TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

August 15, 1978

Prefatory Note

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

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

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

Staff Statements Appended to the Transcript

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

Meeting of Federal Open Market Committee

August 15, 1978

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C.,on Tuesday, August 15, 1978, at 9:30 a.m.

PRESENT: Mr. Miller, Chairman
Mr. Volcker, Vice Chairman
Mr. Baughman
Mr. Coldwell
Mr. Eastburn
Mr. Gardner
Mr. Jackson
Mr. Partee
Mr. Wallich
Mr. Willes
Mr. Winn

Messrs. Balles, Kimbrel, and Mayo, Alternate Members of the Federal Open Market Committee

Mr. Morris, President of the Federal Reserve Bank of Boston

Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. O'Connell, General Counsel
Mr. Axilrod, Economist

Messrs. Burns, J. Davis, R. Davis, Ettin, Kaminow, Keir, Truman, and Zeisel, Associate Economists

Mr. Pardee, Deputy Manager for Foreign Operations
Mr. Sternlight, Deputy Manager for Domestic Operations

Mr. Coyne, Assistant to the Board of Governors
Mr. Kalchbrenner, Associate Director, Division of Research and Statistics, Board of Governors
Mr. Siegman, Associate Director, Division of International Finance, Board of Governors
Ms. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Czerwinski, Moriarty, and Rankin, First Vice Presidents, Federal Reserve Banks of Kansas City, St. Louis, and Richmond, respectively

Messrs. T. Davis, Eisenmenger, and Scheld, Senior Vice Presidents, Federal Reserve Banks of Kansas City, Boston, and Chicago, respectively

Messrs. Brandt, Broaddus, and Keran, Vice Presidents, Federal Reserve Banks of Atlanta, Richmond, and San Francisco, respectively

Mr. Burger, Assistant Vice President, Federal Reserve Bank of St. Louis

Mr. Duprey, Senior Economist, Federal Reserve Bank of Minneapolis

Ms. Tschinkel, Adviser, Federal Reserve Bank of New York

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August 15, 1978

CHAIRMAN MILLER. First, I want to apologize for a little delay this morning. It was because the Treasury [breakfast] had more eggs than usual and I didn't want to pass up the last opportunity to be fed before this ordeal. Before FOMC meetings I get a very big appetite! Second, I have to apologize for Steve Axilrod, but he's going on vacation this afternoon and he doesn't normally dress this way. Actually, when people saw him yesterday in this outfit, the exchange markets, as you know, went wild. Let's see what happens.

The first order of business is for me to recommend to you the election of Murray Altmann as Secretary. I think you all know Murray. He's a New Yorker and has been with the Federal Reserve System since 1949--going on 30 years almost--and most recently, of course, has been working with the FOMC as Deputy Secretary. And I take great pleasure in recommending him to you as the Secretary. Is there such a motion?

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN MILLER. Any discussion? All those in favor?

SEVERAL. Aye.

CHAIRMAN MILLER. All opposed? Now, the reason Murray has been selected is because he has a mean streak. Art Broida was so kind that when I asked him to get a timer with a bell on it to keep us under control, he just couldn't get up the courage to do it himself. But as he left, he presented me with these timers, which [are hourglasses with sand and] don't have any bells. So I'm going to try to set them up when each of you starts to talk and Murray is going to show a mean streak--since I'm a gentleman--[and tell you when your time is up].

MR. PARTEE. What are they--three minutes?

CHAIRMAN MILLER. Yes. And when your three minutes is up, he's going to say “next speaker.” Three minutes for each one of us is an hour, so if we each speak three times for three minutes, it’s three hours.

VICE CHAIRMAN VOLCKER. How many times can you talk, though?

CHAIRMAN MILLER. Less. So those are your time limits. You didn't know this was your duty, did you?

MR. ALTMANN. No, I didn't. I'm not sure yet whether you're serious.

CHAIRMAN MILLER. We are having a lot of fun but we are serious.

My second serious duty is to note that Bob Black, Roger Guffey, and Larry Roos will not be at this meeting and they are being represented by their First Vice Presidents. George Rankin is here from Richmond, Henry Czerwinski is here from Kansas City, and Don Moriarty is here from St. Louis, so we are all represented, and we welcome you. I think at least for Henry and perhaps Don this is your first time attending [as a participant] at this table, though you've been [at FOMC meetings seated in] other places. We are delighted to have you and we hope you will speak up.

The next thing I would like to mention is a concern that has come to my mind about possible inadvertent, but nonetheless potentially damaging, leakage from the FOMC meetings. We have seen a recent article by Ben Weberman that comes very close to indicating that he has inside information about what goes on in these meetings. And that could only come from someone here. It is not coming from anyone because of a leak. It's occurring because of the general capacity of the journalist to put 2 and 2 together--by calling you and chatting and by innocent questions and silences during these calls around the country--to make up a story. I think this is very damaging. There have been memos circulated in the past about how we take special care for security and there is, I believe, a procedure where each March the Committee is reminded of this problem.

But I would like to suggest to you that all of us are subject to our egos being massaged by the press calling us and saying how important it is to get our views on the economy. And a few questions put here and there [can give them a story]. Frankly, I think it would be well just to decline to take calls from the press for a respectable period after an FOMC meeting and not get trapped in this procedure. Have your public information people take the calls and ask what the subject is. I think we should be--and I hope we will be--more sophisticated than to let ourselves be trapped because I do think it does damage for stories to get out about what goes on inside these meetings.

If you'd like, we can circulate some of the memos on this subject going back to 1972 and 1975, but I think you all probably appreciate what I am talking about and I hope we can watch it. Unless I have omitted something, Mr. Secretary, I think we can now proceed with the regular agenda and ask for approval of the minutes of the actions taken at the FOMC of July 18. Are there any questions or changes that have not already been [submitted] to the Secretary? Hearing none, and in the absence of any dissent, we will assume the minutes are approved. Next is a report on foreign currency operations since the last meeting. Scott Pardee.

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

CHAIRMAN MILLER. Any questions or comments?

MR. COLDWELL. One question, Mr. Chairman. Scott, to what extent do you ascribe some of the dollar's difficulties to the effort we've made to repay German debt?

MR. PARDEE. I think at this stage very little. It comes back to the question of how the marks are pulled out of the market. That is, the marks that we have acquired have been directly from the Bundesbank, which itself has been absorbing marks from the market in connection with capital export conversions. We have not been buying in the market itself and we have not been perceived as a buyer of marks in the market itself, so that would not influence market psychology. So I don't think it has had an effect.

MR. MAYO. Is this publicly known, Scott?

MR. PARDEE. We've announced it, yes.

CHAIRMAN MILLER. Yes, the Treasury's Tony Solomon made an announcement some weeks ago. I think it's the first time the public had been informed of substantial repayments. Ernie, I think you had a question.

MR. BAUGHMAN. I was wondering if Mr. Pardee could elaborate a little on the characterization of "ridiculously low levels." Can you put that in a setting a bit?

MR. PARDEE. Well, there are a number of ways you can look at it. As I say, these rates have moved [substantially]. The Swiss franc has moved practically 50 percent in the past few months and the yen the same--just in terms of how far the rates have moved in a very short period of time. Yesterday the Swiss franc moved by 5 percent. And to the extent that anyone goes to these countries and finds how expensive it is to do anything--in terms of inflation differentials or those kinds of analyses--I think you'd find that the dollar is currently undervalued relative to these currencies. As I say, I am essentially trying to report to you what people are telling us from the market. These are the people who are selling the dollar.

CHAIRMAN MILLER. This is not your own characterization.

MR. PARDEE. Well, in fact it is, but I don't want to interpose my own views because, as I say, we have been inundated with calls. People out of retirement have called and said, we want to find someone we can talk with to express our concern about what is happening to the dollar. We think the situation is ridiculous, it's overdone and we want to see what can be done at this stage to turn this thing around. It's hard to follow the market and to do what little intervention we've done while getting all of these other phone calls from people who want to talk for half an hour and explain their frets.

CHAIRMAN MILLER. With your permission, at the end of this meeting I'd like to bring up the subject of countermeasures to this sort of situation. I'd prefer not to do it now but at the end of the meeting, if you all don't mind, because we had not prepared to do so. I'd better bring it up because there is something to [discuss]. I'm not trying to cut into the questioning to Scott.

MR. WALLICH. Any clue, Mr. Chairman, on the discussion of the yen swap?

CHAIRMAN MILLER. I think we should discuss that with the Committee, yes.

MR. WINN. What happened yesterday, Scott, that caused this outbreak in markets?

MR. PARDEE. Well, under floating exchange rates, Mondays are usually the bad day because everybody--at least outside of New York--has newspapers to sit and read and Sunday newspapers tend to pick up all of the tag ends of [the news]. And when there's bad news for the week, that's the time when money managers begin to mull things over in their minds as to what they are going to do. So, quite often Monday is an exaggeration of whatever problems we had the week before and, therefore, we had a more serious problem, I think, to some degree. Phil Coldwell asked last month whether the corporate treasurers were moving, and we had a feeling yesterday that the corporate treasurers were now moving in bigger volume to sell dollars to cover their positions. [They apparently felt] that the decline of the dollar had gone so far that they could no longer sit tight and say this will blow over. We had been describing this as a professional market--traders dealing with each other--but we are running into the situation now where there's more money coming in from treasurers outside.

MR. WINN. What sort of volume did the market have yesterday?

MR. PARDEE. We had a big volume. Anything we wanted to do could have been done. We could have done $1/2 billion, if we wanted, in intervention. That would have satisfied some of the pent-up demands for other currencies. If you're not there, then not so much will go through, but the rates will move further.

CHAIRMAN MILLER. Chuck Partee.

MR. PARTEE. I think maybe that partly answers my question. I was going to ask you, Scott, whether you sense the kinds of conditions that would be characteristic of a climatic sell-off in the market. That's an analogy with the stock market and I gather that you are [getting] much more participation in the selling as you see it. The volume is up and the thing is moving now very rapidly. You can't tell how far down it will go but it is of the nature of that final sell-off surge.

MR. PARDEE. But it’s not a final sell-off; these things can go on for a longer period.

CHAIRMAN MILLER. I don't think we could characterize it as final.

MR. PARDEE. But it’s a climatic situation.

CHAIRMAN MILLER. You have a massive amount of dollar holdings that could be moved if there were a real panic.

MR. PARTEE. So it could go much further.

CHAIRMAN MILLER. Oh yes, because you have, of course, substantial holdings of foreigners, of OPEC countries--

MR. PARTEE. Well, of course, you have all the Americans with their holdings of dollars that they could move into foreign currencies.

CHAIRMAN MILLER. You have a bottomless pit--in some sense--of panic. In the international field, I don't think we have mechanisms to avoid a panic.

MR. MAYO. Was yesterday a disorderly market?

MR. PARDEE. By all [means], when the Swiss franc moves by 5 percent.

CHAIRMAN MILLER. By all the standards we developed before, Bob, it was disorderly.

MR. COLDWELL. What has the market done this morning?

MR. PARDEE. Well, the dollar was lower and now there has been a technical rebound in the last half hour. The Swiss government is having a cabinet meeting tomorrow and, as I say, people worry about their Draconian measures. The Swiss have taken several Draconian measures and people worry about them before they are taken and after they are taken. They say, well, that won't work and then they buy Swiss francs anyway. The Swiss went and this last month by, as I say, creating worth of Swiss francs, which turns out to be about percent of their monetary base, simply as a way of trying to flood the market with Swiss francs and turn the thing around. But the Swiss franc is up about 15 percent. So anything they have done has been thrown right back in their faces and they are rather frantic at this stage. They do have their own economy to manage under these circumstances.

CHAIRMAN MILLER. So we need your action to ratify the transactions since the previous meeting. I believe they have been reported to you. Is there such a motion?

MR. COLDWELL. So moved.

CHAIRMAN MILLER. And seconded. Any discussion? All those in favor, say “aye.”

SEVERAL. Aye.

CHAIRMAN MILLER. It is so voted. Scott, I think you also have some recommendations with respect to renewals of swap drawings, and perhaps you can go on to report on the Bundesbank’s proposals.

MR. PARDEE. Right. On the renewals of German mark swaps, we have four drawings, totaling $246 million, coming due in September. These are second renewals and the Bundesbank has agreed to renew them. And I recommend that the Committee approve their renewal.

CHAIRMAN MILLER. Any discussion? Then we may have a motion for a renewal.

SPEAKER(?). So moved.

CHAIRMAN MILLER. [None] opposed, so voted.

MR. PARDEE. I'd like to add that Mr. Gleske of the Bundesbank has written to Alan Holmes with some points that the Germans would like to reconsider in the basic swap agreement with the Bundesbank, which would be up for renewal in December. They are raising these points now so that we can consider and discuss them in due time.

First, they suggest that the even sharing of exchange risks on drawings be dropped so that we would bear all of the risk. They are prepared to accept that drawings be at their interest rates, which are currently 4 to 5 percent below ours, rather than at U.S. Treasury bill rates. So there is a tradeoff that's involved in that point. Second, they would like to have any renewals made at current rates of exchange rather than at the rate of the original drawings. This would mean, in effect, the booking of profits and losses on individual swap drawings on a quarterly basis. Finally, they would like to have the language tightened up on the mode of repayment, making clear the principle that first efforts to acquire marks would be in the market.

I have nothing to recommend today in this regard. All of these points require study. But we are preparing a memorandum to lay out the issues before the Committee. Some of these proposed changes are of a fundamental nature, such as the 50-50 loss sharing and would have to be extended to the swap arrangements with other central banks as well as with the Bundesbank. We have to consider them carefully.

MR. PARTEE. The recognition of profits and losses quarterly is also quite fundamental. We've never done anything like that before.

