

Transcript of Press Conference

with

Paul A. Volcker, Chairman

Board of Governors of the Federal Reserve System

held in

Board Room

Federal Reserve Building

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Mr. Coyne: Gentlemen and ladies, we are sorry to bring you out on such a beautiful day but I know you are all interested in this. This is all on the record. I think you all know Chairman Volcker. This gentleman is Stephen H. Axilrod. Steve is the Staff Director for Monetary and Financial Policy here at the Board. On the Chairman's left is Peter D. Sternlight who is the Senior Vice President at the Federal Reserve Bank of New York and Manager for Domestic Operation, System Open Market Accounts. Mr. Chairman --

Mr. Volcker: Ladies and gentlemen, I know we have had somewhat unsettled and problem markets in recent days. I will tell you that the major purpose of this press conference is to show that I have not resigned -- the way the early rumor had it yesterday -- and I'm still alive -- contrary to the latest rumor. We have been busy during the day with the Federal Reserve Board and the Federal Open Market Committee in developing a series of actions that is reflected in the release in front of you. I think in general you know the background of these actions; the inflation rate has been moving at an excessive rate and the fact that inflation and the anticipations of inflation have been unsettling to markets both at home and abroad. That unsettlement in itself and its reflection in some commodity markets is, I think, contrary to the basic objective of an orderly development of economic activity.

These actions do effectively reinforce actions that have been taken earlier to deal with the inflationary environment insofar as it is related to credit and financial markets, that it will have a healthy effect on expectations and will be and is fully consistent with the broad effort to bring inflation under control and to facilitate and ease any adjustments in the real economy that are underway. I think with that

background you can appreciate the particular measures that were announced here.

I would emphasize that the broad thrust is to bring monetary expansion and credit expansion within the ranges that were established by the Federal Reserve a year ago. They were reviewed in mid-year and reconfirmed and reported through regular procedures to the relevant Congressional committees. I think there has been broad support for the targets themselves. In recent months the money supply has been running, and bank credit has been running, in excess of the amounts we would like to see, in excess of the ranges we have set. Let me point out we are not basically outside of the targets but the projectory of growth has been excessive and we believe that these measures will work to bring the money supply and credit down and assure control. We have already taken action in that direction, as you know. All the actions we take operate with a lag. We feel that actions that we have already taken have moved in the same direction, and in a sense the actions announced today are reinforcement. With that, let me open this up for any questions that you may have.

Question: Can you explain that Item 3.

Mr. Volcker: Yes, unfortunately this gets into a somewhat complex area but it's been an area that has been under very active discussion among economists, within Congress, in financial markets, for some time. The Federal Reserve for some years has ordered a good deal of its emphasis in actual day-to-day operations to maintaining a high degree of stability in the Federal Funds rate which we most directly influence. That rate, of course, has been influenced in one direction, but generally by small increments in order to effect the growth in the money supply. Now what is implied here is a somewhat difference approach

where the primary emphasis is put on the supply of reserves which ultimately controls the money supply. I don't want to suggest that the control is so precise that it works week by week or even with precision month by month. But by emphasizing the supply of reserves and constraining the growth of the money supply through the reserve mechanism, we think we can get firmer control over the growth in the money supply in a shorter period of time -- greater assurance of that result. But the other side of the coin is in supplying the reserves in that manner, the daily rate in the market -- the rate without in itself great economic significance -- is apt to fluctuate over a wider range than has been the practice in recent years. We at the Federal Reserve will take less interest, if you will, in the daily fluctuations of that very short-term rate.

Question: Are you saying that Item No. 2, the marginal reserve requirement, could be something that you might change rather frequently in order to accomplish Item No. 3?

