

Meeting of Federal Open Market Committee

May 6, 1980

A meeting of the Federal Open Market Committee was held on Tuesday, May 6, 1980. This was a telephone conference meeting, and each individual was in Washington, D. C., except as otherwise indicated in parentheses in the following list of those participating.

PRESENT: Mr. Volcker, Chairman  
Mr. Guffey (Kansas City)  
Mr. Morris (Boston)  
Mr. Rice  
Mr. Roos (St. Louis)  
Mr. Schultz  
Mr. Solomon (New York)  
Mrs. Teeters  
Mr. Wallich

Messrs. Baughman (Dallas), Eastburn (Philadelphia), Mayo (Chicago), and Willes (Minneapolis), Alternate Members of the Federal Open Market Committee

Messrs. Balles (San Francisco), and Black (Richmond), Presidents of the Federal Reserve Banks of San Francisco and Richmond

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

Messrs. Balbach (St. Louis), J. Davis (Cleveland), T. Davis (Kansas City), Eisenmenger (Boston), Kichline, Truman, and Zeisel, Associate Economists

Mr. Sternlight (New York), Manager for Domestic Operations, System Open Market Account

Mr. Coyne, Assistant to the Board of Governors

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Mrs. Deck, Staff Assistant, Open Market  
Secretariat

Messrs. Forrestal (Atlanta), and MacDonald  
(Cleveland), First Vice Presidents,  
Federal Reserve Banks of Atlanta and  
Cleveland

Messrs. Brandt (Atlanta), Boehne (Philadelphia),  
Burns (Dallas), and Scheld (Chicago),  
Senior Vice Presidents, Federal Reserve  
Banks of Atlanta, Philadelphia, Dallas,  
and Chicago, respectively

Messrs. Bisignano (San Francisco), Broaddus  
(Richmond), Cacy (Kansas City), and  
Danforth (Minneapolis), Vice Presidents,  
Federal Reserve Banks of San Francisco,  
Richmond, Kansas City, and Minneapolis,  
respectively

Transcript of Federal Open Market Committee Conference Call of  
May 6, 1980

CHAIRMAN VOLCKER. I think we should proceed, even though some of the Board members have not yet arrived, because I have very little time myself. Mr. Axilrod, why don't you proceed?

MR. AXILROD. Mr. Chairman, [as the Committee knows], of course, we have had continued very weak money supply data since the last get-together. And total reserves for the four-week intermeting period, estimated from what we can tell about the amount of required reserves and the excess reserves that would be held at roughly current interest rate levels, seem to be running about \$800 million below the target path. And that's with borrowing coming down very close to nominal levels. In the current week, borrowing ex First Pennsylvania is now down to about \$500 million. Our projection and expectation is that in the next two weeks it will run around \$250 million ex First Pennsylvania. Thus, if any more reserves were put in to try to attain the total reserve path, they would have to go into excess reserves, which would cause a very sharp drop in the funds rate from the recent level. The funds rate has been moving down toward the 13 percent bottom limit of the Committee's range and yesterday was below it. Thus, effectively now, the funds rate is a constraint on the adjustments we would make to the total reserve path. We won't have any additional data on the aggregates until tomorrow, but I would not expect them to change substantially enough to indicate that the funds rate would not remain a constraint in adjustments to the reserve path.

CHAIRMAN VOLCKER. The general question we face here, to which no one knows the answer, is how forceably we have to push in reserves to get the money supply turned around or what influence that has on the federal funds rate. We are operating in an area in which we haven't operated before under the present technique. But it seems quite clear that if we do not change the federal funds rate constraint, we will simply be operating at a 13 percent level of the federal funds rate indefinitely without any assurance, and with a probability, that that will not in the short run turn the money supply around. The question in my mind is how much additional leeway should be given. I suspect that 12 percent [as a lower limit] will mean that we will operate with a 12 percent federal funds rate, so I would propose going somewhat below that. My own hope would be that the funds rate won't necessarily decline all that much further with the necessary injection of reserves. But we don't know, and I think we ought to give ourselves a little more leeway. I would suggest 11 percent as a possibility, but people could talk about other numbers as well. We meet in two weeks; whether that kind of adjustment will hold us until then I do not know. It all depends upon what happens to the data, what happens to reserves, and what happens to interest rates during that period. We could have a little more leeway if we moved it down to 10 percent, which is still consistent more or less with the present level of market rates for instruments other than federal funds. But that presumably would also be consistent with further declines in those rates. It would give us more opportunity to be sure that the reserve base was performing the way it's supposed to perform. But that's a matter of choice. I think we have to make some reduction, and it's a question of how much. I will stop right there.

