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
January 13, 1995

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Hoenig
Mr. Kelley
Mr. LaWare (in Georgia)
Mr. Lindsey (in Virginia)
Mr. Melzer
Ms. Minehan
Mr. Moskow
Ms. Phillips
Ms. Yellen

Messrs. Boehne, McTeer, and Oltman, Alternate Members of the Federal Open Market Committee

Mr. Forrestal, President of the Federal Reserve Bank of Atlanta

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

Messrs. T. Davis, Dewald, Slifman, Stockton, and Vander Wilt, Associate Economists

Mr. Fisher, Manager, System Open Market Account,

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Wiles, Secretary, Office of the Secretary, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Simpson, Associate Director, Division of Research and Statistics, Board of Governors

Messrs. Conrad and Guynn, First Vice Presidents, Federal Reserve Banks of Chicago and Atlanta, respectively

Messrs. Beebe, Goodfriend, Lang, Rolnick, Rosenblum, and Sniderman, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Richmond, Philadelphia, Minneapolis, Dallas, and Cleveland, respectively

Ms. Rosenbaum, Vice President, Federal Reserve Bank of Atlanta

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

Transcript of Federal Open Market Committee Telephone Conference
January 13, 1995

CHAIRMAN GREENSPAN. The purpose of this meeting is to bring everyone up to date on the rather rapidly moving affairs relevant to Mexico. I thought I would start off with Ted Truman who can give you a rundown of hour-by-hour or day-by-day developments--whatever he deems useful at this moment.

MR. TRUMAN. I don't think anybody would sit still for an hour-by-hour report! The useful thing may be to start two weeks ago when you had your conference call and added 50 percent--$1-1/2 billion--to the Federal Reserve's swap line in complementarity with increases in the Treasury and Canadian swap lines and consistent with the BIS agreeing to try to put together their $5 billion short-term financing facility and the commercial banks their $3 billion facility. That added up to the $18 billion total that was announced on Monday, January 2. That financing was put together in the context of President Zedillo's speech and was intended to reinforce his economic program. As you are probably aware, that speech was delayed several times; it didn't occur until about midday on Tuesday, January 3. It was not greeted with a great deal of enthusiasm in the financial markets, and the situation continued to be quite soggy.

Over the last weekend, there was a growing concern that it was necessary or desirable to try to stabilize this situation by demonstrating a bit more financial resolve. That led to some intervention on Monday by the Bank of Mexico, which previously had refrained from engaging in any open foreign exchange market intervention, and the Mexicans took the unusual step of asking the Federal Reserve Bank of New York to operate for their account in New York. The Federal Reserve Bank of New York issued a statement saying that it was acting for the Bank of Mexico's account in operations consistent with the general support we have been giving to Mexico. The Mexicans also announced that they had drawn on the swap line. The purpose was to indicate that there was some real money involved. Since then, an additional drawing has brought the total up to $500 million on us, $500 million on the Treasury, and a corresponding amount of Can$166 million on the Bank of Canada. They also announced the size of their reserves and promised to continue to announce their reserves on a regular basis. This was designed to show that they had some reserves and to lock in a general policy of announcing their reserves on a regular basis. Lastly, they agreed to undertake a significant tightening of monetary policy, pushing up short-term rates 8 or so percentage points to 20 percent in terms of dollar-denominated assets and raising rates somewhat more--by 10 or 12 percentage points --on peso-denominated assets. I think it's fair to say that these actions did not meet with a great deal of success and the auction of tesobonos on Tuesday was decidedly weak despite the increased interest rates that were offered on those assets. They received bids for only $163 million, as I remember, and only accepted roughly $60 million at their rate of 20 percent.

