Federal Open Market Committee

Conference Call

June 24, 1991

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Forrestal
Mr. Keehn
Mr. Kelley
Mr. Mullins
Mr. Parry

Messrs. Guffey, Hoskins, Melzer, and Syron, Alternate Members of the Federal Open Market Committee

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

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Lindsey, Promisel, Siegman, Associate Economists

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

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Broaddus and Ms. Lovett, Senior Vice Presidents, Federal Reserve Banks of Richmond and New York, respectively

Transcript of Conference Call of
June 24, 1991

CHAIRMAN GREENSPAN. The purpose of this call is to bring you up-to-date on the contents of the G-7 meeting in London yesterday and on a currency exchange between the Bundesbank and the Treasury and ourselves. Let me first start with the G-7 meeting. While discussions of the exchange markets were contemplated, the basic thrust and expectation of the G-7 meeting was that it would be a fairly detailed discussion of the Soviet Union and the options that were available to the various members of the G-7, with the hope that the finance ministers would have an early shot at a number of the proposals that had been running around. The objective was that by the time the finance ministers joined with the heads of governments and the foreign ministers at the Summit in London in a few weeks, there would be a little more discussion of economics and finance and at least a modicum less of politics. As a result of that, there was an endeavor essentially to clear the communique in the sense that in previous meetings a substantial amount of time was involved in discussing the communique and in many meetings the thrust of the meeting really was governed by structuring that communique. As a consequence, rather than find that we were spending all of our time on non Soviet-related issues, a communique was set up that was essentially pre-cleared. And I use the word "essentially" in the sense that all the deputies, with the exception of the Brits who had a minor exception, had signed off.

In the event, regrettably, there were lots of second thoughts about the content of the communique, and while [the discussion of] the document was not as combative as at previous meetings, we nonetheless spent a goodly part of the time on that, especially in the areas of foreign exchange. The most important issues from our point of view were in this area. The basic thrust of the Europeans and to a slightly lesser extent the Japanese was that the dollar was moving too high and creating significant problems for them. I would say without exception that the general view of the six was that the dollar was at the outer edge and that something in the way of intervention was clearly called for. The general view of the group, however, is not essentially interventionist even at this particular stage. What was most interesting about the discussion was that whereas in previous meetings Secretary Brady and Karl Otto Poehl often would take differing positions on intervention--with Poehl basically consistent with our view that there should be little, if any, and Treasury officially on the side of a lot--in recent months that has changed quite dramatically and the most formidable ally of Brady turned out to be Poehl.

The real problem in the basic discussion of exchange rates occurred as a consequence of a very serious and formidable attempt by whose purpose was to try to lock in not only strict intervention but, if he possibly could, even ranges. The particular language that he was employing for purposes of discussion in the context of a communique was to stipulate in effect that further increases in the value of the dollar would be counterproductive--a term used previously in communiques, often as a prelude to significant currency intervention. We largely resisted that at some length to a point where actually threatened not to sign the communique. All of us were really quite concerned that that in fact might end up being the case; and that, of course, would be the big news. Nonetheless, it was highly undesirable to acquiesce in some of what he was endeavoring to create, and eventually at the end he backed down as came up with language that was in between the somewhat stronger language of and our desire not to get too closely tied with the words "stabilization," which was another alternate formulation of the potential focus of intermeeting exchange rate policy. came up with a concept in which they talked about "orderly markets" or, earlier on, "orderly and stable" markets. But "stable," according to Brady, was too close to "stabilized" and he argued strenuously for "orderly" and finally won the day. did back down and the communique came out as many of you probably have seen it.

The major interesting issue, as we learned at various times in the meeting, was that the Europeans particularly were concerned about the status of the Soviet Union--fearful of a major breakdown and as a consequence some considerable weakening of the mark with major pressures within the ERM. And to a substantial extent I would expect that their concerns relevant to the issue of the rise in the dollar [reflected] a fear that this was only the beginning and that there would be substantial further increases that they judged would be counterproductive to their recovery largely by producing inflationary pressures that they felt they would have difficulty containing. Nonetheless, when the discussion finally terminated on the exchange rate issue, there was a general agreement that to the extent that there was intervention at any particular time it was not going to be preannounced in the communique and that to whatever extent it occurred it presumably would be modest. There was, with the exception of acquiescence in that. The Japanese, who are concerned that anything over 140 on the dollar/yen exchange rate would be a problem for them, were not as concerned as the Europeans but nonetheless would have been fully supportive of any language that stipulated that further increases in the value of the dollar would be perceived to be counterproductive.

