Meeting of the Federal Open Market Committee

November 4-5, 1985

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 Monday, November 4, 1985, at 3:00 p.m. and continuing on Tuesday, November 5, 1985, at 9:30 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Corrigan, Vice Chairman
Mr. Balles
Mr. Black
Mr. Forrestal
Mr. Keehn
Mr. Martin
Mr. Partee
Mr. Rice
Ms. Seger

Mr. Guffey, Mrs. Horn, Messrs. Melzer and Morris, Alternate Members of the Federal Open Market Committee

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

Mr. Axilrod, Staff Director and Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield. 1/ General Counsel
Mr. Kichline, Economist
Mr. Truman, Economist (International)

Messrs. Broaddus, Kohn, Lindsey, Prell, Scheld, Siegman, and Ms. Tschinkel, Associate Economists

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

---

1/ Entered meeting after action to approve minutes of meeting held on October 1, 1985.

Mr. Coyne, 1/ Assistant to the Board of Governors
Mr. Roberts, 2/ Assistant to the Chairman, Board of Governors
Mr. Promisel, 3/ Senior Associate Director, Division of International Finance, Board of Governors
Mr. Slifman, 3/ Deputy Associate Director, Division of Research and Statistics, Board of Governors
Mr. Gemmill, 2/ Staff Adviser, Division of International Finance, Board of Governors
Mr. Hooper, 3/ Assistant Director, Division of International Finance, Board of Governors
Mr. Stockton, 3/ Economist, Division of Research and Statistics, Board of Governors
Mrs. Low, Open Market Secretariat Assistant, Board of Governors

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

Messrs. Balbach, J. Davis, T. Davis, Lang, Ms. Munnell, Messrs. Rolnick and Rosenblum, Senior Vice Presidents, Federal Reserve Banks of St. Louis, Cleveland, Kansas City, Philadelphia, Boston, Minneapolis, and Dallas, respectively

Mr. Judd, Vice President, Federal Reserve Bank of San Francisco

Ms. Walter, Adviser, Open Market Operations, Federal Reserve Bank of New York

---

1/ Entered meeting after action to approve minutes of meeting held on October 1, 1985.
2/ Attended Tuesday session only.
3/ Attended Monday session only.

Transcript of Federal Open Market Committee Meeting of
November 4-5, 1985

November 4, 1985--Afternoon Session

[Secretary's Note: The beginning of this meeting, which consisted of the Committee's action to approve the minutes of the previous meeting and a special staff presentation and discussion of economic and policy implications of exchange rate adjustments, was not transcribed. The presentation, by Messrs. Axilrod, Hooper, Stockton, and Slifman, is included in the Appendix.]

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

MR. RICE. Sam, what will the BIS do with the deposits of marks?

MR. CROSS. They will deposit them in banks.

MR. RICE. Where? In Germany?

MR. CROSS. In German banks.

CHAIRMAN VOLCKER. In Germany?

MR. CROSS. I think the idea is that the Bundesbank

So I assume that most of this will get back into Germany.

MR. BOEHNE. You talked earlier about selling dollars in markets outside New York as well as in New York. My general sense is that the extent to which you're intervening in markets overseas is a good bit more than has been the practice in recent years. I wonder if you could comment on the pros and cons of that and how you would judge the effectiveness of being more active in markets in the Far East, for example.

MR. CROSS. Well, I think it can be helpful at times. For example, at times when the Japanese were intervening rather heavily in the yen we were intervening in the Far East, kind of following their action, to keep some action with respect to the mark. It showed evidence of a somewhat coordinated approach. And since we hadn't done that sort of thing very much, as you said, certainly in quite a while, that certainly can have an impact in the proper circumstances.

MR. BOEHNE. Have you been as open in these markets as you are in New York? Is it as obvious to people in the market?

MR. CROSS. It's certainly known. We have tried different approaches in our own market and elsewhere, at times operating through agents, at times trying to operate as openly and as visibly as we could--dealing with a whole bunch of banks at once--in order to make clear to all the participants that we were there and that we were acting in a firm way. But it depends on the particular circumstances and the time of day and things of that sort.

CHAIRMAN VOLCKER. Any other questions? We have a recommendation to renew the swap arrangements.

[Secretary's Note: Motions to renew the swap arrangements and to ratify the transactions in foreign currencies were made, seconded, and approved without objection.]

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

CHAIRMAN VOLCKER. Any discussion?

MR. BOEHNE. I have a question. You said November 15 is "drop-dead day" or whatever.

MR. STERNLIGHT. Yes, "drop-dead day"--when they have to trot out some gimmick.

MR. BOEHNE. Right. Are there gimmicks there that can be used?

MR. STERNLIGHT. They did some disinvesting of trust funds a few days ahead of the normal schedule in order to make benefits payments to Social Security and other pension recipients just in the last couple of days--last Friday and today. Conceivably, they could do some disinvestment of trust funds even further ahead of time. But that's something they have talked about in their inner circle discussions at Treasury but have no intention, as far as I know now, of doing. There was mention, I think, in one of the letters that went up from Secretary Baker to the Congress about the possibility of selling gold but they said that the Administration is totally set against doing something like that. There are probably half a dozen other things that are conceivable but that they have said they just don't want to do.

MR. PARTEE. Have they used up the Federal Financing Bank?

MR. STERNLIGHT. It will be just about used up by the $3 billion cash management bill that they announced early this afternoon and will carry through tomorrow. I think that will leave about $1 billion.

MR. MELZER. Peter, would you say that the somewhat firmer and more volatile funds rate is associated primarily with this uncertainty surrounding the Treasury's financing requirements? Or are there other factors that are operating now?

MR. STERNLIGHT. Well, the firming of the funds rate has been rather minuscule; it has changed from a 7.90 percent average to an 8 percent average, approximately. It is conceivable that some of the changing pattern had to do with low Treasury balances in the money center banks, which may have put them under a little more pressure to buy in the fed funds market, but I'm not sure it was very significantly that. I think it may have been more a carrying through of the slight adjustment that had been made in our degree of borrowing pressure before the last meeting that was achieving its maturing effect in the recent period.

MR. MELZER. Did the intervention activity create any difficulty for implementing domestic--?

MR. STERNLIGHT. I don't think so. We had a good handle on what it was. Typically, that takes place in terms of the actual reserve impact with a couple of days' lag, and we were totally on top of what was happening there.

CHAIRMAN VOLCKER. Any other questions? If not, we have to ratify those transactions.

MR. PARTEE. So moved.

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN VOLCKER. Without objection. We can go home unless you want to hear an economic report. Mr. Kichline are you prepared to give an economic report?

MR. KICHLINE. Sure.

CHAIRMAN VOLCKER. You want to go home?

MR. PARTEE. I think we ought to have Mr. Kichline's report in the morning.

MS. SEGER. I do too.

CHAIRMAN VOLCKER. We'll see you all in the morning.

[Meeting recessed]

November 5, 1985--Morning Session

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

CHAIRMAN VOLCKER. Comments?

MR. MELZER. Jim, in what kind of shape are inventories in general?

MR. KICHLINE. We think really quite good. Obviously, part of what is going on in the aggregate numbers is this auto story: stocks were run off substantially in the third quarter and are being rebuilt now. As we go through the various sectors, in putting together what we know, we think that inventories are about in line in the aggregate, and in the forecast we just have them rising with sales. So they don't really run off any more and they don't contribute to growth; they're a neutral factor. There are a couple of areas that I think are important. I have seen some figures for Sears, for example, which presumably is pretty close to the industry in planning. They still feel that inventories are a little on the high side, are banking on decent Christmas spending, and expect that will take care of it. But if indeed consumer spending turned out to be a little weak, I would think retailers might not be very happy as they enter the new year. Still, in that general merchandise area, particularly with respect to apparel and some soft goods, it depends on decent sales prospects coming along.

MR. PARTEE. Jim, that is an extraordinarily low saving rate in the third quarter. Would you attribute that mainly to the surge in car sales and the credit associated with it, or what?

MR. KICHLINE. Well, it is two things: one is the surge in car sales; the other is that income growth was weakening and consumer spending outside of autos was still pretty good--not that weak. If you want to take a percentage point or so off for auto sales, you might do that. But even so, what we have been looking at is fairly good consumer spending and weakening real disposable income growth, so that consumers really have been in a position of reducing their saving rate, borrowing a lot and so forth, to fund expenditures. So, I think it is more than autos.

VICE CHAIRMAN CORRIGAN. We did a calculation on that point that is kind of interesting. It is not an entirely valid calculation because you can't hold everything else equal, but with that limitation it is a valid calculation. If you use a benchmark of, say, 5 to 6 percent as the average for the preceding quarters and work off that, the combination of two things--the reduction in farm income and higher net interest payments by consumers--appears to be worth a little more than a percentage point on the saving rate itself.

MR. PARTEE. Higher net interest payments?

VICE CHAIRMAN CORRIGAN. Net.

MR. PARTEE. Oh, net interest; so, payments minus receipts.

VICE CHAIRMAN CORRIGAN. The combination of both of those things. Again, given the limitation of the way you do your arithmetic, farm income and interest payments are about a half a point each.

MR. PARTEE. I assume farmers aren't spending any money?

MR. BOEHNE. Some farmers are. Some farmers in New Jersey and Pennsylvania and Delaware are going out to places like Iowa and buying up machinery that is on the block out there cheap and hauling it back.

MR. PARTEE. Hauling it back?

MR. BOEHNE. Hauling it back. They are buying implements that might cost $50,000 to $60,0000 and picking them up for $15,000, $20,000, or $25,000. It is worth the trip out.

MS. SEGER. That isn't recorded as consumer spending though, is it?

MR. BOEHNE. No. But some farmers are spending. That's my point.

CHAIRMAN VOLCKER. Does anyone have any more comments on the business scene?

VICE CHAIRMAN CORRIGAN. I myself just can't see anything out there that is going to get growth up into the 3 to 3-1/2 percent range as opposed to the 2 to 3 percent range. For a long time I thought housing could make the difference in terms of that marginal contribution, but I can't see that now either. Looking across the sectors of the economy at this point, it is just awfully hard to find sources of marginal growth that would get us to a bit more respectable range on a forecast basis. On top of that, the anecdotal reports that I, at least, am getting from business people and directors and so on--for what they are worth--are distinctly on the sour side.

CHAIRMAN VOLCKER. Mrs. Horn.

MS. HORN. Looking around the District I find, much as is the case for the national outlook, that the incoming data are not conclusive. I see no evidence of accumulating weakness nor signs of stronger growth in the months ahead. The business investment picture has come in consistently weaker than I had expected, both in the District and of course nationally as well. But I wouldn't see a change in that outlook. Housing, which Jerry just spoke of, has responded to the lowering of interest rates with less strength than I and many of us had expected, and that is in the District as well as nationally. The real question is with the consumer, and in our District retailers are encouraged about the Christmas season. Also, in talking to people in the business community I have noticed what I think is a change in attitude toward their formerly optimistic feeling that the fiscal impasse might be resolved. I have long thought that it probably would not but in that I differed with the business community that I talked to; they had been optimistic up until the last couple of months but I think now their view is that the fiscal impasse will remain an impasse. I am not sure that I can take the next step and say how that will change their planning for the future, but I think there has been a distinct change in attitude there. I would say that the business people I talk to continue to be guardedly hopeful about efforts to reduce exchange rates. While they realize the dangers connected with an overly fast reduction of the exchange rate, I think they view what has happened perhaps as being maintainable. And if exchange rates were to back up, I think their reaction would be disappointment and that might affect their future plans.