MR. MAYO. Bob Mayo here, Paul. Just to put it on the table

I move that we go to a 10 to 17 percent tolerance range [for the funds rate]. That's 3 percentage points off on both ends. The symmetry with removing the 3 percent surcharge is purely coincidental. But I think that would give us the flexibility we need.

CHAIRMAN VOLCKER. Other comments?

VICE CHAIRMAN SOLOMON. Paul, this is Tony Solomon. I think we ought to move the funds rate as gradually as we feel we can. Even though I feel that we will end up with 11 percent, I would hope that we could operate for the next week or so at slightly above 11 percent. So I would like to recommend that we put the floor at 11 percent. I don't have any strong feeling on the ceiling.

MR. BALLE. Paul, this is John Balles. I would go along with moving the floor down to 11 percent; I think we have to take [whatever steps] we have to take to get the money supply turned around. But, having said that, I do want to convey to you the strong feeling that was expressed to me over the past week when I met with several members of our board of directors. I've written you a letter, which probably hasn't landed on your desk yet, hoping and urging that you would find an appropriate occasion to make a strong public statement as to why we have not resisted this decline of interest rates. [I'd urge you to say] that it does not mean we're [abandoning our] anti-inflation fight and to explain that it's to head off the unexpected and undesired absolute shrinking of the money supply. In short, these directors feel that there's a great danger of a broad-based public misunderstanding of what we're up to that may be interpreted as an easing of our anti-inflation policy and may result in some bad effects on inflation psychology.

CHAIRMAN VOLCKER. I'm aware of that [risk]. We've been pretty lucky in escaping it so far. I think we've fairly largely escaped it. I do not have a lot of time, so I hope the comments can be kept fairly brief. Maybe we could hear from the members first.

MR. MORRIS. Paul, this is Frank Morris. I would support moving [the lower limit] to 10 percent. I think 11 percent is a little tight, even for the [short] interval because the commercial paper rate is already below 11 percent. So if we have to catch up with the rest of the money market structure, it seems to me that 10 percent is consistent with the rest of the market.

MR. GUFFEY. Paul, Roger Guffey. I would reluctantly accept 11 percent but would be happier with 12 percent. I would hope that the move down would be very cautious and that [we] will catch up with the market someplace around [that] level.

MS. TEETERS. Funds are already trading at around 12 percent, aren't they, Steve?

MR. AXILROD. Peter may wish to speak to where the funds rate is this morning. Yesterday it averaged 12-1/4 percent. I think it's around there this morning.

MR. STERNLIGHT. The last I heard it was 11-7/8 percent. The market is really waiting to see what actions the Desk might take because there is a sense of reserves being available today.

CHAIRMAN VOLCKER. Do you have to take any action the rest of this week?

MR. STERNLIGHT. Well, I think it depends on the Committee's decision, Mr. Chairman.

CHAIRMAN VOLCKER. I thought it depended upon the reserve base.

MR. STERNLIGHT. Well, compared with our interim nonborrowed reserves objective, we're looking at a need to take out something like \$500 to \$700 million. But one might say that there isn't a great need to take that out, given how far below we're running on total reserves, as Steve has outlined.

MS. TEETERS. If you left the \$500 to \$700 million in, what would happen, Peter?

MR. STERNLIGHT. The funds rate presumably would soften, down to whatever lower bound the Committee agrees on.

MS. TEETERS. All the way to 10 percent?

MR. STERNLIGHT. I think it could, yes.

CHAIRMAN VOLCKER. We're not talking about a lower bound that is necessarily binding every day. Who else has a comment? I'll just go down the list. Governor Rice.

MR. RICE. I don't think it makes a great deal of difference whether we lower it to 11 or 10 percent. I would go along with either. It's a matter of [what level] we expect the funds rate to reach if we continue to follow our objectives. So, either 11 or 10 percent [is acceptable to me]; I don't think it makes much difference at this point.

CHAIRMAN VOLCKER. Mr. Roos. Is there no Mr. Roos?

SPEAKER(?). He's coming in a second.

CHAIRMAN VOLCKER. Governor Schultz.

MR. SCHULTZ. Well, given what appears to be extreme weakness in the economy, I would favor 10 percent. I had been afraid that perhaps we could get some surge in either the economy or the money supply but the chances of that at this point seem slim or none. So, I would agree with Frank Morris that we ought to go down to 10 percent.