There was also growing evidence that the problems in Mexico were spreading to other emerging markets in Latin America and elsewhere in the world. That led to an intensification of consultations with the Treasury Department on Tuesday afternoon involving the then still Secretary-designate Mr. Rubin, who actually became the Secretary of the Treasury by the end of the day. Mr. Rubin spent his last hours as a free man worrying about Mexico and almost all his hours since then worrying about Mexico. After meeting with the Chairman for three hours, he had a meeting lasting several hours with his colleagues in the White House and with the President. The President endorsed the Treasury's idea of investigating whether a program of loan guarantees for Mexico would be saleable on Capitol Hill on an expedited basis. The President made personal calls to the leadership of the Congress on Tuesday evening saying that the Secretary of the Treasury and the Chairman of the Federal Reserve Board would follow up the next day with consultations with each of the leaders and, as it happened, a subset of some of the key committee chairmen and other interested parties. Those consultations culminated in a meeting yesterday afternoon--and I think I'll leave the reporting on that to the Chairman--between the President and the leadership of the Congress at which the President said that he remained convinced that it was important to go forward with this, and that he understood from Chairman Greenspan and Secretary Rubin that that was the sense of the leadership of Congress. He proposed that they make a joint announcement to that effect. That proposal won the endorsement--I don't want to say the enthusiastic endorsement but I don't think it was a contentious endorsement--of the leadership. Early yesterday evening it was announced that they had agreed that a program of loan guarantees would be proposed to the Congress on the joint recommendation of the President and the four leaders. At that point, the figure for the total amount of loan guarantees or instruments that would be guaranteed had been left open. As a result of these rather extensive consultations on the Hill, it was fairly widely known that the figure being suggested was in the range of $25 to $40 billion. Indeed, a number of individuals on the Hill suggested that they thought it was wiser to go for a larger amount rather than a smaller amount, and that is currently the position as I understand it.

MR. BOEHNE. Is that all new money?

MR. TRUMAN. Yes, it would be new money in one sense. Let me make two points about that before I turn this issue back to the Chairman. There would be up to $40 billion in loan guarantees. What is involved in this program would be that Mexico would be borrowing dollars, I assume on the international capital markets or our capital markets, up to that amount with the guarantee of the United States government. At least in the first instance, that guarantee would cover interest and principal, but in the later phases it might cover only principal. That would be new money in the sense that they would be raising new money. However, the purpose of that new money, granting that money is fungible, would be primarily to fund the fairly large stock of short-term obligations that the government of Mexico and some of the Mexican banks currently have outstanding. It would be used to replace short-term debt with 5- to 10-year debt, and to the extent that that was done it would be essentially a funding operation. The particular mechanism that was used in 1992, and more recently in an ongoing program with Israel, has the feature that it essentially has no budgetary impact. The reason for that is that the country, Mexico in this case, would pay a fee for the loan guarantee and that fee in turn is based upon the risk element associated with Mexican borrowing, as judged by a generally accepted, robust set of procedures that have been in place for several years and are overseen by OMB on the one hand and CBO on the other. So Mexico would pay a fee essentially covering the risk, and that fee would be revenue which would offset the expenditure charge associated with the risk of the obligation. In this particular proposal, the Administration would suggest that there be an extra charge not only to cover Treasury expenses, but to provide an extra cushion as well as an incentive to Mexico to move quickly back into the market on an unguaranteed basis. In that sense the proposal would be budget neutral.

CHAIRMAN GREENSPAN.

SPEAKER(?).

MR. TRUMAN.

CHAIRMAN GREENSPAN.

SPEAKER(?).

CHAIRMAN GREENSPAN.

MR. TRUMAN.

CHAIRMAN GREENSPAN.

I don't think we are going to know that until pretty far on. Are there any questions with respect to the presentations of either Ted or myself, or does anyone want to throw anything new into the pot that has not been discussed?

MR. BLINDER. I have two small technical questions. The first relates to hearings. Which committees have jurisdiction?

MR. TRUMAN. It is not yet decided which committees would have jurisdiction. I have been informed on the one hand that this is a matter for the parliamentarians to decide, and on the other hand a matter for the leadership to decide. The most likely committees at this point would be the foreign affairs committees of the two bodies. That is what I was just told.

MR. BLINDER. Helms in the Senate and McConnell in the House?

MR. TRUMAN. No, it's Gilman in the House.

MR. BLINDER. The other question has to do with budget scoring. You said the proposal was that the fee the Mexicans would pay should exceed what I'll call the actuarial cost or something like that.

MR. TRUMAN. The risk.

MR. BLINDER. And then you said it should be budget neutral. It sounds like it should be a budget gainer.

MR. TRUMAN. That's why I said "approximately" budget neutral! I was also leaving aside recognizing that this is just a matter of scoring as opposed to--

MR. BLINDER. Scoring--I'm only talking about scoring.

MR. TRUMAN. Yes.

MR. BLINDER. It's either going to be a gainer or a loser depending upon what happens.

CHAIRMAN GREENSPAN. The scoring is neutral because there is a calculated loss that will be occurring as a consequence of the guarantees and that loss is offset by a comparable fee coming from the Mexicans.

MR. BLINDER. Right.

MR. TRUMAN. But there is going to be a supplemental fee that would be higher than what the normal charge would be, and that would be a gainer.

CHAIRMAN GREENSPAN. So that the federal budget deficit will decline!