My view of the economic outlook is about the same as the staff's forecast--I don't know whether to describe that as moderate expansion--in the next couple of quarters. As I look at the 2 to 3 percent number, which may [turn out to] be closer to 2 percent, and ask myself if that is a good or bad number to be looking at in the forecast, I am not sure I come to a conclusion. If I talk to my directors and others and look at the gaps in the economy, I see a lot of room to say it is not a good number. On the other hand, when I remember the difficulty of reducing inflation and the high price we paid, it looks better in that context.

CHAIRMAN VOLCKER. Governor Martin.

MR. MARTIN. Jim has given us a ritualistic comment that there has been no change in the forecast and I am going to give the ritualistic response to that and say that there has been a change in the forecast in a direction with which I concur--that is to say, it is more realistic in that the numbers are down a few tenths for the next five quarters and unemployment is constant or creeping up a bit, depending on how well the forecast tracks. Like others, I [have reservations] about the assumption of the saving rate staying at a little over 4 percent, but we explored that pretty thoroughly and there is no point in going over that further. It is interesting that the forecast contains a shift in government spending in the full employment budget deficit sense, which should be a matter of some interest with regard to what Jerry Corrigan has indicated as a very cautiously optimistic outlook with no sector particularly giving a push. It does not look as though [stimulus] is going to come from the federal government sector. I am delighted to see the housing forecast revised downward a little. I like that old joke about the people who lived in [unintelligible] and everybody knew everybody's story, so their stories were numbered. I am going to number my comments, so I will simply say "number 17" rather than make you listen to my ritualistic housing comment. I warn you, however, that tightening of credit standards by lending institutions has yet to have its full effect and that is coming. That is down the road and I think it will be in 1986 but that--in other words, "17."

MR. PARTEE. Does that mean that you agree with the forecast?

MR. MARTIN. No, I said "17" already, Chuck. That means I think it is a little too optimistic.

MR. MORRIS. The tightening of lending standards doesn't seem to have hit the commercial construction market. How do you account for that?

MR. MARTIN. No, I am talking about housing. I am talking about that 1.8 million housing figure and that $5.6 billion residential spending number, neither of which we will ever reach.

MR. MORRIS. What I don't understand is why the lending institutions are still lending for office buildings at the rate they are. I don't quite comprehend.

MS. SEGER. It's the lags.

VICE CHAIRMAN CORRIGAN. I got the answer to that the other day, Frank. We had the chairman of one of the largest commercial construction companies in the world into the bank for lunch and I asked him that same question. I said "How come you're still building all these buildings in Dallas and so on?" He said: "It is very easy; the banks keep giving us the money. As long as they give us the money we will keep building."

MR. MARTIN. The banks, the thrifts, the life insurance companies--

MR. FORRESTAL. Why are the banks extending the money?

MR. PARTEE. They don't have any other place to put it!

MR. MARTIN. I think the reason is different. I think it is because there still is, from the '70s, the expectation that those office rents and that percentage lease income from the commercial property are going to increase with inflation down the road--in three, four years, whatever. I think that's built in. These people have equity positions and they feel that the office rents and the percentage returns off the commercial property will [provide a good] return. In conclusion, I don't think the major issue here is downside risk. Let me break another rule and say that I think this is a courageous forecast. I think the staff was willing to revise it in a downward direction and take the risk that they might be pessimistic. It has implications, of course, for our next round of discussion with regard to monetary policy. There is that assumption of somewhat lower interest rates over the 5- or 6-quarter period--a drop of 150 points in one case and 100 points in the fed funds rate in the other case. We have to consider whether the forecast results are appropriate--whether the monetary policy we adopt here is consonant with that 150 basis points decline over this period of time. I think it's a good forecast.

CHAIRMAN VOLCKER. Mr. Boykin.

MR. BOYKIN. Mr. Chairman, I can't bring in any great amount of optimism to this discussion. Our part of the country, I think it is fair to say, is pretty sluggish. It is uneven; it depends on where you happen to be sitting. We had an unemployment rate for Texas last month of 8.1 percent, which is very unusual. The unemployment rates in Louisiana and New Mexico are even higher. In the various sectors of the economy, there is really not anything positive that seems to be happening. We continue to feel that the energy situation will remain [poor] even though there has been some firming in the price. We think that is temporary and that the price will start sliding as we get through the winter. In our latest survey of our agricultural banks it is fairly obvious that the tone has changed and that some of those problems now are starting to materialize. From that last survey, the decline in land values now is estimated to be about 10 percent, which doesn't sound like all that much compared to what is happening in the

Midwest. But that is the first time that I have seen a number that large from our respondents. The only thing that is really happening, and this was mentioned earlier, is in non-residential construction. We just had another major office building announced in Dallas by Republic Corporation; it is going to be a 60- story building that they are going to build with a developer--Vantage Company--and in the process they are going to reduce their occupancy costs; they have really made a very nice scenario on how all that's going to work out. I was reading in the paper coming up on the plane yesterday that Prudential, which now owns the second tallest building in Dallas, one of the newer ones--InterFirst Tower II, which InterFirst sold--is going to spend $50 million putting a new facade on that building so it will look prettier. I guess that is a good business decision; I don't know. But it just keeps on. We set new records in August in terms of the amount of commercial construction. Even in Houston--and I think I mentioned this before--there is a $250 million building coming out of the ground in downtown Houston. But that developer is going to catch the curve right; he is going to come on stream just at the right time. I am inclined to agree with Pres in terms of the outlook 3 to 5 years out: that there still seems to be the conviction that you can catch the turning point and it will pay off.

CHAIRMAN VOLCKER. Mr. Forrestal.

MR. FORRESTAL. Mr. Chairman, the Sixth District is seeing a definite tapering off of economic activity. Unemployment is up somewhat. The same sectors that have been suffering over the last several months are still in difficulty, basically textiles and apparel. Agriculture, while not as bad as in the Midwest, is still in the doldrums, and energy is pretty bad. On the other hand, we have this continuing activity in the commercial real estate sector, which I find very, very difficult to understand. I get the same answer that other people get: They're going to continue to build as long as they have the money to do it; I guess that's the way developers usually think. But it does seem somewhat irrational in that I think they are going to pay the price for it along the way. Housing, on the other hand, has been fairly decent in the Sixth District. All of the statistical information shows a downturn, but I must say that the attitude of directors and business people that I talked to is fairly optimistic. Again, I find it a little difficult to understand where this optimism is coming from. Even in New Orleans and in Louisiana generally, which are really in the pits as it were, they seem fairly sanguine about the situation and are looking for some uptick in activity.

Going to the national scene, I don't have any strong disagreement with the staff; I think they are about right. I think that Jim is quite right to put out some of these warning signals, particularly with respect to the consumer. Housing is definitely something that, if it continues, is going to be a source of strength to the economy. There really isn't much else that one can point to in the near future that's going to be a positive force. But I'm a little concerned that housing may not be as strong as the forecast. On the other hand, I don't really see that we're going to have any appreciable decline in activity. So, I think the staff's forecast is about right. I should add--and I meant to note this in my District report--that people are talking about beginning to see some price pressures building up in some businesses. They say it's related to the value of the dollar, which surprises me a bit, because that would suggest that the effect is occurring a little faster than we would have expected. But they are definitely reporting some increase in prices coming from abroad.

CHAIRMAN VOLCKER. Who is?

MR. FORRESTAL. "They" are basically in textiles--shirt manufacturers and people like that. Their raw material is increasing in price.

MR. MORRIS. What are the chances, Jim, that you're too conservative on the net exports side? You don't show net exports as being a drag anymore but, certainly, we're not seeing any significant response to the fairly sizable decline in the dollar that has taken place. Now, is this the normal--?

MR. KICHLINE. I think what we have built in here is a fairly normal historical response. I'll let Ted answer. I might say that question catches me a little by surprise because the usual question we get is: Why do you have net exports rising? So, I haven't thought about this one recently.

MR. TRUMAN. I think that's the right answer; that's my reaction as well. We do have some increase. In fact the percentage change on the export side we have is an increase of 7 percent in real terms for goods and services and 9 percent for goods alone. The import side is essentially flat or a very small decline--less than a percent in the imports in goods and a small increase in services, which would depend on more debt. So it's basically in line with what we have tended to say--this is the same question about the price question on the other side. If you don't think prices are going to change as much as some people argue, then import prices aren't going to reflect it as quickly or as fully as with past exchange rate changes. It also follows that you shouldn't get the response to the exchange rate changes as fully or as fast as in the past. So the two things are sometimes linked together. We have tended a little toward the conservative side on prices for various reasons, at least in the short run. Until we know what is underway, we feel we shouldn't put a large number in the forecast. Therefore, we also don't have a large number on the other, [real, side]; it's somewhat attenuated. But I think it's not far from what we believe is historical experience, given the quality of information on trade data at this point, which is not very good.

MR. KICHLINE. I might say that the net export sector contributes about a half percent to growth next year. So, we would have essentially 2 percent real growth fourth-to-fourth quarter if you held net exports constant. That's the impact of these numbers Ted is talking about.

MR. MORRIS. On your gradual depreciation path, at what point will we expect to get a real upward kick from net exports? Obviously, it's not in 1986.

MR. TRUMAN. Well, I think that's a pretty big kick: 9 percent.

MR. KICHLINE. Well, you get a kick early on from service receipts in the reevaluation in the current quarter. But looking ahead, where we think this begins to kick in is at the very end of 1986; presumably 1987 is the important year and it's beyond the forecast horizon. But it's late '86 at best where we see some particular strength and then we see it carrying on.

MR. TRUMAN. That's essentially a delayed reaction to the very steep decline because from here on out we have a gradual move.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, I wonder if I might ask Jim a couple of questions. Jim, you made some passing reference to the introduction of IBM's new Sierra mainframe computers. I was struck by this weekly publication of Citicorp the other day that estimated there are 400 or 500 already on order to be delivered in the fourth quarter. That would cause a pretty sizeable increase in total producer durable equipment expenditures; it seemed huge to me, just looking at it. I wondered if you had made any estimate of what that might do. The second thing is that I'd taken some encouragement from the nonfarm payroll employment figure and you suggested that ought to be averaged with September, if I understood you correctly. Do you think that is a seasonal adjustment problem there or what?