Mr. Volcker: I would not look necessarily to frequent changes. I do think that kind of reserve requirement is not the ordinary kind of measure that one would like to keep in place permanently. It is designed to fit a particular situation and I'm sure both we and the banks will be happy to get rid of it as the situation warrants -- as credit expansion -- in particular becomes aligned with policy intentions. The nature of this requirement is to take a basket of liabilities, deposits or other forms of borrowing from banks, in short-term markets -- but not encompassed in the ordinary definition of the money supply. This kind of access to the money markets that the banks have has expanded quite rapidly in recent months and it has been the source of financing a considerable portion of the increase in bank credit. So as we actually strain the money supply itself more assuredly, it only seems appropriate and logical that the forms of financing for banks that are outside the narrow

definition of the money supply also are to a degree inhibited. Let me point out that our targets for the money supply this year continue to envision some growth, which is normal, natural and appropriate. Growth in the money supply, in moderate amounts, in measured amounts, growth in bank credit in moderate and measured amounts is certainly suitable to the current economic situation. What we are guarding against here is excessive inflationary growth. We are looking to deal with the excessives not with normal process of credit creation and money creation.

Question: What impact will the marginal reserve requirements have on money funds which mainly hold these kind of liabilities?

Mr. Volcker: Well, I can't predict that fully. Money market funds to a very considerable extent, at least, are dealing with smaller amounts of money from individuals which are not encompassed in this managed liability concept of banks. This covers large CDs in negotiable form over \$100,000 and under a year's maturity. That's a big wholesale market. It covers purchases of Federal funds outside the member banking system. Purchases of Federal funds from non-banks or from non-member banks. It covers funds that banks obtain from the Eurodollar market. These are all big wholesale activities. Money market funds are basically directed toward a different market than direct competition with the kind of liabilities we have in mind here. Our money market funds do themselves invest in some of these liabilities. They are a source of funds to the banks and the effect would be to -- all other things equal -- perhaps make that outlet for funds grow less attractive.

Question: Mr. Volcker, just a couple of weeks ago the Board split four to three in raising the discount rate by just a fraction. What has happened since then to change the Board's mind so dramatically that they would raise it by a full point?

Mr. Volcker: I tried to make that clear through the many comments that I had at that time. Board members come to the table with independent minds in judging a specific situation. They bring differences of opinion. We voice our opinions. We vote, I think it is wrong to imply, as I said at that time, that a vote in a particular situation implies great and dramatic implications for future attitudes. What has changed since then is quite clear. We have had some business data; you have had some inflation data; we have had a lot of market data. If I may summarize it roughly: the business data has been good and better than expected, the inflationary data has been bad and perhaps worse than some expected and we have had developments in markets that suggested more forcibly than before the dangers of instability and inflationary expectations. I speak for myself and at least in most connections I was not voting for more than a half a percent discount rate increase two weeks ago. In that sense, I changed my mind.

Question: Mr. Volcker I wonder if you would go perhaps a half a step further and characterize and perhaps attach a certain amount of urgency to whatever events happened the last few days that we would have such an extraordinary session like this.

Mr. Volcker: It is not the events in the last few days; it is the events of the last few weeks. We have had unsettlement in the financial markets and these indications that I mentioned of economic and inflationary trends. There is no question that given a degree of unsettlement in financial markets, whether foreign exchange markets or domestic markets, running back two weeks or so maybe a little bit more, the anticipation that markets have had seemed to make it desirable to announce whatever we have to say at the earliest reasonable opportunity and particularly when the market is closed.

Question: Is gold's role a key in this or is that just a symptom?

Mr. Volcker: I think that gold is a symptom in a sense. It happens to be a market that gets a lot of attention and I think inevitably . . .

Question: On page 3 you have a statement here the Board stresses that banks should avoid loan activity that supports speculative activity in gold commodities in foreign exchange markets. Is there anything more to add to this?

Mr. Volcker: No, I don't want it interpreted as any feeling of necessarily substantial bank credit involvement in those markets at this time, although I have no statistics and no direct evidence. But there have been increasing speculative overtones, not just in the gold market but in other markets recently and in view of those speculative overtones we thought it was useful to remind banks that it is not the most productive activity in the world to be financing sheerly speculative movements of markets.

Question: Is this indicative that you are going to be paying any closer attention to bank activities in these areas? This is just a reminder of a statement of intent.

Mr. Volcker: I think that's essentially right.

Question: You wouldn't be thinking of controlling margin requirements in those areas?

