

Federal Open Market Committee

Conference Call

October 17, 1989

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Guffey
Mr. Johnson
Mr. Keehn
Mr. LaWare
Mr. Melzer
Ms. Seger
Mr. Syron

Messrs. Boykin, and Stern, Alternate Members
of the Federal Open Market Committee

Messrs. Black, Forrestal, and Parry, Presidents of
the Federal Reserve Banks of Richmond,
Atlanta, and San Francisco, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Assistant Secretary
Mr. Gillum, Deputy Assistant Secretary
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Lindsey, Promisel, Simpson, and
Slifman, Associate Economists

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

Mr. Coyne, Assistant to the Board, Board of
Governors
Mr. Keleher, Assistant to Governor Johnson,
Office of Board Members, Board of Governors
Ms. Low, Open Market Secretariat Assistant,
Division of Monetary Affairs, Board of
Governors

Mr. Stone, First Vice President, Federal Reserve
Bank of Philadelphia

Transcript of Federal Open Market Committee Conference Call of
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CHAIRMAN GREENSPAN. Good morning. I wonder if Mr. Cross would start us off.

MR. CROSS. Mr. Chairman, after our meeting yesterday morning, the dollar did strengthen somewhat as the stock market recovered during the course of the day, although the exchange market continued to be rather nervous. The dollar came up by a couple of pfennigs and 1-1/2 yen. In the markets overnight in Asia and Europe, the currency was relatively stable as we saw the stock markets in those countries generally recovering some of the losses--in some cases about as much as 1/2 of the losses--in the stock market of the previous day. But in the foreign exchange market, the players were somewhat restrained prior to the release of the trade figures; they were waiting to see what that was going to show when the other data came out this morning. When the trade deficit was announced at \$10.8 billion, that was well above the market's expectations, which had been in the \$9 to \$9-1/2 billion range. The immediate reaction was for the dollar to slip by a couple of pfennigs and one yen. It has continued now to trade around those levels or a little higher. We're now looking at numbers of about 1.85 on the mark and 141 plus on the yen, which as I say is about 1-1/2 to 2 pfennigs and about a yen down from where they were immediately prior to the release of the trade figures. We do hear some concern that the trade figures may lead to a resumption of declines in the stock market when it opens up; and the immediate reaction as our trade figures were announced was some slippage in the price of U.S. securities in London as well as in London's own market. So that's where we are at the moment, Mr. Chairman. Thank you.

CHAIRMAN GREENSPAN. Thank you. Mr. Sternlight.

MR. STERNLIGHT. Thank you, Mr. Chairman. As you know, the U.S. stock market rebounded considerably yesterday. The Dow Industrial index came back about halfway from its big drop of Friday; some other measures [showed] less of a recovery. As stocks came up, the expectations of a flight to quality faded, so Treasury issues actually gave back most of their big Friday gains. One press story that I saw this morning talked about dealers having gotten caught after loading up with securities on Friday and then they even used the phrase "got slaughtered" yesterday. I'm rather skeptical of that; we'll check into that more, but our spot checks during the day yesterday did not suggest any big loss pattern like that. They made quite a bit in the bond market Friday and gave back some of it yesterday; but I don't think that there were massive moves. I don't think there was the inventory around to have done that kind of loading up on short notice.

This morning we've had some gyrations in the market. Bond quotes were initially up moderately from the overseas trading; they fell back on that bad trade number that Sam mentioned and then came back a little most recently, so they were showing some very slight gains over last night's close. Compared with last Thursday evening, that leaves Treasury bill quotes down something like 20 basis points; coupon yields backed down and then were up about 5 to 10 basis points. The high-grade corporate area showed lesser swings than Treasury bonds

but broadly in the same direction. The junk market you have to think of really as two different markets--or one market and one virtually non-market. The better grade low-rated issues had been down sharply on Friday and weakened somewhat further yesterday morning and then recovered to show little change on the day for a number of issues and even some net pluses on the day. Apparently, there was no big move to redeem shares in junk bond funds, which had been one of the fears late Friday and yesterday morning. And we were hearing of some buying of the better grade junk issues by some of those high-yield funds. As for the other so-called "punk junk," that market is still in the tank. It's highly illiquid; there is a waiting calendar of high yield issues to come in this quarter, and one hears repeatedly that there may have to be considerable revamping or restructuring of some of those deals before they can be successfully launched.

