

Transcript of  
Press Conference  
of  
Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System  
at the  
Business Council  
Hot Springs, Virginia  
October 9, 1982

CHAIRMAN VOLCKER: I might say just by way of introduction that I thought I had a good idea a week or so ago, I had a little sense that maybe we wouldn't put our usual emphasis on M1 as an operating target for a while for reasons I'll explain in a minute, or explain in the statement. I realized if we were going to do that I'd have to tell the public, through the press, so that they all understood it. Joe Coyne suggested to me, well, why don't you have a press conference after the open market committee meeting. My immediate reaction was no. If I do that they'll blow it up all out of proportion and I'll get completely misinterpreted. What I'll do is, I'll go down to the Business Council and tell them, and just explain this little technical matter. So you can see how successful I was in keeping it in that full sense of proportion.

I have this little excerpt that I gave you from my talk with the Business Council and I'll just read a couple of portions of it:

"As you know, yesterday we made a further reduction in the discount rate to 9-½ percent. As is usually the case, that change was, in an immediate sense, designed to maintain an appropriate alignment with short term market rates. It was, of course, also taken against the background of continued sluggishness in business activity, the exceptional recent strength in the dollar on the exchange markets and indications of strong demand for liquidity in some markets.

"In the light of all the potentially confusing comment in the press in recent days...it may be desirable for me to reiterate what seems to be obvious; the small reduction in the discount rate--as in the case of the four changes of similar magnitude in July and August--represents no change in the basic thrust of policy."

Now, let me just summarize some of the points in the rest of the paper and put them on the table for whatever questions you may have. Let me say I am encouraged. I've said it on a number of occasions that I think the inflationary momentum that has come to grip the economy in the 60's and the 70's has been broken, and I do think the prospects are good for some further reductions; that we can build up a momentum toward price stability. But I am under no illusions that that look at the future depends upon continuing vigilance and discipline in monetary policy. None of us have any feeling that that concern of monetary policy--that continuing concern about inflation--is something that can be turned on and off, and it's not going to be turned on or off.

Now you people and all of us, I think, have some difficulty in characterizing monetary policy in a headline or in a short story. Whether it's easing or tightening, I hope we've learned--and that's the next point that's made--that we can't measure that by fluctuations in interest rates. The point of policy significance is we do not think we can force interest rates lower; we will not force interest rates lower; we welcome declines in interest rates, obviously, but those have to be based upon the sense of progress on the inflationary front if they're going to be sustained apart from the cyclical elements in interest rates.

But because, in part at least, of the difficulty of measuring--maybe the impossibility of measuring--policy by interest rates, there's been a lot of emphasis on so-called monetary aggregates. And our policy is based on the basic premise that over a period of time you've got to keep the monetary growth under control if you're going to keep interest rates under control. But I'm sure all of you have on a number of occasions heard me try to caution about the validity of any single measure, or even

all the measures, in the short run. The problem now is precisely that one of those contingencies we are faced with in lesser degree all the time is here with respect to M1. Simply because of regulatory and legislative change that figure is going to be distorted. It is a fact of life. We know it's going to be distorted because of the termination of all saver's certificates right now, and some temporary movement of funds through demand balances or through NOW accounts.

About the time that should settle down, in a few weeks, we face the certainty of distortions arising out of this new money-market fund type of account that the banks will be able to offer within a matter of six weeks or so. We know there will be distortions. Nobody knows how to measure those distortions. Nor will they be easily measurable after the fact. In those circumstances, all we are saying is that, as I note on page 4, the fact that for the time being underlying monetary growth in reserve provision cannot sensibly be gauged by directly observing movements in M1 up or down is a technical fact of life, it has no broader policy significance. It strikes me if you want an analogy, it's like driving down the road and finding a construction project. Construction in this case is reconstruction of the depository system. You'll have to make a little detour before you get back on the road.

Finally, the point is made as you know that our monetary aggregates judged generally have been hovering by and large somewhat above our targeted levels. That is true even though the most recent movements in M2 and M3 have clearly been toward the slowing direction. I note again what I noted in July: that growth somewhat above the targeted ranges would be tolerated for a time and circumstances in which it appeared that precautionary or liquidity motivations during a period of economic uncertainty and turbulence were leading to stronger than anticipated demands

for money. We will look to a variety of factors in reaching that judgement, including such technical factors as the behavior of different components in the money supply, the growth of credit, the behavior of banking and financial markets and, more broadly, the behavior of velocity <sup>and</sup> in interest rates.

That is what I said in July. I believe recent assessment of recent developments in the light of those factors does suggest that preferences for liquidity have generally been relatively strong. They've been reflective, in part, in some abnormal pressures in parts of the private credit markets. As we said in July the fact that some of the aggregates have tended to run somewhat above their target ranges has been fully acceptable to the Open Market Committee. I will conclude by saying I can speak for all members of the Committee in saying that those judgments have been reached and they're going to continue to be reached in full recognition of the need to maintain the progress toward price stability.

Now with that much review of the statement let's proceed.

