

**FEDERAL OPEN MARKET COMMITTEE  
CONFERENCE CALL  
June 5, 1980**

**PRESENT:** Mr. Volcker, Chairman  
Mr. Gramley  
Mr. Morris  
Mr. Partee  
Mr. Rice  
Mr. Roos  
Mr. Schultz  
Mr. Solomon  
Ms. Teeters  
Mr. Wallich  
Mr. Winn

Messrs. Balles and Baughman, Alternate Members of the Federal Open  
Market Committee

Mr. Bernard, Assistant Secretary  
Mr. Petersen, General Counsel  
Mr. Oltman, Deputy General Counsel  
Mr. Axilrod, Economist

Messrs. Balbach, J. Davis, T. Davis, Eisenmenger, Ettin, Henry, Keir, Kichline,  
Truman, and Zeisel, 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. Prell, Associate Director, Division of Research and Statistics,  
Board of Governors

Mrs. Steele, Economist, Open Market Secretariat, Board of Governors

Messrs. Doyle, Gainor, Monhollon, and Smoot, First Vice Presidents, Federal  
Reserve Banks of Chicago, Minneapolis, Richmond, and Philadelphia  
respectively

Messrs. Corrigan, Fousek, Kantnor, Keran, Parthemos, and T. Davis, Senior Vice Presidents, Federal Reserve Banks of New York, New York, Atlanta, San Francisco, Richmond, and Kansas City respectively

Mr. Meek, Monetary Adviser, Federal Reserve Bank of New York

Messrs. Broaddus, Cacy, Cox, Mullineaux, and Ms. Nichols, Vice Presidents, Federal Reserve Banks of Richmond, Kansas City, Atlanta, Philadelphia, and Chicago respectively

Mr. Miller, Assistant Vice President, Federal Reserve Bank of Minneapolis

Transcript of Federal Open Market Committee Conference Call of  
June 5, 1980

CHAIRMAN VOLCKER. We don't seem to have all the Banks on the line but why don't we proceed. I think we can have a rather brief meeting. I wanted to touch base before I go off to China and also we certainly are running into our checkpoint constraint [for the federal funds rate] if not the other constraint. Perhaps Mr. Axilrod can just fill you in on the situation.

MR. AXILROD. Well, Mr. Chairman, the latest deposit numbers we have that we'll be publishing tomorrow--and of course these can revise even in the next 24 hours--indicate a drop in M1 for the week of May 28th. Whereas on the basis of preliminary numbers we had been expecting an increase of \$1.2 billion, the drop in M1 in the week of the 28th could be on the order of \$600 million. And the early data we have for June suggest that M1 is at a lower level than we had been expecting when we built the path. Thus we have a situation where at the moment our best estimate for M-1A growth in May is around 3 percent and for M-1B growth it's closer to 1 percent. M2 is still holding up rather strongly because of the great strength in money market funds and we have its growth in May at 8-1/2 percent. Our estimates for June are all for more rapid growth rates based on our continued expectations of a rebound. But the two months together would be at a slower growth rate than the minimum growth that the Committee was contemplating at the last Committee meeting.

That means in effect, without going into the details of the path, that in the current week and in the next week--taking those weeks as the remaining part of an initial four-week period--borrowing would probably drop to zero. While it should need to be around zero, that is virtually unattainable because someone is bound to borrow from us. And in adhering to the original nonborrowed path, excess reserves would probably move up above the \$250 million minimum to between \$250 and \$275 million. So under those conditions we would be confronted probably with a drop in the funds rate from recent trading levels. The only other point I might add, Mr. Chairman, is that the rough estimates we have for May for bank credit show continued substantial weakness in that measure, with probably a further negative in total loans and investments. So in those categories, total loans and business loans, the outstanding amounts also would be dropping.

CHAIRMAN VOLCKER. Well, I think we have a general picture [of weakness]. Contrary to the weekly estimates we seem to get early every week continued weakness in the M1 categories and in bank credit. M2 and M3 look more like they're returning to target but largely because of money market funds rather than any really rapid growth in either deposits at the thrift institutions or the time deposits of banks. Although they should be improving they have not improved dramatically in the latest figures we have, despite the [market] rate declines. Everything that Steve says points to a drop in the federal funds rate, but in fact the federal funds rate so far has been more or less comfortably, in terms of our checkpoint, above the 9-1/2 percent level. But it surely looks as if it will go through that. I don't know whether at this stage our account managers in New York have anything to say.