MR. PARDEE. No.

MR. WALLICH. But isn't the Treasury doing that now?

CHAIRMAN MILLER. Well, that's internal accounting.

MR. PARDEE. No, not on the Bundesbank swaps. They are doing it for their own account.

MR. TRUMAN. The Treasury is doing it for their own purposes.

MR. PARDEE. This would be a rewriting of the swap [arrangements].

CHAIRMAN MILLER. This would change the relationship for repayment purposes. Any questions? I think we will have much to consider in that field as this develops further. You'll be coming back to us with something further?

MR. PARDEE. Right.

CHAIRMAN MILLER. I believe that completes the [subject of] foreign currency operations unless there are still questions. We will go on to the economic and financial situation and outlook. This month Jerry Zeisel will report. Jim Kichline is on vacation despite the terrible international outlook.

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

CHAIRMAN MILLER. Thank you, Jerry. I would suggest that we now take a period of time first for questions of the staff and then, as we've been doing recently, that we do the go-around and get your own views on the outlook for the next four quarters on real GNP, inflation, and unemployment. Are there any questions now of the staff before we begin?

VICE CHAIRMAN VOLCKER. I take it the revised GNP figures are going to come out fairly shortly. Do you have any strong feelings that they're going to be revised upward or revised in either direction?

MR. ZEISEL. The major revision is likely to be in the net export figures and that's substantially upward. That could be as large as, what--

MR. TRUMAN. We think it could be as much as 3.8.

MR. ZEISEL. Which would be possibly 3/4 of a percent or in that range.

MR. PARTEE. That's the second quarter you're talking about?

MR. ZEISEL. It's the second quarter, right, so [GNP growth] could well be above 8 percent for the second quarter.

CHAIRMAN MILLER. Other questions?

MR. PARTEE. One of the particularly striking aspects of the forecast, Jerry, is the continued relatively low personal saving rate that is projected. That is relatively low by historical comparison, and I wonder if you could talk a little bit about the justification for that.

MR. ZEISEL. Obviously, that's rather a key element in the forecast. We maintain the saving rate in the upper 5 percent range--somewhere around 5.7 percent toward the end of the projection period. If the saving rate were to be significantly higher, obviously, the implications for consumption and overall activity would be on the downside. Our feeling is that the relative price movements, particularly for food, housing, services, and other necessary outlays have put so much of a burden on disposable income that just to maintain the standard of living is going to require people to keep their saving rate at a relatively low level during this period. And that's, I guess, the key element in our projection.

MR. COLDWELL. Could I follow that with one question in the same area? Jerry, what's your opinion regarding debt burdens as far as consumer spending?

MR. ZEISEL. Debt burdens are high in historical terms. They are particularly high when one incorporates mortgage debt burdens along with the others. However, there has been no indication as yet of a deterioration in the quality of debt, and defaults don't show any significant deterioration. Our feeling is that as long as income growth is maintained at a reasonable pace, we'll probably be all right. But obviously, we have factored in this high debt burden and it's one of the elements that led us to conclude that consumer outlays would not be rising at a very rapid pace over the next year.

MR. COLDWELL. Your banking contacts don't indicate deterioration?

MR. ETTIN. On the contrary, the delinquency rates declined in the most recent months. I might also add, Governor Coldwell, that there are demographic reasons that would suggest that the amount of consumer borrowing should be rising. The baby boomers are between 25 and 35 years of age and this is the sector that tends to accumulate the most debt as it is acquiring capital assets and beginning family formations.

CHAIRMAN MILLER. Bob.

MR. MAYO. Just to support the staff's response to Phil, one of the nation's largest retailers reported to us just three days ago that their delinquency rate is lower than at any time in the past six or seven years. They're amazed themselves, but they're having no problems whatsoever.

CHAIRMAN MILLER. Henry Wallich, you have a question, do you?

MR. WALLICH. I see we are now counting on a full employment surplus in the second quarter of $12 billion. We still have a very large actual unified budget deficit. How do we get from a large deficit at about 6 percent unemployment to a full employment surplus at, I would assume, 4.9 percent?

CHAIRMAN MILLER. This is a leading question, so be careful how you answer it.

MR. WALLICH. No longer is there basis--

MR. PARTEE. You can't even find the tax cut there.

CHAIRMAN MILLER. The answer is what you assume to be full employment.

MR. WALLICH. Well, I thought it was 4.9 but if you tell me it's otherwise, then you've resolved my perplexity.

MR. ETTIN. I don't know the explicit number in the calculations but there has been increasing criticism of that concept--not only because of how one determines what is full employment but also because the effect of any given surplus or deficit depends so importantly on the composition of tax revenues and expenditures. The staff here is trying to develop other methods of measuring the same thing that the full employment budget surplus or deficit tries to measure. It is a very complicated issue and we've only made minor progress so far.

CHAIRMAN MILLER. Well, gentlemen, I would suggest that since we went around this way last time, as I recall, we'll go around the other way this time. Let me start off, as usually I end up. I would call your attention to Part 1 of the Greenbook, page 6. Under changes, it shows the projected changes; it says '78 II to '79 II, and that's the line we're talking about in a way. If you look there, you'll see that on a four-quarter basis the staff is projecting real GNP to grow 3.6 percent, they're looking at a deflator of 7.4 percent, and they're looking at an average unemployment rate in the second quarter of 1979 of 5.8 percent. Those figures are the ones we're going to try to get your feeling on. Now we know what the staff thinks and we're going to see what we're all thinking around the country about the orders of magnitude [for those variables].

In my own case, I don't believe I've really changed my feeling from the last meeting. I think that real GNP is apt to grow at 3-1/4 to 3-3/4 percent in this period, that the deflator is apt to be between 7 and 7-3/4, and that the unemployment rate will be 5-3/4 to 6. I believe those are the figures I had last time. I'm not going to fill in any comments because I know what we've seen in the Redbook and what we've seen in the Greenbook. [I wonder] if we all could at least get that general feeling that the economy is slowing [but] it's still fairly well balanced in the sense that there are no major sectors that are either expanding [or going] down rapidly. We're talking nationwide. Obviously, cement is short in some places but generally there are no capacity constraints. There seem to be no general excesses of inventory and there seem to be no general deflationary pressures in any particular sectors. It’s a fairly well balanced situation with some leeway. Paul.

VICE CHAIRMAN VOLCKER. I've changed your figures by about 1/4 point--3 to 3-1/2 percent on the growth, 7-1/2 to 7-3/4 on the inflation factor, and unemployment somewhere around 6 or a little below. The growth outlook doesn't look entirely unsatisfactory to me; the inflation outlook does.

CHAIRMAN MILLER. Phil.

MR. JACKSON. I don't think I've changed my mind significantly. I still think we are likely to have better growth than the projection for the balance of ’78 and probably worse than the projection for the first half of ’79, but on balance the growth would probably be about the same. I would say that if there's any news since the last meeting in my own mind it looks like we're going to get less cooperation from organized labor on the inflation front and to that [extent] we may have a slightly higher net result over the year than we expected, though not to a major degree. But considering the present level, any increase is a significant increase and, therefore, probably worrisome. If anything, I'm probably inclined to be up a 1/4, to maybe 7-3/4 on inflation by year-end. Unemployment probably will be up in the 6 percent range. It strikes me that we are likely to continue to have some discipline in the manufacturing sector but the service and government sectors are probably where we will continue to be in trouble--and probably worsening trouble over the year. Therefore, the 30 percent of GNP that's in [those areas] will probably be adversely affected.

CHAIRMAN MILLER. Phil, I was particularly waiting for your remarks because anyone who spent two weeks in the wilds of Canada has the most balanced view of what the outlook might be--not contaminated by being too--

MR. JACKSON. I would say that for the last two days--having been completely without news of any sort for seventeen days--the labor question is the one thing that hit me since coming back. It looks like the environment in labor is worse than it was when I left.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. I'm disappointed, Phil. I thought you were going to say that you could hear the roar of Nancy all the way up there! I think Phil is exactly right to feel that the signs of serious labor difficulty are the most important developments of the last month. I would be inclined to feel that would mean both that wage rate increases next year will be going up more rapidly than we had anticipated and also that there will be considerable strike interruptions in the course of the period. It is, of course, very difficult to forecast. I do believe that the effect of the labor developments are more in terms of a continuation of a high rate of inflation next year than of changing the outlook for the twelve months under review here, of which a large part is already predetermined by the wage increases in process, and the minimum wage and social security [increases to come]. And food output, which may have improved somewhat in the course of the past month, [may also be a factor].

I haven't really changed my view either from the last time. I feel that we'll come out on the low end of the real GNP projection that the staff has here--probably with a little better second half, although the second half is not looking so good right now, and a distinctly weaker first half next year. I would say 3 to 3-1/2 percent for real GNP over the period. I haven't much quarrel with the price projection; 7-1/2 is probably now about right for this period, but I think it may be gradually rising, so if you were to look at 1979 as a whole, it would be more than 7-1/2 percent. And I would still say that the unemployment rate will be a bit higher by the second quarter of next year, say 6-1/4 percent.

CHAIRMAN MILLER. Thank you, Chuck. George.

MR. RANKIN. Mr. Chairman, in general we think the profile of the staff's forecasts pertaining to inflation and moderate real growth is probably correct. We're not quite as optimistic on real GNP over the forthcoming period; we'd guess it may go as low as 2-1/2 percent. The fixed-weight deflator we'd guess at 8 percent and the unemployment at maybe 6.2 percent.

CHAIRMAN MILLER. Mr. Winn.

MR. WINN. I am concerned about the inflation developments and I'm not sure that they're all attributable to organized labor. As you know, we suggested to our Chairman that he not send a letter to the [banks] on inflation issues and the Secretary of the Treasury did. And I noticed that a large number of banks were having very substantial [wage] increases at midyear this year. When you talk to them they say: Well, we're afraid of wage controls and we want to get them in early. So, we're starting to see this sort of a movement. If you go to a restaurant and you complain about what's happening to their prices, they say: Well, we're afraid of price controls. We hear more and more of this in conversations as we talk to business people; they're all very quietly trying to get their prices up just as rapidly as they can, which tends to accelerate. I think [it’s] a rather broad view.

Second, I'm a little more concerned [about capacity constraints]. While I agree that generally capacity looks all right, it's the bottleneck problem that kills you and we’re seeing that more and more in terms of skilled labor. More [firms] are using this as the restraint--their ability to increase not physical capacity but the skilled labor component. The steel companies will say: Look, if we could change the mix, we'd be all right. But talk about drilling equipment, we're in trouble; talk about wire, we're in trouble. If we talk about certain flat steel for automobiles, we're in trouble. But in general people still talk about 80 percent or 85 percent in terms of capacity. So you see, the general figures look good but you get to specific areas and you begin to [see] the bottlenecks. Whether that will show up in prices or in delayed delivery or what, I don't know.

So, I think the capacity problem may be more of a constraint than indicated and, therefore, I would say that the real growth would probably be in the 3-1/2 to 3-3/4 area but my price concerns would be higher. I'd be in the 8 to 8-1/2 percent area [with] everybody starting to raise [prices] in view of the real certainty they feel that price controls are around the corner. And they look forward to rent controls, so everybody is trying to get in [price increases] in advance of controls. So I think you're going to see a frightening--

CHAIRMAN MILLER. So competitiveness makes no difference, even with slack?

MR. WINN. I was just mentioning that the banks are now raising their wages in view of the letter they received from Mr. Blumenthal. They've had very fine earnings this first half, as you know, and instead of waiting until the end of the year they're making the adjustments now and saying they'll be more in line at the end of the year. But [the wage increases] will be in advance of any possible wage controls. On unemployment, I'd say around 6 percent.

CHAIRMAN MILLER. Thank you. Dave.

MR. EASTBURN. My figures are quite similar to the Board [staff projections] and are quite similar to last time: real growth 3-1/2 or a little under; the deflator at 7-1/2 percent; the unemployment rate 6 percent plus a little bit. I think it's quite clear that the economy is running out of steam. The only question that I was trying to resolve between the meetings was this question that we explored last time about liquidity problems. Remember, there were a number of charts discussed at the last meeting and I took the occasion, on the basis of those charts, to talk to a number of bankers about liquidity conditions both in the corporate and consumer areas and at banks. And uniformly I got expressions of no concern. They didn't see evidence of corporate sector problems and they didn't see evidence in the consumer sector. [Their views] supported the kinds of figures that have been mentioned about delinquencies in consumer loans and they felt reasonably comfortable as far as their own situations were concerned.

I raised the question as to whether they might have said the same thing in 1974. They said that's possible--that things can happen of which they're not aware and can happen fast--but they don't think so. They're really much more aware of the problem than they were at that time. So this gives me some feeling of reassurance that we're not going to have that kind of crunch [or] up and down situation. I think it's going to go out with a whimper, if it goes out, rather than a bang.

CHAIRMAN MILLER. Thank you, Dave. Bones.

MR. KIMBREL. Mr. Chairman, we have observed pockets of weakness, but on balance our people are still very optimistic. They're concerned more than [anything else] I guess about prices, for the reasons pointed out [by others]. Labor and energy--the availability and the cost--are very [much in the forefront] in their considerations price wise. Also in the background is the possibility of OPEC repricing or changing the manner in which it prices. Even in the food sector--cattle prices [and] related [products]--they expect strength. And price supports seem to indicate that food is going to be [unintelligible]. Even the lumber area continues to show the possibility of increased prices.

Well, that brings us to the numbers. I guess if we were going to be specific, we'd say 3 percent or less on real GNP, unemployment at 6.2 percent or more, and at least 8 percent on the deflator.

CHAIRMAN MILLER. Thank you for the report, not the information. Don.