MR. BLINDER. It's a major selling point!

CHAIRMAN GREENSPAN. Right!

MR. LINDSEY. Could I ask Peter Fisher a question? There has been a lot of talk that the dollar is going to be weak for a number of reasons. In the case of a leveraged takeover, which is how some people view this, should you short the acquirer, which is us? In addition, this is kind of un-Bundesbank-like of us isn't it?

MR. FISHER. The dollar's big decline against the mark last week really occurred independently of Mexico, but I think the last few days have to be viewed slightly differently. The first stepdown several days ago was really the result of large speculative positions in dollar/mark that speculators had put on at the end of the year in the hope those positions would be profitable with a rise in the dollar/mark to around 1.58 to 1.60, and that did not happen. The speculative holdings were sold off rather abruptly as the mark strengthened within Europe after the pressures emerged in Italy and Spain. The dollar has weakened in the last few days. In this case I think the reason is still a rush of money from emerging markets and peripheral European countries into the mark and the yen. The dollar has benefited relatively less than have the mark and the yen. So there has been a slight effect in the last few days, but the initial weakness was not related to developments in the emerging markets. I would say also that underpinning this whole 10- to 15-day period has been a much greater nervousness in the foreign exchange market, given the large speculative positions that were based on expectations that the dollar would go higher because of the prospect that the Committee would tighten at the end of this month. That is, the foreign exchange market has been somewhat more anxious than our domestic debt markets that the Fed might not be tightening by 75 or by 50 basis points at the end of the month. I really do think that has been the dominant effect. There has been a lot of talk in the last few days concerning the impact on the exchange market of the announcements about the loan guarantees, but frankly that has been so positive for the Mexican market in the last two days that I don't see a direct play-through of the loan guarantees into the dollar market yet.

CHAIRMAN GREENSPAN. Any other questions or comments?

MR. FORRESTAL. Alan, this is Bob Forrestal. Perhaps you don't even want to think about this, but what happens if the Congress doesn't buy this program?

CHAIRMAN GREENSPAN. I was about to get to that next because it is a separate subject that I think we have to focus on. So let's hold that for just a second, Bob.

MR. FORRESTAL. Okay.

MR. MELZER. Alan, in that context will you be talking about the prospects for additional drawings on the swap line and how they might be secured?

CHAIRMAN GREENSPAN. Yes, exactly, that's precisely the next topic.

MR. MCDONOUGH. Mr. Chairman, this is Bill McDonough. Let me add for the Committee's benefit that the other Latin American countries are very anxious that this effort be successful. We had the finance minister of in New York for three days this last week, and he is convinced as is the that they are being very badly contaminated by the spillover from Mexico. They are very anxious that this U.S. government effort to help Mexico be successful. There had been some question as to whether some of the other countries might feel that separating out Mexico and making it special could be adverse to them. That certainly is not the view of the two most obviously vulnerable countries in the hemisphere.

CHAIRMAN GREENSPAN. Let me just say that the most likely scenario at this stage--I don't know what the probability is, but I suspect it's a shade better than 50/50--is that we will have testimony, the bill will go to the floors of both houses, there will be a considerable amount of posturing, and it will pass. At that point the issue of our swaps and everything else obviously will become moot. In the event that this legislation crumbles and there is a high minority probability that it might, then the situation will get extremely unstable. I think we would be unwise to make any more swap extensions in that type of environment, because it truly would be money down the drain. The crucial question we are going to have, which is going to be a very tough one, is that if this legislation is progressing and appears to have a reasonable possibility of passage but the markets get a little nervous and funds are flowing out of the Bank of Mexico, it probably is going to be desirable and necessary for us to allow the Mexicans to make some additional drawings on the swap line. I think the Congress would be thoroughly supportive of such drawings at that particular stage, but if the situation arises I don't think that we are going to have much time to discuss it. So, I would merely like to say that I would intend, unless I hear very strong objections, to authorize some modest additional drawings in conjunction with the Treasury in the event that there appears to be some need to do this prior to final passage of legislation. I suspect that the probability of this happening is low because either we are going to learn very quickly that this legislation is going to pass, in which case further drawings will be unnecessary, or it is going to go south pretty quickly in which case further drawings will be inappropriate. The only scenario involving further drawings is a wiggle scenario where the probability of legislation goes up and down and we can't quite trace it. That is what I would like to do unless somebody offers some objections.

MS. PHILLIPS. How will you know how far to extend the swap line?