MR. KICHLINE. Yes. Let me comment on the employment figures first. The problem occurs particularly in manufacturing and construction. In manufacturing, employment dropped 110,000 in September, which we really didn't believe; and it rose 60,000 in October, which we don't believe either. And neither does the BLS. There are a couple of things going on. One is that the survey week in October was the earliest possible that could have occurred. The seasonals are thinking in terms of declining employment in October, and it is thought that the survey week was so early it didn't pick up all of the decline; hence, seasonally adjusted, you get a larger increase. Now, that's one part, particularly in manufacturing. We have some other evidence in terms of physical product and other information that leads us to think there are some distortions. But I would still say it's a good number in that it is very clear that those two months together look better than earlier in the year.

With regard to the Sierra, we have seen [shipments] numbers that range from an impact of $3 to $10 billion annual rate in the fourth quarter. We have talked to IBM and we have talked to others.

So they are trying to build up what was a dismal year for IBM's earnings expectations and make it all up in the fourth quarter, or do the best they can.

Other manufacturers, being one, are just not doing very well at all. So we think some offsets are occurring there. In addition, in the fourth quarter we expect a very sharp decline in business purchases of autos since some of those autos sold in the third quarter were business purchases at cut-rate terms. So the Sierra effect is a little uncertain. In our own thinking we picked a low-end number and used a positive $4 billion annual rate attributable to that, largely offset by autos and to some extent truck sales, which we think will be down. But it is a big impact. If we're wrong--. As I say, the numbers outside [forecasters are using] range from $3 billion to $10 billion annual rate and it depends in part on what you assume is happening elsewhere in the computer industry.

MR. BLACK. And also partly offset by declining shipments of others.

MR. KICHLINE. That's right, yes.

MR. BLACK. What they must have done in that Citicorp report, which was not clear to me, was to look just at the gross effect.

MR. KICHLINE. Yes.

MR. BLACK. It was surprisingly large; I wish I could remember that percentage because it shook me. I ought to remember it, but senility has overtaken me and I can't.

MR. PARTEE. You need a computer!

MR. BLACK. I may be too old for that!

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. There really is very little to report in the way of change in our District since the last meeting. Those businesses that have been showing some strength continue to do reasonably well. But there is certainly no noticeable improvement for the beleaguered. The steel industry and most lines of mechanical equipment remain awfully weak. On the steel side, the import restraints have had some effect but they have been far from perfect. And pricing conditions in the industry are very intense. Agriculture, I think, speaks for itself. The harvests have been late because of wet weather. Nonetheless, the crop estimates are being increased a bit, so that the pressure will continue on commodity prices. More positively--we've commented on the construction industry--certainly commercial construction in Chicago is very strong. I saw a presentation the other day showing that Chicago is going through a building period that has been unsurpassed since the great fire. An awful lot of buildings are going up. Just to add a comment to what Jim said earlier, the auto inventories really are very low; when they finished this big sales program they were down to 24 to 26 days' [supply], which was the lowest inventory level in some 20 years. So, for the rest of this quarter and going through January, one manufacturer at least is going to be running absolutely flat out including their maximum overtime schedule. They will be running their plants at the absolute maximum at least through January. Their outlook for '86 with regard to car sales is pretty good--a bit lower than ours but nonetheless the recent sales program hasn't had as big an impact on the '86 volume as one might have expected. On balance, as we look at conditions in the District, the staff forecast would be rather consistent with the way that we see it.

CHAIRMAN VOLCKER. We haven't had the last 10 days' auto sales yet have we?

MR. KICHLINE. No, it comes out this afternoon.

CHAIRMAN VOLCKER. Mr. Melzer.

MR. MELZER. To pick up on what Bob Forrestal said, I heard the same thing from a major retailer in St. Louis: that in the Far East the Japanese and others already are beginning to jack up prices on apparel and other textile goods. One other thing I've noticed in talking to people around the District is that there seems to be an interest developing now in bidding on farm land. People have talked about it before but I sense now that there is some very serious expression of interest, along the lines of what Ed Boehne was saying in terms of equipment, for putting together groups to bid on the land, which I think is a constructive development.

CHAIRMAN VOLCKER. The first I've heard.

MR. MELZER. That's at very low prices. This would be in Arkansas and northern Mississippi and I'd say prices are probably down 40 to 50 percent from their highs.

CHAIRMAN VOLCKER. Mr. Stern.

MR. STERN. Well, on the one hand, it appears that the spillover effects of the agricultural problem in our District are growing in the sense that recent gains in employment in the District states, to the extent they have occurred at all, have been sluggish. Unemployment rates in most District states have been on the increase. On the other hand, if you get away from the agricultural sector, the tone of the anecdotal comments that I've been hearing is that the situation isn't great but it isn't bad either. I take that to be roughly consistent with the kind of forecast reflected in the Greenbook. And I think the Greenbook forecast is largely consistent with the incoming evidence that we've been seeing in terms of employment as discussed, the strength in final demand, relatively acceptable levels of inventories, and so forth. I guess it's fair to say that we do have an ongoing construction boom in the Twin Cities. In both Minneapolis and in St. Paul vacancy rates have been rising, although they haven't kept up with the Sun Belt, so they don't look too bad relative to some of the national numbers. Developers that I've talked to give roughly the explanation that you've heard: that basically it's an equity play for some financial institutions who feel they missed out in the late '70s and early '80s and don't want to miss the next opportunity. Finally, I have not been disappointed, to date anyway, by the performance in housing. At least in terms of the level of starts, the first half came in somewhat stronger than I had expected. The fact that the last few months have been weaker doesn't really surprise me. I don't think we're very good at timing these things precisely and I suspect that just as we did maybe a bit better in the first half, we're now going to do a little worse. But, net, I don't see any reason to think that anything terribly unusual is going on so far in the relationship between rates and housing activity.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLES. From the Twelfth District, there's a combination of good news and bad news that we have had now for some long time. The areas which have been weak and continue to be weak are the traditional ones that I have talked about so many times: forest products, agriculture, and oil. And now more recently, somewhat to our consternation, the electronics industry is in something of a slump, at least for the time being. On the other hand, there is considerable strength in defense spending and in the kinds of companies that benefit from that. I suspect we are on the receiving end of an unusually big share of that in the West. My staff tells me that two of our states taken together, California and Washington, have about 28 percent of defense contracts, so that's obviously a strong plus in terms of the tone of business, at least in those two states. Retail trade figures seem to be going very well; most stores have been reporting year-over-year sales gains of 5 to 10 percent. Auto sales are going well in most of the states. And of course the service industries, which are not nearly as identifiable as anything like steel or whatever, are reporting pretty good news in terms of their performance. Our staff reports that the market for single-family housing appears to be relatively healthy, which I was pleased to see. Whether it's permits, sales, or prices, all seem to be holding up in most markets, although it differs quite a bit if one moves from state to state. We do have nine states, but as a generalization this does not appear to be an area of great weakness at the moment.

In terms of the outlook, our view is not much different from the Board staff's with respect to the balance of this year. Our staff is a little more optimistic as we look into 1986, simply in the sense that we expect somewhat greater shrinkage of net imports--that there won't be as big a drag on the economy as there has been in 1985. Of course, this is a judgmental difference, but we think we ought to get a little more kick out of the improvement in our foreign trade position coming from the expected decline in the value of the dollar. That's the thumb-nail sketch from the West.

VICE CHAIRMAN CORRIGAN. John, I don't know whether I should ask you or Bob Forrestal, but do you know if Boeing is expecting great things, particularly in the export side, from this new model 747 that they are beginning to market?

MR. BALLES. Do you mean the 757?

VICE CHAIRMAN CORRIGAN. No, they have a new model, a very highly fuel efficient 747.

MR. BALLES. Gee, Jerry, I am not familiar with what that is, unless it's a 747 SP.

VICE CHAIRMAN CORRIGAN. No, no, it's a new generation of--

MR. BALLES. I haven't heard about that I am sorry to say.

MR. STERN. Northwest ordered a bunch of them--I don't remember how many--as part of the $2 billion capital spending program that they have just initiated. But that's all I know about it.

VICE CHAIRMAN CORRIGAN. Do you know anything about it, Jim?

MR. KICHLINE. No, I don't. I'm sorry.

CHAIRMAN VOLCKER. What are you assuming in your budgetary projections about a farm bill?

MR. KICHLINE. We have a $45 billion deficit reduction package for next year. That's about $8 billion less than the Congressional estimates. They expected $53 billion or so for fiscal 1986.

CHAIRMAN VOLCKER. Not real?

MR. KICHLINE. Well, what I am trying to tell you is that we didn't accept the $53 billion figure. We think there will be overruns in a number of areas. The farm area is a prime one; we don't have the specific number on the farm bill, but we think that it is going to come in higher than the Congress had expected.

CHAIRMAN VOLCKER. [Unintelligible] pretty optimistic--that's [unintelligible]. Why did you lower prices in your forecast?

MR. KICHLINE. Why did we lower them? They are not reduced by much, a couple of tenths.

CHAIRMAN VOLCKER AND MR. MARTIN. One half percent.

MR> KICHLINE. Which price measure are you looking at--the deflator?

CHAIRMAN VOLCKER. Well, I'm looking at any of them--gross domestic business product deflator.

MR. KICHLINE. All right. That's .4 down.

CHAIRMAN VOLCKER. Excluding food and energy.

MR. KICHLINE. A couple of reasons: One is that the incoming information in a couple of areas was a little better than we had thought in the third quarter. That's the case for the gross business product deflator. On compensation and wages, we went through that again and that continues to look really quite good to us, or indeed maybe a little better. And with weakness in economic activity, we now have a little more slack in labor and product markets than we had before. In addition, taking another look at what we were doing on import prices, we felt that perhaps there was a reason to say it will come along a little slower--that is, rising prices from the dollar would occur later on in the year--so we pushed that back a bit. And all of those things together add up to .4 on the index.

CHAIRMAN VOLCKER. Governor Seger.

MS. SEGER. I just had two comments. One involves housing and the comment is that the tightening of terms and lending standards is there and that it is going to get more prevalent. We haven't seen much of it yet in the statistics but that doesn't mean it won't show up in 1986. I just hear too many comments from specific lenders about either tightening on their own or being forced to by the mortgage insurers; so I think that that may knock 100,000 to 200,000 off the numbers we are showing. Also, a comment on office building financing: If you get into some of the details, what you find is that the banks are doing the construction financing and they are willing to do it because there is permanent financing being supplied by the life insurance companies. Also, there is still a lot of syndication going on. There are rich doctors, lawyers and dentists who haven't adjusted to the new economic realities of a less inflationary environment and, also, they view this kind of investment as a good tax shelter. If tax reform measures actually get passed and the marginal rates are cut, I think that will kick that in the head real well. So, again, the combination of the financing facts and the agency rates suggests that sometime this is going to peak out, although I am not smart enough to know when.

One final comment about the value of the dollar: The business people I talked with in the Midwest are certainly not sitting there worrying about the inflationary impact of further declines of the dollar because they long ago ceased believing their economists' forecasts. But one thing they do know is that the appreciating dollar nearly killed them and they are making decisions right now on things such as closing plants or moving production abroad. So time is of the essence here to get the dollar down, because these are decisions that are not going to be reversed quickly if they ever are reversed. Somehow or other I don't think that we necessarily appreciate that fact. They are not that concerned about what the declining dollar will do to inflation, but they are very concerned about what will happen in terms of their survival if it doesn't decline.