We finally got that element of the communique out of the way and went on to discussions of the Soviet Union, which had been going on before and [continued] after [the meeting]. And the most interesting aspect of that discussion was that, despite the fact that a number of individuals in the group had said to me privately that they were very concerned about the state of the Soviet Union, when I raised the issue of potential hyper-inflation taking hold there was [some] dissent. In the discussion there was a much softer response; even though there was considerable discussion about there having to be conditionality on any assistance funds to the Soviet Union, there was little in the way of trying to formulate what such conditionality would mean. What would it mean in effect to have Article IV discussions with the Soviet Union and get into a position where the IMF would insist that certain basic statistics and goals be met? They talked as though it were Argentina or Paraguay or even Mexico. But the difference that would prevail with the Soviet Union is clearly one which is of a monumentally different order and raises a whole series of questions about whether there is a reasonable concept of conditionality with respect to economic programs for the Soviet Union. There was a strong desire to support reform but a recognition that there seems to be a degree of naivete in the ruling circles of the Soviet Union, and no one is quite sure whether all of this is not significantly premature. At the end of the day I at least came away with the view that there is a general awareness that aid will be forthcoming and it was more a concept of political aid than it was economic aid because no one really wanted to get down to hard economic issues to the extent I thought we were going to. And I thought the meeting ended basically with little indication other than support for special status [for the Soviet Union] at the IMF; I was surprised it came out that way because I thought we were trying to avoid preempting anything of that nature from the Summit.

MR. TRUMAN. It had been announced. The President announced his proposal in December and Baker had it in his speech last week.

CHAIRMAN GREENSPAN. Yes, but I found a little surprising but not unexpected that all the members basically were supportive of it. All in all, it was a meeting which I think underscored growing concern in Europe because of the Soviet situation and growing concern about the weaknesses of their currencies. The Germans, obviously, are concerned about strong wage increases, which are possibly engendering inflationary pressures. And I sense that there was a greater element of confidence that if the Soviet Union doesn't fall apart and all other things are equal, Europe will hold together. told me in a private meeting that they thought their economy had improved since April--or more exactly since the conversation I had a couple of weeks ago with [unintelligible.] But while the tone was somewhat more supportive of recovery, I had the sense that there was a jitteriness amongst that group, which probably reflects to a large extent the deterioration of the Soviet system [unintelligible].

Before I go on to the second related subject, I thought I would just open up [the floor] for any questions. If there are none--and assuming that everyone is still on the line--I'd like to discuss for a minute an issue that, as all of you know, has been on the discussion agenda for quite a while with the Bundesbank going back to the beginning of the year: The potential of an off-market swap for dollars and DM on the grounds that our [foreign currency] balances have gotten exceptionally large, which is a view concurrently held by the Bundesbank. We have been involved in somewhat passive discussions on this issue for quite a while. It picked up a couple of weeks ago and reached fruition in the last several days. I thought I would ask Sam Cross if he wouldn't mind trying to give us a little background on the development of the program and its specific details. Sam?

MR. CROSS. Thank you, Mr. Chairman. As you say, this matter of reducing the foreign exposure resulting from these currency balances is one that the Committee members have been expressing some interest about for some time. We have been working with the Treasury and the Bundesbank to try to come to a satisfactory solution. The plan that we've worked out with them is to exchange over a period of time a total of 10 billion deutschemarks that the Treasury and Federal Reserve are holding for equal value of the Bundesbank's dollar holdings. We would make these exchanges at market rates but in off-market transactions. The first exchange, which will be for 4 billion deutschemarks against an equal value of dollars, is scheduled to be made tomorrow for settlement on Thursday. The overall understanding that we worked out also calls for six subsequent exchanges of 1 billion DM each on a particular agreed date, one in each month over the second half of this year. These six exchanges are to be transacted at forward rates for those particular dates as those rates are calculated tomorrow. We will calculate them on the basis of tomorrow's [exchange] rate and the interest [differentials.] Now, this arrangement was agreed to in principle with the Bundesbank and the Treasury last Friday. It essentially will mean that we will be exceeding the daily and intermeeting limits. The transaction was cleared with the Chairman and the Foreign Currency Subcommittee in accordance with the Committee's Procedural Instructions. We also have agreed with the Treasury that 60 percent of the mark balances to be exchanged will come from the Federal Reserve balances and 40 percent from the Treasury's ESF. It should be noted in this connection that the Federal Reserve balances are currently substantially larger than Treasury's. So, the particular allocation will tend to make them somewhat more equal. But I should also emphasize that the entire arrangement must be kept completely confidential at the present time. The Bundesbank is profoundly concerned about possible adverse market perceptions from any kind of premature disclosure or from discussion or misunderstandings in the market about the purposes and implications of this exchange. So, at the present time it's very important that there not be any comment about this arrangement. That completes my comments, Mr. Chairman.

