes.

CHAIRMAN VOLCKER. I don't have in my mind a 10 percent funds rate at this point.

MR. PARTEE. I don't think we are talking about very much, Lyle.

MR. GRAMLEY. If the funds rate were to get down into the 10-1/4 to 10-1/2 percent range, I wouldn't be acutely uncomfortable. If it gets down to 10 percent, having been up to 11-1/2 percent only a few weeks ago, that just seems to me to be too big a move.

MR. PARTEE. But the 11-1/2 percent was an aberration to a considerable degree.

MR. GRAMLEY. Well, yes, except it stayed up in that 11-1/4 to 11-1/2 percent range for quite some time. To go down more than a full percentage point in a matter of 6 to 8 weeks--.

CHAIRMAN VOLCKER. Well, nobody knows. And we get daily fluctuations in the numbers; we already have. But to give you the state of my mind: I'm not thinking of a 10 percent funds rate at this point as a likely outcome without a good deal more weakness than what we've already seen.

MR. CORRIGAN. There is one thing I'm very uncomfortable about. As you stated, when you start out at $750 million, you're willing to go to $650 million and if the funds rate comes down a little more in the circumstance that you described, I think that's probably all right. My hunch is that, absent this precautionary premium or whatever we want to call it, the funds rate probably would move down by itself in the fourth quarter in the context in which we had money growth around 6 percent and borrowings around $750 million. But my real concern is the other contingency: that events could very well precipitate an increase in that precautionary premium. Then, we would end up with a situation in which at any borrowing level, the federal funds rate would tend to be higher. And then we would be left with a Catch-22 situation where money growth, wherever it may be, could be in some structural sense out of line with what is observed in the federal funds market and what is observed with the level of borrowing. And I just don't know what to do about that.

CHAIRMAN VOLCKER. I'm not sure what contingency you're talking about. There could be a million of them. Are you saying the implication, if the money supply should be high, is that--

MR. CORRIGAN. Now, that would be the worst. I'm saying that the contingency I'm concerned about would be if this precautionary atmosphere that we see in the way banks are managing their money is intensified.

CHAIRMAN VOLCKER. I understand that, but if that gives a tight [funds] market and money supply growth is relatively low, presumably we would ease the pressures on reserve positions. That's fairly easy.

MR. CORRIGAN. Yes, but my concern is that we might get that in a context in which money growth is strong.

CHAIRMAN VOLCKER. Well, then you've got a different situation.

MR. CORRIGAN. Then we have a real problem.

MR. PARTEE. But we have these guides in the directive for the money supply growth, if it is strong.

CHAIRMAN VOLCKER. Yes, but he's saying he doesn't like that, presumably, when something looks contrary or peculiar. If we had rising interest rates and high money supply growth, then I think we would have to rethink it. I don't know how you write that in the directive.

MR. MARTIN. You can't cover every eventuality.

CHAIRMAN VOLCKER. I think that is clearly one where we'd have to rethink it.

MR. CORRIGAN. I think there's a good chance we may be confronted with that.

CHAIRMAN VOLCKER. Well, we may; I don't know what we would do about it.

VICE CHAIRMAN SOLOMON. We have to be careful not to go back and overemphasize the importance of short-run money supply numbers. They may not be telling us anything.

MR. PARTEE. Or they might be telling us something.

MR. MARTIN. When we've had them for four months!

VICE CHAIRMAN SOLOMON. But, normally, we look at longer periods, and in longer periods we seem to be all right. I understand that a lot of the recent economic indicators are somewhat weaker, but as long as we're doing so well in the long run [with respect to] the annual money targets why should we be that concerned about correcting the short run?

MR. MARTIN. [Is] the short run 3 to 4 months?

VICE CHAIRMAN SOLOMON. I don't know what that lag is.