MR. MORIARTY. Thank you, Mr. Chairman. Our figures come out to be very similar to those we've heard already and for many of the same reasons. We believe the economy is slowing but pretty balanced. Our particular figures would reflect an inflation rate of 7 percent to slightly higher, real output at about 3 percent, and the unemployment rate at about 6.2.

CHAIRMAN MILLER. Thank you. Let's pop over [to the other side of the table] to Henry.

MR. CZERWINSKI. Thank you, Mr. Chairman. Our view is a little less optimistic than the Board's staff. We would estimate real GNP at about 3 percent, inflation close to 8, and unemployment at about 6.

CHAIRMAN MILLER. Okay, thank you. Bob.

MR. MAYO. We share the point of view that has been circulating around the table here that the economy is slowing perhaps, but is in pretty good balance. We don't see any serious problems, nor do the people that we have direct contact with. I would say again 3 to 3-1/4 percent for real GNP and I consider that a quite reasonable sort of projection--not a pessimistic projection. Prices we have at 7-3/4 to 8 percent. For unemployment, I think we're already at the 6 to 6-1/4 percent range, if you look at the figures over a more sensible period of time than the last two observations on a monthly basis. And I don't think it is going to get significantly worse than that.

CHAIRMAN MILLER. Thank you, Bob. Mark.

MR. WILLES. Thank you, Mr. Chairman. Real GNP 3.52, down from 3.53.

CHAIRMAN MILLER. I like someone who'll stick his neck out! Remember we're keeping the record, Mark.

MR. JACKSON. Is this the second adjustment or the first adjustment?

MR. WILLES. That's the first. Inflation of 7-1/2 to 8 percent and unemployment around 6 percent. The only comment I would make--I guess we've all been going through the same kind of exercises trying to see where the imbalances are and whether we really see a recession coming. I don't. Things do seem remarkably well balanced for this stage in the expansion. I would endorse, however, the concerns that have been expressed about what has happened in labor. That not only has some potential difficulties for prices, as has been indicated, but a severe work stoppage. In our state they're talking about how high interest rates are and they want to put usury ceilings back to 8 percent for the homeowner, that sort of thing. If the response of labor is such that it's forceful and effective, then that could generate some of the imbalances that could precipitate a recession. Other than that, I think [the outlook] on the real side remains good at this stage and inflation is the only thing that's really [unintelligible].

CHAIRMAN MILLER. Thank you, Mark. John.

MR. BALLES. Well, I guess up to this point, I'm the great bear in the crowd. That may be only incidentally related to having been chased by a brown bear in Alaska, which made me a little more cautious than ever! We've shaded our forecast down a bit from last month and are among the least optimistic now in that our real GNP is 2.4 percent, inflation is 7.7, and unemployment is 6.1. The major differences in our forecast and the Board staff's are much as I recited last time. We expect the consumer spending drive to run out of steam. [People] have been buying in advance of expected price increases; that's drawing business from the future. The ravages of both actual and expected inflation will make themselves felt in consumer psychology and business spending plans and will feed back on inventory positions. That in a nutshell is why we come out somewhat less optimistic. And I guess I'll call a spade a spade; the numbers we have would actually constitute a growth recession.

MR. PARTEE. Do you [expect the economy to] weaken over the period, John, or is it pretty much even?

MR. BALLES. The real weakness is in next year, when every quarter of real growth is under 2 percent.

VICE CHAIRMAN VOLCKER. What kind of monetary policy do you assume?

CHAIRMAN MILLER. Prudent.

VICE CHAIRMAN VOLCKER. Measured by interest rates.

MR. BALLES. Well, my general point would be that there is such a lag in the impact of policy that even if we move now we probably couldn't head this off, and it would merely exacerbate the inflation situation. I'm presuming that monetary policy will be about in the range we've set for our 12-month ranges. And even if we ease up beyond that, it would have little noticeable impact in the forecast horizon; it takes 6 to 9 months for the policy even to show up, in my view in the real economy, and 1-1/2 to 2 years to show up on the price front.

CHAIRMAN MILLER. Thank you, John. Ernie.

MR. BAUGHMAN. Mr. Chairman, our numbers have come down somewhat from what we had last time. On real GNP, we would now think that the staff's projection is a very reasonable one. With respect to prices, also essentially [we agree with] the staff projection of about 7-1/2 percent and we have on unemployment about 6 percent. I would like to underscore what Willis Winn has [reported]. I encounter a good bit of expectations that wage and price controls will be imposed within this forecast period and I share that feeling myself. I [base that on] the continuing evidence that the existing tools are not impacting significantly on the inflation problem and the indication that labor is building a stage for very large demands, which probably will not be vigorously resisted in the absence of controls. [So, I think] the political conclusion will in fact be reached that that's the necessary and appropriate thing to do.

CHAIRMAN MILLER. I'm curious about those feelings, which I'm sure are accurately reported. In a sense it's hard to believe that this Congress could be motivated between now and their election to put in wage and price controls. It's hard to see the circumstances where that could be. You can't get them to do sensible legislation, let alone irrational legislation! Then that means we're into the next session, because I don't believe you could bring back a lame duck Congress to do it either. We don't have any wage and price controls on the books, so we'd have to have an awfully big emergency to get either this Congress or the lame duck Congress to do it. Starting with the new Congress I guess the President would have to announce a request for it [and have] a date in mind [with] no changes past that date--or ask for legislation barring changes past a certain date. And that's a very clumsy situation.

MR. BAUGHMAN. I believe public opinion surveys are beginning to show a preponderance of a willingness to accept price controls. It’s a saleable view.

CHAIRMAN MILLER. Yes, that's the people who are tired of inflation and wouldn't have to deal with whether it would work or not. Everybody is in favor of stopping price increases, I think; that's what public opinion polls are showing. I can't translate that easily--in the next six months--into legislation myself, unless there's a much bigger crisis. But I'm sure that's the [view]. It's very disappointing to see bankers say that the problem is labor, but we're raising our salaries above the guidelines because we want to be ahead of the wage and price controls. However, labor is guilty. Now, that kind of attitude [among] people who presumably should be leaders of their communities is really shocking. Well, it's fairly discouraging. And they point the finger at labor. We're taking care of ourselves and our own fat salaries, but we're going to blame it on labor. It’s a very sad situation.

MR. BAUGHMAN. You see increasing indications of it in businessmen's administration of prices also. For example, I believe, one of the Chevrolet products has had about eight price increases since it was introduced.

CHAIRMAN MILLER. Very, very discouraging. And there’s little hope that you could keep a system together if people have such little willingness to show restraint. And there’s so little competitiveness taking place. I would think some businessmen would want more share of market--apparently not.

MR. BALLES. Mr. Chairman, there's another aspect of this, which I'm not sure has been fully covered. I hear increasing complaints from directors in a wide range of industries in our District that it's just getting awfully tough to hire skilled labor. Another outstanding example is the case of Boeing, which is undergoing a big expansion program right now--three new model planes. They've already hired 12,000 people and they are looking for another 15,000 and it's absolutely messing up the Seattle labor market in a major way. They're hiring people away from every other employer, including our Seattle branch. This is just one example. We get the same complaint from San Francisco, Los Angeles, Phoenix, and Portland. You name it; there's not a big city on the West Coast where [major businesses] have not expressed a severe concern. This is helping to drive wage rates up.

MR. PARTEE. They always do talk about shortages in skilled labor during the late stages of a boom. I've never known it not to happen.

MR. MORRIS. We've got a developing shortage of labor in Connecticut to make the engines for those airplanes.

CHAIRMAN MILLER. Well, let us move to you, Frank.

MR. MORRIS. Mr. Chairman, I think we were the most pessimistic last month on the outlook.

CHAIRMAN MILLER. You may lose your position this time.

MR. MORRIS. And we still retain that position. The evidence of the past month of a leveling off of retail sales, and very poor new orders figures--particularly for capital goods, which I thought were very disappointing--lead us to still think the staff projections are too optimistic as far as real growth is concerned. We would look for 1-1/2 to 2 percent real growth during the period you suggested.

CHAIRMAN MILLER. Where does that take place, Frank? Do you see it being a progressive downslide? That's a very low average. If you start off with over 3 percent in the third quarter, you have to get down pretty low before you're through.

MR. MORRIS. I think the last half of this year is going to be somewhat less strong than the Board's staff is projecting. And we're not looking for much, if any, growth at all in the first half of next year.

CHAIRMAN MILLER. You're looking at a pretty low first half. Okay.

MR. MORRIS. The main areas of difference, I think are in consumer durable goods and housing and also state and local government. On the other hand, I'm more optimistic on prices as a consequence of this more sluggish economy. The fact is that I've noted a very tight correlation in the past few years between the rate of growth in the economy and the rate of change in prices, excluding things not related to the rate of growth in the economy like food and so on. So I would look for a deflator in the range of 6 to 6-1/2 percent--which I think is the lowest around here--and an unemployment rate of 6-1/4 to 6-1/2.

CHAIRMAN MILLER. I think you do win. Okay. Thank you, Frank. Phil.

MR. COLDWELL. Mr. Chairman, when it comes to the figures that you asked for, I'm talking in terms of real [growth] of about 3.2, an inflation rate between 8-1/4 and 8-3/4--probably centered on the high side of that--and an unemployment rate of 6 percent. I think the slackening that has occurred from the second quarter was expected and, to a considerable extent, desirable. Inflationary pressures to me are building faster, and the dollar depreciation of the past few weeks I think is going to add a major fillip to that inflationary problem. The wage problem into ’79 I view as being pretty close to your crisis [situation] here. If we do get the kind of price inflation that I'm looking for--not with any anticipation but looking at--I think we're going to get wage requests certainly up at the coal settlement level. And I think this will [lead to] a number of strikes and interruptions and I caveat my real growth projection on the basis of that. That is, if we do get major strikes, we could have a negative real growth rate.

CHAIRMAN MILLER. Okay. Henry.

MR. WALLICH. Well, just to give it a little variety, I think it's quite difficult now to be married to a single forecast. One has to ask oneself what the probabilities are of a negative growth rate sometime in 1979.

MR. PARTEE. You mean in some quarters?

MR. WALLICH. Successively, say in the first half of '79 or beginning in the second quarter and following through so that it will be classified as a recession. I would think that there are enough imbalances, even though the situation looks quite well balanced by usual standards. But there’s heavy consumer credit, the creeping up on us of capacity limitations, and diverse seemingly unimportant shortages that I think we underestimate. And more than anything, there are the wage settlements that seem to be pending and the inflation. I think that is the key factor--that the inflation accelerates--and I would guess if there's no recession 8-1/2 is the least we can look to. But if the pressures are very strong there, then the chances of an end to the expansion become much greater. If we can hold it a little better, then I think the other two-thirds of the probabilities are that we'll get something like the staff's projection: 3 to 3-1/2 on growth, unemployment at about 6, and inflation I would say even in the most favorable case at 8 percent.

CHAIRMAN MILLER. Thank you, Henry. Steve.

MR. GARDNER. I wasn't here last month, so I don't have to correct what I said.

CHAIRMAN MILLER. You have a clean slate.

MR. GARDNER. I don't take any exception to the general consensus including the staff's 3-1/2, 7-3/4, and 6.2 for unemployment. I've felt that this recovery is a little stronger than most of my colleagues, I think. I've always felt that. It hasn't yet disappointed me although it may be going to do so very soon. In any event, I have gone along on that course for quite a number of months and I'm not going to change at this point.

CHAIRMAN MILLER. Thank you, Steve. Just looking down this quickly, in outline, for real GNP we seem to come out with a consensus lower than the staff's--that is, a little lower than 3-1/2 percent. Inflation looks to be maybe a little stronger than the staff projection, at 7-1/2 plus, and unemployment looks higher at a 6 percent plus figure. That's very helpful to us. I think this is a very helpful process.

MR. COLDWELL. I thought it was interesting, Mr. Chairman, that I didn't hear anybody talking about the unemployment rate varying any more than 5-3/4 percent to 6-1/2 percent--a very narrow range.

CHAIRMAN MILLER. That's correct. It looks like there are not many below 6 percent, so it's a 6 plus kind of thing. Interestingly, it looks like on labor [our view] is that we're in that range and the other things are going to slow down the economy [but firms will] not discharge labor because apparently productivity is not going to [increase]. So apparently that is the judgment built into this and that's not surprising.

Well, may I [say that] I want to give the Federal Reserve medal of honor to the counterclockwise process, considering that this time we completed the whole circle in the time it took us to go through three speakers the other way last month. I want to commend you and I won't say who was sitting on which side at the time. Too beaten down to make a speech, it is kind of a dull, dreary thing. We have a few minutes before the coffee is being sent up and I would like to indulge your attention and have Peter Sternlight report on the open market operations and ratify his transactions before we take the coffee break. Peter.

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

CHAIRMAN MILLER. Peter, it seems to me that the Committee at the last meeting gave you a very difficult assignment to operate in the intervening period. I think you've done it very credibly and I commend you for it.

MR. STERNLIGHT. Thank you. I acknowledge Lady Luck as part of it, giving a helping hand in carrying that out, too.

CHAIRMAN MILLER. I didn't think you were going to be able to do it. [I don't know] whether it was luck or skill. I have to assume that it was skill, so you have my congratulations. Are there any questions or comments? A motion would be in order to ratify the transactions since the previous meeting. I believe they have been reported to you. Is there--

VICE CHAIRMAN VOLCKER. So moved.

SPEAKER(?). Seconded.

CHAIRMAN MILLER. Any discussion? All those in favor say "aye."

SEVERAL. Aye.

CHAIRMAN MILLER. Opposed? So voted. We will take a recess for coffee.

