

**FEDERAL OPEN MARKET COMMITTEE
CONFERENCE CALL
November 10, 1993**

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Ms. Phillips
Mr. Stern

Messrs. Broadus, Forrestal, Jordan, Oltman, and Parry, Alternate Members of
the Federal Open Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of
Kansas City, St. Louis, and Boston respectively

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

Messrs. Lindsey and Siegman, Associate Economists

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

Mr. Checki, Executive Vice President, Federal Reserve Bank of New York
Mr. Beebe, Senior Vice President, Federal Reserve Bank of San Francisco

Transcript of Federal Open Market Committee Conference Call
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MR. BERNARD. Let me mention once again that this meeting is being electronically recorded.

CHAIRMAN GREENSPAN. As differentiated from what? [Laughter] There have been two developments in coming to grips with the details of the issue of the support for Mexico that we discussed previously. Fundamentally there has been little change, but since the details are not quite [final but] significantly close to being final I thought I'd ask Ted Truman, who is now back from his sojourns abroad, to bring us up-to-date on the behavior in the markets so far today with respect to the peso and to outline the developments of the last 24 hours.

MR. TRUMAN. Thank you, Mr. Chairman. As for the financial market developments, in light of the response to the debate and/or the sharp increase of about 3 or 4 percentage points in short-term interest rates, depending on which rate you choose, the peso appreciated today from about 3.27 to 3.21. And the stock market is up by a remarkable 4.2 percent in Mexico. It has a tendency, as the man from the Bank of Mexico just said to me, to overshoot--to be either over enthusiastic one way or over depressed [the other].

As far as the arrangements are concerned, I think the most useful thing to do would be to go through the outline of the approach that we now envision on a contingency basis, most of which I think was described yesterday. A couple of points are new and important. It has now been decided to ask the BIS to try to put together a package from the other G-10 central banks and Spain. So, we are now shooting for an overall package of a short-term credit facility, of which \$6 billion would come from the United States and would come from the BIS. Half of the \$6 billion would come from the Federal Reserve and half would come from the ESF. One change from the way we described things yesterday is that up to one-third of the total package would be made available upon request from the Mexicans. That means in our case for the \$3 billion that we would be putting in, up to \$1 billion could be drawn. Any disbursements in addition to that would require the mutual agreement of Mexico, the United States, and the BIS on behalf of their piece. All the disbursements, with one qualification, would be in proportion to total commitments. And there would be no disbursements made after December of this year. This is envisioned as a short-term credit facility designed to deal with the run up to the NAFTA vote and the immediate aftermath. Drawings would be repayable three months later and the entire facility would expire on March 31, 1994. It would have standard interest rate terms. We would get the U.S. Treasury bill rate. There would be a link to a favorable indication about Mexico's policies coming from the Managing Director of the International Monetary Fund.

Because one of the changes from what you thought about and talked about yesterday is that

one then has to ask oneself the question: How are we going to assure that we would be repaid? The mechanism we have outlined is that Mexico would commit to maintain \$2 billion of reserves on deposit at the Federal Reserve Bank of New York and \$2 billion at the BIS, though with mutual agreement those reserves could be drawn down lower. Thus, in effect--

CHAIRMAN GREENSPAN. I think you ought to say "only" with mutual agreement.

MR. TRUMAN. Only with mutual agreement could the reserves at those two institutions be reduced below that level; that includes our agreement. If there were an outstanding balance at the expiry of the facility in March 1994, the standard condition of these arrangements is that the Federal Reserve Bank of New York could sweep in all deposits of Mexico that are available at the Bank to repay any outstanding balance. That would take care of our repayment.

In addition, Mexico would commit to consult with other participants on its financial developments and policies in the event that its gross reserves decline. That is a checkpoint of a sort, to make sure or remind them at least if we think they are wasting too much money in this effort.

