TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE CONFERENCE CALL

July 17, 1979

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.

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FEDERAL OPEN MARKET COMMITTEE
CONFERENCE CALL
July 17, 1979

PRESENT: Mr. Miller, Chairman
Mr. Volcker, Vice Chairman
Mr. Black
Mr. Coldwell
Mr. Mayo
Mr. Partee
Mr. Rice
Ms. Teeters
Mr. Wallich

Messrs. Guffey, Morris, Roos, and Winn, Alternate Members of the Federal Open Market Committee

Mr. Baughman, President of the Federal Reserve Banks of Dallas

Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mr. Petersen, General Counsel
Mr. Mannion, Assistant General Counsel
Mr. Axilrod, Economist

Messrs. Ettin, Henry, Keir, Keran, Kichline, Scheld, and Truman, Associate Economists

Ms. Greene, Assistant Manager for Foreign Operations, System Open Market Account

Mr. Coyne, Assistant to the Board, Office of Board Members, Board of Governors
Mr. Kalchbrenner, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Farar, Economist, Open Market Secretariat, Board of Governors
Mrs. Deck, Staff Assistant, Open Market Secretariat, Board of Governors

Messrs. Doyle, Forrestal, Gainor, Smoot, and Williams, First Vice Presidents, Federal Reserve Banks of Chicago, Atlanta, Minneapolis, Philadelphia, and San Francisco respectively

Messrs. Boehne, Burns, Senior Vice Presidents, Federal Reserve Bank of Philadelphia and Dallas respectively

Messrs. Broaddus, Cacy, Cox, Danforth, Mac Donald, Vice Presidents, Federal Reserve Banks of Richmond, Kansas City, Atlanta, Minneapolis, and Cleveland respectively

Transcript of Federal Open Market Committee Conference Call of
July 17, 1979

MR. ALTMANN. Good morning, everybody. This is Murray Altmann. I would like to call the roll by Districts and I would appreciate it if each President or First Vice President would tell us who is there with you. [Secretary's note: The attendance list is provided on the previous page.]

CHAIRMAN MILLER. Let me outline why I have asked that we have this consultation. At our last FOMC meeting the discussion included some thoughts [about] what the President might propose in his energy speech, and we tried to anticipate what monetary posture we might be prepared to arm ourselves with. At that meeting it was, I think, our mutual view that we shouldn't try to guess what the President would say in his energy speech but should wait to hear it and then consult if appropriate. Our purpose would be to evaluate the outcome, its effect on markets, and how [the energy program] relates to our general monetary and economic strategies and see where we go from there.

I will give you a quick personal reaction. The President's speech is still being evaluated; the fleshing out of his concrete proposals will have to take place before there is finally a sense of how this will work and whether it will make the kind of progress that we all hope. In the meantime there has been a mixed reaction in both domestic and, particularly, international markets. The international markets I'm going to have a report on in a moment. I would just note that when the President spoke, the markets in the Far East were open. Upon the completion of his speech there was a slight uptick, I believe, and then generally a bit of softening but nothing momentous. But in the intervening days the market generally has been eroding downward and considerable resources have been required in [foreign exchange] intervention. Under those circumstances rather than wait for some event that might be more difficult than we've had so far I just thought we would be well advised to (1) have a briefing and (2) get a reaction from people and viewpoints so that we are prepared and up to date. Now we've lost Boston. We may just have to forget this whole thing and try it again later. I think we ought to not pay the bill for this [teleconferencing] system until it works every time. There's just no point of having this. Boston is not on? Well, let's all hang up again and we will try it once more. Anybody left on the line?

[Secretary's note: The phone connection was re-established and the roll was called again.]

CHAIRMAN MILLER. Again, I thought it would be wise if we would all consult. To start off I think we have in New York--I hope--Gretchen on the line to give us a rundown on what is happening in the foreign exchange markets.