On our operations, we added some reserves yesterday, essentially because the markets were so expectant of seeing us after some of that weekend press. The reserve numbers showed us to be about on path or maybe a shade over path after making some modest allowances for excess reserve demands and borrowings earlier in the period. Fed funds were fairly comfortably around 8-9/16 percent at the time, but we added about \$2 billion through a customer RP. Funds were steady to actually slightly firmer over the balance of the day. The effective rate yesterday was 8.63 percent and that left us [averaging] 8.86 percent so far this reserve period. Funds started out today trading at 8-11/16 percent, so there may not have been quite as much overabundance as we thought we might be creating by putting in some reserves yesterday. As to where the market now thinks we are or might be heading in regard to policy, I would say that before the Friday stock market plunge there already had been some sentiment developing--although certainly not a firm conviction--that we were encouraging or allowing a little more accommodative stance, with perhaps something like an 8-3/4 percent funds rate, as opposed to something around 9 percent, being permitted to emerge. I think that view has gained some further adherents in the last couple of days, though there are still some participants who would say they are not yet convinced that we've made any clear move away from something around 9 percent. At the same time, because of the last couple of days, there are some who feel that the rate is now more likely to settle in around 8-1/2 percent because the Fed will be impressed with the stock market and the junk bond market fragility as well as other factors that already had been there in the general economy. I think that you had a fair amount of support early yesterday and maybe somewhat less so as the day went on, but it has by no means disappeared. That's all I have, Mr. Chairman.

CHAIRMAN GREENSPAN. Are there any questions for either Mr. Cross or Mr. Sternlight?

MR. JOHNSON. I have one question.

CHAIRMAN GREENSPAN. Go ahead.

MR. JOHNSON. Peter.

MR. STERNLIGHT. Yes.

MR. JOHNSON. One concern I had yesterday, and some others I think expressed it here, was that doing a customer RP yesterday--even

though it was fairly small--with funds trading around 8-1/2 percent looked like we were sort of confirming 8-1/2 percent in the market. I noticed there's a Wall Street Journal story this morning that says that that might be the case and that we might go up to 8-3/4 percent. I'm a little concerned, given that customer RP, that the market--or at least half of the market--may be thinking more like 8-1/2 percent and that now any attempt to discourage them from that is going to look like a "whoops, sorry" thing. At least that's the impression I get. What's your impression?

MR. STERNLIGHT. I would say that some do hold that view. As I said, I was hearing more of that earlier yesterday. Later in the day funds had firmed, and I was hearing less of that kind of talk. Also, some of the people looking at what we did yesterday felt that one really couldn't gauge it by the normal measures--that we were dealing with the extremely jittery stock market and that it was almost irrelevant where funds were at the point that we went in. As to the decision to go in, even though the stock market was not tumbling yesterday morning, it was so jumpy--it had come down early and then it did come back--that I felt, because of the sense of expectation that had come out of the weekend press, that not to do something when there was that great widespread expectation of our coming in--. If things had turned sour in the stock market later in the day, I felt it would have resounded very unfavorably on the Fed's supposed adherence to what people had thought was some kind of commitment--however inaccurate or accurate that perception might have been. In any event, I don't know that there is going to be that much of a problem of a sense of whipsawing. As I say, funds are at 8-11/16 percent starting this morning. I don't know yet what the reserve outlook is; but if we're able to stay out today, I think that might be a very nice outcome for this whole situation.

MR. JOHNSON. Yes. I was just making a comment because I did see a few comments about the market on the screen prior to our action suggesting that there might even be a mild draining need. There was some perception of a modest drain necessary in the market and that's why I was asking.

MR. STERNLIGHT. There have been those views. In fact, we thought there was a draining need when we finished our operations on Friday. Then, as I said, we got some revisions that put us just about on path or with a very, very small draining need. Some others still see that draining need. There have been a few analysts, though, who thought there was an "add" need. So there is a range of views there.

MR. JOHNSON. Okay, thank you.

CHAIRMAN GREENSPAN. Tomorrow is the end of the first week of the period?