CHAIRMAN VOLCKER. Do you ever find a businessman worried about his ability to raise prices when--. They like that.

MS. SEGER. They also buy supplies, though, that are imports, It's a very competitive world out there.

MR. PARTEE. They prefer to buy low and sell high.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I tried to have a very optimistic view of the economy all through the summer, thinking that there would be a pretty good resurgence in the fall. There were some pretty favorable indicators at our last meeting, but I must say that this recent set bothers me. I am most affected, I guess, by the McGraw-Hill survey which is down one percent--and nobody mentioned that--in nominal terms. Now that's a pretty good survey. It's the oldest, and we always thought the best, of the private surveys. That's a pretty poor, unrespectable survey result to be occurring in the fall after boards have met and plans have tended to firm up for the next year. That did shock me. The other thing that I worry about is that personal saving rate; the only thing you can do really is assume that it won't come back very much. But it's so low that one wonders whether there hasn't been some kind of a spending desire on the part of consumers associated with the use of credit that will disappear, and that in fact the automobile producers are wrong about their forecasts for next year and it won't be as good as Si, I guess it was, suggested. I don't know; that bothers me. I am not sure, but it's a very mysterious thing to have a saving rate that low. After all, there was supposed to be an environment that would encourage saving in connection with supply side economics. It's totally the wrong answer that has come out of the data from that point of view. It's very difficult for me to incorporate the net export/import picture because we have had so little experience with that being a large factor. It might be that there could be a bigger increase in exports than the staff has forecast, but the fact of the matter is that for the next year they have a contribution coming from net exports--that is, smaller net imports. It's the first time since 1980 that there has been any contribution to the economy from that source, so it is a rather radical change in GNP effect that they have already put in there. As far as office building is concerned, I think the longer it goes on the worse it is going to be. I don't know when it is going to break, but it is going to break pretty big; and the longer it goes on the bigger the break will be when it occurs.

So, I'm starting to lose my optimism; I figure at best we will get the staff forecast for the period to come and it could be a good deal worse. There is a possibility of a recession and we need to recognize that. I said that last time, thinking of it as sort of a remote possibility. My feeling is that the possibility is a little stronger now that there will be a recession some time in the next nine months. It's a distinct possibility. In any event, I would want to point out to you--and I think this is what Pres Martin did--that the staff forecast is well below our bogey for the performance of the economy. We [as a group] forecast 4 percent for the second half of the year, I believe, in real terms. Apparently, it is going to be well below that. We forecast a pretty good 1986, and it looks as though it is going to be below that by an appreciable percent or so. So we are below our bogey; that seems to be increasingly clear as the months go by, and I think we will need to take that into account in determining what the monetary policy ought to be.

CHAIRMAN VOLCKER. You have made our forecast a bogey.

MR. PARTEE. I thought it was a minimal acceptable performance of the economy that we predicted in July. That's the way it was presented in the Humphrey-Hawkins report, I thought: as a satisfactory performance. Otherwise, we would have needed a change of monetary policy to get a different economic result. So it was acceptable, but now we have fallen more below that.

CHAIRMAN VOLCKER. You seem to be a GNP targeter.

MR. PARTEE. I think I am, yes.

CHAIRMAN VOLCKER. I am not sure that the Committee has accepted that. Mr. Boehne.

MR. BOEHNE. As far as the District goes, I continue to think that the tone is a little better in my part of the country than it is in many of the other Districts. Even in the District, though, it is usually described as not great but not terrible. But I think it's generally above the national average.

As far as the economy across the nation goes, I think we are very much in the hands of the consumer and that gives me some pause at this stage of the recovery, because I would have hoped that we could be getting some help from some of the other sectors, notably investment. But as Chuck pointed out, that doesn't seem to be there; in fact, it seems to be a drag. Therefore, [the economy] pretty much is riding on whatever momentum there is that the consumer is going to provide; and looking at that one can avoid extreme pessimism, but it is awfully hard to get very upbeat about it. If you look at what drives the consumer, the job income side is moderate, but it seems to me the consumer is held back by the debt situation. Inflation has been another factor that has either helped or hindered consumer spending. That seems to be about neutral: it doesn't seem to be getting any worse and it doesn't seem to be getting any better. But in a kind of static dynamic view of the situation, we are not getting any help from there anymore. And that leaves interest rates, which also have a major impact on what the consumer does, and I suppose the outlook there is flat to down. We do have some constraints on the international side [in terms of] what we can do there. But I just get the feeling that the expansion is much like a person entering his senior years. He can go on a while longer, but I get the feeling that he could fall over any time. And while I wouldn't predict a recession, I get the sense that sometime out there in the forecast horizon this recovery is just going to fall over.

MR. PARTEE. He's a lot younger than the average age.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thanks, Mr. Chairman. I don't think I shall burden the Committee with reciting again the problems in our regional area, other than to tell you that the latest survey we have done at the banks suggests that farm land prices have fallen another 5 to 6 percent.

MR. PARTEE. In what period is that?

MR. GUFFEY. That's in the third quarter; they are down in the 40 to 50 percent range now below the high of 1981. But there is another activity that I would like to bring to the Committee's attention. Because of the rather depressed conditions in our region, and based on the resourcefulness of the people who live in the Midwest, they do turn to other activities to provide food for the table. As a result, game wildlife hunting is a big activity this time of the year and I can tell you that, at least in the immediate area around the Bank, there is some optimism for the Thanksgiving holiday because the hunting season opened early. You will find four out of seven Bluejays and four out of seven Cardinals will be served!

MS. SEGER. I thought you were going to say that they got a couple of bankers to serve.

MR. PARTEE. That's an upbeat report.

CHAIRMAN VOLCKER. Let's turn to Mr. Axilrod.

MR. AXILROD. Mr. Chairman, I can be quite brief. It seems to me that the alternatives presented--not alternative C, but alternatives A and B at least--are generally consistent with the growth path adopted by the Committee for the fourth quarter at its last meeting. One is toward the bottom end of that range and one, in a sense, is toward the middle or upper end. I should point out a technical point: that M1, for example, under alternative B we have 5 percent; the Committee said 6 to 7 percent or lower. The hurricane effect raises M1 growth in September by 3 percentage points and reduces it in October by about the same amount. So in some sense that 5 percent under alternative B could be construed as 6 percent with the hurricane allowed for. That's a minor bit of expertise. It does tend to buttress the point that the differences between "A" and "B" relative to the growth path adopted by the Committee are small. The only other point that perhaps one might make in a general way, Mr. Chairman, is that the weakness in the economy is in those areas most susceptible to long-term rates, and one could advance very gingerly a proposition that in providing reserves as they will have to be provided over this period perhaps there is some usefulness in providing them through acquisitions of coupon issues, at least to a degree, to do whatever could be done to keep pressures on long rates from going up or encouraging them to go down even while short rates might need to be sustained for international reasons or for reasons of monetary growth rates.

MR. MARTIN. Steve, let me ask: You pointed out some of the similarities of "A" and "B" with regard to the aggregates. Could you help me understand the differences--and I am talking forward now--in alternative A for the next short-run period versus alternative B? You have borrowings on page 8 [in the Bluebook] of $450 to $550 million for "B;" you have borrowings of $200 to $300 million for "A" on page 10. That seems to me a rather substantial difference. Can you help me rectify this?

MR. AXILROD. Well, that was essentially a difference we thought was roughly consistent with a drop of a half point in the funds rate, and presumably to a degree in other short rates. The--

MR. PARTEE. And with no drop in the discount rate, I take it?

MR. AXILROD. No. But I feel absolutely certain that if the Committee leaned in the direction of alternative A, expectations of a discount rate decrease would shortly begin to dominate the market. And I think the risk, as we tried to indicate, would be that short rates--at least in the short run--would fall more than is specified.

MR. MARTIN. From midpoint to midpoint, that would be $500 million for borrowing for "B" and $250 million for "A." So that's 50 basis points?

MR. AXILROD. Well, one model gives you 25 basis points per $100 million [on borrowing], and we tend to think judgmentally more like 20 basis points per $100 million. These relationships are quite loose, so I think that is consistent with what we have there.

MR. PARTEE. You suggest a little operation twist.

MR. AXILROD. Well, I didn't mean to be very--

MR. PARTEE. As long as we have some time, would you like to discuss that a little more? That's an unusual recommendation.

MR. AXILROD. We are coming to a period of reserve need, and I guess I was bitten by fears of the dollar dropping sharply. Working through that chart show, I think that the dollar is probably sensitive to both short-term as well as long-term rates in some degree. So in providing reserves over this period, I was trying to think of a way that would minimize the possibilities of adverse expectational effects on the dollar. So I didn't really mean a substantial operation twist, but that when the opportunity came it might be desirable to think about buying coupon issues rather than bills, depending a little on the circumstances at the time and how people were thinking in the markets.

MR. PARTEE. Well, there will also be a bunch of Treasury issues, I assume. Will any of those be coupons?

MR. STERNLIGHT. There are likely to be. Yes, there is the normal 3-, 10-, and 30-year issues that would have been up for auction this week that have been postponed. They just did last week the 4-, 7- and 20-year issues that had been postponed by about a month because of debt limit problems.

CHAIRMAN VOLCKER. The only long-term fixed rate borrower we have is the U.S. Treasury. I think there is very little in that idea.

MR. AXILROD. You see that was not checked with the Chairman!

MR. RICE. Is that because you think long-term rates have as much effect on exchange rates as short-term rates?

CHAIRMAN VOLCKER. First of all, I don't think the difference in their rate levels will be visible to the naked eye; and I think yes, that is a possibility.

MR. PARTEE. We did study that operation twist at some length, and I can't recall that there were any findings of significant difference.

CHAIRMAN VOLCKER. In fact, I don't think there are many private borrowers out there in the long-term markets.

MR. PARTEE. Well, you have the mortgage borrowers; there are a lot of those. And they prefer fixed rates if they can get them.

CHAIRMAN VOLCKER. It's probably related more to the short-term rates.

MR. PARTEE. There's [unintelligible] at least in the home mortgage market. Consumers have a very distinct preference for fixed rates.

CHAIRMAN VOLCKER. Some of it is fixed rate and some of it is floating rate.

VICE CHAIRMAN CORRIGAN. I am attracted to the idea of trying to do a little something in the coupon end--not because I think it's going to have any great effect on relative rates--but just because the thought runs through my head every now and then that at some point down the road we may feel that we have to do something in coupons for other reasons, and if we get so removed from that segment of the market the mere fact of doing something for a particular reason has much more signal effect to it than we might otherwise want.

CHAIRMAN VOLCKER. If we want to do it for a particular reason, we presumably want to signal.

VICE CHAIRMAN CORRIGAN. Well, I am not sure of that.

MR. RICE. You mean we may need the twist somewhere down the road?

VICE CHAIRMAN CORRIGAN. We may need something.

MR. PARTEE. What do you mean: because the Treasury will have so much difficulty financing? If so, why would they continue to issue coupons?

