Transcript of Federal Open Market Committee Conference Call of July 25, 1980

CHAIRMAN VOLCKER. I conclude from all of this, gentlemen, that whatever people say about our monetary policy, our technology is worse! We will see what we can do to improve it. [Secretary's note: The Chairman was referring to problems with the telephone communications equipment.]

The general question that I wanted to review with you is the reaction to this targeting [or] nontargeting that we went through for 1981. I think it's apparent after going through several days of hearings, not only with the Banking Committee but with other committees, that we have contributed to a lot of confusion about what our intention was in not presenting targets [for 1981]. Of course, the testimony and the statement and the report were couched in terms of working toward some reduction in the targets. But I am afraid in the [interpretation] that came through that was not at all clear because otherwise we would have said something about the targets. So they doubt our conviction as well as our good will in following what they conceive to be the law. This leaves me troubled somewhat--not in [regard to the] substance--but that our trust and good faith have been questioned by a large number of people. And I think it could lead to some continuing problems. It will certainly lead to a very adverse Committee report, but that in itself was anticipated. What disturbs me is this underlying sense of a lack of trust in our good faith.

I have a specific request from Mr. Proxmire, which I am now fulfilling, to review this situation with the Committee. [The Banking Committee] challenges us on legal grounds, I think, as well as on substantive grounds. I think the legal position is perhaps a little fuzzier than we thought it was at the time [of our decision]. What they point out is that there is a Senate committee report that has fairly specific language. It's just a Senate committee report, but nonetheless it's there, and it speaks of "numerical" monetary targets for a fixed calendar year. Of course, by coincidence that was precisely the language that I used in the testimony--that we didn't choose to give them precise numerical targets. So they found some language that spoke precisely in terms of numerical targets. That committee report isn't absolutely conclusive but it surely had some coloration to the effect that we would have precise numerical targets for both years. So I think our legal ground is still valid, but it's not quite so one-sided as the presumption that we had at the time we were discussing it at the Committee meeting. But more fundamental than the legal question, which our legal counsel is still sure he could win, is that the issue is just a little more clouded, as I understand it. I'm not sure there's any merit at all in getting into a legal argument. In the end they can change the law, obviously, if they want it clearer. There was no support for our position by anybody, and there was bipartisan concern up and down the line in the Banking Committee. And, as I say, [the issue] was mentioned in some other committees.

This leaves me personally with the feeling that we probably ought to go ahead and give them some quantitative idea as to what we are talking about. The substantive problem is that, with all of the institutional changes, [numerical targets] are likely to confuse them. I told them that 19 times, to no avail. I am in the process of preparing a letter that will go to both committees, if we want to go this way. It starts out by saying: "It's apparent to me from the questions and discussions in the recent monetary policy oversight hearings that confusion has unfortunately arisen over the intent of the Federal Open Market Committee in characterizing monetary target ranges for 1981 in general terms. I was, for instance, disturbed that some members of the committee apparently seriously considered that the Open Market Committee was somehow signalling a reluctance to provide numerical targets for 1981 at any time--a thought that I can confidently say has never entered our discussions." The letter then explains why we chose to do what we did. But it goes on to say that it's going to be terribly confusing if we try to give all these targets. But the key sentence would say, if I can find it: "Abstracting from institutional influences and the questions cited above"--and all those questions are about the fact that we don't know what the impact of NOW accounts is-- "we find it difficult to gauge the continued significance of the money market fund growth and we need to learn more about this apparent shift in M1 demand." So abstracting from all of those things, "the general intent of the FOMC at this time can be summarized as looking toward a reduction in the ranges for M-1A, M-1B and M2 on the order of 1/2 percent next year." The letter would go on to say that if we translate that into specific targets, we have to allow for all of these shifts. And then it gives them some numbers, but it says don't take these numbers seriously--they're all illustrative and we will have to look at them again. All we are trying to say is precisely what we already said and I repeat the language that we have already used in the report and in the testimony. That's what should come through and not all of this arithmetic, and we hope the arithmetic doesn't confuse you. We fear that it might, but since you insist upon asking for [numerical targets] we are giving them to you.