MR. STERNLIGHT. I didn't hear your question, Mr. Chairman.

CHAIRMAN VOLCKER. What do you have to say?

MR. STERNLIGHT. Well, I agree with Steve that on the path he outlined we are likely to be encountering that lower bound of the funds rate. I think it has been somewhat fortuitous that in the latest week the average rate moved up to about 10-3/4 percent from the 9-1/2 percent of the previous week. In meeting this week's reserve need I think we are likely to find that 9-1/2 percent checkpoint constraining. And it could inhibit our meeting the Committee's reserve path.

CHAIRMAN VOLCKER. What does our foreign manager have to say? Our foreign manager isn't there?

MR. PARDEE. I'm here. There was some pressure on the dollar just after the last FOMC meeting and we did have to intervene, and in bigger amounts than we had before. But the market has quieted down since then, given some good coordination between us and the Bundesbank in our intervention. And the firming of the domestic rates and Euromarket rates particularly helped. The market is currently quiet but very, very uneasy. I think we've been lucky that there's a lot of selling of U.S. dollars out there but money is going into the Swiss [franc], the Japanese yen, and the pound sterling rather than into the mark. So people have not been interpreting it as a general weakness for the dollar. However, we do have an ominous rise in the gold price--it touched \$600 this afternoon in the [Comex] and the silver market prices are still creeping up. Whether or not we're getting more speculative influence creeping in the markets, I don't know.

MS. TEETERS. What is the reason, do you think, that the gold price is going up?

MR. PARDEE. I haven't found a satisfactory answer from anybody. It broke out of a trading range. People are worried about the oil price that will come out of the OPEC meeting. There are a number of things in the Middle East that are bothering people as well as these general fears of inflation that still haven't been killed completely.

CHAIRMAN VOLCKER. When is the OPEC meeting?

MR. TRUMAN. Monday.

MR. PARDEE. It's supposed to be next week. I don't know if the date--

CHAIRMAN VOLCKER. Monday, Mr. Truman says. Well, I suspect we are in a difficult area in the exchange markets, [with a] psychological reflection of the same factors in the gold market and elsewhere. Ordinarily I would think that we wouldn't necessarily need this consultation today, but I'm not going to be here [for a period of time] and all the present indications point in the direction of slippage, at least in the M1 targets, from where we were. Bank credit is weak, as Steve said, and all the paths certainly look like they will threaten and conflict with a 9-1/2 percent funds rate, our checkpoint. This doesn't take any vote, but I would suggest that we take this as that checkpoint and pass [through] it if the market develops that way.

I would not propose at this stage that we anticipate the need for dealing with the 8-1/2 percent [lower bound on the funds rate range]. We've been a fair amount away from that. I would visualize that that could well become a constraint before too long and it will have to be dealt with one way or another when it does. But I see no reason to prejudge that this afternoon. I would let it happen and my guess would be, unless we get a radical change here, that it's going to happen before very long. But we can bump up against it for a few days anyway. I don't interpret these constraints as saying we have to avoid the rate falling below [the lower limit] on a particular day. The general understanding has been a weekly average kind of [constraint] and it has to be judged in part ex post rather than considering the limits as an absolute constraint on day-to-day operations. So that would be my proposal. If anybody would like to comment, I think it is timely to do so at the moment.

MR. BALLEES. I would certainly concur, Mr. Chairman.

MR. MORRIS. I would, too.

MR. WINN. I join the group.

MR. ROOS. Yes.

MR. MONHOLLAN. Yes.

MR. DOYLE. Yes.

VICE CHAIRMAN SOLOMON. Yes.

MR. GAINOR. Yes.

MR. BAUGHMAN. Yes.

MR. SMOOT. Philadelphia agrees.

CHAIRMAN VOLCKER. Has everybody outside of Washington been heard from? I have a silent, surly looking group in Washington. Strike that adjective. It's not true. Governor Wallich.