VICE CHAIRMAN CORRIGAN. I don't know what the precise circumstances might be. I think preserving some flexibility--

MR. PARTEE. I understand.

VICE CHAIRMAN CORRIGAN. --in our market presence is desirable.

MR. PARTEE. You don't extend that view to agencies, I take it.

MS. SEGER. Like Farm Credit?

MR. PARTEE. Well, I didn't want to mention any particular--

MS. SEGER. It would narrow that spread, if they knew the Fed was in buying the Farm Credit ones.

CHAIRMAN VOLCKER. The only argument I hear for buying long-term issues is that the market expects us to buy long-term issues in some [unintelligible] or that we expect ourselves to buy long-term issues and, therefore, we ought to buy them.

MR. BLACK. Oh, it might be kind of fun!

CHAIRMAN VOLCKER. But we buy them once in a while, you know. For what reasons, it's not quite clear to me.

MR. PARTEE. Steve, you have [forecast] a pretty calm M1 behavior for the remainder of the year. You are not expecting any year-end surge or anything like that?

MR. AXILROD. Well, it's calm, largely because of the averaging of the zero to minus one that we are projecting for October. Growth would have broken out--whether it's "A" or "B"--in between 8 and 9-1/2 percent over that last two months of the year. Those are fairly substantial growth rates in and of themselves and, as we mentioned, if rates went down and particularly if expectations carried them down more, we could get a powerful surge in M1 as rates moved closer to these NOW account ceilings. So there is a considerable risk of a very substantial growth, particularly under "A," I think.

CHAIRMAN VOLCKER. M1 is very high. Well, I think our problem on that is relatively simple and difficult at the same time. I don't attach a lot of weight to small changes in this forecast, whether it's prices or GNP within the ranges that are set. I don't think that we know what GNP is going to be in this quarter. Things have somewhat less than an ebullient tone to them, so I think: "Fair enough; one might think of easing slightly if the dollar gave one room to do that." I am not sure it does right at the moment, but that's [unintelligible] a shorter-run perspective. I am considerably concerned that a continuing sharp decline and a real change in sentiment there, which I think we're on the edge of, would give us more difficulties than we bargained for. And whatever we do has to take that into account. The stronger the dollar is, the more we can ease; the weaker it is, the more stuck we are.

MR. RICE. But the amount of intervention that has occurred most recently would suggest that there are still some strong upward pressures.

CHAIRMAN VOLCKER. Well, it's all a matter of judgment. The intervention that took place when we were intervening heavily is what: two weeks old? The big intervention was what: ten days ago? Since then the markets definitely have been on the other side. How much of this is short term? It could go back the other way; I don't know. I wouldn't be unhappy if it went back the other way; it will give us a little more room. But this is all a fairly narrow focus. Mr. Morris.

MR. MORRIS. Well, I agree with your analysis, Mr. Chairman, because I don't think we have much room to maneuver here. If we had some evidence that the economy was softening, then I think we could go ahead and move to lower rates, despite the growth in the aggregates. But I don't think we have anything to tie an easier posture to at this moment.

CHAIRMAN VOLCKER. I think there is another element that could arise. I don't know what the odds are, but if Congress really passed one of these budget resolutions that calls for a sharply lower deficit than I think is at all probable in the current fiscal year, it necessarily follows that within weeks after they passed this bill, I presume, they would have to do something to cut expenditures in a big way. I might point out that the way some of those bills are written, it could include the Federal Reserve. Then I think we have a kind of platform, and maybe a necessity, for seeing that interest rates go down. I don't know how much easing that would take; they might go down by themselves.

MR. MORRIS. That's exactly the kind of thing--something to hang our hat on--that we don't have now.

CHAIRMAN VOLCKER. I don't know what the odds are on something like that happening. I am totally confused by this process; I don't know whether it is all a game, whether there is any chance that they are going to get together, or whether they are carefully making positions that are mutually inconsistent so [unintelligible]. They may end up with a bill that is vetoed. If it happened that we got a dramatic difference in the budget, in one sense it would be constructive and in another sense it may be rather chaotic if they do it in a hurry. Then I think we have a new ingredient that we'd have to take into account.

MR. PARTEE. Well, Frank, I don't know. If we have a continued sub-par performance of the economy, it would seem to me that that would be a reasonable justification. On Friday of this week we will get the McGraw-Hill survey, which I think is going to be a big news item. In addition, I think the retail sales figure, just because of car sales if nothing else, is going to be very poor.

MR. MORRIS. I personally think that McGraw-Hill survey will reflect the decline in exchange rates. That certainly has to be a plus for domestic investors.

CHAIRMAN VOLCKER. I don't think that it's going to make much of a difference--maybe in the short run. I don't know how good that survey is. Retail sales are assumed to be down because of auto sales; I guess you look at the rest of it.

MR. PARTEE. Yes. I have no idea what that will show.

MR. BOEHNE. I take it your basic proposition is to stay where we are now but be alert for opportunities to ease, and that those opportunities may come from the international side or the budget side or wherever. I think that makes a lot of sense.

CHAIRMAN VOLCKER. That's sort of where I am.

MR. BOEHNE. I think that general proposition is quite sound.

MR. RICE. I certainly agree with that proposition.

MR. BLACK. Maybe we can get the post FOMC questions pre-lunch today.

CHAIRMAN VOLCKER. Well, let's not assume too much.

MR. BLACK. I just said "maybe." I didn't--

CHAIRMAN VOLCKER. Well, looking at operational policy in our usual format, I didn't hear anybody talking about anything that sounded like alternative C. I suppose it's impossible that the monetary numbers would come out that low. Who knows? But I don't think anybody wants to drive them there, if I heard the conversation correctly. The difference between "A" and "B" in the actual numbers I'm not sure is big enough to send anybody very much. We had 6 to 7 percent last time. We're in one of these mid-quarter periods when, just as a matter of form, I prefer to make fewer changes rather than more in these targets that we don't meet anyway. But--

MR. PARTEE. We might as well leave it the same, right?

CHAIRMAN VOLCKER. Well, that is my inclination unless somebody--although where we had them was 6 to 7 percent and that may be a little high.

MR. PARTEE. That was for M1?

CHAIRMAN VOLCKER. I think it was--

MS. SEGER. M2 and M3.

CHAIRMAN VOLCKER. --6 to 7 percent for all of them. We can easily say around 6 percent for all of them without it being a substantial change. But in terms of the borrowing and our actual operations, I heard more worries about being too tight than too easy purely on the domestic business outlook, which is not the whole equation, certainly. From the standpoint of the international debt situation and a lot of other things if interest rates came down, it would be nice. On the other hand, I continue to be impressed by the amount of credit that this economy is dealing out, including in the real estate construction area. I'm not sure that inviting it to spew out a little more is in the long-term interest of anything. But there we are. Right now, as I suggested before, I would look toward not making any very startling changes; but if the dollar really gave us the opportunity or--more remotely but conceivably--if the budget gave us more opportunity, I'd be alert to go down in the absence of any new striking news in the other direction. There's a slightly peculiar situation in the market right now. We have had borrowing low all week but the federal funds rate is higher than one would expect, presumably in reaction to Treasury financings. I presume that's just a passing phenomenon and that the market doesn't seem to be taking it seriously. Well, let's see what others have to say.

MR. PARTEE. It's going to be hard to evaluate the budget thing isn't it, Paul?

CHAIRMAN VOLCKER. Well, I don't know. I have no idea what's coming out. I don't particularly expect this, but I suppose one possibility is that they could pass something that virtually demanded expenditure cuts pretty quickly. I don't know how you avoid them if they pass something. The budget is clearly running above what they say. I can see how they might ignore this law next year if they pass it; it's a little hard to see how they ignore it three weeks after they pass it. I have no idea what's going to come out of this. I would think from the Administration's standpoint, Congress has managed to screw it up enough that the bill would end up being vetoed, so you have nothing. I would think that may be the most likely scenario--or that they just never agree so they finally pass the debt ceiling bill and they give in on the thing.

MR. PARTEE. Yes, that's possible.

CHAIRMAN VOLCKER. Or they could pass it in the Senate version and could say that it has no implications for this year so they'll think about it next September, in which case it would not have much implication for us either, I guess. Any one of the above [is possible], and I have no idea how it's going to come out.

MR. MARTIN. Mr. Chairman, would that argue for a bit wider range in the borrowing without having to consult with this group, considering the wide range of both that uncertainty and the dollar uncertainty and so forth?

CHAIRMAN VOLCKER. Well, I think we ought to leave ourselves a little range on the dollar side. I don't mind consulting when the change gets significant in any event, but a little week-to-week flexibility or two-week flexibility is useful.

MR. RICE. Or aiming for the lower side of the range more so than the upper.

MR. PARTEE. Or changing the range.

MR. RICE. Oh, I wouldn't go that far.

CHAIRMAN VOLCKER. Well, what do have now: $400-$600 million?

MR. RICE. We could talk about $400 to $500 million.

MS. SEGER. $300 to $500 million.

MR. RICE. Aiming at being more comfortable? Or is it as close to--

CHAIRMAN VOLCKER. $350 to $550 million. I think we're in that neighborhood someplace.

MR. MARTIN. $350 to $500 million.

MR. PARTEE. We're now at $450-$550 million, and saying we would like to err toward some ease--if there is an opportunity--and widening that band on the low side is a good idea.

CHAIRMAN VOLCKER. Just in case we get too involved in the numerology here: These are always starting points and if something else happens, we can go below it or above it.

SEVERAL. Sure.

CHAIRMAN VOLCKER. It's clear enough. Mr. Melzer.

MR. MELZER. One thing that struck me, really, is the volatility of expectations about the economy around the table. This month they tend to be negative, while last month they were very constructive. Before that I think they tended to be negative. That only leads me to the conclusion that there is still a lot of uncertainty with respect to what's going on in the economy, and I personally wouldn't be inclined to overreact to that. The other thing I would say is that there was mention yesterday of expectations in the market about the possibility of a concerted action among the G-5 countries to get the dollar down. So any easing that is undertaken in the near term here could be misconstrued in a sense, in the context of that, and could be potentially very damaging in terms of that thought. It could cause a more dramatic fall in the dollar.

CHAIRMAN VOLCKER. I might say in that connection, just in case there's any uncertainty around the table, that this move of the Japanese to increase their rates came out of the clear blue sky as far as I am concerned. I still don't quite comprehend it. I'm not sure, but in the larger scheme of things I assume they did it--maybe it will affect the yen in the short run--given that the Japanese economy is not showing much pep and that they just absolutely are blocked on the fiscal policy side. It's not the move that I would have chosen.

MR. MARTIN. It's certainly not consonant with the action plan: the notion of stimulating housing and infrastructure spending.

CHAIRMAN VOLCKER. It goes I think in the wrong basic direction. Excuse me.

