Meeting of the Federal Open Market Committee

November 26, 1980

A meeting of the Federal Open Market Committee was held on Wednesday, November 26, 1980, at 12:20 p.m., at the call of Chairman Volcker. This was a telephone conference meeting, and each individual was in Washington, D. C., except as otherwise indicated in parentheses in the following list of those participating.

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman (New York)
Mr. Gramley
Mr. Guffey (Kansas City)
Mr. Morris (Boston)
Mr. Partee
Mr. Rice
Mr. Schultz
Mrs. Teeters
Mr. Wallich

Messrs. Baughman (Dallas), and Eastburn (Philadelphia), Alternate Members of the Federal Open Market Committee

Messrs. Black (Richmond), Corrigan (New York), and Ford (Atlanta), Presidents of the Federal Reserve Banks of Richmond, Minneapolis, and Atlanta, respectively

Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. Petersen, General Counsel
Mr. Oltman (New York), Deputy General Counsel
Mr. Axilrod, Economist

Messrs. R. Davis (New York), T. Davis (Kansas City), Eisenmenger (Boston), Ettin, Henry, Keir, Kichline, and Truman, Associate Economists

Mr. Pardee (New York), Manager for Foreign Operations, System Open Market Account

Mr. Sternlight (New York), Manager for Domestic Operations, System Open Market Account

Mr. Coyne, Assistant to the Board of Governors
Mr. Beck, Senior Economist, Banking Section, Division of Research and Statistics, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Boehne (Philadelphia), Brandt (Atlanta), Burns (Dallas), Fousek (New York), and Parthemos (Richmond), Senior Vice Presidents, Federal Reserve Banks of Philadelphia, Atlanta, Dallas, New York, and Richmond, respectively

Transcript of Federal Open Market Committee Conference Call of November 26, 1980

[Secretary's note: At the beginning of the meeting the Secretary called on each Reserve Bank in order to verify attendance.]

MR. ALTMANN. Thank you. If you will all stand by, we are almost ready to go. We expect to have all members of the Board and the usual members of the staff. Let me give you the phone number to use if you should become disconnected from the network. Call us on another instrument at 202-452-3317 and we will try to get you back on the network promptly. If you will bear with us for just another minute or two, I hope we can get started.

CHAIRMAN VOLCKER. Everybody's on and we're all here?

SEVERAL. Yes.

CHAIRMAN VOLCKER. Well, gentlemen--or rather, lady and gentlemen--I think we ought to have a little review of the situation. We may want to make a decision. Let me just say in a preliminary way that there is not much we can do about it right at the moment but these money supply figures have been plaguing us in terms of revisions. We have known this for some time and it has just gotten worse. It's absolutely clear, in my judgment, that there is a systematic bias in these numbers. When they go down, all the estimates are successively revised down. And when they go up, all the estimates are successively revised up. This [pattern] has cumulated over a period of time [and] has become quite serious in my judgment.

Now, I don't know what theoretical reason there can be for this. I don't think there can be a theoretical reason. The [errors] should be random unless we are getting bad reporting. The only plausible explanation I can see is that early reporters are not reporting the right numbers in some cases. I don't know, perhaps they report last week's number or something, so when they are in an up trend it is always low and when they are in a down trend it is always high. But I will have some people here, as soon as they get out from under, organize some way to look at this. I suspect it's going to have to be done by looking very carefully at the individual bank level to see whether there is any systematic bias in reporting by some of the banks. I don't know any other way to go about it, but we are looking into it. Did you know a characteristic is [that we have had big revisions shortly after our meeting]? Maybe we shouldn't have any more Federal Open Market Committee meetings so we can't have an eye on money supply numbers that we discussed at a meeting! That's a part of this general upward revision syndrome. We have had some upward revisions since the meeting, so why don't I ask Steve to describe where we are.

MR. AXILROD. Well, Mr. Chairman, as you suggested, immediately following the meeting we had a considerable upward revision in the money supply data, measured by M-1A. For the week of [November] 5th we published a level that was $1.2 billion higher than what was implied by the growth path adopted by the Committee, and for the week of the 12th we had a level $1.8 billion higher. So the markets [saw] an increase for the 5th--the final number--of $2.9 billion and a further increase of $1.8 billion for the 12th. The preliminary data we had for the 19th had suggested no change from the level of the 12th. The data we have as of about an hour ago, without nonmember banks available, suggest a downward revision. [The numbers] suggest that we may show a drop of $1-1/2 billion from the week of the 12th for M-1A and a drop of similar magnitude for M-1B. Even with these latest revisions, money growth will be running above the total reserve path adopted by the Committee. As of yesterday, it was running about $400 million above on a weekly average basis, and this increased demand for total reserves was pulling [up] the demand for borrowing. The amount of borrowing was up from the $1.5 billion initially assumed to $1.9 billion. We have not made any downward revision in the nonborrowed reserve path to take account of the increase in total reserves at this point, as we normally do not do that this early in a period. In any event, as I say, we now have had the first sign of a downward revision in the money supply. Whether it will hold up, Mr. Chairman--

CHAIRMAN VOLCKER. I'll believe that when I see it.