MS. GREENE. I'm afraid I have to report that the market responded to the Carter address with some disappointment--disappointment that some of the immediate questions about the economy have not been addressed and that the issues that were addressed were of a long-term nature providing nothing for the market at the moment. And in that position the market has a bit in its teeth. It is true that the initial reaction in the Far East to President Carter's speech was, on balance, positive. But it was not sufficient to keep the dollar rate at the level at which it was trading at the time of the speech. As of this moment we have lost approximately 1 percentage point from that level, going down to a low

this morning of 180.90 to 181. In the process we provided sustained support both in the Far East and in New York Sunday night, Monday, and Monday night. As of 11:30 this morning the U. S. authorities had sold net something like $700 million of foreign currency, mostly German marks, since the Carter speech. This has brought the total of our intervention since the time the market turned around in mid-June to $3.1 billion. Of that, $1.3 billion had been on behalf of the System. The amount of swap drawings totals about $1.2 billion if we include what we have done today. The remaining $1.8 billion has been financed by the ESF; that has brought the ESF into a net minus position inasmuch as the marks that it now holds in balances are less than required to cover the Carter bonds. The $3.1 billion of net currency sales since the middle of June compares with about $3.7 billion of purchases by foreign central banks. The most important of these has been the Bundesbank buying about and the Swiss National Bank I'd be very happy to answer any questions you may have.

CHAIRMAN MILLER. Gretchen, what is your feel of the market? Who is in the market? What is its direction? Are we seeing official accounts, corporate accounts, and trading accounts shifting out of dollars? What is your evaluation?

MS. GREENE. I would say that the pressure has been building up since about this time yesterday. It started, I would have supposed, largely with professionals. There was quite a bit of European selling yesterday and in the Far East last night that pattern continued. Sterling is in very strong demand this morning, the rate being up to 2.7. The Bank of England says they have also heard that in addition to professional buying of sterling there is considerable Middle East interest, which has the smell of diversification about it. So I would have to say that on very sketchy impressions we cannot exclude the possibility that the dollar is being hurt by these shifts of investment funds. I have not heard of a lot of Latin American names or a lot of corporate names such as we heard last fall; I would say that it has been more European and more traditional investors.

CHAIRMAN MILLER. Phil.

MR. COLDWELL. Gretchen, is there any marked change in the Bundesbank's position as far as intervention is concerned? Are they moving aggressively in this market?

MS. GREENE. I am not sure I heard the question.

CHAIRMAN MILLER. The question was whether the Bundesbank in the week since the speech has shown any different attitude, the implication being that perhaps they were somewhat reluctant in supporting the dollar prior to the speech--from mid-June to last week. Have they become more active in helping to support the dollar or not?

VICE CHAIRMAN VOLCKER. If I can try to respond to that one, Mr. Chairman: In amounts they have been much more modest than we have been. There is a little feeling in the market, I'm sure, of reluctance on the part of the Bundesbank but it has not been as evident as earlier. And they did make a little splash in Frankfort this morning by spending right off the bat rather openly, which the market saw as a kind of signal. So the answer is a bit mixed. Now, as to the extent they

have been aggressive, and they haven't been terribly aggressive, Gretchen and others have been in pretty continuous contact with them telling them that we have been aggressive. So it's hardly [an aggressive] response [in terms of] having responded to what they perceive as our attitude.

CHAIRMAN MILLER. Well, let me just pick up from what has been said to give you an idea of what my concern is and what I would like to feel out the Committee about. One could take the view that this is a natural reaction following the weakening of the dollar, for whatever reasons, from mid-June until the present and that as people understand and see the follow-up action by the President there will be a renewed sense of confidence in the dollar. And with active intervention but not with massive intervention the dollar will stabilize and we will not see it dip below the November 1 levels and we will work our way out of this.

The other possibility is that we're seeing the tip of the iceberg [from] both the U.S. and foreign authorities. Plus there's the question about the impact of the substantive moves the President is initiating. Plus there is beginning to build up the usual groundswell of action, which leads professionals to be followed by others into these accounts and it ends up with a more precipitous move on the dollar, which gets away from us. If it gets away from us and if central banks have already in a month spent $6-3/4 billion, of which $3.1 billion of the $6.8 billion, I guess, is for the U.S. accounts, we'll probably spend over a billion dollars this week. Are we in for a period that we can [manage to] hold it? If we do not, what worries me, of course, is that we will trip the confidence lever again. We not only do that but a lower value of the dollar also has actual impacts on our economy through the higher cost of imports and the same inflationary impact we saw before. And that only exacerbates our problem and puts us back on the track that was troubling us last year. So, what to do?