MR. WALLICH. I would like to postpone the time when we drop below our checkpoints as long as possible. I know that Milton Friedman is tremendously excited about our failing to hit our targets, but I just can't follow him.

CHAIRMAN VOLCKER. What does postponing as long as possible mean practically? We really haven't hit it yet, Henry. You're saying do what we would normally do except that if we run into the 9-1/2 percent, let it stick there for a few days anyway?

MR. WALLICH. Yes.

MR. PARTEE. I don't agree with that. I think we ought to let [the rate] fall. I didn't care much for the checkpoint in the first place, as you know. In fact I didn't care for the 8-1/2 percent lower limit either. So it's obvious that I feel we ought to continue to operate in a way to find a market level at which some borrowing occurs again and at which there is some expansion in the narrow

monetary aggregates. I'm not at all certain that we've seen anything like the total configuration of the decline in business that's in process. I haven't heard anything as yet of any stopping of the decline, of any comeback in consumer spending, or of anything other than further cutbacks in production. Tomorrow morning we get an unemployment figure and employment figures in the BLS series. It will be very interesting to see what they show. But I wouldn't expect improvement in either employment or in the unemployment rate compared with last month's number. So I think we still ought to try to find that level, which means going right through 9-1/2 percent if providing the reserves would take us through 9-1/2 percent. I agree with Paul very much that there's no need to make any decision on the 8-1/2 percent at this point. We'll have to wait and see whether it's tested or not.

CHAIRMAN VOLCKER. While I think of it, if anybody out there at the other end of the telephone has any particular insight they want to offer as to what's going on in the economy generally or whether you see any revival of home building or anything of that sort, you may as well take this opportunity to report it. I don't want to interrupt what comments the Board members may want to make on this particular proposal at the moment, so let me ask who else wants to comment here?

MS. TEETERS. I basically only have a question for Steve. Is commercial paper [issuance] still rising? Are the corporations turning to that market?

MR. AXILROD. I don't have up-to-date figures with me, but it has been rising. And of course corporate bond issues have been extremely strong. So it [accounts for] a large part, but I don't think all, of the weakness in the business loan component of bank credit.

VICE CHAIRMAN SOLOMON. I'm informed that it has gone up \$3 billion since the 2nd of April.

MR. AXILROD. Well, a large part, but not all of the weakness in business loans probably represents refunding of short-term debt into long-term debt and also continued use of the paper market where the rates are considerably lower than the prime rate. But I would say an additional part of it represents the underlying weakness in the economy, the weakness in credit demands. And that's particularly evident in the real estate area and probably the consumer area as well as the business area.

CHAIRMAN VOLCKER. What happened to this loan demand that was supposed to result from a decline in consumer spending leading to a build-up in inventories which would lead to a temporary increase in borrowing? In other words, what is happening to inventories? Mr. Axilrod is looking at Mr. Kichline.

MR. AXILROD. Desperately!

MR. KICHLINE. Inventories seem to be rising, on the basis of the manufacturing data we have for April. I would only say that it's very difficult to track [inventory] developments in one month with business borrowing at banks in a given month. We do know that business borrowing in the first quarter substantially exceeded

external financing demands, so presumably some of the financing of the corporate sector is being done internally with [the proceeds from] the heavy borrowing they had undertaken in the first quarter.

CHAIRMAN VOLCKER. They're living off their fat in part, but you said you think inventories are going up. Can you quantify the order of [magnitude] of the rise compared to what we were getting? Is it very much faster or about the same rate of speed?

MR. KICHLINE. It's a bit faster [than earlier] in book value terms. The latest data we have is just for manufacturing in the month of April. And manufacturers' book value inventories rose at about a \$49 billion annual rate compared to a \$40 to \$41 billion average in the first quarter. I might note that production dropped substantially in the month of April. And the limited but significant information we now have available for the month of May suggests at least as large a decline, if not larger, in industrial output in that month.

CHAIRMAN VOLCKER. I am concluding, rightly or wrongly from what you say--concluding is too strong a word--that there may be some inventory buildup but it's not very great because production is declining very rapidly.