Mr. Volcker: There is only one margin requirement that is under our control and that is the stock margin requirement. I don't think speculative activity has been evident in an unhealthy way in the stock market, in my personal judgment.

Question: There is one more question. On the international front. Have you \_\_\_\_\_ of this package that you have announced here? Have you taken any action to reactivate swaps which you arranged last year or actually swaps which you arranged last \_\_\_\_\_?

Mr. Volcker: We have swaps activated as you know, and in general, resources are available in that area. In general, we have had some discussions, as you know, in recent days and weeks to provide even closer coordination on tactics and intervention in exchange markets particularly with German authorities. You well know that money has not been a problem. I think we have had some very useful discussions in that area of intervention. I think there is a meeting of minds among the various authorities involved there. But I would emphasize that the fundamental solution to the instability of foreign exchange markets does not require intervention. And the kind of actions we take here are hopefully more important.

Question: Report of activation of swaps. Does that actually happen?

Mr. Volcker: The package that we announced last November was activated, remains activated, there was nothing new to activate last week.

Question: Is there any thought to expanding, mobilizing additional resources? You spoke of market anticipations. That's one thing the market is anticipating.

Mr. Volcker: There are various methods that could be used to obtain additional financing. I have no announcements to make there now. I'm sure that one of several particular techniques could be used as appropriate but the basic point is there is no urgent problem in this connection.

Question: Are you saying hands off altogether on the Federal funds rate or will you still have some ceilings in mind for it?

Mr. Volcker: Cautious central bankers never talk in extremes but I think the banks will find that they will have to learn again, in a sense, how to make reserve adjustments on a daily basis or a weekly basis in a Federal funds market that does not have the same official chaperonage on a day-to-day basis.

Question: But it still won't be completely free to go as high as it might?

Mr. Volcker: I don't know what you think is as high as it might. There will be substantial freedom in the market.

Question: Mr. Volcker, what domestic of economic effects would you anticipate from this series of actions? Would you expect it to further slow the economy or deepen the recession?

Mr. Volcker: I would hope that these actions, and expect that these actions, would ultimately have a settling effect on financial markets. I think it is basically good for longer-term interest rates which are the most important in terms of the economy because they are sensitive to inflationary expectations. It would be my hope and expectation that this will help to avoid distortions, help to avoid excessive inflationary expectations . . . Which comes back to the basic point. I'm sure you heard me say it before. I don't think it is good for business activity, I don't think it is good for productivity, I don't think it is good for growth to have inflationary expectations running ahead, and to the extent that we can deal with that problem we have a firmer and better base for dealing with economic developments.

Question: But in immediate terms does it have an effect that will tend to slow down economic growth that is already too wishy-washy in this country?

Mr. Volcker: Well, you get varying opinions about that. I don't think it will have important effects in that connection. I would be optimistic in the results of these actions. But we're in an area dealing with economic events that are not fully predictable. I think the main thing to say about the economy right now is that it is somewhat stronger than anticipated. The outlook continues to be, in a general way, that some inventory adjustment may be in prospect. I think the best indications that I have now in an uncertain world is that it can be accomplished reasonably smoothly. There are always risks when one looks ahead but I think again, just looking at recent history,

expectations of the worst are not always a valid basis for policy-making. And I am not inclined to sit here and say let's dream up the worst that can happen and base all our policy decisions on that kind of thought.

Question: What kind of staff forecast for the domestic economy were you looking at at the time you made this decision?

Mr. Volcker: Well, I don't think we ordinarily reveal all our staff forecasts. Our staff forecast like any other staff forecast is probably not up to what has been happening recently. But there is a widespread feeling, as I said, and I'm sure shared among most members of the Federal Reserve staff, that the current rate of inventory accumulation will probably have to come down and that that has potential impacts on production in the short-run . . . It might give a little glow of ruddy cheeks to the economy for a few months but it would really be a sign of feverish cheeks to have a burst of inventory speculation at this point. I don't think we need that so that in that sense it is an example, and an important example, of how inflationary expectations can basically complicate and endanger the economic outlook.