One [alternative] is to make a judgment regarding which general direction is correct. If the former [view] is correct, I think our option would be just to stay in here and keep our intervention [going], be persuasive with the Germans to be helpful, and weather the storm. If the latter is likely to be the case, then one option is for the Federal Reserve to take monetary action that would indicate our determination to defend the dollar and to try to turn around the psychology of the situation. The disadvantage of that, of course, is that we already have a weak economy. Nothing has happened new in the economy that we know of that would change the outlook from what we were looking at a week ago. Therefore, would our action--if we did it--to help the dollar and to offset the inflation [effects] set off some other chain of events that would worsen our recession? Would it lead to counter actions in the form of tax reductions or other things that would merely take away what we had just accomplished? Or would it be possible to take the action, risking that with a stabilized dollar and renewed confidence we'd be able to back off of the monetary action in a couple of months and go back to the path that we thought most likely [to be successful]? Those are the kinds of the issues that I see. I haven't come to a conclusion; I just wanted to suggest that we kick them around. Why don't we start here with some of the governors and then we'll go right down the list and ask for everybody's view. Phil.

MR. COLDWELL. Mr. Chairman, it seems to me that we have not yet fully evaluated what the market trend is going to be. I think we are getting hit with some reactions here. I'm not yet willing to buy it as having a snowball effect that forces action but I do think we are going to have to

watch it with intense care. And if by the end of this week we see any snowballing of this [development], then I think we will have to consider monetary action and my preference there would be a prompt discount rate increase.

CHAIRMAN MILLER. Chuck.

MR. PARTEE. Well, I agree with Phil that it's a little early. It looks as if it could be quite a problem but it's a little early to say for sure. I believe that a significant tightening of money would have bad consequences for the U.S. economy in a situation that is weakening. [Our economy] is weakening already and, therefore, it's something that I would contemplate with only the greatest reluctance. But I guess I have to indicate that if we have a snowballing situation, with a cumulative decline in the dollar and a loss of confidence in the currency, that may be our only course. I think that an increase in the discount rate wouldn't be sufficient; we'd have to follow through with some federal funds rate action. So, let's be clear about it. What we are really talking about is a tightening in monetary policy that isn't associated with the performance of the domestic economy and that is a major, major step to take. In the meantime, of course, I think we ought to try to defend the currency. And we ought to have an active intervention program because it's particularly difficult for the President in the way his speech is received to see the market declining hour after hour and day after day. That will certainly undermine whatever psychological effect it might have had.

CHAIRMAN MILLER. Thank you. Nancy.

MS. TEETERS. Mr. Chairman, I strongly support an intervention policy to maintain the value of the dollar in this particular situation. I think it was inevitable that we were going to get an adverse response to the President's speech regardless of what he said. I have a feeling that the market was just looking for something to use as an excuse to start speculating again in the dollar. I think we need to keep in contact as we go along. I would join Chuck in saying that I am extremely concerned about the domestic economy. To move to increase interest rates and to [tighten] for international purposes, [the concerns] have to be overwhelmingly important to offset the adverse effects on the domestic economy if we do that.

CHAIRMAN MILLER. Thank you, Nancy. Emmett, you may want to pull that mike forward. We are having a little trouble with the sound system.

MR. RICE. I agree with everything that has been said so far. I think we have to watch the situation very carefully and when we are sure that the situation is beginning to get out of hand then we need to consider monetary action. At this time I would consider that a very serious step, as Chuck said. In the meantime, I would favor a very active interventionist policy--perhaps the stronger interventionist policy we normally would take in circumstances like this--with the hope that it would [avert] any need for monetary action.

CHAIRMAN MILLER. Thank you, Emmett. Let's go right down the list [by District]. Boston, Frank.

MR. MORRIS. Mr. Chairman, with the economy in the fourth month of a recession which could turn out to be quite severe, I don't think we can use monetary policy to deal with the [international] situation. The recession will improve the fundamentals of our balance of payments. When that shows through, that's going to help the position of the dollar. In the meantime, I think the only instrument that is appropriate for us to use is intervention policy, which I would be willing to use on a wide scale.