MR. KICHLINE. That's correct. We have a faster pace of accumulation in our forecast but not a substantial pace and we would not expect--given all the other borrowing, the first quarter performance, etcetera--to see from the inventory side a substantial increase in demand for business loans at banks.

CHAIRMAN VOLCKER. Well, let's return to the specific subject. What other comments do we have? Any other comments on the Washington end?

MR. GRAMLEY. Mr. Chairman, I would associate myself with Henry Wallich. I think we are looking at a very steeply declining economy. I don't think, however, that a further drop in interest rates is likely to be very helpful in turning the economy around. I think what we need is mainly a consolidation of declines in interest rates on things like mortgages and the prime rate to catch up with what has already happened to short-term market interest rates. And I would prefer not to be overly impressed with this drop in M1. I remember that Steve in his presentation at the FOMC meeting indicated that some of that drop might well be a consequence of another downward shift in the money demand function. So I would rather hang on to the 9-1/2 percent consultation level for as long as we can.

CHAIRMAN VOLCKER. Let's get a little more precise about where the aggregates are. I'm not talking so much about M1, which I know is way below the target, but it is correct that M2 and M3 have come up into the target range in our present June estimates?

MR. AXILROD. Yes. I don't have the precise number, but with the June estimates for M2 the December-to-June growth rate would be above 6-3/4 percent, probably on the order of 7 percent.

CHAIRMAN VOLCKER. That's almost in the middle of the range, or a little below the middle of the range.

MR. AXILROD. It's coming up into the target [range]. On M3 we would have a December-to-June growth rate, if our projections are right, on the order of probably between 7 and 7-1/2 percent.

CHAIRMAN VOLCKER. The M3 growth is less than M2? No, I'm sorry, it's [a little] higher. Now, both of those figures allow for quite a big increase in June as I recall.

MR. AXILROD. Yes, though not so much for M3. Well, it is 9.3 percent against our current estimate for May of 8.7 percent.

CHAIRMAN VOLCKER. And M2 was over 10 percent?

MR. AXILROD. For M2 we had an 11-1/2 percent estimate for June, tracking the very high estimates for M-1A and M-1B also.

CHAIRMAN VOLCKER. What other comment do we have here?

MS. TEETERS. Mr. Chairman, I would think that whether we go through the 9-1/2 percent depends on what happens over the next two weeks. If we continue to get very low rates of growth and we don't realize these June money targets, then it seems to me we should slide through the 9-1/2 percent and down to the 8-1/2 percent. On the other hand, these numbers have been so unbelievably volatile between the first estimate and the second estimate that I think this is one of those cases where we need to feel our way along. If the numbers continue to come in weak, then we go through the 9-1/2; if the levels projected for June begin to be realized, then we more or less keep [the funds rate] in the 9-1/2 percent area.

CHAIRMAN VOLCKER. Are you basically joining Henry and Lyle?

MS. TEETERS. Well, I think I'm halfway in between. Depending on how things develop, we go through the 9-1/2 percent. And if it looks as if the economy is turning down as rapidly as we think it is, we'll reach [the 8-1/2 percent lower limit].

CHAIRMAN VOLCKER. In any case, we're not saying in our initial comments that we aim below 9-1/2 percent; we're just assuming that the path will bring us there.

MR. AXILROD. Mr. Chairman, I think both Mr. Sternlight and I have the feeling that if an effort is made to provide the reserves to hit this literal nonborrowed reserve number, the funds rate will drop rather soon.

CHAIRMAN VOLCKER. Yes, I think we want to be clear on that point though. We're just dealing with a contingency here which Mr. Axilrod and Mr. Sternlight think is a highly probable contingency. But nobody is arguing--at least the question was not posed this way--that we deliberately aim below 9-1/2 percent. It was just a matter of a fallout from the other operating procedures. The opposing view is that if that contingency arises, the checkpoint is held for a few days or longer. Governor Rice.

MR. RICE. Well, my views were well expressed by Governor Partee. I don't believe that we should become excessively alarmed if the funds rate, in the normal course of events, falls below the 9-1/2



percent level. But I also agree with others that we don't need to decide anything today.

CHAIRMAN VOLCKER. Did you say something, Governor Schultz?