MR. MELZER. The other thing that I have been turning over in my mind, in reaction to yesterday's presentation, is a feeling that in terms of responding to a rapidly declining dollar my instincts lead me to feel that the right national policy response to that is probably for interest rates to rise somewhat. Easing in response to a weaker dollar had some implications that I didn't particularly like. What I've been thinking about is that we already have had a fairly significant decline of the value of the dollar and that possibly some of the general dynamics that were talked about in the hypothetical presentation yesterday may be coming into play here. We may be dealing with a sort of natural increase in interest rates and I don't know, frankly, whether it would be appropriate to lean against that too heavily. Now, I know there are other considerations. Net, based on those several considerations, I would be inclined to stay where we are, with some degree of reserve restraint, and not be looking for the next opportunity to ease at this juncture.

CHAIRMAN VOLCKER. Well, let me introduce another small refinement, given where the dollar is now and given the greater hesitancy in the market and all the rest. It is given that there are risks on both sides. But given the risks of this thing getting a little out of hand--in terms of speed anyway--I guess I don't see much point in intervening aggressively to push the dollar down or to hold it down. If the dollar is all that strong, in the short run it might be that the proper response is through a modest monetary policy change rather than trying to do it by intervention. It takes a little flexibility to get it on the monetary policy side. So, intervening very heavily increases the risk you are talking about: it freezes us; it has the opposite effect.

MR. PARTEE. I get awfully uncomfortable with the idea that we should put the dollar as the centerpiece of policy. I think the economy is the centerpiece of [policy].

CHAIRMAN VOLCKER. I am not sure I see that distinction.

MR. PARTEE. I don't disagree that the dollar is a significant variable, but I would point out that the objective was to get the dollar down. That was a program to which you agreed: to get the dollar down. And it has come down and, I think, has behaved extremely well. I thought for the whole period between meetings that the dollar had a lifting tendency and that's why we had to do the intervention. If it doesn't lift, we don't do the intervention. It was just very recently that we got a little weakness. And I think the weakness has come because of the Japanese raising their rates, which is certainly a contra-economic policy from a world point of view--not because of anything we did. So, I don't disagree with what is being said about the dollar, but I would again want to emphasize that I think what we need to have is a decently performing domestic economy. That's the primary objective of monetary policy.

MR. MORRIS. I can see the case for moving to somewhat lower interest rates, but I don't see that that necessarily means we shouldn't intervene also.

MR. MARTIN. It seems to me--I don't know whether Tom would agree with this--that we're talking about the immediate 2 or 3 weeks of the 5- or 6-week intermeeting period. I would think by the end of 5 weeks we might have enough feedback from the markets and from our own economy to change our position, which I would certainly agree to. We don't need to ease this moment but that doesn't say that 5 weeks from now we might not.

MR. MELZER. That's right. Sure.

MR. RICE. Where do you see the natural tendency of interest rates--to rise right now?

MR. MELZER. I guess it's relatively minor, but some weeks back we were running borrowing levels that were well in excess of the somewhat lower target and funds were trading below 8 percent. Now we tend to be running at borrowing levels that are somewhat below the target and funds are modestly above 8 percent. It's relatively minor: 15 to 20 basis points.

VICE CHAIRMAN CORRIGAN. Chuck, I agree with your point about the primacy of the economy, but I come out a little differently in terms of emphasis at the margin. With that primacy in mind I say to myself: What are the things that are on the table in the very near term that could really louse up the situation with the domestic economy in a major way? And the one that just leaps out at me is the risk--and everybody puts his own arithmetic on this--of the dollar breaking out on the down side. If that happens, the one thing we're sure of--or at least I'm sure of--is that that would do considerable damage to the domestic economy and the world economy.

MR. PARTEE. If it broke down sharply, yes. We have had a great big program to bring it down and we have gotten it down a little. The evidence hasn't been that it is tending to rush away. Maybe it will. I agree with you that that would be a bad thing.

CHAIRMAN VOLCKER. It is down

MR. PARTEE. I don't know.

CHAIRMAN VOLCKER. I know.

MR. PARTEE. Nobody ever told me what the program envisaged, so I don't have any sense [of that].

MR. MORRIS. If you attribute it solely to the program.

CHAIRMAN VOLCKER. I'm not talking about the long run--

MR. MORRIS. We have had a bigger response than I would have expected solely from the program.

MR. PARTEE. Oh, we certainly have. I think the timing was excellent in terms of making the program look effective. Anyhow, having been worrying about a high dollar for the last year and a half or two, I find it a little odd that we're now talking about how serious the possibility is. And there is a possibility that it is going to break all the way down; [I don't know] how clear and present the danger is. I suspect that some of Gov. Seger's manufacturers wouldn't mind a little further drop.

CHAIRMAN VOLCKER. They would like the yen at about 120 and--

MR. MORRIS. The fact is, Chuck, that the markets that have a high level of speculative activity tend to overshoot, both on the up and the down side. And that makes this not something to be concerned about in a [unintelligible] way.

MR. PARTEE. Are you suggesting that after I have left here, the Committee is going to keep the interest rates very high to keep the dollar from falling? And thus put [the country] in a major recession that the rest of the world is in--

MR. MORRIS. No.

MR. PARTEE. With the same bad policy?

MR. MORRIS. No. I would think that one would describe what we are talking about now as hoping to avoid the necessity for that.

CHAIRMAN VOLCKER. Precisely. The dollar going down isn't a free ride. That's what the people were supposed to demonstrate yesterday. It may have to get down over a period of time; it probably does. How it gets there and what the accompanying policies are makes all the difference.

VICE CHAIRMAN CORRIGAN. Again, go back to that chart nine in yesterday's presentation. We sit here and we have a situation, which we have had for a long time, where we have a simply lousy fiscal policy. Monetary policy is trying to out-muscle and out-maneuver that, and there is a point here where it just can't be done.

MR. MARTIN. Let me play devil's advocate for just a minute. We have been talking about what I think is the real risk of a precipitous decline of the dollar. We had a good staff presentation yesterday on the same subject. On the other side of this issue is the lack of real action by our trading partners of any kind of coordination of policy, fiscal or monetary. And the Japanese contradiction is exhibit A. Now, suppose the market players feel that there is not going to be any change in fundamentals--we all know the limitation of intervention policy--and the market moves the other way. Is that of some probability? It may not be the most probable outcome.

MR. MELZER. I think that's possible.

CHAIRMAN VOLCKER. Then if domestic business looks somewhat on the softer side, then it is an opportunity to ease--to lower interest rates.

MR. STERN. That strikes me as a possibility as well. And that probably would provoke some natural upward pressure on the dollar.

CHAIRMAN VOLCKER. Well, then we're in the dilemma that we have been in for years. You have a simple choice: What sector of the economy takes the rap for inflation?

VICE CHAIRMAN CORRIGAN. Then they all take the rap.

CHAIRMAN VOLCKER. This is all very useful, but I detect that we have a rather more limited range of possibilities. I think this conversation is very relevant, but I don't know whether you want to extend the general conversation or focus on just what we put down here for a directive.

VICE CHAIRMAN CORRIGAN. As far as policy itself is concerned, I'd be quite comfortable with alternative B as in the Bluebook. That had borrowing of $450 to $550 million, but I could go with the $350 to $550 million range that Governor Martin suggested.

CHAIRMAN VOLCKER. Making it 5 to 6 percent [unintelligible], I guess--that's one possibility. We could just reduce it from 6 to 7 percent to 5 to 6 percent.

VICE CHAIRMAN CORRIGAN. I'm somewhat agnostic on that. I think the [unintelligible] to me at this point isn't so much whether it's 5 to 6 percent or 6 percent, it's the framework that we described: that given the domestic economy, if the opportunity were there to try and nudge things down a bit we would grab it. I don't know how you can articulate that in a very precise way. So, I would lean toward the 5 to 6 percent.

CHAIRMAN VOLCKER. What this will be, I suppose, is "maintain the existing degree...." It has fluctuated a little.

MR. MARTIN. We wouldn't want to say "decrease slightly"?

CHAIRMAN VOLCKER. If you take the most recent week, it's down below $400 million, I presume. The most recent 2 weeks--

VICE CHAIRMAN CORRIGAN. I don't think we can quite say that. We might be able to jiggle "woulds" and "mights."

CHAIRMAN VOLCKER. But all these words imply more precision than we have had in the last 4- or 5-week period in terms of a precise level of borrowing. Most of the time we have been below what we are talking about.

MR. MORRIS. Since we are having a wider borrowing range, wouldn't it make sense also to have a wider range for the aggregates--maybe 5 to 7 percent?

CHAIRMAN VOLCKER. Well, it wouldn't bother me. But I'm just wondering whether there is some word in that first sentence that implies something consistent with the existing degree but also implies a little broader interpretation of what the existing degree is.

MR. AXILROD. "About"?

CHAIRMAN VOLCKER. We could say "about the existing degree". We could say "seeks to generally maintain about...." Do we put in 5 to 6 percent or 5 to 7 percent?

MR. RICE. 5 to 6 percent.

MR. PARTEE. I would think we ought to put in 6 percent or around 6 percent.

CHAIRMAN VOLCKER. Do we still say "a marked slowing of M1 growth"? It depends. It's certainly true for the quarter. But it is not exactly true if you take October as the base. I guess it's over the period there as a whole.

MR. PARTEE. It's certainly true that we already have had the number that makes the 3 months slower. I wonder whether we should leave it out and make it around 6 percent in all three [aggregates] in the previous sentence.

CHAIRMAN VOLCKER. Well, I don't feel strongly about this but that implies that we drop out the other part of the sentence that says we don't mind if M1 comes in quite low. Do you want to drop that out or not? As I look at it, it might be useful to keep that.

MR. PARTEE. That's right. We could keep that the way the staff has it here in brackets and still not have that previous phrase, Paul.

MR. BLACK. We could just say "Growth in M1 over the period at an annual rate of around 6 percent is also anticipated."

MR. GUFFEY. Yes. I think that's good.

MR. MARTIN. That's not what's anticipated in the Bluebook. It's 7 percent.

MR. BLACK. It is if you go with--

CHAIRMAN VOLCKER. 5 to 6 percent is what's anticipated. Well, I am not sure how much that captures what we are talking about: "The Committee seeks to generally maintain about the existing degree of pressure." Then it is "6 percent," "6 percent" again, and "slower growth would be acceptable."

MR. MARTIN. And "somewhat lesser would" and "somewhat greater might."

CHAIRMAN VOLCKER. The way it is written now there is one verb for both of them. How do we split it? We used to split it. Now it seems to take a radical change in language.

MR. AXILROD. You could say "somewhat greater reserve restraint might and somewhat lesser restraint would be acceptable, depending on" behavior. That makes it very clear.

MR. MARTIN. The juxtaposition would delight the Fed watchers.

CHAIRMAN VOLCKER. Boy, I tell you! That really emphasizes it.

MR. MARTIN. They would count the words in prior directives.

MR. BLACK. I think we create less problems if we always keep them as "woulds" so it is symmetrical in both directions.

MR. MARTIN. We don't want to be symmetrical.

MR. BLACK. I know you all don't. But symmetry is one of my favorite attributes. You can't tell by looking at me!