CHAIRMAN VOLCKER. Governor Teeters.

MS. TEETERS. I suppose I'd go to 10 percent if the market is as weak as it sounds. If we settle on 11 percent, I think we will be back here pretty quickly, probably before the end of the week or certainly the early part of next week. We might as well give ourselves the leeway and let the market sort of find its own level at this point. So, I would favor going to 10 percent.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I think we're in danger of making a great mistake. The real policy action is on interest rates, not on the money supply. Whatever happens to the money supply over a period of a month has next to no effect on the economy. But these interest rates --not only internationally but domestically--convey an impression of a drastic shift in policy and create expectations that we're all for inflation as soon as we work out of this difficulty. So, I'd stick with 13 percent.

MR. ROOS. This is Larry Roos. I would strongly recommend the 10 percent figure. I think we've got to be willing to let interest rates move fairly freely, both upward and downward. And 10 percent would be my position.

CHAIRMAN VOLCKER. Do others want to make a quick comment?

MR. BAUGHMAN. I would prefer the 10 percent.

MR. WINN. In Cleveland we would prefer the 10 percent, too; we need the flexibility.

MR. BLACK. Same in Richmond.

MR. EASTBURN. Philadelphia would go with 10 percent, and I second John Balles' views [regarding a public statement by you].

MR. WILLES. Minneapolis prefers 10 percent.

MR. FORRESTAL. Atlanta prefers the higher number, but we'd be willing to go with 10 percent. However, we still think, as does Governor Wallich, that inflation is the major problem and that two months of decline in the money supply should not cause us to overreact. So, I would prefer a number higher than 10 percent.

CHAIRMAN VOLCKER. Well, we obviously have a somewhat split view. Does anybody have any further comments?

MR. MAYO. My support of 10 percent, Mr. Chairman, is really to give the Desk the flexibility that I think it badly needs. I'm not saying that we ought to go to 10 percent; we should do what comes naturally in terms of the way the market responds. But I see no particular point to moving [the lower limit] to 11 percent and then having to come back in another week or so and move it to 10 percent.

VICE CHAIRMAN SOLOMON. I really feel that it's not a question of catching up with the market. Whatever action we take will influence the market. We have to be perceived as moving fairly gradually and prudently. And I would hope that everybody feels as well that we want to retain the perception that the Fed is not changing its policy [of fighting inflation]. So it's really important to show a sense of prudence and gradualism in this [so as] not to precipitate further sharp declines in the market rates by people seeing us move so abruptly to a level as low as 10 percent. I would hope we would move down to 12 or 11-1/2 percent in the next week or so and maybe stay there for a week, and then move to 11 percent if necessary.

MR. ROOS. There are [several] points I would like to make. First of all, we have announced that the foundation of our policy is to permit money to grow at 5.5 percent. Secondly, we have announced that we have abandoned the policy of attempting to stabilize interest rates. And thirdly, I think we recognize that the most important objective of the Federal Reserve today is to restore credibility in our willingness and our ability to stick with a long-range policy and not change course the minute any short-term phenomenon occurs. So in addition to what Tony Solomon said [regarding] our objectives, I think the most important objective is consistency and re-establishing our credibility. And I know of no way to destroy that credibility more quickly than to start dancing back toward the stabilization of interest rates, after you and all the rest of us have said that we're no longer targeting on the fed funds rate.

CHAIRMAN VOLCKER. Well, I think there is some question as to how credibility gets defined in these circumstances, which I suppose is what the argument is about. In my mind, the one thing that bears upon this a little is that whatever we decide is going to be published fairly quickly. I don't know what way that cuts, but it leads me to be a little more conservative than I would otherwise be. And that lends some support to the 11 percent number. On the other hand, I don't like the idea of just going to 11 percent and sitting there on a floor for too long, because I think it might be inconsistent--though we don't know what the money supply figures will be--in getting [money growth] turned around. So I'm left in a bit of dilemma. But we can always meet again. And if it makes [Committee members] more happy or if we maximize the satisfaction and minimize the risk by taking an interim step to 11 percent, recognizing that we may have to come back next week, that's okay with me, too.

MS. TEETERS. You know, Paul, I'm a little disturbed by the fact that when [the funds rate was] going up nobody was concerned about the speed at which it went up. It ratcheted up over a period of about six weeks. And if we are really going to follow this policy, then we're going to have to let the market determine how rapidly it comes down. It seems to me we should give ourselves some leeway and if we're wrong, the market will turn the rates around and they will go back up again.