MR. SCHULTZ. No, and I don't have anything special to say. I think we're talking about contingencies and we'll move down through 9-1/2 percent if we have to. If things are very weak and we begin to bump against the 8-1/2 percent, we'll look at it on a weekly basis. But we will not push it down; we'll just respond and do what we have to do.

CHAIRMAN VOLCKER. I'm just wondering where this leaves us. We do have some voices of caution and I'm wondering how best to incorporate perhaps a little more caution than was implied in what I may have stated initially.

VICE CHAIRMAN SOLOMON. The market has seen the Desk enter earlier at 8-3/4 percent. It has seen the Desk enter at 9 percent. I think there's a general impression in the market that that's the area of our floor but it's an impression of a fairly wide range in terms of the floor. It seems to me, even though I've been rather strong in my arguments against precipitous declines, that it's perfectly comfortable to let the floor stay in an area that would be somewhere in the present range. I think the 9-1/2 percent would be interpreted --if the market were to see us entering at that rate in a consistent way--as being somewhat higher actually than it believes [the floor] to be. So I don't have that much difficulty living with your earlier proposal that if necessary we come down to the 8-1/2 percent level. But if there is more support for a more cautious approach among other members of the Committee than there has been in the past, then we might suggest to the Desk that it continue basically operating in this range around 9 percent.

CHAIRMAN VOLCKER. Well, I think the substance of this problem--

MR. ROOS. I feel strongly that our greatest danger currently would lie in draining reserves at a time when the aggregates are already on the weak side. If anything were done to drain reserves further, I think we would merely be accentuating the recessionary influences that exist. I thought we agreed a few minutes ago--and I thought we agreed in our last call--that we were going to set 8-1/2 percent as the bottom limit. To equivocate and not to let the fed funds rate fall through the 9-1/2 or 9 percent level, if it would normally do that, I think merely creates additional problems for us. Fundamentally, if we're going to be hanged, I think we're going to be hanged for letting the aggregates weaken as a result of our efforts to drain reserves when we started seeing interest rates and the federal funds rate dropping. I think that's the fundamental issue. And I feel very strongly that we should stay with our 8-1/2 percent floor until rates get there.

VICE CHAIRMAN SOLOMON. Larry, are you aware of the fact that we are hitting our reserve path?

MR. ROOS. I'm not really clear on the reserve path. I don't have the--

VICE CHAIRMAN SOLOMON. We have been hitting our reserve path. But the economy is somewhat weaker and the monetary aggregates are not performing in relation to that reserve path as we had assumed [they would] at the last Open Market Committee meeting.

MR. ROOS. Well, maybe the reserve path is the wrong reserve path. From all I hear the aggregates are undershooting our targets. The problem is even a little perverse as we see it now. And if we end up not achieving our objectives in terms of the aggregates, I think a very good case can be made that the Federal Reserve has exacerbated the present recession, as it has many times in the past, by trying to inhibit the normal movement of the fed funds rate.

MR. MONHOLLAN. We would like to echo the sentiments of Mr. Roos.

CHAIRMAN VOLCKER. I think the substantive problem we have here is that nobody much cares about what happens to interest rates if that didn't affect some other things--like the exchange markets or inflationary sentiment--and cast doubts about our intentions and all the rest. If I were sitting here alone--it's a little more difficult when you're in a committee--I would say this: We've got an 8-1/2 percent floor and if we begin approaching that in the midst of great concern in the exchange market and the declining dollar, I'd be a little more cautious under those conditions than if we approached it without that. Now, I don't know how to translate that [into precise operating instructions]. We don't have to write a directive here, but I'm perfectly willing to be left with a basic decision that 9-1/2 percent is not the floor we have in the sense of a floor. We do have an 8-1/2 percent floor in the interpretation that we gave earlier. There is a certain cautious note that a number of people have struck which should be reinforced tactically depending upon what was going on [elsewhere], let's say in the exchange market. In other words, if we can get by with it, I'd go right to 8-1/2 percent--we're talking purely about contingencies here--if that's where the path brought us. I might be a little more cautious in precisely when I time my operations if it were a bad day in the exchange markets or whatever.

VICE CHAIRMAN SOLOMON. I think that's a fair statement.