Question: With the economy stronger as you say than had been expected and inflation worse than had been expected and now you are taking these actions, do all of these factors argue against tax reduction on the part of the Administration anytime soon?

Mr. Volcker: Well, I have expressed the view before, and the Administration has expressed the view, that this is not the time for tax reduction and there is nothing in these actions that alters that. I think that what has happened recently underscores the wisdom of that position and the wisdom of the Administration's position on that score. It has been fully underscored. What happens out in the future, as I've said before, I'd like to see a tax reduction of some sort, a well-structured tax reduction, but this is not the time.

Question: Mr. Chairman, since the spring, the Federal Open Market Committee,

in fact, has been permitting larger than normal swings in the Federal funds rate on a daily basis, particularly on the Wednesday closing dates. There has been a swing of as much as a point and a half. There was an occasion this spring when this was happening. Is a point and a half the kind of fluctuation range that anticipates a new regime or larger? What are the outer limits that you would imagine that ---

Mr. Volcker: I'm not sure that your premise -- maybe you follow it more closely than I do -- that Wednesday is always a peculiar day in the Federal funds market. I am not particularly sensitive of those fluctuations having been greater recently than before. Mr. Sternlight could perhaps inform us both. I don't think I want to comment upon any precise range of fluctuation. I think there will be substantial dips. Let me put it this way. There could be substantial volatility on a day-to-day basis which I don't think is significant in itself, but maybe we will be surprised as banks learn to deal with this, and they're quick learners, in this area. It is their job, it is their professional job, to smooth out these day-to-day fluctuations in the money market because it is money to them. They don't want to sell Federal funds at a low rate one day and have to buy back at a high rate the next day, so you've got an enormous cadre of professional money managers out there whose lives and jobs are designed to arbitrage from one day to another between markets . . . you might see a rather smooth market develop rather quickly as these people do their everyday job and many people in the money markets think that's precisely what will happen in a very quick period of time. So I don't want to sit here and forecast fluctuations. What I will say is that we will not shepherd the market so closely from day to day, but that's not the same thing as saying that it will affect fluctuations.

Question: Can you tell us the terms in which you are going to be issuing directives to Mr. Sternlight? Now you in the past have talked about the Federal funds rate and rate of growth to the aggregates.

Mr. Volcker: We will talk about rates of growth in the aggregates as the fundamental objective of the economy. We have been concerned about the aggregates right along, and in terms of the directive, there will be that same concern about the aggregates. What will differ is that more emphasis will be placed upon a translation of those aggregate objectives, which in themselves have not changed, into their implications for the Reserve Banks for actual reserves and for non-borrowed reserves. Mr. Sternlight and Mr. Axilrod will be heavily engaged in that process that I have described and Mr. Sternlight will be heavily engaged in translating that in daily open market operations . . .

Question: Mr. Volcker, is there any help that you're hoping for from any other quarters, be it the Executive Branch or Congress or business, against inflation?

Mr. Volcker: We're always looking for help and indeed I think we are going to get some help. We live in a difficult world, as you know. Fiscal policy is restraining in relative terms and it has been a move often overlooked. The budget is still in deficit, I recognize that, but it has moved very substantially over a period of a couple of years. Expenditures have been restrained, so that area, I think, is pulling its weight. The Administration has been struggling, as you know, with the guideline program and the cooperation of business and labor that is aimed at the same problem, and we're getting help, as you put it, I think, in that direction. Maybe it might properly be said that we are giving them some help too. I think our priorities are similar in both areas, so in that sense it can be considered part of a broader program. There are a lot of other economic policies, many of which have

a longer term of significance. The whole regulatory business which the President has given some attention to. It's nothing where you make striking progress in any short period of time. When one looks at this whole range of problems, you can't help to be impressed.