MR. PARTEE. I agree with you, Tony, but I do think that as the evidence accumulates we have to begin to recognize it. We had the weak July and then the staff said that August would snap back. Then August was low and they said that September would be good. Now September seems to be revising down, and in this case they don't seem to have much hope that October is going to be strong. Maybe, to complete the whole circle, October will be very strong. Right now it doesn't seem to look it. So, we're starting to develop [a pattern of] some months.

CHAIRMAN VOLCKER. If October is going to be strong, it's going to have to show up, I suspect, in the figure for October 8th, which we won't have for a while. And, if it doesn't show up then, we'll be in trouble in October because we'll have a couple of weeks in October below the September average.

MR. PARTEE. Well, the $8 billion increase that's--

CHAIRMAN VOLCKER. Yes, they usually come in the first or second week in the month; that's why I say that. If it doesn't come by October 8th, I think we're unlikely to get an increase like that.

MR. PARTEE. So that becomes four months of low growth. Four months is not as long as a year, but it's approaching six months and one starts to take it into account a little. At least that's the way I look at it.

CHAIRMAN VOLCKER. As in September, if we had a great big increase that first full week in October, it wouldn't mean much; it might be necessary to put October at 6 percent.

VICE CHAIRMAN SOLOMON. Which would be all right.

CHAIRMAN VOLCKER. Which is what happened in September.

VICE CHAIRMAN SOLOMON. Coming back to the question that you posed, I would agree with the basic strategy as you formulated it in terms of continuing where we are on the borrowing level, the alternative B numbers, and using your discretion that if everything comes in weak to go down to $600 or $650 million [on borrowing]. But it seems to me that a large number of us are concerned too about the perception as well as the substance of a large drop in interest rates engineered by the Fed in the next critical 5 to 6 weeks. And it seems to me that, under those circumstances, there would have to be a strong enough case for you to call a Committee consultation if you want to go below $600 million. If it's something in that area, that seems to me an appropriate way of touching different bases.

CHAIRMAN VOLCKER. I don't have any great problem with that, but my only connection with all the various political or semi-political sensitivities that have been mentioned is that, just speaking personally, I'm not very impressed with any of them I must say. I don't necessarily agree with the Vice Chairman's fiscal policy strategy. I'm not sure we'd know how to play that one. I'd just play it straight. And, in connection with the next few weeks, I'd play it straight too.

VICE CHAIRMAN SOLOMON. Yes, if there's an overwhelming case for--

CHAIRMAN VOLCKER. Well, you say overwhelming--

VICE CHAIRMAN SOLOMON. Or clear case.

CHAIRMAN VOLCKER. A reasonably clear case. That's all I'm saying.

VICE CHAIRMAN SOLOMON. The markets don't have as pessimistic a view as I think you and Pres Martin and maybe Emmett have been reflecting today.

MR. RICE. I don't have a pessimistic view.

VICE CHAIRMAN SOLOMON. Oh, I misunderstood you. I think the market view is quite clearly one that this is a temporary weakness--this 3-1/2 percent that we see on the third-quarter flash [GNP report]--and that the fourth quarter will continue with moderate strength. And I think it's important that we have a clear case before we're perceived as doing some very substantial easing.

CHAIRMAN VOLCKER. Well, it's a matter of degree. But I think it can be overemphasized. The market may be wrong and then we're going to look like damn fools, and pretty quickly. The market couldn't understand that we were easing earlier. But I think it's fully accepted and it's very hard to [find] fault with it, I think, in their view. I don't get any sense of complaint about it or wondering about it at this stage, although they didn't quite anticipate it. There was a kind of disbelief for some weeks.

VICE CHAIRMAN SOLOMON. I think you did the right thing.

CHAIRMAN VOLCKER. The question is how the economy and the dollar and all the rest will behave. And none of us knows that.