MR. SCHULTZ. I would hate to see that.

CHAIRMAN VOLCKER. We may be in a situation where literally in order to get the [money supply] turned around [the funds rate] has to go very low and then go right up again, which bothers some people, including me. But I don't know how to avoid that either. If we were only talking about the funds rate, it would be one thing. But we're talking about dragging the whole structure [of interest rates], probably.

MS. TEETERS. Well, with the prime rate at 17-1/2 percent, it doesn't bother me very much to drag it down.

CHAIRMAN VOLCKER. That I don't think there'd be any argument with. Well, the choice is between 10 and 11 percent, I think; and I don't know that anybody wants to change his or her mind basically. It comes out with a slight majority for 10 percent, I think. Well, maybe--

MS. TEETERS. Could we settle for 10-1/2?

MR. ALTMANN. Six [members indicated their acceptance of 10 percent].

CHAIRMAN VOLCKER. One, two, three, four.... I don't know how you get six.

MR. MORRIS. Paul, this is Frank Morris. I wouldn't object to adopting 11 percent, with the proviso that we have another meeting a week from today. I just don't think that 11 percent is going to do it. But if you want to proceed on that basis, that would be acceptable to me.

MR. ROOS. This is Larry Roos. I feel that setting up a meeting a week from now could be bad practice, if we were to tolerate a further withdrawal of reserves. Our big problem right now is that the aggregates are undershooting our targets. If, for example, for four or five days the Desk had to withdraw reserves in order to keep the funds rate at 11 percent, that would further exacerbate our undershooting problems. And I think we'd end up being accused of having once again been procyclical in making the prospects for a recession even more real.

MR. SCHULTZ. Prospects? It's here.

CHAIRMAN VOLCKER. It sounds to me as if maybe we ought to do 10-1/2 percent.

MR. RICE. I really don't think it makes any difference.

MS. TEETERS. We're in a range where it doesn't make any difference.

CHAIRMAN VOLCKER. Let's vote on 10-1/2 percent.

MR. ALTMANN.

Chairman Volcker	Yes
President Guffey	No
President Mayo	Yes
President Morris	Yes
Governor Rice	Yes
President Roos	Yes
Governor Schultz	Yes
President Solomon	No
Governor Teeters	Yes
Governor Wallich	No

CHAIRMAN VOLCKER. Did you get everybody? Did you get Mr. Mayo?

MR. ALTMANN. I got Mr. Mayo. There were seven votes for and three against. We only had ten [voting members present].

CHAIRMAN VOLCKER. Okay, I guess we're settled. Thank you.

MR. BALLEES. Paul, would this be an appropriate time to spend a few minutes on the discount rate?

CHAIRMAN VOLCKER. Well, I don't have a few minutes. I assume that we're going to remove the surcharge very promptly.

MR. MAYO. The Chicago board has just approved that.

MR. ROOS. So has St. Louis.

MR. GUFFEY. I would hope that the Board of Governors would wait until the end of the week to announce it.

CHAIRMAN VOLCKER. Well, we'll have to decide that today, but I don't know quite why you say that.

MR. GUFFEY. Well, because some of us have meetings [of our boards of directors] on Thursday and would prefer that this not appear to the market to be an unusual action by the Board of Governors or the respective Banks.

MR. BAUGHMAN. We just had a special meeting to approve this. We had a special meeting on the presumption that it would be announced promptly; otherwise, we would have waited until Thursday.

MR. MAYO. Same way with Chicago.

MR. EASTBURN. Same for Philadelphia.

MR. ROOS. Same for St. Louis.

CHAIRMAN VOLCKER. Well, we'll be considering that today.

MR. SCHULTZ. I have one other comment. I would hope that everybody out there is doing some hard thinking about how and how quickly we can get rid of these credit controls.

MR. BLACK. Yesterday!

MR. EASTBURN. Philadelphia votes yes.

MR. MAYO. Keep the money markets mutual funds control on a little longer.

MR. GUFFEY. Let's declare a victory and withdraw.

MR. WALLICH. I would agree with that.

MR. BALLE. If we go down to 10-1/2 percent on the funds rate, that's going to make the basic discount rate a real penalty.

SPEAKER(?). Yes, we'll consider that Thursday.

MR. SCHULTZ. Okay. Thank you very much.

END OF MEETING