MR. AXILROD. Only time will tell. With borrowing running recently around $1.9 to $2 billion, the federal funds rate has moved up. After the discount rate was raised on Friday, the funds rate moved up to around 16-1/4 percent on Monday. It had been running at around 16-1/4 to 17 percent and now, most recently, it has been running between 17 and 18 percent. The average for the week to date is 17 percent. Yesterday it was 17.28 percent and it was running very high today, on Wednesday, the last day of the statement week--17-1/2 to 18 percent--and then moved above that later. Mr. Chairman, I think that very briefly updates the Committee on the aggregates and related reserve and money market conditions.

CHAIRMAN VOLCKER. I don't know whether you want to add anything to that Peter.

MR. STERNLIGHT. I have nothing very interesting. In some very light trading, [the funds rate was] somewhere around 18 percent and [unintelligible].

CHAIRMAN VOLCKER. The general problem, as I see it, is a fairly simple if awkward one: The money supply is running significantly higher than was assumed at the meeting. The kind of borrowing assumptions we were using convert, without any discretionary changes, into something like $1.9 or $2.0 billion. The question of a discretionary change is at issue certainly. But even without that, if we stick to the minimal "holding steady" on the nonborrowed reserve path, we have a level of borrowing that obviously puts into jeopardy the 17 percent funds rate ceiling. I would just propose, as a holding action at the moment anyway, that we move that to 18 percent, subject to review next week if we have to do it.

MR. EASTBURN. Paul, this is very different. May I ask Steve a question? Are you revising the December [projections] for the aggregates?

MR. AXILROD. We were in the middle [of those estimates] before we got this very recent data. Our estimate for M-1A growth for November was on the order of 9 percent or a little higher, and for December it had been around 1-1/2 percent. Our estimate for M-1B was around 12 percent for November and close to 3-1/2 to 4 percent for December. Whether these latest data will cause any further downward revision to that depends on the week of the 26th, for which I just don't have any data. If they prove to be somewhat weaker also, I suspect the December number will revise down, because the latest data in November will be lower and that will tend to carry through somewhat and lower the December average level. But that's highly tentative, President Eastburn.

MR. EASTBURN. Thank you.

CHAIRMAN VOLCKER. I'm afraid those projections have had virtually no informational content in the past 4 or 5 months.

VICE CHAIRMAN SOLOMON. Paul, this is Tony Solomon. Can you hear me?

CHAIRMAN VOLCKER. Yes.

VICE CHAIRMAN SOLOMON. I think the recommendation is a wise one; I think we should go to 18 percent. The market view is that we are already in a 17 to 18 percent range, and it seems to me that we really have no alternative.

MR. GUFFEY. Paul, this is Roger Guffey. I have just a couple of questions. When you were talking about an 18 percent cap, [does] that conflict [with] no increase to the nonborrowed path?

CHAIRMAN VOLCKER. Well, that might depend upon how this next money supply figure comes in. I think it is hard to defer [the issue] if it comes in high. If it comes in low, maybe we could defer the question. The preliminary indication is a little on the low side. If we didn't have that, I would be very hard pressed to say we shouldn't change [the nonborrowed path] a bit.

MR. GUFFEY. The other question--perhaps Steve could respond to it--is [whether with] an 18 percent rate, [which we have] in fact, we're still looking at about $2 billion in borrowing?

MR. AXILROD. Yes, the implied borrowing literally called for in the path is $1.9 billion. And given the way the federal funds rate has been running, [a funds rate of] 17 to 18 percent ought to be generally consistent with that. But if the borrowing were to rise significantly higher--if the money supply came in stronger--then of course there would be a question about the 18 percent itself. I might also add that last week we had an unusually large amount of borrowing from banks over $3 billion in size. Virtually half of the borrowing was from them, and they are the banks more prone to try to avoid the window because of the surcharge. So it may be that we are getting more pressure from the surcharge than we might have expected. That may abate but, again, I'm not certain.

MR. GUFFEY. Well, I'm with you and Tony Solomon in supporting the proposal.