VICE CHAIRMAN SOLOMON. I think you did the right thing, but I guess I'm surprised also. For a man who's as skeptical as you are and most of us are about what the economic indicators are telling us about the real economy, don't you think it is dangerous to try to fine-tune an interest rate response so quickly? After all, we only began to see these weaker economic indicators that I'm talking about in the last few weeks. I think your judgment has been vindicated, but we only began to see a few weeks ago these indicators showing more weakness. And they could possibly have been wrong.

CHAIRMAN VOLCKER. It wasn't just the numbers on the economy. I think they began showing up immediately after the last meeting. We had an extreme movement in the dollar and continued weakness in the monetary aggregates.

MR. PARTEE. There were shortfalls in all of them.

VICE CHAIRMAN SOLOMON. Yes, but since we ignored the strength of the dollar previously in domestic monetary policy, I guess I don't quite understand why this last speculative bubble had that much more impact on this situation. Although I agree with the direction of it, the--

CHAIRMAN VOLCKER. It was pretty extreme. In terms of my foreign colleagues, outrage is a little strong, but [their reaction verged] on outrage that we didn't pay more attention to it.

VICE CHAIRMAN SOLOMON. I know. But then I heard very critical comments from the key actors on the European side--central bankers I'm talking about--that our intervention was so feeble that it didn't really mean anything.

CHAIRMAN VOLCKER. I don't disagree with that, but there was very little support for intervention without monetary policy action on the part of the United States.

Well, I think we are in an asymmetrical position; that's where my gut tells me we are. [The issue is] whether or not we put it down in the directive. I would. If the economy suddenly rebounded and the money supply began running significantly higher than alternative B, I would question what we do, particularly in the context of the dollar not strengthening further. I can imagine circumstances in which one might want to tighten, but I'd be pretty hard pressed to imagine what those circumstances would be in the next five weeks. It does not strain my credulity at all to think that we might want to go at least modestly in the other direction in the next five weeks. And I would think that the directive ought to reflect that. But just how it reflects that is--

MR. PARTEE. Well, as I suggested, we could just change the "might" and "would."

CHAIRMAN VOLCKER. Yes, I know. We could do that.

MR. PARTEE. Or we could change the order of the two parts of the sentence.

CHAIRMAN VOLCKER. That, I think, is the minimum that one ought to do. Mr. Axilrod could distribute this [draft] that really is asymmetrical, if you're interested in looking at it. It would start out by saying "In the implementation of policy in the short run the Committee seeks to maintain the lesser degree of restraint on reserve positions sought in recent weeks." That's more or less technical; it acknowledges that we did something. Then, we'd put in the sentence with basically the alternative B [specifications]. It would go on to say that a somewhat or slightly further lessening of restraint on reserve positions would be acceptable in the light of significantly slower growth in the monetary aggregates, particularly in the context of continued moderation in economic activity and inflationary pressures. Then we'd go on with the standard language.

VICE CHAIRMAN SOLOMON. I thought it would be "only" in the context. That implies that even without any weakening in the real economy there would be even less restraint just because of weakness in the monetary aggregates--that that alone would trigger it.

CHAIRMAN VOLCKER. It says "particularly in the context of."

VICE CHAIRMAN SOLOMON. Whereas the one we had before that said--

MR. PARTEE. It said "only."

VICE CHAIRMAN SOLOMON. --"only in."

MR. MARTIN. Continued moderation in economic activity and inflationary pressures.

MR. GRAMLEY. You're dropping out the tightening [alternative] altogether.

CHAIRMAN VOLCKER. In this version. We can put it back in, but I'd put it in another sentence--unless you want to use something like "particularly." Otherwise, we could just drop the next sentence.

MR. PARTEE. Yes, or leave the next sentence and drop the last phrase.

CHAIRMAN VOLCKER. The one thing that bothers me about this is that there is then no mention, except in another paragraph, of credit market conditions and the exchange rate. That is obscurely in there now with financial market conditions. That could be worked in somehow, I suppose. Let's put a comma, and then "taking account of financial market conditions and the rate of credit growth."