There has been a discouraging trend in this country about productivity. We had, in a sense, bad news on that again yesterday, because with the revision of the labor force figures, and particularly the employment figures, the benchmark revision that was announced we found out that employment was even higher than we thought it was and the growth of employment was even greater than we thought it was--and of course, let's not forget, we had an immense growth in employment in this country in recent years but with output as it was, we now find out that employment was still higher and the productivity figures are looking worse than they did before--and they didn't look good before those figures came out. We have an adverse trend in productivity to the point from last year where the figures are actually negative. They have been computed with these new figures but it is a significant negative figure. You know what that means--when employment is increasing, relatively and there haven't been any substantial changes in the unemployment figure during this period. We're getting less output per worker. We've had a lot more workers, but perworker there is less output. That only can get translated into a decline in the standard of living, and you can't be too surprised when at the other end of the sausage grinder, so to speak, you find prices rising more rapidly than income. That is inherent in a situation where productivity is declining.

Now we also have another wedge in a different context from the increase of the OPEC oil prices. In effect, a tax of something like

\$25 million dollars wedged into the American economy between prices and income.

And so we've had two very fundamental reasons why real income has declined. And the reason it's so closely related to this inflationary process is that people understandably don't like real income declining. So they say: "Let's catch up with real income. Let's catch up with it in our wages with the prices." If you have a decline in productivity and if you have higher import prices, strikingly higher import prices, the inexorable fact is you can't catch up. Because the output is not there to permit the increase in real income. And so it is in a very fundamental sense something that we have to accommodate ourselves to. Well, the answer is very obvious. Raise productivity and get stability in import prices. I must say that stability in the exchange value of the dollar is not irrelevant. . .

Question: Mr. Volcker, have you discussed these measures with anyone in the administration, and what were their reactions?

Mr. Volcker: Of course, I've kept them informed of thinking as it has developed. I don't think it's really appropriate for me to speak for them, I think they ought to really use whatever words they care to use. But I will emphasize, there's no surprises.

Question: Mr. Chairman have you had any pledges from the \_\_\_\_\_ on their interest rates and view of your discount rate increase, they have been marking up more or less \_\_\_\_\_ with us and it has been \_\_\_\_\_ assume to be a very large part of the short-term cash rose in determining. . .

Mr. Volcker: Well, there have been some allegations of that sort. I don't have any pledges from them. In very broad terms there have not been any recent measures in Germany. There were some sizable interest rate increases earlier this year and they are explainable, quite readily, in terms of the

problems they've been having. They've been having quite a brisk economic expansion and by their standards rather sizable increases in consumer prices so the kind of measures that they're taking are not surprising on those grounds. Let me say in that connection--while it not reflected in the consumer prices and I'm not suggesting that they expect it will be reflected in consumer prices, but its indicted as a general problem-- that wholesale prices in Germany and in most other industrialized countries in the months of this year have been very comparable in proportion to the increase in producer prices in the United States. That hasn't gotten a lot of attention. I have not looked at the figure frankly for the past two or three months, but when I last looked at it, approximately two months ago, curiously enough the increase in the producer price index in the United Staes, up until that time, was among the lowest among the industrialized countries from the beginning of 1979. I don't cite that as a brilliant record obviously on the part of the United States. But, this is, to some degree, part of a world phenomena. . .So in that connection it is not entirely surprising to see some parallelism in the kind of actions taken. Having said all that, I think the kind of consultation that we have had with foreign monetary authority is in the degree of intensity, and closeness greater than anything I've seen in my experience, and I've been in this game for a while.

Question: Mr. Chairman would you say the effect of this kind of action would be on the business lending and also consumer problems?

Mr. Volcker: I would not expect it to have any particularly direct or quantitative effect on consumer loans to single those out, especially. I do think total loan growth has been excessive in terms of an environment in which we want to move back towards more stability. The biggest chunk of that recently has been in the business loan area. Now let me emphasize

the object of this action is not to turn this off. We expect some growth in the money supply. We certainly expect growth in business lending. Inventory accumulation is high; it needs to be financed. What we want to get at is the excess. And the figures have been high enough to suggest that excesses have entered into the process.

Question: Do you expect that the bottom results of these actions will be to make credit unavailable at any price, some otherwise creditworthy ones?

Mr. Volcker: No.

Question: That is that people will not be able to roll over (?)

Mr. Volcker: I definitely do not. As I just indicated, our objective here is not to shut off the flow of credit, but to hold it within those proportions consistent with the orderly evolution of the economy. . .