CHAIRMAN MILLER. Thank you, Frank. We will go to New York and while we are there let's have both Paul Volcker and Henry Wallich give their comments.

VICE CHAIRMAN VOLCKER. Well, If you want me to begin, I guess I have a somewhat different opinion. Nobody knows the future but I think there is a substantial risk of an iceberg here and in my view a little action earlier rather than later would be effective, particularly since I don't think the market is expecting it. Observing this market for the last couple of days, I've come to the conclusion that now is the time to move on the discount rate and a bit on the funds rate in amounts unspecified for the moment. I say that against [the background of] an additional element that I don't think has been mentioned--that the aggregates are running a bit on the high side. Though not dramatically so, they are off in that direction. I am extremely skeptical that intervention will be adequate to handle a situation of this sort. The market has had enough experience with intervention alone that it gets to the point where one wonders whether it's helpful or harmful in some circumstances, particularly against the background where the Bundesbank may well get very restive very soon about the amounts of liquidity we're creating in their markets. I think they've been, in their light, quite cooperative up to now but they haven't been doing very much and we are going to be getting complaints very soon. Gretchen [heard] some grumbling [about that] this morning and it looks like it's pretty big. So I think it's a bit of an illusion, if this continues, to think that we can rely upon intervention. It seems to me that there is enough [reason] internationally and with the aggregates pointing in the same direction for us to make a modest move that I think could be reversed if things turned out well. We would be better off in the long run [and would not inflict] any substantial damage or any damage at all, as I see it, to the domestic economy.

The main comment that I picked up about the President's speech was that it wasn't really a bad speech--I agree a little bit with Nancy here --but that he didn't address himself at all to the inflation problem. And indeed there is skepticism as to whether the Federal Reserve is addressing that problem.

MR. WALLICH. This is Henry Wallich. I think we have the makings here of a possible crisis. I define as a crisis a situation where in the case of quite heavy intervention we would find the market breaking 180 on the D-mark. I think under those conditions monetary policy action would be appropriate--some rise in the discount rate, some rise in the funds rate. Hopefully we can say that this will be reversed as soon as conditions in the markets stabilize, although that would reduce the effectiveness of the action somewhat. I think what we will need in order to take monetary policy action in the face of the weakening economy is clear evidence that there is an urgency in the exchange market. And that, in my view, will be brought about by some snowballing effect in the face of strong countering intervention. I think intervention has a very limited effect. Certainly it should be tried as far as we can, but we should not rely on that.

CHAIRMAN MILLER. Thank you, Henry. We will go to Philadelphia. Am I correct that Dick Smoot is on the line?

MR. SMOOT. That's correct, Mr. Chairman. We would agree that it was a predictable response to the speech. We would be reluctant at this point, due to the condition of the economy, to take a monetary policy action. But we don't in any way discount the potential buildup of additional difficulties and suggest that we watch the situation closely.

CHAIRMAN MILLER. Thank you, Dick. Cleveland, Willis Winn.

MR. WINN. Mr. Chairman, I have a feeling that we may have more of an iceberg here than we like to think. Intervention alone won't [work] and probably is too expensive [if our aim is to achieve] a turnaround. I am a bit sympathetic to [taking action] a little earlier rather than later because we can reverse it. A discount rate change and a slight fed funds rate [increase seem] appropriate. But I think the question we need to ask is: If the first move in this direction doesn't stem the flow, are we really prepared to go further along this line? Apparently the answer to that question is more uncertain. I think I'd have a tendency to march down that road much earlier than later, however, thinking that we'll know very quickly [as we undertake] that move.

CHAIRMAN MILLER. Thank you, Willis. Richmond, is Bob Black on?

MR. BLACK. Yes, I'm here, Mr. Chairman. With the situation as fluid as it is now, I don't believe it's wise to move at this particular point. I think a move could be interpreted as a lack of confidence in the President's program, which some of us may feel, but nevertheless it would not look good as a policy action. And we've not yet reached the trigger point on the aggregates although, as Paul Volcker pointed out, we are quite close. Like Paul, Willis, and Henry, I'm afraid that this is the tip of the iceberg. But I would wait until the weekend and no later and then if we see signs that it is snowballing as Governor Coldwell suggested, I would be prepared to move at that time.

