TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE CONFERENCE CALL

October 5, 1979

Prefatory Note

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

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

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

FEDERAL OPEN MARKET COMMITTEE
CONFERENCE CALL
October 5, 1979

PRESENT: Mr. Volcker, Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Mayo
Mr. Partee
Mr. Schultz
Ms. Teeters
Mr. Wallich

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

Mr. Eastburn, President of the Federal Reserve Bank of Philadelphia

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

Messrs. Ettin, Henry, Keir, Keran, Kichline, Scheld, and Truman, Associate Economists

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

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

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

Messrs. Doyle, Forrestal, Gainor, Smoot, and Williams, First Vice Presidents, Federal Reserve Banks of Chicago, Atlanta, Minneapolis, Philadelphia, and San Francisco respectively

Messrs. Broaddus, Cacy, Cox, Danforth, Mac Donald, Vice Presidents, Federal Reserve Banks of Richmond, Kansas City, Atlanta, Minneapolis, and Cleveland respectively

Transcript of Federal Open Market Committee Conference Call of October 5, 1979

CHAIRMAN VOLCKER. Gentlemen, we will have a bit of a rump session this morning. This is by no means meant to be any kind of decisionmaking session. I just wanted to bring you up to date a little. I expect to see you here [in Washington] for a meeting tomorrow. I am sorry for the uncertainty about the scheduling of the meeting, but a few things had to be put in place and there was some uncertainty about when they would be put in place. But I think we can go ahead tomorrow. The general issue, of course, is whether the present situation requires some monetary policy action and if so, what kind. The reason I think we should come together physically is that we really want to consider a change in operating technique of the kind that we have often discussed one way or another in the past.

You will have very shortly, if you don't already, a memorandum that Steve Axilrod and Peter Sternlight prepared describing a possible approach that involves leaning more heavily on the aggregates in the period immediately ahead. [Secretary's note: A copy of the memorandum is appended to this transcript.] And the complement of that is leaning less heavily on the federal funds rate in terms of immediate policy objectives. We have had some considerable discussion of that over the past couple of weeks here and that memorandum attempts to distill some of the thinking. I want to discuss tomorrow whether we want to adopt that approach, not as a permanent [decision] at this stage, but as an approach for between now and the end of the year, roughly, in any event. This will [involve] a series of decisions--whether we want to adopt that technique, and if so where we want the money supply path to be, what kind of broadened constraints we want around the federal funds rate, and so forth. I think those are the kinds of policy decisions we would have to focus on.

Of course, there are other possible actions that could be taken that are more immediately under the purview of the Federal Reserve Board itself rather than the Federal Open Market Committee. Before getting any further reaction--and I don't think we ought to have a long substantive discussion this morning by any means because that's the purpose of the meeting tomorrow--it may be useful to review very briefly where we stand. [Let's hear] from Mr. Kichline on the economy, Mr. Axilrod on the monetary side, and Mr. Truman on the international side, with any comments that Mr. Pardee and Mr. Sternlight want to add on the immediate market situation. So let's just take a few minutes to do that if we may. I'll turn the floor over to Jim Kichline.

MR. KICHLINE. Recent information on the economy has tended to come in somewhat stronger than the staff had anticipated. This was indicated most clearly this morning with the information on the labor market situation in September. Employment increased significantly in September and the unemployment rate is reported to have dropped 0.2 percentage point to 5.8 percent. In light of this information and some selected information on fiscal output, we would anticipate that industrial production probably rose about 1/2 percentage point in September.

In other areas, the data also have generally tended to be a bit stronger. For example, the new order figures and shipments data for August have been revised up substantially. One cautionary note relates to inventories where the most recently available information now suggests that inventories grew very strongly in August following, as you know, a very rapid increase in the preceding several months. Overall, our tentative thinking now is that real GNP in the third quarter probably increased around 1-1/2 percent at an annual rate--about 3/4 percentage point more than we had anticipated at the August meeting of the Committee. We believe that part of the increase--in fact the major part--will disappear as we get into the fourth quarter [when we think] we will be seeing some inventory adjustments. So we have a little larger negative in the fourth quarter. That, of course, remains to be seen in terms of what actually transpires. I would say that overall the information on the near term is clearly stronger than we had anticipated.

On the inflation side, it's hard to find good news. The new information obviously is the producer price index, and that shot up 1.4 percent in September. The increases were widespread, but particularly difficult is the food situation where we had anticipated some relief. And given the large increases in food prices at the producer level, this should feed into consumer prices over the next several months.