Now, there is one qualification with respect to timing. The aim is to put the overall facility in place as soon as possible. However, it is recognized that it is easier and quicker in principle to put the U.S. component of the facility in place rather than the BIS component of it. So, assuming that we could get everything done and we were requested by Mexico, the United States would be prepared to announce its credit arrangement before the overall facility had been agreed upon. And the U.S. announcement might indicate that efforts are under way to develop a larger multilateral facility. That is the outline of the terms and conditions as we now envisage them.

CHAIRMAN GREENSPAN. Are there any questions for Ted?

MR. BOEHNE. Do we have a formal request from Mexico for this at this point?

CHAIRMAN GREENSPAN. We do not.

MR. TRUMAN. Excuse me, I forgot to tell you. Bill McDonough?

VICE CHAIRMAN MCDONOUGH. Yes, Ted.

MR. TRUMAN. You have had a call, right, from Governor Mancera?

VICE CHAIRMAN MCDONOUGH. Yes. Governor Mancera, who is the head of the Bank of Mexico, called me and did request a central bank-to-central bank facility.

MR. LINDSEY. Does that mean the answer is yes?

MR. TRUMAN. Yes.

MR. ANGELL. With a specific amount?

MR. TRUMAN. Just the framework--[a request to] try to work something out within this framework.

MR. KELLEY. Bill, in addition to creating the standby [facility], would they go ahead and draw down the first tranche of \$1 billion?

VICE CHAIRMAN MCDONOUGH. That is not at all clear. What Miguel Mancera said was

Therefore, even though they would have the right under the facility, as Ted Truman described it, to draw down in our case up to the amount of that first billion dollars, it is not at all clear that in fact they would do so.

MR. TRUMAN. In fact in my conversations with the Mexicans, they have indicated that the current intention would be not to do so, though they have not ruled out the possibility.

MR. ANGELL. Ted, does the ESF have the liquidity to [provide] the \$3 billion?

MR. TRUMAN. I think so.

MR. ANGELL. That about puts them up to their--

MR. TRUMAN. Well, they have the liquidity to provide the \$1 billion, which is all they need to do at this point.

MR. ANGELL. All right. So they do not have the liquidity to do \$3 billion?

MR. TRUMAN. I have not checked the balance sheet.

CHAIRMAN GREENSPAN. I doubt if they have \$3 [billion].

MR. ANGELL. I thought they did not have the liquidity.

MR. TRUMAN. As of six months ago they did not, but I am not sure what the situation is at the moment.

MR. LINDSEY. Does that require [a Congressional] appropriation?

MR. TRUMAN. No. To do something more it does; but to use the funds for this purpose does not require an appropriation.

MR. LINDSEY. But if they have \$1 billion and only \$1 billion, how would they go to \$3 billion legally? How would they acquire the rest?

MR. TRUMAN. There are lots of ways they could do it. In the meantime, they might sell some of their other foreign exchange and acquire dollars as a consequence.

CHAIRMAN GREENSPAN. That's all they have to do; it is the dollars they need. They obviously have a very large stock of foreign exchange.

MR. LINDSEY. Of foreign exchange, I see.

MR. ANGELL. I would not object on a permanent basis, as long as it is not a repo.

CHAIRMAN GREENSPAN. The reason I am skeptical that they have it is that I have not seen any diminution in their foreign exchange holdings in any one period.

MR. TRUMAN. We looked at this last March--that's the last time I saw their balance sheet--and they had, as I remember, about \$2.7 billion at that time. The question is whether the accumulated interest has raised it any more between then and now.

MR. LINDSEY. Mr. Chairman, do I understand that if we were to vote, this would be released next Friday?

CHAIRMAN GREENSPAN. I am not requesting a vote yet because this is still in the discussion stage.