CHAIRMAN MILLER. Thank you, Bob. Atlanta, I believe we have Bob Forrestal.

MR. FORRESTAL. Yes, that's correct, Mr. Chairman. Yesterday we were heartened by the fact that the effects on the dollar were rather insignificant. It was not as bad as we had expected. Having said that, we think it's probably premature at this time to make a move. I, too, would be quite concerned that a Federal Reserve move at this time [would be viewed] as reflecting a lack of confidence in the President's program. And given the domestic situation with the aggregates, while admittedly at the upper end of the ranges, they are not bursting out at this point. For all of these reasons we think that for the short term, intervention activities are probably appropriate. I do think that we have the potential of a crisis developing, perhaps rather significantly even today, but we would be inclined to give it a little more time and to hold firm for the time being.

CHAIRMAN MILLER. Thank you, Bob. Bob Mayo in Chicago.

MR. MAYO. Well, Mr. Chairman, I would give it one more day and that's all. It seems to me that if intervention doesn't quiet things down or if the markets don't quiet by themselves by this time tomorrow, we should move with a quarter percentage point on fed funds rate and a half percentage point on the discount rate. I would put it strictly on the basis, as both Paul and Henry have said, of a move that is required for support of the dollar. I would not, however, announce that it could be reversed. People know that and I think it might have a backfire effect. The President's speech, from what I've heard--and there was a lot of conversation about it among executives from all over the country prior to the dinner with the Chinese Finance Minister dinner here last night--was generally viewed as the most brilliant speech that President Carter has ever given. But there was general agreement, too, that it was a bit too "preachy" in the first part and a bit too long-range and [expansive] in the second part, with no concern shown for the short-term situation either on the inflation front or the [energy front]. Many of my friends say it was really a missed opportunity to take a positive leadership role in the restoration of nuclear power as an important source of energy for the next ten years. [That] could eliminate half the problem if he would have gone forward on that. And we are far enough away from Three Mile Island now that a lot of the emotional response--and most of it was emotional--could have been reversed with a strong leadership position. But as I say, on our own problem I'd give it one more day and then I would move if things don't quiet down.

CHAIRMAN MILLER. Thank you, Bob. St. Louis I don't know if you are hearable, Larry. We are not picking up a signal from St. Louis here at the Board. I don't know what we can do other than suggest that we contact Larry later and get his thoughts. We are not going to take a vote or anything anyway; we are just trying to get counsel. Larry, if you can hear me, that's what I would suggest. I'll just go on to Minneapolis where I hope Mark Willes can hear me.

MR. GAINOR. Mark Willes is not at the Bank. This is Tom Gainor and I'll make the remarks.

CHAIRMAN MILLER. Okay, Tom.

MR. GAINOR. We have not been encouraged by the President's speech nor by the reactions to it. We agree with the points that have already been raised that the condition of the economy makes it very difficult for us to take monetary action at the present time. I understand the crisis in the international markets, though, and I agree with the comments that have been made that we're in a day-to-day situation here and we should look at it from that basis. I would be very glad to see us consider it again tomorrow or the next day if something changes in the international situation. We don't favor action at this time.

CHAIRMAN MILLER. Thank you, Tom. Kansas City, I think Roger Guffey is on.

MR. GUFFEY. Yes, I am, Mr. Chairman. With respect to the President's speech, Bob Mayo synthesized the comments that I've heard here almost to a tee. That is, there isn't great enthusiasm perhaps because of the long-range nature of [the proposals] and it was not aggressive in terms of the domestic inflationary problems. As to the international situation, it does seem to me that [unintelligible] have been met, they're going to go farther than they perhaps should. Under the

circumstances we face, I would be prepared to recommend that we take rather aggressive action in the intervention [area] for obvious reasons but also I would increase the discount rate later this week if conditions remain as they are today. Also, I'd be prepared to increase very modestly the fed funds rate either at the same time or preferably early in the following week if the discount rate [move] does not have the effect that we'd like it to have.