That is the way I would propose going. I could send out a draft of this letter to you this afternoon. We don't have to take any formal action right now, but I wanted to relay this concern, the formal request of Senator Proxmire, and my sense of how it should be handled. I basically don't think we have much to win in this game by sitting on our present position, because I think genuine confusion has arisen among some of those who are most supportive of our general policies and approaches. It's unanimous in that sense. So that is [my recommendation] in substance. Now, I had tentatively put in this letter a sentence that speaks of a reduction "on the order of 1/2 percent" [on the ranges] for M1 and M2. But also there is a sentence saying consistent with that, at this very early stage we think there probably shouldn't be any reduction next year in [the ranges for] M3 or bank credit, because in a recovery period those measures tend to be a little higher relative to M1 and M2 than in another kind of period. So the letter just speaks vaguely of [those ranges] being unchanged. I don't think that's necessarily essential, but that's again talking somewhat in the abstract. Also, the letter in great tortuous detail goes over how it would look, not in the abstract [but] on the basis of arbitrary assumptions as to NOW accounts and money market funds and so forth. That is the essence of it, and I [would be interested in] any reaction you have at this point to the general idea.

If we want to go ahead in this fashion, I can send this [draft letter] out. I don't think we need further conversation if it's generally acceptable, but we would need a formal vote at [some] point, since the [decision] is being put in numerical terms. I don't mean a formal vote this afternoon, but when you see the actual--

MR. EASTBURN. Paul, this is Dave Eastburn. I think that's just fine; I think that's the way we should go.

MR. WINN. This is Willis Winn. I agree with you, Paul. Do you want to put in any remark saying that, of course, in February these circumstances that we've footnoted may cause us to alter these?

CHAIRMAN VOLCKER. It says that at great length. I could read this to you and--

MR. WINN. No, no.

CHAIRMAN VOLCKER. The draft as it is now goes on about five pages. And the reason it goes on is that it keeps telling them how arbitrary these assumptions are on NOW accounts and--

MR. WINN. That's good.

CHAIRMAN VOLCKER. --and how we are going to have to look at it all again in February. It says that in three different ways.

MR. ROOS. St. Louis enthusiastically agrees with you.

MR. BLACK. So does Richmond.

MR. MAYO. And Chicago.

MR. FORRESTAL. And Atlanta.

MR. GAINOR. And Minneapolis.

MR. BAUGHMAN. Dallas agrees.

MR. BALLES. San Francisco also.

MR. CZERWINSKI. Kansas City agrees. Mr. Chairman, we had one question. You mentioned a reduction in the ranges. Does that mean on both the top and the bottom?

CHAIRMAN VOLCKER. Yes, this talks about on the order of 1/2 percent, so that's the presumption. It is not meant to convey rigidity on those kinds of questions because the tone of the whole letter is not to convey great rigidity. But it specifically says nothing about that point. The key sentence is the one that I read.

MR. CZERWINSKI. One would assume that it would imply both the top and the bottom.

CHAIRMAN VOLCKER. Yes. I think in the absence of saying anything else that's the clear implication.

MR. WALLICH. Is there anything said about the possibility at this time of widening the ranges now that we have to make a statement?

CHAIRMAN VOLCKER. Well, we have had a little discussion of that informally here--not with the Committee but with Mr. Axilrod and others. We could do that for the M1 ranges very easily in my opinion because they are 2-1/2 percentage points [wide] now. To make a range wider than 3 percentage points for the others I think would look a little peculiar. I just wonder whether it would undermine the exercise a bit. I have, as you know, traditionally been in favor of wide ranges. But there's a point at which I begin gagging a bit at their significance if we make them too wide.

MR. WALLICH. The second question that I would like to ask is: Do you think we accomplish our objective by a five-page letter? Would it perhaps be better to have a short piece and then somehow add the rest of the material as an appendix?