MR. BROADDUS. This is Al Broaddus. Could I ask on this first \$1 billion drawing whether we have any risk of loss or are we completely covered for that under the \$4 billion I gather the BIS will be--

MR. TRUMAN. We think, because of this mechanism of the reserves being held at the Federal Reserve Bank of New York and our consent being required for them to draw down those reserves, that we would in effect be covered for that \$1 billion.

CHAIRMAN GREENSPAN. In other words, it requires our assent basically to draw against that account. If we do not give our assent, then that account is in the Federal Reserve Bank of New York and unavailable [to them], except to repay the drawing.

MR. MULLINS. As a practical matter, under what conditions would we ever decline to let them draw on that?

MR. TRUMAN. I think as a practical matter--

CHAIRMAN GREENSPAN. I think the question should be reversed.

MR. TRUMAN. That's right. I cannot anticipate all [that could happen in] the future. That is why we have set this up so [it requires] mutual agreement if something happened. I do not think we can completely anticipate all the developments that might take place over the next seven days or the next seven weeks.

CHAIRMAN GREENSPAN. I will say this: In the event that something emerges that is even close to that, this Committee would be informed.

MR. TRUMAN. The way we would set this up it would require mutual agreement on two [specific aspects of the overall] agreement.

Any drawing beyond the first third would require mutual agreement. And there would have to be agreement to draw down the [remaining] balances at the Federal Reserve Bank of New York.

MR. ANGELL. But at the same time it seems to me that we should be aware that our setting up the facility, which might thereby be announced, and then our being unready to meet that outgo could have certain market repercussions.

CHAIRMAN GREENSPAN. Yes, but remember what we are talking about is something in the area of \$18 billion in reserves that they have to go through before they even come down to the base. My impression is that before we get even remotely close to the triggering point where our funds become exposed in any respect, there will be all sorts of additional events.

MR. ANGELL. But it seems to me that the monetary policy regime that is in place in Mexico is a very sound one. That they are asking for this with such large reserves is to me an indication that they have moved into another realm of central bank operations, and I think we should recognize that. I feel that it is quite unlikely that they are going to need [to draw on those funds], given their willingness to push real interest rates where they have and to produce such a significant slowdown in the Mexican economy that is already under way. They have in place a monetary restraint which makes it somewhat unlikely that they are going to need--

CHAIRMAN GREENSPAN. I think it is extremely unlikely. What we are trying to do here is to convey a major element of moral support. It is clearly not an internationally altruistic event because if something adverse occurs in the financial system in Mexico, our export trade to Mexico will be very significantly affected. And that is obviously something we have to be very much concerned about. So I think what we want to do is to be as supportive as we can and to address the issue they are addressing. But in this context what they are asking for is really fundamentally moral support, not financial support.

VICE CHAIRMAN MCDONOUGH. I fully agree with that analysis.

MR. ANGELL. I understand. But at the same time, however low the probabilities are, I believe we have to be aware before we make this move that in the unlikely event they would need to draw that money down, it could be a somewhat disruptive event for us to say "no" at that point in time.

MR. TRUMAN. That is why we proposed that they would be able to draw at least the first tranche. That is the point. Although there would be protections, that [tranche] could be drawn free and clear. Their own stated intention, as the Chairman has said, was not to get themselves in a situation of overly defending an exchange rate or not defending it enough with monetary policy so that their reserves would be drawn down so much that they would even come close to the low levels that we are contemplating. So they might draw, but they are most likely to maintain. That is what the number comes from. At least in gross reserves, they would have to reconfigure--even if they already have been--what they think their overall policies are going to be.

MR. ANGELL. My statements have been made in the context of my being a supporter of what you are asking.

CHAIRMAN GREENSPAN. No, I think [your points] are well taken. Any other questions for Ted?

MR. MCTEER. Bob McTeer in Houston. I gather that the restrictions on the use of this were suggested by the Mexicans rather than [requested] by others from them?

MR. TRUMAN. There was mutual recognition involved, I think, Bob.

MR. MCTEER. Would you say that we are treating them less favorably than we would other countries under similar circumstances or we would be treating them the same?