[Coffee break]

CHAIRMAN MILLER. Before we proceed, let me just mention a couple of things that have happened with the breakout of the yen. A couple weeks ago we began to look at the bag of tricks that might be examined in connection with the foreign exchange markets. I guess we had a little premonition because now the foreign exchange markets are [being] disorderly. Yesterday afternoon, Henry Wallich and Paul Volcker and I met with people from the Treasury at their request to see if we could review some of the possible steps that might be taken to counter disorderly conditions and to look at the more fundamental causes of the continuing decline of the dollar. I think our discussions today are relevant because the international situation does become a relevant factor when you have such dramatic changes and all the repercussions that may come from them. I don't need to spell out to this group the possibilities of this kind of disorder becoming increasingly disturbing and leading to wholesale disruptions and long-range problems that would be very serious indeed. And we know that in the absence of some sense of direction, there is a very large potential for disruption that could continue.

Things that the Federal Reserve could do are, as usual, relatively limited and might be ineffective unless coupled with Treasury Department/Administration actions that look to things within their control and in some longer-term areas. It's a very sensitive area and I would ask you to pay particularly close [attention] to security possibilities in this area because we are dealing with markets that can run any direction just from a leak at the meeting. I was called out from this office a moment ago to respond to a call that has asked me to come over to the White House this afternoon and see what can proceed along these lines. I would ask you not to indicate that such a meeting is even being held because that's, I think, in the control of the President. If he wants to announce it or indicate it, I think that’s how it should be. Just as Scott said--or someone said: The Swiss cabinet is meeting, and the market reacts just to a meeting. I think we should avoid any such discussion from our side. The White House security is terrible because the message came through some of our staff not cleared for FOMC [materials] even. That shows you my problems [on security].

Anyway, [there are] things that we might consider doing, obviously. In combination with [our] economic views, we might look at changes in reserve requirements for CDs so that we could--the Board of Governors could--substantially increase the reserve requirements for domestic CDs short-term, and we could lower to zero the reserve requirements for CD dollars acquired from abroad. [That would] therefore make it possible for banks to offer a higher interest rate without changing domestic interest rates, in terms of attracting capital from abroad--making it more interesting to hold dollars. We could also consider raising the discount rate, which--if coordinated with other policies we'd do anyway--would be perceived as an announcement signal that we intend to [do something about this situation].

Another thing we might do--and we'll discuss this later--is to consider activating the swap line on yen, provided we could get a series of commitments from the Japanese. That would include a commitment to lower their discount rate to 2-1/2 percent, say--thereby greatly widening the differential and assisting the exchange adjustments--and a commitment to go forward with their stimulus program of 4 trillion yen. [They can] no longer have it be "we'll think about it in September;" but the Prime Minister will say he is going to call on his cabinet and endeavor to do so and perhaps take some steps on trade and other things. It's possible that we can agree with the Treasury--incidentally on the yen swap we'd want Treasury participation and we'd want to leverage it with considerably more commitment with the Japanese intervention than our intervention so that we'd get more bang for the buck. Or yuk for the yen or whatever it is. If it's possible, the Treasury [may] announce that it is going to draw on the IMF to acquire currency to replace swaps, thereby taking the reverse market pressure off. It would be possible for the Treasury to announce that it might increase its sales of gold, which we might admit doesn't have tremendous technical advantage, except that it has psychological advantage. It may be a good way to bring in dollars at these prices of gold. It does, at least, put the supply [as a] factor of the gold situation. We could persuade the President to put on quotas on oil as a definite step--that no longer will he wait considering the disruptions in the international situation, etc.

I don't know how any of these will come out, but it seems to me that they may be relevant to this Committee in terms of the directive to the Desk in the interim period. They certainly are relevant in terms of the authority of this Committee to decide on swaps and, as I say, before this meeting is over I'd like to get some sense in that direction. Up until now there's been a strong consensus--at least I felt there was a strong consensus on this Committee--that it was not appropriate to go into yen intervention. And I have certainly shared that view and expressed it consistently. On the other hand, we have not foreclosed that forever and ever, because conditions do change. They may be at a state now where we want to think about it or be prepared to do it rather quickly. If we're going to do any of these things and be effective, they must be done promptly. If we can put together a package of actions and proposed actions, it must be done probably within 48 hours to have an impact--or by Friday, let's say.

Meantime, we have the problem of what the Administration says, because they cannot remain silent. If they remain silent, that would be interpreted in the market as not caring at all. If they say something that is in the nature of a promise that is interpreted as something dramatic like capital controls or wage and price controls, that could be disruptive. If they tell the truth, nobody knows what that is until we decide what to do. So it's a very, very ticklish situation and I hope you all will bear with us as we try to struggle through it. With that preliminary to excite your imaginations, let us proceed with what is your pleasure on the directive. We'll start with our eminently attired Steve Axilrod.

MR. AXILROD. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN MILLER. A twist.

MR. AXILROD. A little twist.

CHAIRMAN MILLER. Thank you, Steve. Any questions before we begin to give our personal views?

MR. BALLES. What are your estimates for September M1, Steve? I missed that.

MR. AXILROD. For September, it's close to 8 percent--a shade over.

CHAIRMAN MILLER. Gentlemen, I think we might as usual call the roll--with voting members first and then the other Presidents--and ask for views. I might express a little personal statement before we start that. As you know, for some time, after substantial tightening up in the spring, I've been interested in being sure that we didn't move too rapidly until we saw how the economy was behaving after what I considered to be abnormal conditions of the second quarter. I say abnormal because of the carry-over from the first quarter of a strike and winter weather, and because of the pull forward [from] the third quarter because of anticipatory buying. At the same time, I feel the timing is extremely important. Nothing in recent events, as seen in the external world, would indicate a particular need to change the Federal Reserve's policy. In fact, the morning paper predicts that we'll stand pat because what the world has seen is a rally in the bill and bond markets. And they've seen a slowing in the rate of growth of the aggregates--slower than we've seen for quite a while--and the economy is slowing down and unemployment is going up. So the expectation would be--with all those things happening, and the Fed's policy beginning to bite and things happening that one would like to see happen--no need for change.

However, my view is that we have the aggregates moving in the right direction and we ought to keep them moving in that direction and not let them bounce back up on us. Second, I think the international situation is critical to our inflationary fight because if we should continue to have an erosion of the dollar, we're just feeding inflation and making our problem worse and worse. I think we need a series of actions. Therefore, I would tend to favor a program that would be nearer to alternative B. I tend to agree with the ranges for M1. Some of you who favor tightening may want to suggest lower ranges but let me remind you: Considering that M1 grew last year at 7.9 percent and has been growing pretty much in the 7-3/4 percent area for a while and with the economy as weak [as it appears] I'm not sure how hard we'd want to bang down on it. So 5 to 9 as the range does have an upper limit of our long-term range, for which we expect to be hunting around [for growth at] sort of the midpoint. The M2 ranges are satisfactory, and I would think a federal funds range at 7-3/4 to 8-1/4 would probably be the right next move. And the expectation is that in the interim before the next Committee meeting, if the aggregates behave along the lines projected, we'd find ourselves getting toward the upper end of that range, which absent another consultation I would think would be enough action in the interim. Those aren't hard and fast views; they're views that suggest another notch is desirable.

I think it would be consistent, if we moved the federal funds rate fairly soon to 8 percent, for us to consider a move in the discount rate of perhaps as much as 1/2 percentage point. The reason for that is, as I say, timing is something. Some of you may wonder why we haven't moved it. Well, one reason is that now it gives us the time to move it where we can do something instead of just having to dribble along. So we might consider a move of the discount rate--if the [Board members] so elect and they may not--in a way that would keep it in alignment with the fed funds rate of 8 percent. And it would give us a chance to somehow make one step in accommodating the international disorder. So with those general views, subject to being [influenced] in either direction and being very flexible, I will now turn to the members of the Committee. Paul, would you like to comment first?

VICE CHAIRMAN VOLCKER. Let me say, as I heard the economic forecasts around the table--and I had a much lower inflation forecast than some, although slightly higher than the staff's--that I also have some sympathy, or fear or whatever the right word is, that those with the high [inflation] forecasts are going to be the ones who are right. Phil Coldwell's forecast was [high] in particular and I don't consider that out of the realm of possibility at all. It's the kind of thing I hope we can avoid; I'm not sure of it. And that affects my policy judgment as well as the feeling that a slower rate of growth in business, while certainly slower, is not unsatisfactory.

The kind of projection that I've had in mind does assume that interest rates would be up some. I don't think monetary policy has bitten particularly hard on the interest rate side thus far and I'm not concerned about some modest further increase in interest rates purely on domestic grounds and would have been in favor of some snugging regardless of the international situation. But for all the reasons you've already referred to on the international side, I do think it's important that we make some move now. There has been some confusion over what our intentions have been, rightly or wrongly, and I think it's important particularly in view of the international situation that we correct the misapprehensions about our lack of concern over inflation. I do think it would be wise to put a specific mention of the international situation in the directive at some point. We can talk about the wording later; I would just make that point while I think of it. We have a precedent for that, of course.

In terms of the specifics, you suggested 7-3/4 to 8-1/4, which seems quite reasonable to me. A week ago or even a few days ago I might have said let's wait for the aggregates to come along and I would expect they would move it to 8 percent but I wouldn't have felt it was urgent. Given what's going on in the rest of the world, I would say let's move to that midpoint of 8 right away and be prepared to move further if the aggregates so suggest. I feel a little more restrictive than you do, Mr. Chairman, about the ranges for the aggregates; at 5 to 9, the midpoint does put us above even the high end of the range we've just decided upon. I'd like to get it within that range. It's rather a rare instance--I say without checking the record--having set a long-term range a month ago and we're still within it.

CHAIRMAN MILLER. We should put out a press release!

VICE CHAIRMAN VOLCKER. I would just as soon stay within it. So I was thinking actually 3 to 8 or 4 to 8 as a possibility, and I would also lower the M2 range a bit--say, 6 to 10. That's not much of a lowering but I would get it down more clearly straddling the long-term range. This one is basically above the long-term range; the midpoint's within it, of course, but the lower end is right at the long-term range and the upper end is above it. I would rather straddle it with M1, too, so that's the difference. I do assume in saying that--otherwise I suppose I would be more aggressive--that there will be in view of the international situation now a 1/2 percentage point increase in the discount rate. That seems to me consistent with an 8 percent funds rate, as you suggested, and has more than ordinary importance in view of the announcement effect, given what's going on in the exchange markets.

CHAIRMAN MILLER. Thank you, Paul, I think. Ernie.

MR. BAUGHMAN. My thought process before the discussion was similar to that Paul described, and in particular with respect to our short ranges relative to our long ranges. So the proposal I arrived at was to narrow the ranges on M1 and M2 and also on the federal funds rate. This means that by going with the narrower ranges on the aggregates, I would use the narrow range on the funds rate to constrain the funds rate movement. But it seems to me important that we go to a narrow range on the aggregates at this point in time. So I would suggest on M1 something like 5-1/2 to 7-1/2; on M2, 6-1/2 to 8-1/2 or 9; and on federal funds 8 to 8-1/4. And I'd move to 8 promptly and after a week or so, if we were at the top of these lower ranges on the aggregates, I'd move to 8-1/4. And I agree with the suggestion that it is probably timely to move on the discount rate at the present time.

CHAIRMAN MILLER. Thank you, Ernie. Phil Coldwell I believe is next.

MR. COLDWELL. Mr. Chairman, I came prepared to recommend almost exactly what Paul Volcker said--a 4 to 8 percent range on M1 and 6 to 10 on M2. However, I did come prepared to raise the federal funds rate range [to] 7-3/4 to 8-1/2, not 8-1/4. I think we need that margin up there in the event these aggregates do start breaking out--to put a little more pressure on it. I'd adopt a money market directive, which would mean that if they're moving toward that upper range you'd start moving the rate. I would skew the midpoint to an 8 percent rate, thus moving to that 8 percent. But I'm leaving myself a half point above that in the event we need it.

CHAIRMAN MILLER. You said to an 8--

MR. COLDWELL. Yes, a flat 8 percent midpoint; a 7-3/4 to 8-1/2 range.

CHAIRMAN MILLER. We just had accounting trouble.

MR. PARTEE. Did you mean money market or monetary aggregates directive?

MR. COLDWELL. If I read the directive right--the way this is written on the back of page 13--you start moving the fed funds rate on a monetary aggregates approach [if growth is] significantly above or below the midpoint and on a money market when it's close to or beyond the upper or lower limits. So I'm talking really monetary aggregates.

MR. PARTEE. Yes, but you said money market.

MR. COLDWELL. Sorry, I meant monetary aggregates. Sorry to have misspoken. I think it's time we cut the availability of reserves. I'm not impressed that we're making much progress in the availability; we're making some progress in terms of raising rates but I don't think that's doing the job. Consequently, I'm toying with ideas of reducing the availability that are not under this Committee's control but are matters which the Board might wish to consider at a later time.

CHAIRMAN MILLER. Dave?

MR. EASTBURN. Mr. Chairman, for the last month I've been on the morning call and, up until recently, I have shared the opinion the market had, as reflected in the Wall Street Journal article this morning, that the fed funds rate had been held remarkably under control--I think because of the Desk's precision--and that the aggregates were behaving. And actually we were having a rally in the bond market and it looked as though we could come into the meeting with a more comfortable feeling about where we were. However, with the aggregates projected as they are, I think we don't have that luxury. So my proposal would be quite similar to yours, Mr. Chairman, with some modifications. I would have an M1 range of 4 to 8 percent and an M2 range of 6 to 10, with a funds rate range of 7-3/4 to 8-1/4 and a money market formulation [of the directive]. My inclination on the international is not to move precipitously for that reason. I would be influenced mainly for domestic reasons, relying on other kinds of devices which you've cited as possibilities to deal with the international situation. But I think what I'm suggesting would be consistent with that. Where I might differ is in the promptness of action. I think I'd be more inclined to let the aggregates move the rate rather than move promptly with the rate itself.