CHAIRMAN MILLER. Thank you, Roger. We'll go to Dallas and I believe Ernie Baughman is on.

MR. BAUGHMAN. Mr. Chairman, I am inclined to the view that what we are seeing may be the front end of a very substantial development. It seems to me that it would be advisable to use some fairly strong and obvious ammunition fairly early in the game. Therefore, I would be inclined to let the funds rate move up a bit now, particularly if the market has been tending in that direction anyway, but then follow along with a discount rate change as early it can conveniently be put in place. Insofar as the response to the President's speech was less than supportive, it seems to me that it's primarily on two counts: (1) the lack of attention to inflation; and (2) the indications of a tendency to go the control route as compared with a heavier reliance on competitive markets [to address] the oil and gas problem. I read the sentiment of foreign countries as being that they will not view our energy program as realistic unless we do let our domestic prices fully reflect world prices.

CHAIRMAN MILLER. Thank you, Ernie. San Francisco, John Williams.

MR. WILLIAMS. Yes, Mr. Chairman. With respect to reactions to the President's speech, I would agree with what Ernie Baughman has just said. With respect to monetary policy, we would agree very strongly with Frank Morris and Bob Black that we ought to stand pat at the present time. We would suggest that if there is a move for raising [interest rates] that the discount rate be raised before the fed funds rate [because] it's 75 to 80 points below the funds rate and raising the discount rate would have the announcement effect without tightening the financial markets [unintelligible].

CHAIRMAN MILLER. Thank you, John. I think we have now completed the go-around. From this I would say the sentiment of concern is pretty clear but [the preference is for] no action at this point. I gather from almost everybody that we should be watching this very closely and I assume that it would be appropriate to have similar conferences each day or as often as necessary as long as the situation is uncertain. But we will try not to have them unless there is some real change in direction or some indication of movement. Are there any comments or questions? I just want to say I appreciate having this opportunity to hear from everyone. It helps greatly to get your views. Any other comments?

MR. COLDWELL. Do you want to take a vote?

CHAIRMAN MILLER. I don't think we intended to take a vote. This was just a consultation.

MR. COLDWELL. No, I'm just talking about the intermeeting limit.

CHAIRMAN MILLER. Oh, the intermeeting limit, I'm sorry. Phil Coldwell was suggesting that we get FOMC permission to raise the intermeeting limit [on changes in the System's foreign currency position] to $2 billion. Is that necessary [today]?

MR. AXILROD. Well, the present limit is $1-1/2 billion. Between meetings the Manager can change the System's position [in foreign currencies] by up to $1-1/2 billion and then [beyond] that point he has to go to the Committee. It might be advisable, in view of the Committee's sentiment, simply to suspend that limit of $1-1/2 billion.

CHAIRMAN MILLER. When we were in trouble, last October I think it was, we suspended the limit for a while. Let's consider that. I'm not sure; do we need a vote on that at this moment?

MR. AXILROD. Well, if intervention continues in size today and tomorrow, we will need to go to the Committee to request that [the limit] be suspended at that point. So you could either do it now if you wish or we could simply send a telegram when required.

CHAIRMAN MILLER. It might be easier if we could send a telegram because I think it's hard--unless there's an overwhelming sentiment among the voting members to suspend the limit. Let's just see quickly.

VICE CHAIRMAN VOLCKER. Excuse me?

CHAIRMAN MILLER. I'm just asking what the sentiment is among the voting members on suspending the intermeeting limit on [changes in] foreign currency [holdings] because of current conditions, as we did last summer.

VICE CHAIRMAN VOLCKER. I won't vote against it but my own sentiment is that I think that action may be built on an illusion that this is the answer to the problem.

CHAIRMAN MILLER. Yes. Well, Bob Black.

MR. BLACK. I'd just as soon wait and vote by telegram, Mr. Chairman.

MR. COLDWELL. I don't care. I think we don't have to do this.

CHAIRMAN MILLER. Okay, we've heard enough sentiment. Let's do this by telegram if we have to. We don't need a split vote on that sort of thing. Unless there are other comments--and I'll pause for a moment--[we can close]. Hearing none, I thank you all very much. We will be in touch. Goodbye.

END OF SESSION