CHAIRMAN VOLCKER. Maybe we can leave it that way.

VICE CHAIRMAN SOLOMON. I think it's a good idea.

CHAIRMAN VOLCKER. If there's some kind of understanding, which leaves some discretion with the Manager, I think that's broadly consistent with what I said initially. His day-to-day tactics may be affected. We give him some room for [judgment in] day-to-day tactics if disturbances are arising or imminent elsewhere that [our operations] could perhaps calm down. And that could benefit us in the long run, given that there is some concern on the Committee about [the decline in rates] being too precipitous--in going below 9-1/2 percent anyway.

MR. MORRIS. Paul, were you thinking of just a general slippage as a constraint or are you thinking of a really disorderly massive move in the markets?

CHAIRMAN VOLCKER. No, I'm not thinking of massive disorder. If we really had massive disorder, we would have to reconsider this. I'm thinking of a pronounced movement that seems to be requiring a lot of intervention--that we have an atmosphere in the market that seems to be cumulating or threatens to cumulate. On the other hand, if the dollar is strong, who cares if the rate goes to 8-1/2 percent? I'm just talking about this as a day-to-day tactical [consideration] but not a floor--specifically removing the floor at 9-1/2 percent to the extent that there is a floor there now. But if we had a day, as sometimes happens early in the week--if it happened on a Wednesday it wouldn't be bothersome--when the federal funds rate seemed to be settling at 8-1/2 percent or below, and as I said earlier we're talking about weekly averages, I think maybe I'd step in on that day if the exchange market happened to be weak on that same day. I would do that so as not to give rise to an impression in the market that the federal funds rate could go to a wholly new level on that particular day. That requires a little fine-tuning if the exchange markets are in fact under pressure. If they are not under pressure, it doesn't require any. I see some nodding of heads in Washington and I think this is broadly consistent, but somewhat more cautious in at least one contingency, than the flat proposal I made earlier. If that is satisfactory, I think we can stop for today. We may need another consultation in a week or so depending upon how this develops. We may even need a decision. We won't need a decision unless we're at 8-1/2 percent, but if we are that question will arise.

VICE CHAIRMAN SOLOMON. We here in New York feel that that kind of strategy makes a lot of sense. If you have nodding heads on the Washington side, I think we ought to go with that.

CHAIRMAN VOLCKER. Well, if I don't hear widespread objection we will leave it at that. We have consulted.

Before you get away, does anybody have anything useful to say on the business scene or on anything they're picking up in their Districts? I'm not interested in doing a mechanical go-around, but if anybody has some insight that they would like to offer, please do so.

MR. WINN. Paul, the steel industry is very much in a state of panic. They are really hitting an air pocket in their business.

MR. BAUGHMAN. I don't know how useful the observations from down here are, but I do hear reports that houses are moving again and I think the references are primarily about used houses. Our department store sales figures are showing increases over a year ago, after running several weeks with no change from a year ago. We have questioned the banks on loan demands, and they continue very weak.

SPEAKER(?). Texas is not useful!

MR. BALLEES. On the West Coast the housing industry is still very much in the doldrums. Some possible revival remains a hope and an expectation rather than a fact because mortgage rates haven't come down enough yet to really do the job.

CHAIRMAN VOLCKER. Where would you say mortgage rates are now in California?

MR. BALLE. Probably at the 12 percent level, or 12-1/4.

CHAIRMAN VOLCKER. Nobody wants to borrow at 12 percent?

MR. BALLE. Not very much.

MR. WINN. Not when your neighbors are out of work, Paul.

CHAIRMAN VOLCKER. That's in Ohio, not in California, Willis!  
Anything else?

SPEAKER(?). The discount rate is still pretty badly out of line with the federal funds rate. Our Bank for one has sent in a recommendation on that today and it's for moving down another point. I think we're going to have to come to grips with that problem.

CHAIRMAN VOLCKER. Well, that will be a continuing problem, I suspect. If we do a point [change], it will still be out of line, so we've got lots of room. If there are no other comments, I thank you.

SPEAKER(?). Have a good trip, Paul.

CHAIRMAN VOLCKER. Thank you.

END OF SESSION