CHAIRMAN GREENSPAN. We are not going to increase the swap line itself; at the moment we have allowed a $500 million drawing on our $4-1/2 billion swap line. The Treasury also has extended $500 million on its $4-1/2 billion swap line with Mexico. What I am raising is the issue of whether to allow some additional amount to be drawn as may be required on the existing line, not to increase the line.

SPEAKER(?). What additional amount of drawings are you thinking about? Is it at most on the order of what we have already committed?

CHAIRMAN GREENSPAN. I really don't know that. If there is anything very special going on and we have time to discuss it, I think it would be wise for us to have a telephone conference where I would outline what is going on. But I would guess that the amount we have authorized so far is probably what would be involved--maybe a shade more, maybe a shade less.

MR. MELZER. Alan, how is the first $500 million secured and would you anticipate similar security on any additional drawings?

CHAIRMAN GREENSPAN. Yes. Has the legal documentation on the $500 million been written up at this stage?

MR. TRUMAN. I'm not going to say what I was going to say--the security aside from the pesos we get--because I'll get laughed at. The security is in terms of oil receivables, a stream of oil receivables. The staff, in conjunction with the Treasury, the Canadians, and the Mexicans has reached agreement on the framework to put that security mechanism in place. It is anticipated that it will be fully in place by early next week. So, although the drawings are not technically secured by oil receivables at this point, the staff is making rapid progress in that direction, and there is a commitment to put that in place. Actually, the commitment is only to put it in place by the end of February, but it probably will be completed shortly after the middle of January.

MR. MELZER. I was going to suggest that maybe it would be appropriate before any more is drawn to get that in place, but it doesn't appear that that would necessarily be feasible.

MR. TRUMAN. Monday is a holiday, so they can't draw between now and Tuesday. The target would be to get it in place essentially by the time of or within a day of any further drawings.

MR. MCDONOUGH. We are looking at probably Tuesday or Wednesday to get the documentation.

MR. MELZER. I guess I'd be inclined to try to insist on that if possible.

MR. HOENIG. I thought there was some collateral, for part of the drawings at least, at the New York Bank; is that not correct?

MR. TRUMAN. No. I don't know where they put the proceeds of the drawings that were made, but they were not required to put the proceeds at the Federal Reserve Bank of New York.

CHAIRMAN GREENSPAN. There is an agreement to pledge oil receivables, and the lawyers are working on the documents to lock that in. At the moment, our security is the word of the Mexican government that they will back them with oil revenues, and that legal documentation should be locked up reasonably soon.

MS. MINEHAN. Are we talking about the $500 million or essentially the whole $4-1/2 billion?

CHAIRMAN GREENSPAN. No, certainly not the whole $4-1/2 billion.

MS. MINEHAN. Okay.

MR. TRUMAN. The security mechanism would apply to whatever is drawn.

MR. KELLEY. Open ended.

MR. TRUMAN. But so far the mechanism is not in place in a formal sense, as the Chairman said; only the promise is in place.

CHAIRMAN GREENSPAN. Are there any further questions or issues involved here? In any event we probably will want another telephone conference to update everybody prior to the January 31 meeting. Everything is moving fast. Hopefully, the press is not going to get everything that's going on, so I'll try to schedule an updating.

MR. TRUMAN. There is a lot in the press, but don't believe all of it--I think that is probably the right way to put it.

CHAIRMAN GREENSPAN. That's correct, because I already have had converstions relating to what allegedly occurred in the meeting with the senators this morning. As I said to somebody, I was there, I was listening, and what was reported didn't happen. That is going to occur quite often in the next several weeks.

MR. BLINDER. Apropos of that, what has been officially announced and by whom?

CHAIRMAN GREENSPAN. The only thing that has been officially announced is the statement by the President and the leadership of the Congress with respect to the commitment.

MR. BLINDER. Last night?

CHAIRMAN GREENSPAN. Yes, last night.

MR. BLINDER. Nothing has been announced today?

MR. TRUMAN. Right. I should add that the $40 billion number--which the Administration now has put forward as their preferred number and I expect to see it on the screen if it isn't there already--is a matter that is being negotiated with the Congress. Even that number has not been announced in any official sense.

CHAIRMAN GREENSPAN. I have been justifying that number on the grounds that the larger the nominal guaranteed total, the safer the American taxpayer will be against any potential loss.

Okay. Let's leave it at this, and we will be back in touch in a week or so. Good night.

MS. MINEHAN. Good night; have a nice weekend.

CHAIRMAN GREENSPAN. Thank you and the same to everybody.

END OF SESSION