MR. GRAMLEY. Mr. Chairman, could we get Jim Kichline to interpret for us those [new orders] figures for durable goods? What do you make of those?

MR. KICHLINE. The new orders figures in total were up a little, following an exceptionally large rise in September. For nondefense capital goods, they were down a little, but that was dragged [down] by aircraft; if we strip that out, they were unchanged. The October level of nondefense capital goods orders is little different in nominal terms from the average in the third quarter, so we don't perceive that a great deal is happening that differs from our earlier expectations on new orders. I might say that the shipments of durable goods were very large and were higher than we had assumed in our GNP projection. So, on average, we don't believe there's much different in the figures, except that there is some near-term strength measured by the information available for shipments in October.

MS. TEETERS. Have you changed your GNP projection at all since last week?

MR. KICHLINE. No, we have not. We have received additional information on housing starts, which were higher than we had assumed. We have the second 10 days of auto sales for November, and they were at a 7.1 million unit annual rate. On average, that's about what we had assumed. So we think growth in the area of 2 to 2-1/2 percent in real terms is still a reasonable forecast for the current quarter.

MR. MORRIS. Paul, this is Frank Morris. I would go along with your 18 percent, but only very reluctantly. I think that we have hit a level right now that [is inducing tightening] into the economy and that we probably are going to produce results in demand or markets beyond [unintelligible]. The rise in this kind of business always leaves us [unintelligible]. After that it's no longer necessary but, as I say, reluctantly I will go along with the 18 percent.

MR. CORRIGAN. This is Jerry Corrigan. I would tend to line up with the remarks of Frank Morris. I do think we have to go to 18 percent, but I myself am reasonably uncomfortable without the implications that we have great [unintelligible] of that. That is my comment.

CHAIRMAN VOLCKER. Shall I go down the list? I have an alphabetical list, it so happens. Governor Gramley.

MR. GRAMLEY. I would associate myself with Frank's remarks and Jerry's and Tony's too. I don't think there is much that we can do, given the fact that the funds rate is already up at 17 percent or over. If we try to push it back down again, in light of these money stock numbers [that would] look rather strange. But I do think we have interest rates as high as we need to have them. I'm going to believe the [weaker] figures [for the week of the] 19th will [show] up, and I'm going to pray between now and then.

CHAIRMAN VOLCKER. [Mr. Partee.]

MR. PARTEE. I'll go along with 18. I guess I do it less hesitantly than the others have suggested because I really don't know what is happening in the economy. I don't know why bank credit demand is so very strong and why we have repeatedly been unable to predict the level of rates that would be consistent with the growth in aggregates that we wish. So, I would say that we should certainly go to 18 percent, and I would be prepared to go further if in fact Lyle isn't right and the performance of the numbers does not show some improvement.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. I would be prepared to go to 18. I don't see any realistic alternative, although I am uncomfortable with the present level of interest rates.

CHAIRMAN VOLCKER. Governor Schultz.

MR. SCHULTZ. I don't think we have any choice on the 18 percent. What I find disturbing is the increasing evidence that people in this country seem to be learning to live with higher interest rates all the time. And that may become a greater problem as time goes on.

CHAIRMAN VOLCKER. Mr. Solomon we have [heard from]. Governor Teeters.

MS. TEETERS. Well, I am sufficiently uncomfortable that I won't go along with 18 percent. We already have the rates too high. It seems to me that you are playing with dynamite. We are [fostering another] cycle like last time. So I would dissent.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. Well, I was prepared to go to 19 percent last time, so I certainly would be willing to go to 18 percent. It seems to me that we are not getting the pressures on the financial institutions or markets that we got last time around [when rates] approached these heights. I think Governor Schultz is very right that people are learning to live with these rates because they are not really [biting after tax]. We have waited long enough for the [unintelligible] effects, and they may still come. But as I say, I think we do have to move now at the minimum to 18 percent.

CHAIRMAN VOLCKER. Mr. Baughman, who is alternate for Mr. Roos.

MR. BAUGHMAN. I have substantial uncertainty, but no reluctance. Yes.

CHAIRMAN VOLCKER. I don't know whether any of the [non-voting Presidents] want to make comments. Mr. Black, Mr. Eastburn, Mr. Ford?

MR. FORD. Paul, this is Bill Ford. I just have one question I would like to [ask]. Are you thinking about the tolerance [unintelligible] level of the discount rate might have other [unintelligible]?

CHAIRMAN VOLCKER. I can't quite hear you, Bill.

MR. FORD. The [unintelligible] also happens fairly quickly on the discount [unintelligible].