CHAIRMAN MILLER. Thank you, Dave. Steve Gardner.

MR. GARDNER. I have no difficulty with the 5 to 9 and 6-1/2 to 10-1/2 or Paul Volcker's specification--and 7-3/4 to 8-1/4. But I am convinced that some reference to the international situation would be well advised in view of our former experience recently and in view of the great interest that has to center around the decline of the dollar. I think the last one worked beautifully and I think this will have a salutary [effect].

CHAIRMAN MILLER. Thank you, Steve. Philip Jackson.

MR. JACKSON. Having argued brilliantly and eloquently but unsuccessfully for raising the targets for M1 last month, I'd be satisfied with the 5 to 9. I do think we ought to increase the range very slightly on M2 but keep the same midpoints. I would argue for 6 to 11. I am concerned that if we have this [experience] we're talking about, we will pick up heavy demand in the next few weeks for the big CDs that are reflected in M2, which will then show up in M2 in a way that [unintelligible] because those non-negotiable CDs on certain types of banks are reflected in that. I would [favor] a range of 7-3/4 to 8-1/4 [for the funds rate]. I frankly don't care if we stick with 7-7/8 or go to 8. I have never felt that an eighth of a point on the federal funds rate was worth that much argument over one way or the other. We could go on to 8 or stay at 7-7/8; it would be immaterial to me. I do think, because we have five weeks between now and the time we meet again, that we may well have a situation in which we’d have a telephone meeting.

CHAIRMAN MILLER. Some of us would have a telephone meeting.

MR. JACKSON. Right.

MR. PARTEE. Those of us who can get on it.

CHAIRMAN MILLER. Phil missed that experience. We lost five [of the participants on the phone call] the other day.

MR. JACKSON. But in short, I'd want a monetary aggregates directive and a reference to the international situation in the directive.

CHAIRMAN MILLER. Thank you. Chuck.

MR. PARTEE. Well, I think we are reaching a fairly sensitive stage in monetary policy. I wasn't able to discern as we went around the table earlier any feeling that there is going to be an explosion of economic growth. Indeed, the average for the Committee members and the other Presidents, too, was that GNP was likely to grow less than the staff projection--perhaps at 3 or 3-1/4 percent or something like that over the period.

CHAIRMAN MILLER. Assuming a tightening up.

MR. PARTEE. And I consider that just barely acceptable. I think anything [less] is going to give us a real possibility of a stall and anything more is going to give us a very real possibility of political repercussions of a stimulative nature in the Congress.

Now, there was some discussion of scarcities but it seems to me, as I said, that a little shortage in skilled labor reported during the latter stages of a boom is a typical, regular experience that I've always seen before. Indeed, it is the way you get employers to train people and improve the skills of the working force. So far as the shortages of material are concerned, it seems to me that they largely relate either to housing, which we expect to be coming down, or to very strong durable goods sales--such as in the sheet area, Willis. And again, we expect durable goods sales to be coming down, particularly car sales.

So I don't see anything in the real economy that would call for a tighter monetary policy. We are having more inflation, and typically monetary policy has brought recessions by reacting to the inflationary threat; and I think that's the danger again. But now in addition we have the international situation where essentially, as I see it, the market is calling upon us to create the same bad economic conditions here that exist abroad. And I think that would be the wrong way for us to go.

I don't have any great problem with your specifications, Mr. Chairman, because I don't think that constitutes much of a move. I would prefer to remain at 7-7/8 until the aggregates beckon us to move and I think we ought to be alert to the possibility that the aggregates will be coming in low rather than high. If in fact the economy is weakening underfoot, which is a possibility, we'll begin to see it in the aggregates and I think we ought to be evenhanded. So when I say a range from 7-3/4 to 8-1/4 with, say, 5 to 9 percent for M1 I mean that we would back down to 7-3/4 if in fact the aggregates came in at the low end of the range, which I think is a possibility. Probably Steve is right that they are going to come in on the high side rather than on the low side. But there's a chance that we will begin now to see in the monetary financial statistics the signs of recession. And we ought to try to adjust to them fairly promptly as we see them. A monetary aggregates directive, I think, is appropriate.

CHAIRMAN MILLER. Thank you, Chuck. Henry, you didn't get [to hear] all of the discussion; perhaps you picked up most of it. Did you hear me when I gave my views?

MR. WALLICH. Well, I'm concerned about a 5 to 9 percent M1 range; that allows for a very substantial rise in September, given what we so far know about August. I think it would allow for up to 12 percent in September and I wouldn't like to give such a signal. So my preference on the M1 range would be 4 to 8. I would move to 8 percent definitely on the funds rate and make the range 7-3/4 to 8-1/4. I realize this is somewhat skewed with respect to the aggregates I am proposing, particularly if I add to this that I'd like to see an aggregates directive so that movement could come immediately. I do think, though, that the situation is very [touchy] on the upside and on the downside so we ought to set ourselves yet narrow limits on the funds rate. I think perhaps we ought to become reconciled with having to have a telephone conversation in the middle of the period more frequently than we have had in the past. I think that would be a way of playing it safe. It would be worth the inconvenience and difficulties associated with that. So that would be my M1 [and funds rate ranges]. Let's see, I haven't given you M2. On M2, 6 to 10 would seem right to me, and that still would allow for a pretty sizable rise in September given what has happened so far in August.

CHAIRMAN MILLER. Thank you, Henry. Mark.

MR. WILLES. M1 for the last six quarters has grown at about 7.8 percent, as you suggested earlier. It seems to me that if we're to give any kind of meaningful signal to labor negotiators next year, to people concerned about the dollar internationally, and to anybody who looks at inflation and our policy responses to inflation, we are going to have to do something that makes people feel confident that we are not going to continue money growth at that rate. On the other hand, I agree with all of the comments that have been expressed that we ought not to move too sharply or we will precipitate a recession. We have done that in the past; we ought not to do it this time. I think we can avoid doing it. But I also think that we could move the rate of growth of money down to around 7 percent--a reduction of about 3/4 of a point on average--without precipitating a recession. And I think that would have very positive impacts in terms of not only the dollar internationally but the rate of inflation domestically.

Now, with what's happened to money in July and the expectation for August, and also given the comments that Chuck made about the possibility that the numbers might be a little weaker rather than a little stronger, it would seem to me that this is a good time to move carefully in that direction and still kind of hedge our bets a little bit. [We could do that] if we accepted a lower ceiling for growth in money for the 2-month period but also indicated that we wouldn't allow rates to move up too high. Therefore, if money growth did come in strong, we still wouldn't have a very precipitous move in the federal funds rate in the short run. I'd really like to see the Committee--coming at the end, it's clear to me it's not going to happen because everybody has already given other ranges--have an M1 range of 3 to 7 percent. [I say that] because if we always have our ranges straddle the midpoint of where we want to be, as long as inflation is going in the direction it's going, we are always going to err on the high side. We will never get down below where we are unless we kind of force ourselves down by bringing the ceiling rate down. So I would have M1 from 3 to 7, M2 from 6 to 10, and then the federal funds rate from 7-3/4 to 8-1/4, which means that under my aggregates conditions [directive] we might hit that top fairly quickly.

But at least we wouldn't go above that unless the Committee made an explicit decision to go above it.

CHAIRMAN MILLER. What would you move to immediately? You have a midpoint of 8.

MR. WILLES. The midpoint would be 8 and I'd have no problem moving to that. I would also agree with those who have indicated that increasing the discount rate would be a desirable thing to do.

CHAIRMAN MILLER. Thank you. Willis.

MR. WINN. Yes, Mr. Chairman, I would also be inclined to lower the ranges a bit on M1 and M2--to 3 to 8 or 4 to 8 on M1 and 6 to 10 on M2. And I'd have 7-3/4 to 8-1/4 on the funds rate, again using this as our discipline to reevaluate the situation rather than permit wider rate fluctuations. I'd also use the aggregates directive and move ahead to the 8 percent and raise the discount rate.

CHAIRMAN MILLER. Thank you, Willis. John.

MR. BALLES. I find myself, Mr. Chairman, very close to the views already expressed by Messrs. Coldwell, Volcker, Wallich, and Willes, so there's no point in repeating those arguments. I am concerned about having too high an upper end on the ranges. My staff has calculated that if we were to adopt 5 to 9 and 6-1/2 to 10-1/2, during this 2-month period M1 could grow at a rate 2-1/2 percentage points above the upper bound of its long-term target and M2 1-1/2 points above its upper bound. To me that's just a bad possibility. I think we are facing a crisis of confidence, and not just in the international field; I see it developing internally within this country in terms of a growing fear of inflation getting out of hand on the upside. And I think a small but prompt and decisive move on our part would, therefore, be well advised. So I would share the growth ranges of some of my colleagues or be down even a touch more: on M1, 3 to 7 and on M2, 5 to 9. I would settle for the 7-3/4 to 8-1/4 percent range for federal funds, moving promptly to the 8 percent midpoint with a monetary aggregates directive.

CHAIRMAN MILLER. Thank you, John. Bones.

MR. KIMBREL. Mr. Chairman, I, too, would like to see something in the range of 4 to 8, 6 to 10, 7-3/4 to 8-1/4, moving promptly to 8, and an aggregates directive. For some time I've had sympathy for a discount rate increase. [My view on that is] much stronger, realizing that with the timing, though, maybe we wouldn't be accomplishing with this a reduction in reserves, and I would very much like to see something in that area.

CHAIRMAN MILLER. Thank you very much. Bob Mayo.

MR. MAYO. I have no problem with your suggestion, Mr. Chairman, except that I, too, would move the M1 range down but only slightly. A 4-1/2 to 8-1/2 percent range would give you a 6-1/2 midpoint, which is at the upper [end] of our long-term target range. [I favor an] aggregates directive. The discount rate I think should be raised if not this next week, soon thereafter. But it could be part of a package; I think that might be the best way to do it. The 7-3/4 to 8-1/4 I think is an appropriate range for the federal funds rate and I would wait until the figures come in on this week's M1 and M2 to see how things are moving. I wouldn't go immediately tomorrow to 8 percent, but I think there's good reason to go maybe next week unless the aggregates are quite weak.

CHAIRMAN MILLER. Thank you, Bob. Frank Morris.

MR. MORRIS. Mr. Chairman, I think the Committee is coming out just about right; a 7-3/4 to 8-1/4 range seems right. I think we can't afford another bulge in the aggregates in September, so I would agree that the ranges ought to be moved down a bit--4 to 8 and 6 to 10 I think are about right. And the discount rate, because of its high visibility and low cost, ought to be part of the international package.

CHAIRMAN MILLER. Thank you, Frank. Did you have an 8 percent midpoint?

MR. MORRIS. Yes.

CHAIRMAN MILLER. Henry.

MR. CZERWINSKI. Mr. Chairman, we would agree with the prescription outlined by Mr. Mayo: 4-1/2 to 8-1/2 on M1, which would put the midpoint at the upper end of the long-term range; 6 to 10 on M2; and 7-3/4 to 8-1/4 on fed funds, moving immediately to 8 percent.

CHAIRMAN MILLER. Thank you, Henry. Don.

MR. MORIARTY. We would generally agree with all of the sentiment, too. With the rates moving up, it's an excellent time to move down on M1 because we are getting the flak one way so let's obtain some benefit. So we would agree with the 5 to 9 and 6-1/2 to 10-1/2. On the fed funds rate 7-3/4 to 8-1/2 seems good. We would suggest maybe a move to 8 to 8-1/8. The reason for the extra quarter above most of the [other ranges suggested] is our concern for having a little more elbow room should the situation tighten up a little bit.

CHAIRMAN MILLER. Thank you. George.

MR. RANKIN. Mr. Chairman, we are pretty much in accord with what is being recommended around the table. We came prepared to hold to alternative B: M1 at 4-1/2 to 8-1/2; M2 at 6 to 10; and the federal funds rate range [at 7-3/4] to 8-1/4 under the specification that we expect the Desk to move the rate up to the 8 percent midpoint at an early date.

CHAIRMAN MILLER. Thank you very much. It will be very helpful if I can see where we stand. We have [by my count] nine of the voting members who have suggested a range on federal funds of 7-3/4 to 8-1/4, [though] not necessarily the same [on the] other ranges. On the M1 range, there are five who are for 4 to 8. If we take the alternatives, there are a couple of those at 3 to 8 or 4 to 8, so I assume they'd go with a 4 to 8. And for 5 to 9, we have four. And 5-1/2 to 7-1/2 is a maverick. There seems to be a little more sentiment on the lower side of M1. For the M2 range, six are at 6 to 10 and three at 6-1/2 to 10-1/2. How many does that add to?

SEVERAL. Nine.

CHAIRMAN MILLER. We're missing a couple. We are going to count again. Well, we have one 6 to 11 and one 6-1/2 to 8-1/2. The midpoint is 8 for almost everybody except two indicated they'd stay at 7-7/8 and several indicated slowness in moving [to 8 percent]. Let's see if I can formulate a consensus. I don't know if the consensus would be to fit M1 at 4-1/2 to 8-1/2. Steve, do you have any comments before we go forward? Peter do you have anything to add?

MR. STERNLIGHT. No sir.

CHAIRMAN MILLER. Does anything here bother you?

MR. STERNLIGHT. No, I'm sure you will be clarifying whatever the--

CHAIRMAN MILLER. Clearly, [we'll talk about] the timing of the move--as the last order of business, I think. First we ought to decide what ranges we are going for and see what the order is of how to get there. Steve, do you have anything to add?