MR. GUFFEY. Doesn't that appear in the sentence immediately above the start of the operating paragraph?

CHAIRMAN VOLCKER. It does, but it doesn't get much attention there. It's not in the operative part of the directive. I don't have it in front of me, but you are right that there is a--

MR. PARTEE. My point, Paul, was that we could drop that whole phrase starting with "particularly" and instead make it a phrase such as "evaluated in relation not only to indicators of the strength of..." and just continue right on. Now, that makes it a one-sided directive, but I think it would solve Tony's problem that we would only look at easing in the context of weak money numbers and the confirming business and inflationary and credit situations.

CHAIRMAN VOLCKER. Well, I think it's a mistake not to have something on both sides. We can achieve the purpose you want by simply revising the existing sentence and putting the easier restraint first and then leaving the rest of the directive exactly as it is. So, it would read: "Somewhat lesser reserve restraint would be acceptable in the context of significantly slower growth of the aggregates or somewhat greater restraint would be acceptable in the event of more substantial growth. In either case..." and so on. It just seems to me that, with a couple of months of weakness in economic activity, to send a signal out that we have completely ruled out of our thinking any possibility that we would react to events on the other side is wrong. It's not the way to do things.

MR. BOEHNE. I'd like to piggyback on that. I think an asymmetrical directive, or at least a tilt in that direction, makes sense. But I think the image that this directive will create, in contrast to the last directive, is a stronger change than I would think the Committee would want to convey. After all, the last directive, which was symmetrical, enabled a rather significant drop in the borrowings, which I happen to think was a wise thing to do. But I just wonder if one has to move that far in this directive. Some tilt or some small signal, yes; but this just seems to me to highlight it and it's awfully strong for my taste.

MR. WALLICH. I think it would indicate a real policy shift if we dropped the up side of the symmetry.

MR. GUFFEY. I would agree.

VICE CHAIRMAN SOLOMON. And I would agree, obviously.

MR. CORRIGAN. In the context of what I thought you were saying before, Mr. Chairman, in terms of borrowings that could get down to, say, $600 to $650 million and a federal funds rate that could get down to 10 percent or 10-1/2 percent or something like that, I think that contingency could be covered easily in a directive that tilts rather than falls. Again, I must say that the danger that really bothers me is this whipsaw phenomenon I spoke of before. If we went through a period where we had, say, a 150 basis points swing up and down in short-term interest rates in a period of three months or so, I think that would be very, very damaging to the real economy and for the thrifts, for the banks, and for everybody else.

CHAIRMAN VOLCKER. I don't see why, but that's--

MR. CORRIGAN. I would say the reason why is that if we start to move in that direction in a context in which it's perceived that there is a potential for a rather large move, the markets will respond very aggressively. We'll get another surge of all this crazy activity in the mortgage markets and then it will just get stopped dead in its tracks if interest rates have to turn around.

VICE CHAIRMAN SOLOMON. I agree with Jerry completely. The more they see us responding quickly to short-run changes in the monetary aggregates, the more people in the market are going to say "Are we going to go back to the extreme swings that we had where rates were running between 8 and 20 percent?". I think we have to be careful of that; we ought to be moving very gradually.

CHAIRMAN VOLCKER. I think you are assuming much more controllability of the market than in fact we have.

MR. CORRIGAN. I don't have any problem--

CHAIRMAN VOLCKER. This great 1-1/2 percentage point reduction in long-term rates took place without any change in our borrowing assumption at all. We reduced the borrowing by $250 million--this massive move that you talk about--and long-term rates are practically where they were before we started moving borrowing down. And how far down the federal funds rate is, I don't even know. It depends upon whether you look at it on Friday or Monday or Wednesday.

VICE CHAIRMAN SOLOMON. Well, that's because of special factors that you talked about earlier.

CHAIRMAN VOLCKER. But it depends upon so many other factors that thinking we can predict this with any assurance is a bit beyond our capacity.