CHAIRMAN VOLCKER. Well, it's just a matter of language. We say: "generally;" "about 6 percent for M2 and M3;" and "6 percent for M1." Then "Slower growth of that aggregate would be acceptable in the context of satisfactory economic performance, given the very rapid growth in M1 over the summer. Somewhat greater reserve restraint might and somewhat lesser reserve restraint would be acceptable." We leave the range of 6 to 10 percent [for the funds rate]. Now, does anybody have improvements on that language?

MR. BLACK. Make them both "woulds."

CHAIRMAN VOLCKER. We have one vote for both "woulds." The borrowing range we're talking about is roughly $400 to $600 million; the possibility of making that $350 to $550 million has been broached. I don't think there is an enormous difference between those two. Mechanically, it's $50 million.

MR. BLACK. It's more important to me where we start off. Is it anticipated that we will start at $500 million? That was sort of the tenor of the discussion, as I read it.

CHAIRMAN VOLCKER. Well, I think that depends a little. You say start off at $500 million; I don't think we will want to go to $500 million this week when the federal funds rate is high, although the dollar is [weak]. Even with the dollar weak, with the federal funds rate as high as it is, we weren't anxious to go to $500 million this week. It may have been what we had in the path but we--

MR. BLACK. I am really talking about the path. I recognize that those points you make are very valid points.

CHAIRMAN VOLCKER. I would say consistent with $350 to $550 million, the center of gravity would be a little less than $500 million but not much. I would say something like $475 million, which is right in the middle. No it's not; it's $450 million. I can't do my arithmetic right!

MR. PARTEE. I would like to see the funds rate drift down, maybe an 1/8th of a point.

CHAIRMAN VOLCKER. If the dollar was not weak, I see nothing the matter with that; certainly, you wouldn't expect it to stay where it is now. And I think there is no expectation in the market, as near as I can see, that that's the appropriate funds rate.

MR. GUFFEY. Mr. Chairman, what do you have in mind when you speak of the dollar being weak, in terms of this intermeeting period? Are you talking about stringing ten days together all on the down side of some magnitude? Or are you going to let it--

CHAIRMAN VOLCKER. I don't have that mechanical a test--that it takes ten consecutive days of decline.

MR. GUFFEY. I guess when you talk about the implementation of this policy, I don't know what "weakness in the dollar" really means.

CHAIRMAN VOLCKER. I am not sure I can describe it purely in exchange rate terms, although obviously a weak dollar means that the exchange rate is tending to weaken. However, when you try to quantify that, I don't know. Sometimes it doesn't feel good.

MR. RICE. A good test is how much intervention.

CHAIRMAN VOLCKER. If we were actively intervening on kind of both sides, that would be a good test. Two weeks ago, or whenever it was that the dollar had a little strong feeling to it, there was a lot of intervention to keep it from going up. It was clearly, in that time period, strong. I would say in the last week it has been a bit on the weak side.

MR. GUFFEY. The weak side with respect to the yen largely?

CHAIRMAN VOLCKER. That would be one of my measures. If it was just the yen and it wasn't infecting the psychology generally and rates generally, we would have a different situation. But that's not what we had in the last week. I guess the movement was greatest against the yen, but it was clearly affecting the others too. I suppose the preferable thing, if the yen really got weaker, is that the Japanese might ease up a bit, but I don't think they'll do it. That might be the better way to do it.

MR. GUFFEY. My point is that I would like to see rates come down a bit, but it isn't clear to me how that occurs. If the dollar is a constraint and the measure of the dollar's weakness is feel, how do you get there?

CHAIRMAN VOLCKER. If the dollar is weak, you can see it in the market, but I don't think you can measure it by the extent of a mechanical measure or movement.

MR. PARTEE. I find your description too subjective also. I guess I would just have to vote for an easier money policy instead of accepting something as fuzzy as you described.

CHAIRMAN VOLCKER. One way of getting out of it is to have a bad policy.

MR. PARTEE. Well, I think it's a private policy. I'm trying to bow a little toward you internationalists, but I can't bow too much because I think we need to be easing up a little.

CHAIRMAN VOLCKER. Well, so we divide it up. What borrowing level are we talking about? Who prefers $350 to $550 million?

MR. BLACK. What is the alternative, Mr. Chairman?

CHAIRMAN VOLCKER. I think the alternative can be anything anybody thinks of.

MR. BLACK. I don't have any problem with that, considered asymmetrically, but I just don't know on which side the other one is going to be. I guess it is going to be a lower level, isn't it?

CHAIRMAN VOLCKER. Somebody expressed an opinion of $400 to $600 million, staying right where we are. That's slightly higher but others may be lower.

MR. BLACK. If we have the choice of staying right where we are, that's the one I would prefer rather than this one. If this is the higher--

CHAIRMAN VOLCKER. At this point, you have any choice at all, but I don't know if anybody's going to join you.

MR. BLACK. Well, if we're reasonable about it, I think I'll join the majority this time. That's what I am trying to do: get something I can agree with.

CHAIRMAN VOLCKER. Well, who wants it higher? Who prefers higher than that? Well, do you prefer slightly higher than $350 to $550 million?. I don't hear anybody expressing that. These differences are very small. The other alternative, I guess is: Who prefers slightly lower than that?

MS. SEGER. I do.

CHAIRMAN VOLCKER. We have one on each side, so I--

MR. BLACK(?). We sit next to each other and balance it out.

CHAIRMAN VOLCKER. I think $350 to $550 million is the closest we're going to come to a consensus.

MR. PARTEE. I think of $450 million as being the starting point. I don't know whether that puts me on Governor Seger's side.

MR. BLACK. That's the midpoint.

MR. PARTEE. Yes.

CHAIRMAN VOLCKER. I have no problem with $450 million being the center of gravity. But--

MR. BLACK. Just as an added bit of information, could we ask Steve and Peter to give us some idea of what they think the federal funds rate associated with that might be?

MR. STERNLIGHT. Well, I think at that level that the funds rate would tend to be around 7-7/8 to 8 percent. My thinking with $500 million is right around 8 percent, maybe 8 to 8-1/8 percent.

CHAIRMAN VOLCKER. An illustration of that, if I am not wrong, is that when we were above $500 million the funds rate was below 8 percent and now that we are at $375 million, it is above 8 percent.

MR. STERNLIGHT. One little thing that has happened is that seasonal borrowing has come off some recently, and I think that tends to make the given level [unintelligible] a tiny bit more.

CHAIRMAN VOLCKER. My guess is that it would be a federal funds rate slightly below 8 percent--or maybe even more than slightly --depending upon expectations in the market. It isn't very reliable from week to week. If people think rates are going down, the federal funds rate will probably go down; if they think they are going to go up, it is going to go up. It sits there for several weeks until people change their minds.

VICE CHAIRMAN CORRIGAN. I think it is generally about unchanged and it will be generally about unchanged.

CHAIRMAN VOLCKER. We have a situation where in the past few days it has been above 8 percent. If the statistics are right, the market is going to be quite easy tomorrow, but that will show up maybe at 4:30 in the afternoon. In the previous two-week period, it was below 8 percent most of the time and showed up in a tight money market what--at 5:30 in the afternoon? For a whole day it was above 8 percent on that Wednesday. I think we are at the center of gravity as nearly as I can see. We are left with what flexibility there is around it.

MS. SEGER. Peter, are you more sensitive to rate movements again? I know we are not targeting them, but are you more sensitive to what happens, say, the first day or two after an FOMC meeting because every Fed watcher in the world is hanging over his or her telerate and over the various machines?

MR. STERNLIGHT. I think there's--

CHAIRMAN VOLCKER. But the plan gets a little tricky here. I think we have been avoiding, except in more extreme cases--well, not that extreme, but 1/4 percent, 3/8 percent above where we would expect it to be--just intervening on the basis of the federal funds rate, because then you really feed this notion that we are going to guide the federal funds rate within an eighth or within a quarter. We got in trouble in the past with that and I want to avoid it if I can.

MS. SEGER. Well, what if tomorrow at 11:00 a.m.--the day after the FOMC meets--the fed funds rate is at 10-1/4 percent?

MR. STERNLIGHT. It's also the final day of the reserve period, and I think that's--

CHAIRMAN VOLCKER. At 10-1/4 percent, we'd probably put some money in, even if it is contrary to what the statistics seemed to show.

MR. RICE. Even if it is the final day of the maintenance period.

CHAIRMAN VOLCKER. Yes, if it's 10 1/4 percent in the morning, I think that might suggest something is the matter.

MR. BLACK. I think I would even advocate.

CHAIRMAN VOLCKER. But that's an outside [case]. If it were 8-1/2 percent or something, it's a more difficult question. It may well happen tomorrow that the federal funds rate is 8-1/4 percent, even though the borrowings are running whatever they are running now--$375 million. Then we have a much more difficult decision to make. We may not do anything, but 8-1/2 percent begins getting marginal; I wouldn't like to do it at 8-1/4 percent or 8-1/8 or 8 percent, just because we theoretically thought that the funds rate should be 7-7/8 percent--or the reverse when it got lower. A few weeks ago it was rather consistently lower. We might do it earlier or later in the week, depending upon how the funds rate was going. I would be less than forthcoming if I did not say those judgments as to whether to anticipate or delay action a little bit partly would depend upon what the dollar was doing on that particular day.

MR. PARTEE. I wonder whether the borrowing level shouldn't be in the directive. It seems to me that that's what we are concentrating on now and it's not even specified. It used to be that we said the aggregates, which were in there; then we said the reserve pressures, which were in there. But the fact of the matter is that this discussion of policy for the last hour has been almost entirely on the question of what the initial borrowing level will be and it is not even mentioned in that directive.

CHAIRMAN VOLCKER. Not mentioned apparently, that's right.

MR. BALLES. The emperor has no clothes.

MR. PARTEE. It might not be a bad time to introduce it, since we have a pretty wide range: $350 to $550 million.

CHAIRMAN VOLCKER. I don't know that we want to take such a radical step this morning at this late hour, but--

MR. PARTEE. I'm just struck by it.

CHAIRMAN VOLCKER. Well, the problem with it is that it pins us to a very precise number. You are right that it is a wide range, but we don't always have that kind of a range. Our ability to hit that consistently is not overwhelming.

MR. PARTEE. Well, that's true of the other things mentioned in the directive.

CHAIRMAN VOLCKER. Well understood. After you put the borrowing level in there for a while and don't meet it, then you will be looking for something else.

MR. BALLES. One more target to miss!

CHAIRMAN VOLCKER. We will put in next quarter's GNP--this is Mr. Partee talking! I don't know whether he wants the flash or the preliminary or the final revised figure 10 years from now.

MR. PARTEE. I want an average for the next four quarters.

MR. BLACK. That's what Mike Keran says our target is, now that he is out of the Federal Reserve System.

MR. PARTEE. I really thought he was right until this morning when the Chairman denied it.

MS. SEGER. If we are forced by Humphrey-Hawkins to talk in terms of GNP growth and unemployment and inflation, it seems to me, though, that sometime it has to be tied into what we do, whether we are targeting it precisely or not.

MR. PARTEE. I used to think that way when the bill was written [unintelligible]. I even thought the Congress might ask: Why don't you get a better outcome?