CHAIRMAN VOLCKER. Thank you, Jim. Let's just go to Steve and Ted and we [can] comment later.

MR. AXILROD. Mr. Chairman, the aggregates are running high in the ranges that the Committee had set at the previous meeting on September 18. At that time, the Committee adopted an M1 range of 3 to 8 percent and an M2 range of 6-1/2 to 10-1/2 percent for the period covering September to October. With data through October 3, our estimate is that M1 growth in that period will be 7-1/2 percent, very close to the upper end of the range, and that M2 growth will be 9.7 percent, also close to the upper end of the range though not quite as close as is M1.

With the money aggregates running strong and a rather considerable amount of churning and pressures in the foreign exchange markets, the federal funds rate has drifted up--I'm sure Peter will go into more detail on that--and along with that we've had some upward pressures on other short-term rates. In the long-term market, [yields on] high grade corporate issues have reached record levels for the year, rising on the order of around 17 basis points since the Committee meeting. They are at the point where in the latest week we estimate a new high grade corporate offering at very close to a 10.15 percent yield, apparently reflecting the worsening of inflationary expectations as well as the fairly sizable calendar of such offerings in recent weeks, led particularly by the IBM offering of a billion dollars.

Bank credit growth continues to be very strong. We had very large demands through the September tax date. I would guess that was because of strains on corporate liquidity positions and the need to finance large inventories while having to make large tax payments. But we have not seen an unwinding of that commensurate with the increases in that period, so for the month of September we think that bank credit is going to grow at about a 19 percent annual rate as compared with 10 and 13 percent in the previous two months. And we estimate that business loans in September grew at around a 20 percent annual rate as compared with an average growth rate of 18 percent in the previous two months. So banks have been very actively searching out funds to finance these demands that they've been accommodating and we have had a resumption of fairly sizable CD expansion in recent weeks as well as continued large takings from the Euro-dollar market.

CHAIRMAN VOLCKER. Mr. Truman.

MR. TRUMAN. Since the last meeting of the Committee, we have two pieces of information on the external side. One was the August trade data, which came in somewhat better than the staff had anticipated; the other was the full data on the second-quarter current account transactions, which showed higher net service receipts than we had anticipated. This has led us to adjust our outlook somewhat in a positive direction but not dramatically. The dollar is down about 2 percent on average since the Committee meeting and down about the same against the mark. This week, however, the weighted average value of the dollar has risen about 3/4 percent and again about the same against the mark. The chief impetus to the dollar's appreciation has been the developing expectations among market agents that a new series of measures to support the dollar's value would be announced during or after this week's meetings in Belgrade. The price of gold, as you may know, has moved quite erratically--particularly this week. It rose to a high of $448 per ounce in New York but this morning it was fixed in London--the first fix--at $367.50. Rumors of stepped up official sales of gold in the future have been one of the factors contributing to the break in the price.

CHAIRMAN VOLCKER. Mr. Sternlight and Mr. Pardee.

MR. HOLMES. Yes, Peter is getting ready to come on. Paul, there is a rumor in the market that I think you ought to hear about.

MR. STERNLIGHT. There has been word from our Desk--I think these rumors actually started in the foreign exchange markets but a few of the domestic dealers have been calling us on this--about a rumor that Chairman Volcker has resigned. And this is having a downward effect on the securities market.

CHAIRMAN VOLCKER. The answer is "not yet!"

MR. COYNE. Peter, this is Joe Coyne. We will be saying "absolutely ridiculous."

MR. STERNLIGHT. Steve reported on the aggregates and the interest rate changes. I just want to convey also the extent of apprehension and the expectancy in the market that something is being shaped up to deal with the current situation. As far as the funds rate goes, as Steve mentioned there were upward pressures around the end of the quarter. We had trouble getting out all the reserves that we would have liked and we had the fed funds rate averaging 11.90 percent in that week; on several days it was higher. We have still been aiming for 11-1/2 percent, but with an approach of being tolerant of rates somewhat above that and strongly resisting anything below that. Yesterday many people in the market were getting the idea that we were probably really aiming at something like 11-5/8 percent. And in restating our approach today, we are making more acknowledgments of that in light of the background situation. We have been saying that we are aiming for about 11-1/2 percent or somewhat higher but if it got up to 11-3/4 percent we would continue to resist a rate as high as that. And now Scott Pardee has some comments.