CHAIRMAN GREENSPAN. I might say further that since there will be a possibility of inferring that something is going on, we prepared, with the Bundesbank's agreement, a way to handle questions that might occur should the particular transaction become transparent. The first sign that will appear in any published data will be in the daily Treasury statement, which I suspect comes out on Monday.

MR. TRUMAN. Thursday.

CHAIRMAN GREENSPAN. On Thursday it's closed.

MR. CROSS. I believe it comes out Friday, Mr. Chairman.

MR. TRUMAN. Friday.

CHAIRMAN GREENSPAN. Friday? My recollection is that the last time we did something equivalent to this off-budget there were several analysts who were able to work through the daily Treasury statements, specifically in the asset and liability accounts, to infer a transaction that is atypical. I would suspect, since this is not a negligible quantity, that it might well get picked up. In any event, next Thursday we will be publishing our balance sheet and [the change in] "other assets" will reflect that in part. So, we may well get a set of queries. In any event, the general answer will be of this form: that the Bundesbank, the ESF, and the Fed felt that their respective operating balances were excessive [relative] to their needs and that it would be to our mutual interest to engage in an exchange; that this issue has been under discussion for quite a long number of months and finally reached fruition this week; it is not a reflection of the United States endeavoring to dump D-marks; it is a technical issue. We hope it will be answered in a manner that is not disturbing to the markets. Eventually, of course, the full transaction will be published; is that in early September, Sam?

MR. CROSS. Yes, we give a report in September, which probably will cover the entire transaction, even though some of the transfers will not have been made.

CHAIRMAN GREENSPAN. I just want to emphasize what Sam has said: It's very important that no mention of this transaction be made unless and until it appears in the public prints with official statements affirming it. Are there any questions for Sam?

MR. HOSKINS Yes, this is Lee Hoskins. I have two questions. It's not clear to me, Sam, what if any impact this has on profit and loss for the System, at least initially. And secondly, is part of the agreement associated with this swap that we will continue to intervene in marks if necessary?

MR. CROSS. Well, on the first, the only implications for profits or loss are that we hold a smaller amount of marks than we held otherwise and, therefore, we are less subject to either gains or losses resulting from changes in the mark/dollar exchange rate in one direction or another.

MR. TRUMAN. Well, we also will realize a small profit.

MR. CROSS. And we realize a profit. For the Treasury, there's a loss on some of the [deutschemark] transactions that we are undertaking. On the Federal Reserve side we will realize some gain because we will in effect be selling these marks at rates that are more favorable than the rates at which we bought them.

CHAIRMAN GREENSPAN. Sam, I understand from the Treasury that their effective cost on the part of the transaction that will occur tomorrow is 1.86 and that unless there's a remarkable change over night they're going to show a small profit.

MR. CROSS. You may be right; my numbers are slightly different, but they may not be up-to-date.

MR. TRUMAN. That's right, Sam. I thought I had understood something different as well, but they may have some other way of doing their accounting.

CHAIRMAN GREENSPAN. Barry Newman told me they're using 1.86.

MR. CROSS. In that case they will make a profit as well.

CHAIRMAN GREENSPAN. Yes.

MR. CROSS. On the second [question], in any conversations that I have had with them we were reassured that there is not any quid pro quo in terms of a policy move--that this particular transaction is a cooperative move by both of us and it does result in improving [unintelligible.] There was not, as far as I was concerned, any quid pro quo in that.

CHAIRMAN GREENSPAN. No, I think that's right, Sam. There were bilateral discussions about this in London with the Germans and the general agreement was that if we had very heavy operating balances, it would limit the extent to which we could engage in mutual intervention. But even with this, it was clearly indicated that we were not engaging in this transaction in order to get some leeway for massive on-market accumulation of marks. That issue, I think, was clearly stipulated and there was no indication or request from for anything else. The impression I got actually is that was more concerned about the possibilities of some problems with the Summit, which might require some modest intervention. But he is not one who is enamored about significant amounts of intervention as a means to alter any important move in the currency. So, I would merely underscore what Sam has just said.

MR. ANGELL. Mr. Chairman, would it not be also true that even though our realized profit is a positive, the fact is that in 1991 we have some unrealized losses that will be made permanent?

MR. TRUMAN. We mark-to-market every month; in fact, those losses, if you want to put it that way, have already been [taken].

MR. CROSS. Our losses earlier this year have already been reflected.

CHAIRMAN GREENSPAN. That's right. The Treasury's receipts for the year from the Fed will be considerably lower than normal. But then again, they were considerably higher than normal last year. Any further questions for Sam? Any further discussion on any issues? If not, thank you very much, everybody.

END OF SESSION