MR. STERNLIGHT. No, tomorrow is the [end of the] final week.

CHAIRMAN GREENSPAN. Tomorrow [ends] the final week, so we have a new period starting on Thursday?

MR. STERNLIGHT. Yes. And that is a period, incidentally, in which we're looking at a very substantial overabundance of reserves and we'll have to go in overtly and take some out.

CHAIRMAN GREENSPAN. Any further questions for either Mr. Cross or Mr. Sternlight? Si Keehn, is there anything in Chicago that you think warrants our attention?

MR. KEEHN. Not particularly, Mr. Chairman. Both the Merc and the Board of Trade had busy days yesterday--not record volumes, but still high volumes. And margin calls this morning were fairly heavy but they were described as being easily met, I think, by the banks in supporting the margin requirements by the dealers. The night trading on the Board of Trade last night was light--supposedly very steady as compared to a very heavy night Sunday night. And both exchanges seem entirely comfortable this morning.

CHAIRMAN GREENSPAN. President Corrigan, are you there?

VICE CHAIRMAN CORRIGAN. Yes. I don't really have much to add. I think there was a very measurable sigh of relief yesterday but there still is an overhang of some anxiety. And the further away from trading rooms you get and the closer to board rooms, I think the anxiety level is probably higher among the more senior people. On London stocks, I just saw a loss of around 33 points there, which isn't dramatic if you allow for the fact that last Friday at best was likely to have some overhang in terms of market openings here. All in all, I think things did work very, very well yesterday at all levels, including mechanical levels. One thing there is a lot of talk about among the more senior people is the amount of restructuring of various deals that is going to have to be done. You're talking big, big money. Another point that's being raised already is that Friday is a double-witching day--not a triple-witching day but a double-witching day--and Thursday is also the day when there's a very, very large prospective settlement of margins on foreign exchange contracts. As I said, all in all, things have worked remarkably well, but I think there is still an overhang of unease out there.

CHAIRMAN GREENSPAN. Yes. I don't know of any stock market that falls 200 points, goes back 100 points, and then stabilizes. This situation has significant gyrations still left in it to work their way out. The presumption that the worst is over is a nice feeling, but I wouldn't want to bet on it. My own view is that the Desk ought to continue to operate flexibly. Barring any unforeseen events, it's probably best that we emerge from this period with a slight easing, probably of the order of magnitude of, say, \$50 million on borrowing and the equivalent of about 25 basis points [on the funds rate]. But I think it's premature at this stage to do any locking in, and we ought to reconvene again tomorrow at 9:00 a.m. But before we close, I would like to throw open the floor--if that's what one would call it--to any comments or additional thoughts since yesterday's meeting by anybody.

VICE CHAIRMAN CORRIGAN. Is Mike Prell there, Alan?

CHAIRMAN GREENSPAN. Yes, he is.

VICE CHAIRMAN CORRIGAN. Mike, is that trade number as bad as it looks?

MR. PRELL. Well, Ted Truman is here and has the numbers. I'll put it to him.

VICE CHAIRMAN CORRIGAN. Okay.

MR. TRUMAN. Well, given the gyrations of these data, it's not outside the realm of normal expectations. We don't have the details yet but I don't think it's likely, in and of itself, to give us a bigger trade deficit for the third quarter than we had been anticipating. We had anticipated that it would be essentially unchanged between the second and third quarters. If we did a straight extrapolation, it would be going from \$110 billion to \$118 billion, but that's a rather mechanical approach. There was an increase in the carryover, which is what caused the revision in the July number; to the extent that that goes back to a more normal number, you'll have the opposite revision in August when the September number comes out. So, there's a bit of fluff in the number, if I can put it that way.

MR. PRELL. President Corrigan, as Ted said, we don't have this fully processed, but I might just note that up to this point the expenditure data for the third quarter were running a tad stronger than we had been anticipating. So, whether this in the end adds up to a substantially different third-quarter GNP increase than we were expecting, I'm not at all sure at this point.

VICE CHAIRMAN CORRIGAN. Okay. Thanks, Mike and Ted.

CHAIRMAN GREENSPAN. Any other comments? If not, can we reconvene at 9:00 a.m. Eastern time tomorrow morning? Thank you.

END OF SESSION