MR. CORRIGAN. I don't have any trouble with the substance of what I think you're saying. I don't even have any trouble with the suggestion that it would take some considerable set of circumstances to envision a tightening move in the next five weeks. But what I do have trouble with is creating a perception that what we have in mind is more than what I think you're saying. Most people are saying--

CHAIRMAN VOLCKER. Well, I think you're assuming conditions that I'm not assuming on this.

MR. CORRIGAN. I may be.

CHAIRMAN VOLCKER. All this easing that you're talking about takes place in the context of continuing quite sluggish business numbers, a strong dollar, and low money growth.

MR. CORRIGAN. Well, in those circumstances, if the borrowing level goes down in this five-week period, or even early in the five-week period, to this $650 or $600 million--

VICE CHAIRMAN SOLOMON. Earlier you said you had no objection to making it double-barrelled as long as it's only tilted, but I assume that you don't object to putting back in some contingency language on the other side.

CHAIRMAN VOLCKER. If it's too formalistic, I think we're just doing a very formalistic thing and not being very enlightening. But I don't have any objection to dealing with that.

MR. BOEHNE. May I suggest that you keep the sentence that you have there beginning with "A somewhat further lessening of restraint" and drop that last sentence? But in its place, we could have a sentence that would go something like this: "Some increase in reserve restraint might possibly be appropriate in the context of substantially greater growth in the monetary aggregates."

CHAIRMAN VOLCKER. I have no objection to something like that.

MR. WALLICH. Other than "possibly."

CHAIRMAN VOLCKER. Yes, I don't know whether you want the word "possibly" in there.

MR. GRAMLEY. Why not just take the existing sentence and reverse the order?

MR. GUFFEY. Indeed. That's a good suggestion.

MR. BOYKIN. Yes, that's what I think.

MR. PARTEE. Well, if we want to tilt it, we could say "well above" instead of "high growth."

CHAIRMAN VOLCKER. This is a very minor thing, but I would not just take this existing sentence and reverse the order because it sounds so formalistic.

MR. PARTEE. Yes.

CHAIRMAN VOLCKER. We would have changed nothing and people are supposed to read great meaning into the changing of the order of a sentence without one iota of change in the substance. That sounds a little too much. But if you put in an adjective or two, I don't mind that if you prefer it.

VICE CHAIRMAN SOLOMON. A moderate adjective?

CHAIRMAN VOLCKER. This time I'm partly objecting because it rather sounds to me like we're playing games instead of reflecting anything substantive.

VICE CHAIRMAN SOLOMON. I think perhaps you have a stronger view from the down side of the economy than most of us have.

MR. PARTEE. If you really want to change the structure, I would go back to my proposal that we use your first sentence and then say "evaluated in relation not only" and so forth. Then we could have another sentence that says "Conversely, if the monetary aggregates are strong and there is associated strength showing in the economy"--

MR. CORRIGAN. I could easily support that.

MR. WALLICH. "Conversely" strikes me as balancing it in the right direction.

CHAIRMAN VOLCKER. It sounds a little less formalistic to me than just reversing [the order].

MR. PARTEE. Well, it is. It really does change it somewhat, I think, but not a great deal.

MR. GRAMLEY. But wouldn't you want to put that sentence before the "in any event" sentence?

CHAIRMAN VOLCKER. Well, he's combining those two sentences.

MR. PARTEE. No, I'm combining them and dropping that.

CHAIRMAN VOLCKER. The way he would have it read is "A somewhat further lessening of restraint on reserve positions would be acceptable in the event of significantly slower growth in the monetary aggregates evaluated in relation not only to the indicated strength of the business expansion and inflationary pressures, but also to financial market conditions and the rate of credit growth." That's a rather cumbersome sentence, but it's all right. "Conversely, greater restraint might" or "would be acceptable."

MR. PARTEE. "Might," I think.