MR. AXILROD. From what you read, Mr. Chairman, it would seem like 4-1/2 to 8-1/2 and 6 to 10 would just about average through everyone's ranges for M1 and M2.

MR. COLDWELL. I believe you've got a majority of seven of the Committee members who are saying either 8 or below as the peak for M1.

CHAIRMAN MILLER. Yes, but one of those would also have the bottom at 5-1/2 so you've got to be evenhanded.

MR. COLDWELL. You've got one, two at 3--

CHAIRMAN MILLER. Well, let's try this for a moment: 4-1/2 to 8-1/2, 6 to 10, and 7-3/4 to 8-1/4 with the midpoint of 8 but discuss later on how we will get to 8. And there seems to be a pretty big consensus for a monetary aggregates directive. Just as a straw vote, [let's have] a show of hands of those who are voting members. How would that strike you? Do we get any votes for that? 1, 2, 3, 4, 5, 6. Yes, I suppose the difference would be if we change it to 4 to 8. Then how many would vote for that proposition--most everybody? Everybody who didn't vote [before]. It's the same--1, 2, 3, 4, 5, 6--a split.

MR. PARTEE. How about trying 5 to 9?

CHAIRMAN MILLER. Yes, how many would go for 5 to 9? All right, four. Doesn't prove much, does it? Looks like 4 to 8 is a pretty good compromise. Yes, you've got company; we have switch votes. What if we have a vote now where you only get one vote? You don't get two votes; you only get one vote. There were two votes, obviously, going both ways there. Let's have a straw vote on 4-1/2 to 8-1/2, realizing you can't vote again. How many would accept the other and 4-1/2 to 8-1/2? Five. And those for 4 to 8? Five. Who is missing? Oh, Mark. Well, you want a lower one altogether. Why don't you stay that way and we'll have a hung jury! But you would vote for 4 to 8 if we had the whole directive this way.

MR. WILLES. I'm still thinking about it. I certainly would not vote for 8-1/2; I might vote for 8.

CHAIRMAN MILLER. Just for a moment, assume we are going to have a 4 to 8 range. It looks like the majority was lined up that way, by a very close margin. Then the next question is: How [directly] do we get to 8, as the midpoint of the [funds rate] range? There's some possibility that we might want to [wait] a few days on moving to 8 and keep where we are so that we can see if some international program will develop in the next couple of days.

MR. COLDWELL. I have another question, too, Mr. Chairman. Could we ask Steve? There's a Treasury financing intervening here.

MR. AXILROD. I don't think that poses any problem over the next few days.

CHAIRMAN MILLER. The only reason I would think of hesitating a little, although I think I originally said move it to 8, would be if in the next few days or by the end of the week we have some international package. Then I think we might reserve this to flow out of that process. That might just be a little running room for us. How do you feel, Scott?

MR. PARDEE. Any time is fine; moving to 8 percent is not going to have much effect.

CHAIRMAN MILLER. Not much effect one way or another.

MR. PARDEE. It would add to the package, but if it came earlier that would be fine, too. The market is waiting for something.

VICE CHAIRMAN VOLCKER. It'll take a day or two for people to realize what you are doing. I would at least state it this way: See whether there is a consensus on this and it shouldn't be [implemented] any later than the international package. There is no point in waiting to move an 1/8 beyond Thursday or Friday if you're going to have an international package.

CHAIRMAN MILLER. Actually, Peter, you'll find that people will test you today or tomorrow.

MR. STERNLIGHT. I think they might very well because we have a reserve need over the next few days and it would be a probably convenient time--if we wanted to accommodate 8 percent--just to kind of permit that to happen.

CHAIRMAN MILLER. What is your preference as the person on the firing line--give you the freedom to go ahead? If it takes too much to hold it below 8, to let it stay at 8?

MR. STERNLIGHT. I think that would be an acceptable approach, Mr. Chairman, yes.

CHAIRMAN MILLER. I think that's a sensible approach. I think there's just too little in it for the international to hold off if you're getting [market resistance]. Now, if the market is just quiescent, I would leave [the funds rate] where it is until we see what things look like this week. That directive language--does that formulation create any problems?

MR. STERNLIGHT. I think that would be fine.

CHAIRMAN MILLER. Anybody feel differently? So we will let the market judge a little. But certainly once the international matter is decided, if the rate hasn't been moved by the market, it will be moved by the Desk to 8. And then we will proceed.

MR. COLDWELL. In no event, later than next week.

MR. PARTEE. Oh, I think the market will move it tomorrow.

CHAIRMAN MILLER. I think that's the truth. Well, thank you. Now we will have an official vote. We will call the roll. It came out that the majority had 4 to 8 and 6 to 10 on M1 and M2 and the range for federal funds is 7-3/4 to 8-1/4. And the midpoint is 8, with the instruction we discussed for moving to 8.

On the draft directive a suggestion has been made that on page 1, line 16, we point out that [the value of the dollar against major] foreign currencies declined sharply further because since this was written there has been a sharp decline. Another suggestion is that, using a monetary aggregates [directive] line 66 on page 4 should read--I was going to read it starting on line 64, but in fact I will read the whole thing--as follows: “In deciding on the specific objective for the federal funds rate the Manager shall be guided by…” strike “mainly” and insert "developing conditions in financial and foreign exchange markets and by the relationship between the latest estimates..." The reason for that is--this is a suggestion--if the aggregates should come in a little weaker than projected and money market conditions are still disorderly, we might want to keep a little firmer hand on it.

MR. PARTEE. I would have thought that would have belonged around line 41, Mr. Chairman.

CHAIRMAN MILLER. Well, let's see.

MR. PARTEE. Where we say “while giving due regard to developing conditions in financial markets….” Add it there especially--

CHAIRMAN MILLER. Well, you can say “domestic and international financial markets” or you can--

MR. PARTEE. Yes, or you could even emphasize the international.

CHAIRMAN MILLER. Well, what was used before was in that place. The language for the short run that we used before said: "In the conduct of day-to-day operations, account shall be taken of emerging conditions in domestic and international financial markets." Where do you prefer it gentlemen--in the paragraph on page 2 or page 4?

VICE CHAIRMAN VOLCKER. I would prefer it in the latter one since it's more operational.

MR. JACKSON. It seems to me that if we want the Desk to actually use it as a basis of decision, it ought to go in the latter part.

CHAIRMAN MILLER. That is Paul's point.

MR. PARTEE. Well then, let's tell him what to do. There's no direction. I presume he would not ease on account of international.

VICE CHAIRMAN VOLCKER. It would not put the federal funds rate down if the aggregates were weak unless they get [extremely] weak.

MR. PARTEE. You're biasing the whole result.

MR. COLDWELL. I think I'd put it in the earlier one.

CHAIRMAN MILLER. It sounds like there's enough confusion; maybe we better put it in page 2. I think we are going to have to have a consultation if things get wild anyway. I don't like to see us operate without talking. So let's do it that way if everyone's agreeable. Hearing no dissent, they are agreeable. Now, let's vote on the proposed consensus I have just outlined. I need not repeat it again. And I will vote for it.

MR. PARTEE. Will you repeat the specifications?

CHAIRMAN MILLER. The specs were: 4 to 8 and 6 to 10 on the M1 and M2 ranges, 7-3/4 to 8-1/4 on fed funds, and a move to 8 on instructions that we have discussed. Now we will take votes.

MR. ALTMANN.

Chairman Miller	Yes
Vice Chairman Volcker	Yes
Governor Coldwell	Yes
President Eastburn	Yes
Governor Gardner	Yes
Governor Jackson	Yes
Governor Partee	No
Governor Wallich	Yes
President Willes	No
President Winn	Yes

CHAIRMAN MILLER. I think that is a remarkable vote. One is negative because we should be higher on M1 and one is negative because we should be lower. So we have two dissents in this case. It’s too bad we can't have a series of votes so we could have a unanimous vote on the [funds rate] range. I don't think we’ve ever formulated a vote that way but it would be nice. The dissent will actually show the individual reasons for dissent.

MR. AXILROD. Mr. Chairman, as a technical point in the directive, the Committee has to decide on the language under alternative B whether it should say a range initially attaining a weekly-average federal funds rate “slightly” or “somewhat” above the current level. I think the Committee has to choose.

CHAIRMAN MILLER. Well, you tell us what we are supposed to choose.

MR. AXILROD. Well, I think the 8 is slightly.

CHAIRMAN MILLER. Is “slightly” satisfactory?

SPEAKER(?). Is “somewhat” bigger than “slightly”?

MR. AXILROD. That's the staff's lexicon.

CHAIRMAN MILLER. You have to know the code words. That's why I asked Steve to tell us what to say. Thank you very much; you had a great contribution.

MR. EASTBURN. Mr. Chairman, do I understand this initially to be a contravention of the instructions that we gave the Desk as to promptness of movement?

CHAIRMAN MILLER. Pardon me?

MR. EASTBURN. What does “initially” mean? Does this have a bearing on the instructions that you gave the Desk as to how promptly we'd move?

MR. PARTEE. Promptly might be a better word than initially.

CHAIRMAN MILLER. I think you have a very good point. Initially means that he should do it immediately.

MR. EASTBURN. Well, that's the way I read it.

CHAIRMAN MILLER. Yes, I think you are absolutely right. We can change the word initially to promptly in due course.

MR. JACKSON. Why don't we just leave out the adverb?

MR. EASTBURN. Do you need it at all?

CHAIRMAN MILLER. Why don't we just say “directed at attaining” and leave out “initially.”

MR. EASTBURN. And it could be understood that the Desk would move as you suggested.

CHAIRMAN MILLER. Right. Thank you for catching that. Are there any other comments on this? We have a vote. Thank you very much. We have the confirmation of the date of the next meeting, which is September 19.

Now I'd like to discuss the international situation. Henry, is there anything you'd like to say before I do?

MR. WALLICH. Well, Mr. Chairman I think you've made it clear that we have a crisis on our hands--a crisis of confidence. For some currencies yesterday, it was a panic. I think it’s at a point where the functioning of the monetary system is in some doubt. That is, it could lead to severe capital controls and it could lead to trade controls--all things that would eventually hit back upon the United States. So whatever is done is really in the interest of the United States primarily, and not just for the sake of international cooperation or helping other countries. That's all I have to say.

CHAIRMAN MILLER. I've outlined some actions that might be taken. As we discussed yesterday, one of the actions is to be more aggressive in the D-mark intervention. But there I believe we have to have a better concept of where we're going or we may find some disagreement from the Bundesbank on what to do. We certainly need to have a more comprehensive program; otherwise it will be viewed as sending good money after bad. So we have to be careful there.

I'll reiterate some of the things the Federal Reserve could do. As I said, one is to adjust the reserve requirements on short-term CDs as to domestic and foreign, to skew it in favor of attracting foreign dollars. Yes, I mean all of the skewing could be accomplished.

MR. PARTEE. Or you could do just the foreign; you could take it to zero.

CHAIRMAN MILLER. That's right. The skewing is a matter of how many basis points difference it makes, Chuck, which would be up to the Board of Governors. We could raise the discount rate. The activation of the yen swap line would be, I think, the one area we should get some viewpoint on now and some direction to us as to proceed or to not proceed, since I believe that has to be decided very shortly. The argument that we've had for not doing it has been, of course, that to us the Japanese have not been terribly forthcoming in solutions to adjusting their surplus and, therefore, to intervene without a more fundamental attack on the problem would be to put band aids on and not solve anything.

More recently the Japanese have been sending their emissaries here to visit and probe again on whether we would activate [the swap]. Among the Administration and ourselves we intend to ask the question: What good is intervention unless there's a package and what kind of package do you see? The package could consist of a commitment by the prime minister to go ahead with the stimulus package in Japan of, say, 4 trillion yen. It could include a commitment to lower their discount rate, which is now 3-1/2 percent, to something below 3 and perhaps 2-1/2 to widen the spread. It could contain some other features in terms of trade and whatnot, but they get very hard to tie down because of the complications. But it could be beefed up with a few other primary things; it might not be those. The terms would have to be worked out where we would have a 50-50 sharing. And the amount that we can activate I believe is $2 billion; we might or might not want to go that far.

MR. PARTEE. Would the sharing arrangement have to be negotiated?

CHAIRMAN MILLER. I think it's already--

MR. PARTEE. It's in there, isn't it?

MR. PARDEE. It's not in, but they've indicated that they'd be very quick to agree.

CHAIRMAN MILLER. We'd also have to agree on the method of operation. It seems to me that we would want to have an agreement on the amount, on the relative amount of intervention they would do for their own accounts in New York and in Tokyo. And we'd want some understanding on the repayment. Those points, Scott, I believe you feel you could work out in fairly short order.

MR. PARDEE. Hopefully, yes.

MR. WALLICH. And, Mr. Chairman, the interest rate.

CHAIRMAN MILLER. And the interest rate would have to be discussed.

MR. WALLICH. So that we don't just pay a higher rate.

CHAIRMAN MILLER. Right.

MR. PARDEE. Now that's a bigger complication.

MR. TRUMAN. That's right, I think, Mr. Chairman.

MR. PARDEE. That would change the nature of the swap arrangement that we have with the Bank of Japan and would be a difference between the swap arrangement we have with them and those with other central banks.

CHAIRMAN MILLER. Yes, you're right; we'd probably have a hard time getting them to agree to that, because it isn't what we're doing with the Bundesbank.

VICE CHAIRMAN VOLCKER. I think you might get them to agree that if we change the others, they would change.