CHAIRMAN VOLCKER. Well, I think the difficulty with that approach is that it rather promises more than we can deliver.

MR. PARTEE. That seems to be true of everything.

CHAIRMAN VOLCKER. That's right. That's precisely it. It is true of most things. If it were as simple as that, we'd never have a recession or inflation. Well, maybe we're prepared to vote. Are we prepared to vote?

VICE CHAIRMAN CORRIGAN. Yes.

MR. BALLES. Can you repeat the specifications so we will all be singing from the same hymn book.

MR. BLACK. You do that and we may not get unanimity!

CHAIRMAN VOLCKER. Well, the numbers are all clear in the directive and the language. They are all 6 percents with a "would" and a "might" worked in there. It's 6 to 10 percent, I presume, on the federal funds rate. And we are talking $350 to $550 million, with $450 million the center of gravity and with some flexibility of going up or down depending upon the aggregates and all this other evidence, including the exchange market.

MR. MARTIN. And a slight bias toward a little more accommodation.

CHAIRMAN VOLCKER. Which is expressed to some degree in changing the range itself and in the "would" and "might" language.

MS. SEGER. But the monetary growth numbers are cut back from what we talked about at the last meeting.

MR. PARTEE. Because we have had that low October.

CHAIRMAN VOLCKER. They are at the bottom end of the range.

MR. BLACK. They don't matter when they are over; they shouldn't matter when they are under either.

CHAIRMAN VOLCKER. We have to discuss this other paragraph too, but if we know enough to vote on this one, let us vote.

MR. BERNARD.

Chairman Volcker	Yes
Vice Chairman Corrigan	Yes
President Balles	Yes
President Black	Yes
President Forrestal	Yes
President Keehn	Yes
Governor Martin	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Seger	No

CHAIRMAN VOLCKER. Now we have this other paragraph. Some people's consciences suggest that something like this is appropriate.

MR. MARTIN. Mr. Chairman, since the market seems to be largely disregarding large swings in M1, I think to add this paragraph that is on page 12 of the Bluebook would call attention to something in an inappropriate way. We had some language in this direction six weeks ago; I think the same logic applies today.

CHAIRMAN VOLCKER. You are right; we had some language in the discussion six weeks ago; we could sharpen that and say something like this in the general discussion as an alternative, if that's desirable. Now, the question that was raised was whether we have to make an announcement of this. I don't mind saying this: Since everybody anticipates it anyway, it looks a little odd to go out of one's way to find the special occasion to say it. I might be testifying later this week. If I do, I could just plant a question; that's easy. But if I don't, I need some natural occasion to--

MR. MARTIN. If we say it this way, isn't there a slight implication that we're leading up to putting M1 in the future into a monitoring range or something of that sort? If we go out of our way to say this, aren't we saying: "Next week, folks, we are going to put M1 on a monitoring--."

MR. MORRIS. I would hope so.

MR. BLACK. If you are right, Pres, you have just changed my whole view.

MR. MARTIN. I'm asking. Is that the implication of stating this?

MR. PARTEE. It seems to me the word is "acceptable" instead of "appropriate." If you use the word "acceptable," it doesn't imply anything as to the future. I wonder what a reading of the Congressional history of the Humphrey-Hawkins [legislation] would suggest. There used to be the idea that if the targets were changed, the Congress would be notified that the targets were changed. We have never utilized that, but I recall that as being characteristic of the Humphrey-Hawkins--

CHAIRMAN VOLCKER. I don't think there's any doubt. If we were making a change in targets and that implied some change in the way we're approaching things, the implication is that we'd announce it. Now, this has kind of crept up on us--well, [not] crept up; it started out with a burst when we did it. But the point of interpretation is that we haven't said we had to announce it when we thought we were going to miss a target. We have missed lots of them. Is this missing a target or is this a change in target? That's the question.

MR. MORRIS. To me, it's changing the targets because we clearly are not attempting to hit the targets.

MR. AXILROD. On Friday, when the directive of the previous meeting comes out, it will be clear, as everyone knows, that the Committee was not aiming at hitting this target, given the September-to-December [figure]. I believe we could put it in the policy record as you suggested, Mr. Chairman, and just say that the Committee, in its discussion, recognized that given the--

CHAIRMAN VOLCKER. Well, I think that takes care of it in substance, but that's not announced for a month; that's the only real problem. Are we forced to make an announcement here? We probably are dancing on the head of a pin, but I don't know whether you can find some previous time where we missed a target--I suspect that you could --whereby this late in the year it was evident that we were not going to hit it and we weren't aiming at it.

MR. GUFFEY. If we were missing M3 or debt, we wouldn't be considering this, it seems to me; and I don't think we should for M1. I wouldn't raise the question: "Why is M1 more important than M2 or M3 in the context of policy?"

CHAIRMAN VOLCKER. People think it is.

MR. GUFFEY. I understand that, but to the extent we could diminish that perception, I think it's important. Therefore, I wouldn't do it.

MR. MORRIS. I recall in October 1982 we specifically stated that we were setting aside the M1 targets for the year, and that was in the minutes.

VICE CHAIRMAN CORRIGAN. Was it in the minutes or did we do that in this business of--

CHAIRMAN VOLCKER. Oh, I think that was announced. The substantive difference is that then we weren't so far off. We were off, but not so far off, and it was meaningful to say we were not [aiming to hit it]. This time people know we're not going to hit it, I think.

MR. MORRIS. Well, as I recall, it would have taken a zero growth rate in the last quarter to hit the target in '82.

CHAIRMAN VOLCKER. This time it would take a minus.

MR. BALLES. Mr. Chairman, do you think there are any expectations or fears in the markets that we might actually take actions to get back close to that 3 to 8 percent range? If there are, I think it would be well if we eliminated those fears or expectations, and putting this paragraph in would be a way to do it.

CHAIRMAN VOLCKER. I don't think there is that expectation, but the question may be there. It's a question of how hard we're trying to come closer; I think that is the practical question. If they did their arithmetic, I don't think anybody really would think we are going to hit it or even are trying, because we would have to say we are aiming for a minus figure in the fourth quarter like we achieved in October.

MR. BOEHNE. If you look at what we say here about the M1 range, we say that there are a lot of uncertainties surrounding it including velocity, etc. When you testified back in July, you wrapped it in a lot of uncertainties. I would think we'd be smarter to treat this as simply a miss of a target and say: "We pointed out last July when we set it that this was a very fuzzy target, given all the uncertainties, and we missed it." My sense is that's the way people on the outside read it now.

CHAIRMAN VOLCKER. I feel under no pressure to make such an announcement on this.

MR. BOEHNE. And I wouldn't want to put the spotlight on this picture.

CHAIRMAN VOLCKER. Well, I have no trouble with doing it if an occasion arose to do it in the next few days very simply. My little trouble is what do we do--put out a press release or something? I don't know what the heck people would--

MR. BOEHNE. I wouldn't do that.

MR. PARTEE. Well, your speech in Toronto was interpreted by some--

CHAIRMAN VOLCKER. I'm sorry now in retrospect that I just didn't say that. I wasn't thinking about it, but I could have easily said that we're not going to meet the target a little more directly. I'm sorry I didn't because that would have taken care of it.

MR. STERN. I think we should say something like this myself, in part because we're not under any pressure to do so, and yet coming forth with some additional information or clarification under those circumstances strikes me as a plus.

CHAIRMAN VOLCKER. The issue, it seems to me, is do we put it in here? What would you do as a practical matter apart from what we put in here? Go out and make an announcement tomorrow?

MR. BOEHNE. I wouldn't make an announcement. I would wait for a very natural occasion and simply say that the uncertainties surrounding M1 continue and the range is--

CHAIRMAN VOLCKER. I do have a speech on the 19th or some time.

MR. BALLES. Yes you do, in Los Angeles.

CHAIRMAN VOLCKER. Yes, but that's two weeks off.

MS. HORN. It doesn't seem to me that time is of the essence here. Two weeks from now is fine; it wasn't as if we decided something at this meeting relative to M1.

MR. BOEHNE. I think if we put out an announcement--

MS. HORN. If it's two weeks from now, it's fine just to say it a little more clearly than you did in Toronto.

MR. BOEHNE. If we put out an announcement along these lines now, I think it will be interpreted as the Fed is about to ease.

CHAIRMAN VOLCKER. Yes, I agree with that.

MR. BOEHNE. I don't think we want to convey that at this point. We may want to ease but I don't think we want to convey that.

CHAIRMAN VOLCKER. Well, if that's the way you feel about it, I'll couch it in appropriate words in Los Angeles if I don't find a suitable occasion when I'm in public to say it before then.

MR. FORRESTAL. And leave it out of the directive?

CHAIRMAN VOLCKER. Well, what do you want to do? I would leave it out of the directive but say it pretty clearly in the discussion.

MR. FORRESTAL. Yes, I think that's a good way to do it.

MR. BOEHNE. I do too.

MR. GUFFEY. Well, given the record that will be published on Friday this week, it will be no surprise that we're not going to make the 3 to 8 percent target. And I don't see any reason to make any announcement at all, unless you're asked the question.

CHAIRMAN VOLCKER. Well, I can put it into a speech easily enough. I could just put in some sentence saying of course we're not going to meet this--that given what has happened, we don't have any expectation that we're going to be within the range. That's not difficult.

MR. PARTEE. We have had commentary from both the House and the Senate on the summer Humphrey-Hawkins [report], haven't we? And the House specifically recommended that we not. But the Senate I think--

CHAIRMAN VOLCKER. Well, I haven't answered those yet, have I? That's another thing we can do. They send a letter and say: What comments do you have? I could just put it in the answer. That's what I could do: put an answer in that letter.

MR. PARTEE. That, it seems to me, would follow the procedure.

CHAIRMAN VOLCKER. I think those are on my desk, aren't they?

MR. AXILROD. This letter?

MR. PARTEE. These are on the two reports. I have copies; I'm sure all Board members have.

MR. FORRESTAL. It's the Fauntroy report.

CHAIRMAN VOLCKER. I think I have those letters on my desk.

MR. AXILROD. Yes.

MR. ROBERTS. You have the Fauntroy letter; I don't know about the Garn letter.

CHAIRMAN VOLCKER. It doesn't make any difference--one or the other.

MR. PARTEE. Yes.

MR. BOEHNE. Yes, that's a good idea--just to have it in that letter.

CHAIRMAN VOLCKER. Okay. We'll word it in the answer to: "What do you think of our report?" I can say that we take your report so seriously that we are not going to meet the M1 target. I think that's quite a natural way to handle it, if I can get it out in the next couple of days, although one can argue about the timing and so forth. Okay, that's the way we'll do that. Do we have anything else to do?

MR. BERNARD. No. We're scheduled to be in Dining Room E at 1:00 p.m.

CHAIRMAN VOLCKER. The Open Market Committee meeting is over then.

MR. PARTEE. How about that!

CHAIRMAN VOLCKER. And we agree that the next meeting is--

MR. PARTEE. December 17.

END OF MEETING