CHAIRMAN VOLCKER. I don't know. I puzzled over that. My conclusion was--whether it's in an appendix or the letter--give them a lot of language to keep reiterating the arbitrariness of these adjustments. So, I don't think just a sentence saying that is going to carry the flavor. And I really believe we want to get that message through somehow. What the letter actually says is: Arbitrarily assume that 2-1/2 percent comes out of M-1A into M-1B and that 2 percent, I think, comes out of savings deposits into M-1B. And this is just the arithmetic: If we lower the range by 1/2 percent and then make those two adjustments, we have an M-1B range of 5 to 7-1/2 percent. It looks high. And that is my concern. Just looking at that range for M-1B, the key aggregate number, it is raised significantly from this year. [The reaction could be that] the Federal Reserve is going to hell with an inflationary policy. Now, it brings the M-1A range down to 0 to 2-1/2 percent.

VICE CHAIRMAN SOLOMON. This is New York. In our judgment [the adjustments] are a little lower than the Board staff's estimates. We have -2 percent for M-1A and plus 1 percent for M-1B. I think the question Henry raised of whether to have a short letter--

MR. BAUGHMAN. This is Ernest Baughman. We--

CHAIRMAN VOLCKER. Just hang on, Ernie. I'm listening to Tony Solomon on another phone and I'll tell you what he said afterwards.

MR. BAUGHMAN. I see. All right.

VICE CHAIRMAN SOLOMON. I think the question of whether we should have a short letter with an attachment as against the five-page letter should be looked at after you send us the draft. I think it's important in the letter not to protest too much about the arbitrariness of the NOW adjustments. We want to do it sufficiently to make our point, but on the other hand we don't want a lot of newspaper stories that say the whole targeting process is becoming meaningless because of the excessive arbitrariness of all the NOW adjustments.

CHAIRMAN VOLCKER. Well, it is quite possible we could write a letter--I'm just thinking out loud here--that is instead quite brief. It would note all this uncertainty that has arisen, the essence of what we are saying, and translate that into the 1/2 percent reduction in the ranges for M-1A and M2 in the abstract. And I could say I am attaching an appendix which [discusses] these further adjustments. That may be a way to do it. It's the same in substance; it's just lifting out 2 pages of this letter and putting it into an appendix.

VICE CHAIRMAN SOLOMON. I think there is some advantage to that.

CHAIRMAN VOLCKER. There may be. Then the letter itself would only speak about the 1/2 percent with qualifications around it, and it would say look to the appendix to see this more or less arbitrary translation into the other numbers.

MS. TEETERS. Are there any qualifications around the 1/2 percent?

CHAIRMAN VOLCKER. Let me go backwards, here. I take it the rest of you didn't hear Tony's comment.

SEVERAL. No.

CHAIRMAN VOLCKER. He was kind of seconding Henry Wallich's proposal to put part of this [lengthy letter] into an appendix. And you heard what I said, I'm sure. He just thought it might be less confusing, from the standpoint of the press, to have the elaborate specific targets developed in an appendix. We can certainly look at that, and it may be better.

Now, Mrs. Teeters just raised a question on how many qualifications I had around the 1/2 percent. Well, it talks about that general statement [as] one of the clearest and most useful indications we can make and [notes that] the numerical ranges might ultimately prove to be a source of confusion rather than clarity. It speaks about the institutional change. The key sentence, again, is the one that I read. It says "on the order of 1/2 percent" and the letter at various points talks about uncertainties, including the public's desire over the longer run to hold money balances in relation to income.

MR. BAUGHMAN. Mr. Chairman, given the admission that 1/2 percent is a pretty small number and the emphasis on imprecision and also your expressed concern as to whether the Federal Reserve is really going to maintain an anti-inflationary posture, I'm wondering whether it would be advisable--even though we are thinking in terms of 1/2 percent--to say on the order of 1/2 to 1 percent. That would give the impression that we are thinking of a minimum on the order of 1/2 percent.

MS. TEETERS. Well Ernie, quite frankly, I'm thinking of a minimum of zero. And going to 1/2 to 1 percent doesn't appeal to me at all for next year because we are going to lock ourselves in. We are not going to be able to change this come February.