CHAIRMAN MILLER. And they're changing in the wrong direction. If we change the non-50-50--incidentally, the other condition I think we would want, if we did this, is to have the Treasury in either as a participant in our swap line or opening a swap line of their own. I don't believe necessarily that we should do that unless there were these other actions by the Federal Reserve contemplated and some actions by the Treasury contemplated and something from the Administration. But I don't know what those can be, so it's hard for this Committee to act [for or] against an unknown package. It's a very difficult problem and crisis. But I would like to know the sentiment of the Committee as to whether there would be a willingness to move in this direction. It would be a change in policy. Now, Chuck Partee's name is first and then John Balles and Phil Coldwell. You better start putting names down, [Murray].

MR. PARTEE. I haven't been an advocate of intervention as a general rule, but I must say that I'm beginning to warm up to a yen intervention program, particularly if we can get some of the conditions that you have specified. I would not as one of those conditions want to encourage them to have a special imports scheme for materials. I think they did that in the early 1970s and the effect of that was simply to tighten up the materials market and raise prices with a lag, and I don't think we ought to encourage them on that. If we can get them to lower the discount rate, fine. But I think we also ought to try to get them to agree to make credit more readily available in Japan because, as I understand it, that is not such a rate-oriented market; it also has a great deal of direct steering by the central bank. And it may be that you would have to have better access to credit to get any positive effect. That would be perhaps more important even than the rate in the way it works.

So far as our intervention is concerned, if we could get some of those arrangements, I think I would agree mainly because surely the dollar is oversold [against] the yen and, therefore, the chances of an ultimate loss on this series of interventions would be quite slight indeed. I realize that the Swiss franc has gone up as much, but that's sort of a currency without a country, and the yen is a currency with a country. Therefore, I think I would be prepared to do it.

MR. TRUMAN. Mr. Chairman, I'd note as a matter of fact to Chuck that the Japanese already are doing that type of import program.

MR. PARTEE. I know they're doing it, and I've been a little worried about it.

MR. TRUMAN. I just didn't want others to be misled, thinking that the Japanese weren't when they in fact are.

MR. PARTEE. I wouldn't want to encourage them to do any more, for sure.

CHAIRMAN MILLER. Thank you, Chuck. John Balles.

MR. BALLES. Well, Mr. Chairman I guess my views are biased strongly against supporting the yen as a result of sitting through a meeting of and giving a speech a little over a week ago to the Japan California Society. Without going into gruesome details, the American contingent there was in a state of deep distress and shock and dismay as a result of the intransigence of the Japanese spokesmen for leading banks and businesses that we have to guess reflects the government view. They were just not willing or apparently able to move decisively or promptly in loosening up both tariff and non-tariff areas of their goods, saying that they need a great deal of time to study all of these questions. I think that could be a move very badly received in the American business community, as a matter of fact. There's a powerful case for doing something against these other currencies. But if we were to do it at all, I must say I would want tougher conditions laid down than just moving to a 2-1/2 percent discount rate and a stimulus program of 4 [trillion] yen. I think they've got to move more promptly, especially on these non-tariff barriers and all the ways they have of keeping out American goods. Their trade surplus with the United States is just fantastic and it's getting worse and not better.

CHAIRMAN MILLER. Thank you, John. Phil Coldwell.

MR. COLDWELL. Mr. Chairman, I have been on both sides of the fence. I think there have been times when intervention has been desirable. If we're going into this we ought to go into it in a major way; I would not want to go into this if we're going to fritter away a few hundred million. I think we ought to embark on a program of this character with the Japanese expecting to spend at least $4 billion.

CHAIRMAN MILLER. Between the two combined you mean.

MR. COLDWELL. No. The Treasury and us.

CHAIRMAN MILLER. And the Japanese, too.

MR. COLDWELL. And the Japanese also. Though actually I think if we're going in with the Japanese, in the sense of coming back from the other side, then my figure might be higher. But I think we ought to at least be willing to commit $4 billion as far as the United States is concerned. I think the conditions that you've said you're looking for are largely long-range conditions and we're looking at a short-range crisis problem. I can't expect that a change in their budget, for example, would suddenly put the yen under pressure or reverse this package. So it seems to me that if we're going into this, we need to go into it with a long-range expectation. I would add one other condition to such intervention on our part--that the Treasury provide a takeout to the Federal Reserve and conversion with long-range bonds if such swaps were outstanding more than six months.

CHAIRMAN MILLER. Thank you, Phil. Frank Morris.

MR. MORRIS. Mr. Chairman, I support the operation. I think [of] the United States currency as a world currency, and we have the responsibility of seeing--to the extent that we can--that the foreign exchange markets operate in a rational way. But I agree with Phil Coldwell that if we're going to do this, it ought to be done on a sufficiently large scale to establish credibility in the marketplace. I think what happened last December and early January, when the United States government came out with an announcement by the President, Secretary of the Treasury, and the Chairman of the Federal Reserve Board that we were going to intervene--and then we failed to operate on anything except a very small scale--was a net loss of yardage in the operation. I think if we're going to do it, we have to be prepared to do it on a sufficient scale to impress the market that we are prepared to be a force in the marketplace.

MR. PARTEE. But $4 billion is an awful lot, Frank. It might come to that but I don't see why you'd operate on that scale to begin with.

CHAIRMAN MILLER. Well, Chuck, if you did $2 billion under one swap line and 50-50 sharing, we're risking $1 billion, other than the interest cost. And if the Treasury did $1 billion, that's $3 billion; if the Japanese did $2 billion more on their own, that's $5 billion.

MR. PARTEE. Well, I think Phil meant $4 billion on our end, and that is pretty big.

CHAIRMAN MILLER. Oh, I see.

MR. COLDWELL. I'm not saying do this tomorrow. But I think the Committee ought to be prepared to commit that kind of money if it's going into this kind of deal.

VICE CHAIRMAN VOLCKER. Four billion on our end ought to imply $20 billion on their end.

MR. WALLICH. This [is] not in line with the rules of floating. We'd clearly be acting to change rates; I would be very skeptical of such a move.

CHAIRMAN MILLER. Well, now to get us back in order. Murray, you'd better put Henry’s name down. Phil Jackson.

MR. JACKSON. I think we're in a process [typical of] most finance committees. Every member of the committee wants to add another condition to the loan, and that's a mistake. I'd like to ask some questions because of the suggestions made earlier. How much yen is being traded and how much is being bought by the Japanese now? And in what proportions will these figures that we're discussing impact on the marketplace? [I ask] because my impression is that last year when we saw $35 billion bought by others it didn't make that much difference. The magnitudes are such that $4 billion may still be just idle conversation except for the psychological impact of it. I would really like some information on what sort of magnitudes we're talking about.

MR. PARDEE. Well, the magnitude can be very big. The Japanese themselves did of intervention in March, as the rate moved against them. And many people felt that they were just sitting ducks. Each day they moved, you’d throw another $100 million at them and they’d move again. You’d take your profits and then throw another $100 million. They were sitting ducks because they were alone. As far as the market is concerned, if the United States is prepared--just the gesture at this stage--to provide its resources to support whatever the Japanese are doing, not necessarily the rate, [it would change the psychology] just that we've got this agreement between the United States and Japan. The isolation of the Japanese at this stage in the exchange market is very important.

So, we can talk in terms of big numbers, but you're frightening me a little bit in how big they are because my objective and the type of negotiation I have in mind is to talk to them as we have with the Swiss. That is, all right we'll intervene in New York and commit our resources because it is important for the United States to commit its resources at this stage to get the psychological benefit in the market that the United States is cooperating. But there will be days in which you'll want to intervene in your own market and in New York when it is not in the U.S. interest, in our judgment, so we would not want to commit our resources. [That is what] we have done with the Swiss. So that some days we're in on a 50-50 basis--half theirs and half the U.S. authorities, and on other days we're simply operating on their behalf. On a cumulative basis they'd end up intervening a lot more in New York than we're likely to be because we are very cautious on the days we bring the System and the Treasury's resources to bear. But we will still have made this very important gesture, showing that the United States is prepared to do something about this disorderly market in yen.

So we can talk in terms of big numbers, again, for the psychological benefit. But I would hope that, as we did on July 4, we'd start off with a splash and then if we win on the psychological effect, we wouldn't have to do very much later on. But that requires some of these other elements such as the policy actions that Chairman Miller mentioned. And a few people on the Japanese side have to keep their mouths shut afterwards and stop criticizing the United States. Because if we're in the middle in the exchange market intervening and we have another one of these comments that the United States is doing this, that, and the other thing, then there's not much help we can give the exchange market or the rate that [unintelligible]. So we have to have a cooling of tempers a bit if this is going to work.

MR. JACKSON. May I ask one more question in that connection? To what extent will our announcement of intervention make it possible for some major holders of dollar reserves to feel that they can then make the currency shift to yen reserves with some more assurance that the market will be broad enough to get out later if they want to? Right now my general impression is that many of these dollar holders are concerned about going into yen because the Bank of Japan is the only basic support. And [they feel] that market is not broad enough for them to have the possibility of getting out if they want to whereas if they see us come in, it may give them a type of bail-out assurance. That would encourage them to make the swaps that they're now not making, which would exacerbate our problem.

MR. PARDEE. We would still have a floating exchange rate and the key element in our experience with the German mark was not to peg the rate. Once we peg, then we provide the substitution facility and everybody will come at it. But as long as they recognize that the risk will go both ways--

CHAIRMAN MILLER. We can't have a zone or a peg.

MR. JACKSON. Well, I recognize that.

MR. PARTEE. The yen would run up.

MR. PARDEE. That's right.

MR. JACKSON. I just wanted to discuss it because it strikes me that it's one of the risks that we have to be very alert to--that we don't provide the vehicle for our own destruction. My impression is that by careful structuring and some very nasty demands, if I might characterize them that way--at least the Japanese probably would--we ought to go ahead.

CHAIRMAN MILLER. Ernie Baughman.

MR. BAUGHMAN. Mr. Chairman, first a question to Mr. Pardee. Could you hang any amounts on the concept of the operations you're suggesting as compared to the $4 billion?

MR. PARDEE. Well, it all depends on how the market takes it and what happens afterwards. The first day or two I would anticipate that we should be there forcefully when the market tests this. We will be tested by the market. Remember, back in January we had a testing period.

CHAIRMAN MILLER. In marks, too.

MR. PARDEE. In marks, and we may be tested in other currencies, including Swiss francs. So we ought to be thinking in terms of a budget in the first couple of days of $200 to $300 million. If we aren't prepared to spend it then, we'll have to spend it later on. But if that doesn't work--of course, you'll have other elements in the package, and so hopefully that will do the trick--then we'd move into the kind of pattern we've had with the other currencies. When we feel it's important, then we will intervene. It may be $10 million or it may $50 million on a day-to-day basis. But [I prefer] not to think in terms of an overall budget except [with regard to the limits] under the authorization and the other guidelines we have, including the procedural instructions.

MR. BAUGHMAN. Is it fair to say that you are thinking in terms of hundreds of millions rather than billions?

MR. PARDEE. I'm not thinking in terms of billions. But if that is part of the announcement, then that would help--that the amount that we might have to deal with is credible.

MR. BAUGHMAN. Mr. Chairman, I would have to admit to never having been an enthusiastic supporter of the swaps program. And I guess I cannot generate much enthusiasm for the [proposed] program. It seems to me that our problem is more basic. Unless we can demonstrate by some means that we're going to make some progress in getting hold of the wage-price push or some progress in getting hold of the continued outflow of dollars on the trade balance, then what we could do in this sort of operation has a fairly high probability of being rather costly and not particularly rewarding. I think that's all I had on that.

On the proposal for a zero reserve requirement on foreign CDs, is it suggested that we have the authority to exempt foreign CDs from reserve requirements or--

CHAIRMAN MILLER. The Board of Governors has the right to set any reserve requirements they want.

MR. TRUMAN. These are eurodollar borrowings--borrowings by banks from the eurodollar market.

MR. PARTEE. Yes, we put [a reserve requirement] on specially some years ago; there hadn't been any before that.

MR. BAUGHMAN. So this wouldn't come under the 3 percent limit on time deposits.

CHAIRMAN MILLER. No, no. Steve, am I correct?

MR. AXILROD. Yes, as an exemption. Reg. D would provide a basis and also Reg. M for both.

MR. COLDWELL. What is the rate now--3 or 4 percent?

MR. AXILROD. Four.

CHAIRMAN MILLER. It's 4 on all.

MR. AXILROD. It's 4 on borrowings from branches and 4 on borrowings directly for that branch.

CHAIRMAN MILLER. The question is how much--you can go up or down--you can differentiate them and create a bias in favor of pulling in eurodollars. Thank you. Bones.

MR. KIMBREL. Mr. Chairman, I, too, have not been particularly fond of swap lines all along, so I have some difficulty generating any warmth for this one. I'd like to feel that maybe we could move in this area and generate some favorable psychology, recognizing that stability would be desirable now. But these numbers that are suggested to possibly accomplish it--very candidly excite me. Then when I look back to my own area and recognize the emotions that have been generated among the textile people and the automobile people and think about how unpopular this could be--and frankly, bottom line, how costly it could be--I really am not excited. Frankly, I'm not impressed with the forthcoming nature of the Japanese. I personally would like to see something [from them] that was visible--was positive and known--before we move into this. I think the timing could be most unfortunate. If I seem to suggest that I lack some enthusiasm, that's correct.

CHAIRMAN MILLER. Thank you. Bob.