CHAIRMAN VOLCKER. Well, I'll just give you a brief answer, and then I think you ought to make up your own mind basically. If these figures don't come down, inevitably that question arises. But it arises against a background--not a conviction--that if we do it, we should not expect it to have any impact on market rates.

MR. EASTBURN. Paul, this is Dave Eastburn. I would go along, but I am [unintelligible]. My [guess] is we will find ourselves putting in a lot of reserves in if we don't. I would certainly favor another [unintelligible]. One thing that we are guessing is that the surcharge [unintelligible]. It's not having the same impact as the surcharge [unintelligible].

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Paul, we did a lot of the small [unintelligible]. We project that correspondents might be tightening in that direction; it depends on where the borrowing really is. But I agree in that I think we ought to go 18; I hope we don't have to go higher.

CHAIRMAN VOLCKER. First of all, [this is how] we are going to play this in the short run or for the moment. We have a decision on the reserve path and we will have another consultation next week. This may be a very interim decision. Just in terms of this general experience--apart from statistical and estimating and other problems--it seems clear to me that the real operating question here is what we do with the discount window. And there's nothing we can decide on that in the short run. But in that connection, how many of you have put any administrative pressure on any banks at all?

MR. EASTBURN. We have in Philadelphia.

MR. MORRIS. We have in Boston.

CHAIRMAN VOLCKER. You have. Interesting.

MR. FORD. Paul, this is Bill Ford. In Atlanta five of the largest banks in our District are right on the edge of being subject to the frequency rules. So we anticipate that it's likely to be [unintelligible]. We have not been putting undue pressure of any kind before--

CHAIRMAN VOLCKER. I tell you, it's a bit of a mystery to me how those rules are interpreted. We don't want any undue pressure but I don't think we want to lean over backwards the other way either. Any other comments?

MR. GUFFEY. We've had no problems in Kansas City and are putting no pressure on the banks.

MR. BAUGHMAN. In the Dallas District we haven't felt that the borrowing is at that level.

MR. CORRIGAN. Same for Minneapolis.

CHAIRMAN VOLCKER. Well, we just have two or three Districts that have been doing something, right?

VICE CHAIRMAN SOLOMON. Paul, we are seeing a rise in the overall level coming from the [unintelligible]--not significantly, just one or two Districts. Are you getting the pressure that we are?

CHAIRMAN VOLCKER. I am not aware of any particular concentration by District, but I am just not aware. Do you have any comment, Mr. Axilrod?

MR. AXILROD. I don't think there is any particular concentration by District. As I say, the only thing we noticed, particularly last week, was that very large banks borrowed a little more than usual, but borrowing by the smaller banks continued very heavy. I might say that over the past four weeks, Mr. Chairman, [one statistic we monitor]--the average number of weeks borrowed in the past 13 weeks--has been creeping up. It's one indicator. It's up to 4.2 weeks; and if we do [the calculation] by size of bank, it looks as if the large banks are very close to the sort of national guideline that had been put out, which would indicate that some will be subject to pressure.

CHAIRMAN VOLCKER. Personally, I am not at all sure that our rules are appropriate for today's banking system. We don't have a situation where a particular bank gets in trouble and has to borrow repeatedly for weeks. All they do is pass the pea around among themselves; they know what the rules are. So one bank borrows one week, and it says I am not going to borrow for a few weeks, we'll let somebody else borrow. So we get no real pressure on any particular bank because it's just a question of whether they buy more federal funds this week or less. We just don't have the situation that existed 20 years ago where a bank got into trouble in some sense and more or less had no alternative to borrowing other than to make portfolio adjustments. The last thing any of them do now is to make a portfolio adjustment.

VICE CHAIRMAN SOLOMON. Paul, to answer your thoughts, another [dimension] of the changing nature of the window that I foresee is that the multi-bank holding company fringe has developed in recent years, especially in our District and a few others with a lot of very large multi-bank holding companies. They see a little less of the money and avoid the surcharges relative to [what is] implied [by their liquidity needs]. In fact, Citibank in New York may not [unintelligible] holding companies. We have a lot of [unintelligible] themselves in December.

CHAIRMAN VOLCKER. Well, there are a lot of questions to consider in this area. But my overall impression is that we don't get much [restraint]. Banks all have their business rate, so they never have to restrain [lending]. They just change interest rates.

SPEAKER(?). I think it may be important to observe, [that if] we start putting pressure at the discount window [what we are] doing is increasing the upward pressure on the funds rate.

CHAIRMAN VOLCKER. That is right, among other things. Okay, we may be back in touch, but for the moment, that's where we are. Thank you. Happy Thanksgiving.

END OF SESSION