CHAIRMAN VOLCKER. I do have some language here [about that]. What is essential is that our intention to lower monetary growth ranges over time toward rates consistent with virtual price stability should remain clear. There is language [regarding our intent to] review this. Here's the sentence I'm looking for. This is close to the end as it's now written: "In accordance with usual procedures, all of the ranges will have to be reassessed in or before next February. The extent of downward adjustments in the ranges not only will be influenced by the technical factors noted above, but also will be conditioned by the speed with which inflationary bias in labor and product markets can be reduced, and by the likelihood, therefore, that the economy can make an orderly adaptation to curtailed money growth. The need for public policies other than monetary policy to move in a complementary way to speed those adjustments was, of course, the essence of my testimony before the Committee." Now, that paragraph obviously could be read either way, as permitting more downward adjustment or conceivably none. I think it's probably the way I would like it read. I must say that if we make enough progress on price stability, we'd go faster. But I think it's formally neutral in its wording. We are caught in a box, obviously. Looked at from one point of view the 1/2 percent doesn't sound like much. If somebody says: Hell, the inflation rate is 10 percent and at best they are going to get down to 0--and the progress will be measured by the decline in the money supply--they have 20 years to go. On the other hand, if someone says something like 0 on M1 monetary growth--or to have a range, let's say 0 to 3 percent--is ultimately where we would end up, we are not all that far from it. It's just these darn lags that have made it look so far off.

VICE CHAIRMAN SOLOMON. Paul?

CHAIRMAN VOLCKER. Yes.

VICE CHAIRMAN SOLOMON. What about seeing what the Committee's feeling is--or what is your own feeling--about making the range as suggested 1/2 to 1 percent?

MR. GRAMLEY. I would be reluctant to see that. I think we do have to make some change, but I am very worried that if we lower our targets too far, we may have to [let money growth] run above them next year. Therefore, I'd rather keep the reduction in the range as low as we can get away with. So I like the [proposed] range as it stands.

SPEAKER(?). We were unable to hear the first discussion.

CHAIRMAN VOLCKER. Did you hear Governor Gramley?

SPEAKER(?). No, we did not.

CHAIRMAN VOLCKER. Well, the question was simply how much sentiment is there for 1/2 to 1 percent--the question that Ernie Baughman raised. And Governor Gramley said he prefers the 1/2.

MR. EASTBURN. This is Eastburn. I would support just 1/2.

MR. ROOS. This is Roos. I'd prefer the 1/2 to 1.

MR. RICE. I would certainly prefer 1/2 rather than 1.

CHAIRMAN VOLCKER. Any other comment?

MS. TEETERS. I have a question. Jerry [Zeisel], the forecast for 1981--

MR. BLACK. This is Bob Black. I think 1/2 is about right, Mr. Chairman.

MR. BALLES. San Francisco is for 1/2.

MR. GUFFEY. As is Kansas City.

MR. WINN. And Cleveland.

MR. GAINOR. Minneapolis, too.

MR. MAYO. And Chicago.

MR. KIMBREL. And Atlanta.

CHAIRMAN VOLCKER. Did you have a question? Well, it sounds to me as if we are at 1/2. I think there is a real problem here in that it will seem very small to people who are unaware of some of the technicalities. The sentence I read to you may help a bit in explaining that, but I guess that's where we are stuck.

MR. EASTBURN. Paul, I assume that in this letter you reiterated "in the long term"?

CHAIRMAN VOLCKER. Yes. I think you'll find this letter reiterates everything! Well, I think we have enough guidance; it's just a question of whether we put the specific ranges in an appendix or the letter. I may try it both ways to see which I like better. We will get this out to you in a day or so and then I think you can respond in a formal way, so that when we have numerical [ranges] we can say there has been an actual vote on this. I don't think we need that today; you might as well wait until you see the language. And I will also call Messrs. Proxmire and Reuss. I presume they will be happy, but if they tell me they really don't want anything more, despite what everybody said, I may drop this whole thing. I think the chances of their saying that are virtually nil.

MS. TEETERS. Mr. Chairman, could I make a request? The [staff projection in the] FOMC material was run on a 4-1/2 percent rate of money growth for next year. I would like to have sent out to the Presidents and members of the Board [an analysis of] what would happen to the projections if money growth were lowered 1/2 percent or a full percent.

CHAIRMAN VOLCKER. We will do that. We'll send it with the letter. Okay, thank you.

END OF SESSION