MR. MAYO. Well, I have to say that I do have some enthusiasm, although it's in a lesser of evils department, I'll admit. I think Scott has given a good explanation of the technical side of this and I concur in what he has had to say. I know exactly what John Balles is talking about. I've had the same experience, having been in Japan several times, and I feel that in the Japanese economy, their traditions have been harder to shake than those of any other country in the modern world. The Japanese have had a marvelous experience in their export industry because they have a rate of personal saving, for example, three times our own. So they can raise capital and this in turn generates the enthusiasm over there for export industry. The attempts by the Japanese government to encourage the Japanese people to buy more worldly goods run up against a stone wall in that the Japanese [home] is not big enough to acquire furniture even, much less a lot of other gadgets. I've discussed this problem with Japanese bankers, some as recently as last week, and I think there is a real feeling that, despite the political difficulties, the Japanese are getting to the point where they feel too that something more drastic has to be done. I think the American business response to the Japanese situation has tended to become more and more emotional and not understanding of the political problems that the Japanese have.

It seems to me, therefore, Mr. Chairman, that we should go into this but with our eyes wide open and with the idea that maybe we are in the best position now to strike a hard bargain with the Japanese that we have ever been in before. It's no great solution or cure-all. The basic solution to the Japanese-American trade balance problem is far more complex than just the initiation of swap agreements that can [not] have any real effect on it. But I think it can have a stemming effect to show that we're not just a sitting duck for the makers of disorderly markets, if I may put it that way.

CHAIRMAN MILLER. Thank you, Bob. Henry Wallich.

MR. WALLICH. I've been a proponent of a yen intervention. I've changed my mind, given the vicissitudes faced by the dollar, but in my view what we should do here is to support the dollar rather than to hold down the yen. The Japanese can do all of that themselves. They can do $800 million in a day and I don't think they need any additional resources. What is needed here is evidence that we are not practicing benign--or malign or whatever--neglect. There is a gap, an implausibility, in our method of operations; we do everything in D-mark and occasionally in Swiss francs and somehow there never seems to be disorder in the yen market. So even though the Japanese through the New York Bank can take care of disorder in the U.S. yen market, we are seen to be somewhat implausible here. We should remove that and we should remove it in a credible way.

I think the only way to get any response from the Japanese in mending their policies is to keep their feet in the fire with a high rate and I would regret it if the yen were to come down from its present level. Their situation, I think, is not nearly as desperate as sometimes it's made out to be. While exporters suffer possible [drops] of profit margins, even losses, this is a very diversified economy. They're making up on cheaper raw materials, which they use [in products for] domestic sale, what they lose on sales to the rest of the world.

So I would do whatever is the minimum to give credibility to our participating. But I'd let the risk and burden of it fall on them to the extent that's possible through loss-sharing and the proportionality of operations. I think we should avoid being sucked into their very large operations; suddenly we'd find if we promised to do a quarter of what they do, they'd do $800 million in one day. I would also avoid violating, obviously, what are still the rules of floating, or at least precepts, namely, we shouldn't push a rising currency upwards. That is one thing we're in danger of doing here. And we should not, of course, aim at a particular rate. We need to explain this to Congress, I think. We need to explain it to the business community. We have to bear in mind that over time if inflation rates continue anything like now, the yen will rise against the dollar, whatever it does in the short run. And we shouldn't do something that goes against this fundamental. And finally, the Treasury, I think, needs to be in and we need to have a package and not just this one operation. I think it would be very unfortunate if we didn't get a package.

CHAIRMAN MILLER. Thank you, Henry. Paul.

VICE CHAIRMAN VOLCKER. Well, [everything] has been said, I suppose, at this stage of the game, although not always in the same way or with the same meaning. Everybody approaches it from a different point of view. You did emphasize right from the start the importance of a bargain here, and one of the reasons we haven't intervened was that the bargain wasn't there. I think that's important. I think people have implicitly been saying, and I just want to emphasize this, that it's probably a matter of where the rate is. I think if we weren't interested in intervening earlier, quite properly it was because there was a great fear that dollar rates would go down some more and that it was against our interest if they didn't. At least some people thought that way. If we still feel that way, I think we shouldn't be intervening. I don't. It seems to me that this rate has gone far enough so that further appreciation of the yen gives us more difficulty than benefit. I feel quite clear about that in my own mind. And if one does not feel clear about it, one ought to be suspicious of this operation.

But when I look at the price of steel going up here, and the price of small cars, and the price of RCA television sets and I look at the repercussions on the Japanese trade balance with all the J-curve perversities and all the rest, I don't think it's in our interest to see a further appreciation of a currency that has already appreciated by 50 percent or 100 percent, depending on which way you calculate it. It's exactly half of what it was against the dollar now compared to 1971. It's twice what it was; I suppose that is the way to state it. I think what the Japanese are interested in is a signal and not just a signal of no benign neglect. They're interested in a signal that the United States says it's okay for them to intervene at these levels forcibly. And that's worth quite a lot to them. If you're not willing to give that signal, you shouldn't be intervening. I'm willing to give that signal at this level.

That suggests that the operation may have to be a big one to make it credible, as Phil suggests. I haven't thought of anything nearly as big as his numbers for us because I would expect that while the numbers could get quite big they should be Japanese numbers. What they're looking for is symbolism from us and not money from us. Now, that remains to be seen, on the negotiating side. But if they did $20 billion, I don't know that we'd have to do $4 billion over the course of a year or so. That remains to be seen. But I wasn't thinking in those kinds of numbers. Initially, I'd certainly have a much more limited number in mind, even though I think they ought to be forceful, let me put it that way. We're giving them permission to be forceful. And I would hope that we don't have to worry about a take-out from the Treasury. I would again worry about the whole operation. I think the take-out ought to be from the Bank of Japan, after about six months. That's what we try to negotiate here so we don't have to go to the Treasury. You get a clean-cut agreement with the Japanese that after six months or nine months, whatever it is, you're out.

CHAIRMAN MILLER. Phil, did you mean a take-out from Treasury in terms of how we get the yen to repay?

MR. COLDWELL. No. I meant in terms of conversion of the swap line into long-term bonds.

VICE CHAIRMAN VOLCKER. So you don't need the yen. I'm saying that we ought to get the yen to repay from the Japanese.

MR. COLDWELL. But if we do that, Paul, then we have not solved the problem. Things continue, and we exacerbate it by--

VICE CHAIRMAN VOLCKER. We're going to get it from the Bank of Japan, not from the market.

MR. COLDWELL. Well,--

MR. WALLICH. It throws the risk back on them.

CHAIRMAN MILLER. From the time you close out, they take the risk. The only reason I wanted to raise the question again is that I'm not sure it would be possible in 48 hours for the Treasury to commit to a yen-denominated [bond]. I just don't know.

MR. COLDWELL. They did a long-term denominated D-mark bond before.

VICE CHAIRMAN VOLCKER. But why wouldn't you rather have the Bank of Japan do it? What advantages are there for having the Treasury do it, assuming they will do it?

MR. COLDWELL. For one thing you continue to keep those dollars off the market. If you dump this back on the Japanese central bank, you know perfectly well they're going to take those reserves and put them out into the market again, as they've been doing with their own reserves.

VICE CHAIRMAN VOLCKER. Well, they do that with a lot of their intervention anyway. The amount involved here, I think, wouldn't affect that volume significantly.

CHAIRMAN MILLER. What I'm talking about in the Treasury is that I'm not sure they can take the currency exchange risk--an unknown risk in advance without legislation. That is what I'm saying. I don't think they have any room in their--

MR. JACKSON. It's outmoded.

CHAIRMAN MILLER. It's completely out of line.

MR. JACKSON. That's what I thought.

CHAIRMAN MILLER. So I don't see how they can agree to something [like that].

VICE CHAIRMAN VOLCKER. The [ESF] would have to take the risk of their swap too and I don't see how they're going to manage that. If they can manage one [unintelligible] they can manage the other.

MR. JACKSON. They have enough accounting problems now.

CHAIRMAN MILLER. They may not be able to.

VICE CHAIRMAN VOLCKER. I would not insist that the Treasury take any major part of this for that simple reason--their financial capacity. We want their support. We want it publicly. All of these political considerations that have been raised are very valid and there's no point in doing it unless we really have White House support and Treasury support.

CHAIRMAN MILLER. As far as any loss on transactions is concerned, it comes right out of the Treasury because our earnings go to the Treasury. If we don't have it, it comes out of the Treasury.

VICE CHAIRMAN VOLCKER. Yes. It's just a question of which pocket it comes out of.

CHAIRMAN MILLER. In that sense, it doesn't make any difference which pocket it is. Okay thank you, Paul. Dave Eastburn has been trying to get a word in here edgewise.

MR. EASTBURN. Very briefly, Mr. Chairman, I'd just like to join those who have expressed reluctance on this. That’s not from the point of view of any fondness or lack of fondness for swaps per se, but I have skepticism as to how much effect this will have and how well it will work. We're dealing with credibility and psychology here to a great extent. I think our record on that is not good and I don't see any reason why it should be any better in the new situation. So I would be very careful about this.

CHAIRMAN MILLER. Thank you, Dave. I think we've heard from all the members of the Committee, except Willis Winn and Mark Willes. Do you have anything to say?

MR. WINN. No I really don't, Mr. Chairman.

CHAIRMAN MILLER. [Would you] say yes or no?

MR. WINN. I share the skepticism. I think we are again addressing the symptoms and not the real problem. I'd rather see our attention focused on the real issues and not divert our attention here.

CHAIRMAN MILLER. Mark.

MR. WILLES. I have nothing to add. I am on the side of those who are skeptical.

CHAIRMAN MILLER. I would add only a couple of words. I don't think there's any point in our taking action on a swap agreement to do intervention for the sake of the Japanese. We should only do it for the sake of the United States, believing that there is no good mechanism to prevent money panics in the world, even though we may have created some ways to prevent them in the United States and our own domestic economy. [Given] the amount of money that could shift around in disorder and the amount of harm that could be done in the United States from a change in pricing of oil constantly or demanding gold for it or something else, it could be very serious.

I do not project that there will be an international panic but I know one can be created if you get a whole series of events. Therefore, I also look upon this in terms of a very simple thing: How does it affect inflation in the United States and how does that affect our long-term objectives? How does it affect the possibility of more serious things happening, in terms of creating recession, in the world? You go on and on and you can [escalate] it up to warfare. As someone said, economics is the profession where if you're wrong, people go to the barricades. That has often been true in history. But if we could couple this with a series of actions and commitments from the Administration to help address a broader program, I think we might be aiding the United States. I don't think we should do it to aid the Japanese at all. Henry's comments along those lines were, I think, particularly pertinent, although on a different slant. I think that's correct.

Steve, I was incorrect. You were silent. I just checked over this [list] quickly and I--

MR. GARDNER. Well, I'm very pleased with what you just said. I concur with Henry and Philip and whoever else was suspicious. There's an underlying problem here that's got to be solved. Now, we can try with intervention and a stop-gap measure. But I'm sincerely suspicious of the effectiveness of that.

CHAIRMAN MILLER. If I counted noses correctly, on the Committee there were seven who expressed themselves in favor of pursuing this course and four who either felt we shouldn't do it or were skeptical. The four who expressed disagreement or skepticism would be Ernie, Dave, Mark, and Willis.

MR. COLDWELL. I would consider myself in that group if we were not going into full-scale intervention.

CHAIRMAN MILLER. Okay, let's put a question mark. It depends on the terms in your case. I think it depends on terms for all of us.

SEVERAL. Yes, the conditions are important.

CHAIRMAN MILLER. So I think we would need [to know them]. I want to be sure I don't mistake this. But there seems to be a clear majority to let us see what can be developed. Obviously, we don't want to open the subject with the Japanese until we know more about a governmental program because the last thing we'd want is to have the Japanese saying we have a swap agreement being activated. So it's a touchy business. All I can say is, with that guidance, we will go forward and see what we come up with. I'm supposed to be over at the White House and I'm going to have to beg off for lunch if you don't mind.

MR. PARTEE. That clock is slow.

CHAIRMAN MILLER. That clock is very slow. That's right; the electricity must have been off. I think the only thing we can do is to come back to the Committee by phone or otherwise and get clearance for the details. Dave.

MR. EASTBURN. I'd just like to say that, speaking for myself, on a matter like this it seems to me important for the Committee to be fairly united and not to have considerable dissent on this kind of action.

CHAIRMAN MILLER. Oh, yes. Anyway, with that guidance, we will go forward. Unless there are any more comments on that, we'll keep you fully apprised and ask you to keep extremely close confidence about this because this is information that can affect markets. Therefore, we have a very high fiduciary duty to see that it is not handled the way the White House handles it.

There are several subjects at lunch that I hope will go forward in my absence. One is to report to you on developments on the membership situation. I think Steve can give you [an update]. I must say that the staff has done an outstanding job in responding to developments since last week and working over the weekends so we could make a response after our discussion on Friday; they continue to work with your comments and are making a number of changes. So we can bring you up to date on where that stands. And Ken Guenther can bring you up to date on the legislative posture of it. In terms of other legislative matters, I think Ken Guenther will be there to brief you.

I've asked Janet Hart to come to the luncheon. I feel it's important that we begin to get a clear understanding within the System of our professional obligation to be diligent in the enforcement of consumer and civil rights legislation. I'm not saying we're not doing it but the internal report of our consultant indicates that we're slightly confused and we're not adequately focused. And I think we have to be. We're starting some things at the Board in terms of direction and resources, and I think Janet can brief you on those issues.

There was going to be, if time permits, an opportunity to bring to your attention some of the subjects that might come up at the IMF meeting in September. Time may not permit. That may have to go by the way. And Tom O'Connell wants to brief you in 30 seconds--right Tom?--on a couple of the court cases. There's nothing about those things that you need me for. I apologize for missing it but I think I'd better pursue the other course and see what I can report to you.

MR. COLDWELL. Good luck.

CHAIRMAN MILLER. The luncheon is on for the Presidents and the host will be the Board’s Vice Chairman Gardner. And I'll have a sandwich in my office in five minutes.

END OF MEETING