MR. TRUMAN. This is a little different than most of the things we have done in the last decade, where the previous ones we've been involved in actually were bridge loans to some [other source of financing]. This is more of a "traditional" use of the swap line--as we saw it used in the past--where there were short-run pressures, capital flows, and so forth and so on. With that qualification, and therefore a slightly different question about where we look for sources of repayment, I think this is well within the basic parameters of how we have treated Mexico three times since 1982 and how the Treasury, in their own operations, has treated other Latin countries.

MR. MCTEER. Yes. I would just hope that we do not leave the impression that we are treating them as second class world citizens in some way.

MR. TRUMAN. I think the discussions that we have had over the last 24 hours, or at least those I have been a party to, have been quite warm and cordial. In fact, Larry Summers at one point said we do have to understand that this is a continuing relationship and we do not want to do things now that would jeopardize [that relationship] in the future or would jeopardize it now. So there is a sense of trying to strike a balance here.

MR. MCTEER. Okay.

VICE CHAIRMAN MCDONOUGH. That's certainly consistent with the tone of the conversations [I've had]. The two I had today with Governor Mancera were exactly the kinds of conversations that one of us would have had with one of the major central bankers of Europe.

MR. MCTEER. That's good.

MR. HOENIG. Ted, it may be too soon to know this, but you mentioned these other countries and the negotiating on the rest of this arrangement. Is that proceeding well or do we know at this stage?

MR. TRUMAN. Before we and the Treasury suggested to the BIS that they go out more formally to ask the other G-10 countries and Spain to participate, I did contact the four biggest players. Starting with Canada, for obvious reasons, the United Kingdom, France,

and Germany, it is fair to say that in each case I got some questions, both on strategy as well as detail. In the first three of those four countries, I got an on-the-whole favorable reaction. Germany was tough. In recent years it has always been tough to convince the Bundesbank to go along on these arrangements. I basically was asking the authorities of those central banks, including the Bundesbank, whether they would recommend to the U.S. monetary authorities that they not try to put together a G-10 facility because we all recognize that if they thought it was a nonstarter and we tried and that got out, then that would not necessarily be helpful to the Mexican authorities. In no case, including the Bundesbank, did I get that kind of advice.

CHAIRMAN GREENSPAN. Any further questions for Ted? If not, let me just indicate that what we are talking about here is something which is in process and may never actually materialize if the markets come around. Rather than take a premature authorization vote, I would prefer not to do that until we get a specific need to do so. What I would request is that the members make sure that Norm Bernard knows their whereabouts at all times. Who is involved in this?

MR. TRUMAN. The Secretary.

CHAIRMAN GREENSPAN. Make sure that Norm knows where you will be at all times so that in the event we need a telephone poll, we can do it expeditiously. Should that become necessary, I will ask for two authorizations at that time. One would be to authorize the establishment of a special swap line with the Bank of Mexico in the amount of \$2.3 billion, subject to the Chairman's determination that the appropriate terms and conditions have been met. The second would be to authorize the Subcommittee to approve drawings on the special swap line and the regular \$700 million swap line, subject to the appropriate terms and conditions having been met. Is that adequate for everybody?

MR. ANGELL. Yes.

MR. KELLEY. Yes, sir.

CHAIRMAN GREENSPAN. Okay. Then I would request that we keep in contact. There is a not unreasonable possibility that the worse could be behind us. I think the odds probably are less than 50/50, but they surely are not negligible. In the event that the markets stabilize and some restoration occurs, we will not have to move further on this question.

MR. LINDSEY. If Bill is going to ask for a request, procedurally what is he going to tell them?

CHAIRMAN GREENSPAN. What we have at this stage is authority to move forward in the negotiations. If we get to the point that a legal action is required, then we will move to get it implemented in a telephone call. Okay? Thank you very much, everybody.

END OF SESSION