MR. PARDEE. Well, the exchange markets are currently very chaotic. The dollar is higher than it was early this week, largely because of supportive intervention by the Bundesbank and ourselves. But the number of rumors and the types of rumors that have emerged--many of them are incredible and some are credible--have dominated the exchange market thinking over the whole week. The one that Chairman Volcker has resigned, with all the elaboration of the scenario under which he resigned, has been going around for the last 2 hours. I hope it is denied very quickly so that at least that rumor would be put to bed. But everyone is waiting for whatever the Federal Reserve is going to do this week, and basically the dollar has not moved very much in the last 2 or 3 days.

CHAIRMAN VOLCKER. Let me summarize some of this by saying that late last week--actually beginning before then but particularly late last week and in the very early part of this week--these markets, by which I mean the gold market very obviously and the foreign exchange markets, were "depressed." I guess that's the right word. And the atmosphere was very nervous. I think that has been largely turned around by an expectation that there will be some action. The markets have recovered to a considerable degree on that expectation, but I'm not sure that there is much else that accounts for [the turnaround].

The discussions abroad were very difficult in a number of respects. The feeling of confidence is not high, I should say, in a number of directions and that increases the difficulty of restoring a sense of stability. One of the alarming things earlier, to me at least, was the sensitivity and responsiveness of some of the commodity markets outside of gold and silver to what was going on. There were some very sharp increases in prices of copper and other metals at the end of last week and at the beginning of this week, a development that has since subsided somewhat with the improvement in the gold market and the exchange market. But, quite clearly, we are in a very sensitive period.

So that is the background in which we will be meeting. Any comments that people at the other end of the telephone might want to add--or any questions--would be in order at this point.

MR. BLACK. How is this memorandum coming to us?

CHAIRMAN VOLCKER. By telegram or telex or whatever the normal method is, so far as I know. It's on the wire. You should have it.

MR. ROOS. May that wire be shared with our research people--those cleared [to see FOMC material]?

CHAIRMAN VOLCKER. I think it can be shared with one or two of them. I guess the message said one.

MR. ROOS. Our research director?

CHAIRMAN VOLCKER. Yes, one. Now let me say in that connection that there are a lot of complications that can be introduced with this procedure and a lot of questions about precisely [how] it can be done. If we are going to go in that direction, I doubt if we are going to decide precisely all these things for all time. In fact, I'm sure we're not. There's going to have to be a certain amount of discretion permitted the Desk and I suppose myself in this, in conjunction with the people here who will have to make the estimates as to precisely how this will work in practice. I think that is a practical necessity if we are going to move in that direction at this time. So, I wouldn't encourage you to come in with the idea that we can have a mechanical answer to all the questions that arise from operating in this manner. I think there would be a very definite change in procedure and approach but I don't think we can identify every possibility that may arise by some mechanical rule at this stage.

MR. BALLES. Steve, if you have the numbers ready there, how do the latest estimates we have on these different M's compare to our long-term ranges? Are we at or above the upper ends in both cases?

CHAIRMAN VOLCKER. That will be in the memorandum. Just roughly, the latest estimates are the estimates used at the last meeting which haven't changed substantially. Whatever you may think of their reliability, which is another question, the estimates themselves are barely within the ranges for the year.

MR. BALLES. One other question, Paul. Without trying to probe into what the forward course of action might be that will be discussed and decided upon tomorrow, is there anything we should be prepared to do on very short notice after the meeting in terms of contacting our directors?

CHAIRMAN VOLCKER. I don't know of anything at this stage and I don't think you should worry about that at this point. I think there is a need to come in here as inconspicuously as possible. I believe you've been working with Murray Altmann and [others] so that you're at diverse hotels. I imagine you do know that the Pope is coming in [to Washington, D.C.], which may be good cover. It may not be. I'm asking for a Papal blessing of this meeting. Murray suggests that we'll have a large cloak under which to put the meeting! I don't know if there will be transportation difficulties--whether you are going to have any difficulty getting to this building in the morning. We don't think so but there may be a certain amount of congestion and disturbance so if you're anyplace close, you'll probably want to walk.

MR. MAYO. Should we plan, Paul, for a meeting that lasts more than three hours?

CHAIRMAN VOLCKER. Yes. I don't know whether it will be necessary but I would [suggest that you] not commit yourself [to leaving by a certain time]. I would hope that we can finish in three hours but if you ask me whether that's a certainty, it is not. It's about as good as the money supply figures; all this scheduling [is difficult]. Obviously we want to emphasize the fact that you should be as quiet as possible. I suspect you will get some inquiries as to whether there is a meeting, so maybe you can make up a cover story for your people so that there isn't any knowledge of this meeting. If there are no other questions, I will see you in the morning at 9:30. Thank you.

END OF SESSION