CHAIRMAN VOLCKER. Is "acceptable" the word? We'd say "acceptable in the event of"--well, "significantly" is the obvious word to put in here but we used "significantly" up above.

MR. PARTEE. "Monetary growth well above the numbers expected." Is that what we call it?

MR. GRAMLEY. "Well above these expectations."

MR. AXILROD. "Growth substantially more rapid."

CHAIRMAN VOLCKER. "Substantially more rapid monetary growth." Is that--

MR. PARTEE. That would be all right.

CHAIRMAN VOLCKER. "And indications of"--we can't exactly say a rebound. "Indications of stronger"?

MR. PARTEE. "New strength" or something like that.

CHAIRMAN VOLCKER. "Economic growth and credit expansion." [Unintelligible] Jack Kemp's concerns.

MR. PARTEE. "Indications of stronger expansion in economic and financial developments."

VICE CHAIRMAN SOLOMON. Sounds great. Real prose--poetry, in fact.

MR. PARTEE. Or "stronger economic and credit market"--

MR. AXILROD. Add "inflationary pressures." I wrote "indications of significant strengthening in economic activity and inflationary pressures."

CHAIRMAN VOLCKER. Yes, I think it's good to get the [reference to] inflationary pressures in there--"of economic activity and inflationary pressures."

MR. PARTEE. It's hard to imagine we'll have evidence of all this in five weeks.

CHAIRMAN VOLCKER. I think that's right.

MR. BLACK. More than fragmentary indications.

CHAIRMAN VOLCKER. Well, I know what I have now, and what's the rest of it?

VICE CHAIRMAN SOLOMON. The usual boiler.

CHAIRMAN VOLCKER. The usual last two sentences, or just the last sentence. It goes directly to the last sentence.

MR. GRAMLEY. Sometime we ought to put out a directive which says "Complete with the usual boiler plate"!

CHAIRMAN VOLCKER. Let me just read it: "In the implementation of policy in the short run, the Committee seeks to maintain the lesser degree of restraint on reserve positions sought in recent weeks. This action is expected to be consistent with growth in M1, M2, and M3 at annual rates of 6, 7-1/2, and 9 percent, respectively, during the period from September to December. A somewhat further lessening of restraint on reserve positions would be acceptable in the event of significantly slower growth in the monetary aggregates, evaluated in relation--." Why don't we take out this "not only" bit to simplify the sentence?

SPEAKER(?). Yes.

CHAIRMAN VOLCKER. --"evaluated in relation to the strength of business expansion and inflationary pressures and financial market conditions and the rate of credit growth." Am I right?

MR. AXILROD. Did you want to put "financial and exchange market conditions"?

CHAIRMAN VOLCKER. "Domestic and international." Put in everything but the kitchen sink! "...domestic and international financial market conditions, and the rate of credit growth. Conversely, greater restraint might be acceptable in the event of substantially more rapid monetary growth and indications of significant strengthening of economic activity and inflationary pressures. The Chairman may call for Committee consultation" etc. And we leave in 8 to 12 percent [for the funds rate range].

SPEAKER(?). Sounds right.

MR. MARTIN. Then we want 8.

MR. GRAMLEY. Would you read that significant strengthening in economic activity [part]?

CHAIRMAN VOLCKER. "...strengthening of economic activity and inflationary pressures."

MR. PARTEE. That's right. The current range is up to 12 percent. That's just as well, isn't it, Steve?

CHAIRMAN VOLCKER. If that is satisfactory, we will vote.

MR. BERNARD.

Chairman Volcker	Yes
Vice Chairman Solomon	Yes
President Boehne	Yes
President Boykin	Yes
President Corrigan	Yes
Governor Gramley	Yes
President Horn	Yes
Governor Martin	No
Governor Partee	Yes
Governor Rice	No
Governor Seger	No
Governor Wallich	Yes

CHAIRMAN VOLCKER. Okay, I guess we are finished.

END OF MEETING