QUESTION: Getting to the emphasis perhaps the problem is the weakness of the banks, has this been in any way a factor of perhaps seeing some potential failure of a bank to solve the problem that requires loosening of the \_\_\_\_\_.

CHAIRMAN VOLCKER'S ANSWER: Well, not in the sense of a failure of a bank. Or I wouldn't term it as weakening of the banks. But I do make an illusion to some unusual pressures in credit markets. There isn't any question there has been an unusual degree of concern in private credit markets reflected in unusually wide margins between government interest rates, look at the Treasury bill rate. You are not getting an indication of what the rate is on short term bank instruments. There's been quite a gap between the deposits rates of banks and the prime rate. There is a gap between

U.S. rates and European rates. All those reflect to some degree the fact that there is no simple interest-rate reading, certainly of government security interest rates in the United States that reflect some elements of pressure in the private market.

QUESTION: Is this after \_\_\_\_\_ those kinds of problems?

VOLCKER: Well, I think it's a combination of a byproduct of economic conditions, a byproduct of some cases of overly exuberant lending policies in the past. The international problems to which you elude all enter into the equation.

QUESTION: Shift in emphasis \_\_\_\_\_

VOLCKER: What shift in emphasis?

QUESTION: Shift in emphasis \_\_\_\_\_

VOLCKER: Doesn't mean more or less. All we are saying is M1, not by choice, by events, is going to give unreliable signals. Now there's some sense that what we are saying is that M1 is going to go way up. I am not saying that at all. The impact probably in the new instrument will be to artificially depress M1, but that depends upon the characteristics of the instrument. I am assuming we don't count it within M1. You can imagine circumstances--that hasn't been definitely designed yet--where it's directly attached to a NOW account. That might have the effect of increasing M1. But my guess at this point and time would be not that the end result is a high M1 but a lower M1 than you would think because of this technical change.

QUESTION: How weak is the economy \_\_\_\_\_ learning prospects \_\_\_\_\_

VOLCKER: My sense has been and you've heard me say this before, that we should be able to look toward some recovery. In fact, I would have thought that we would have seen tangible signs by this time. They haven't developed. Our short term forecasting ability is not impeccable on the up or

down the side. I think everybody has spotted that problem of economic policy; our forecasts are not infalible. But I think there are forces out there that should push the economy toward recovery. I would expect that to be of moderate size. But I think it would be important and obviously reassuring to see things moving in that direction. The policy objective in a sense is to sustain that recovery. It is much less important in my mind just what the numbers show for a quarter or two, than whether we have the conditions that can maintain that for years. And that is in part why the concern we have about inflation has to remain at a very high level. Even though recent data is encouraging, the trend has changed, the momentum has been broken.

QUESTION: \_\_\_\_\_ that the slowness of recovery has effected all the decision of \_\_\_\_\_ of the \_\_\_\_\_ M1:

VOLCKER: It had absolutely nothing to do with deemphasizing M1. Let me repeat, once more, the emphasis on M1--what shall I say. The wind blew a tree into the house so we had to move to an apartment while we repair the house. It had nothing to do, it's got no policy content whatsoever. It is a recognition of the reality that the M1 figure will be distorted and nobody will be able to make an intelligent judgment for some time about what an M1 figure means. Zero policy significance.

QUESTION: Have you moved toward a policy of watching short-term interest rates and deliberately pushing them lower?

VOLCKER: No. I think the implication of a deemphasis on M1 has to be that. It's not new, except in a matter of degree. I say in the statement: We'll look at M2 and M3 to see what information we get from that--because we always do look to them--but we expect those to be less distorted by this technical change because almost all the changes I anticipate will be within those aggregates and not outside.

QUESTION: Will this be considered sort of an experiment as to the possibility of using M2 or a broader monetary base for your target for next year as someone suggested.

VOLCKER: We have looked into that before, this is not new. The market, I'm afraid, has always put a little more emphasis on M1 than we do, among the various targets. It's not an experiment in the sense of going out and making a deliberate experiment. Again, I will repeat once more, we had no choice in the matter. When you have a figure which you know is going to be off base, it makes no sense to follow the figure. Now how soon one gets back, in a sense, depends upon, I think, when one with some sense of confidence and reliability feels that the disturbance has settled down and you can make a judgment about the future of \_\_\_\_\_ in concerns, in relationship to what you are interested in.

QUESTION: When do you expect that to be? \_\_\_\_\_?

VOLCKER: I am sure I said the policy objective is to sustain the recovery in precisely those words. But I don't want to be misunderstood. We want a sustained recovery but, to avoid any misinterpretation I also said that policy required concern about inflation and that's why inflation remains a high priority of policy. It is an objective in the broader sense. After showing that bit of sensitivity, I forgot what the question was.

QUESTION: When will it arrive?

VOLCKER: Well, as I say we have been expecting it right along here. Let me point out that this present forecasting situation, if you may call it that, reminds me very much of a situation we were in in 1979 and 1980 when all the assembled economists of the world-- and the press joined in--and said:

"Next quarter there's going to be a recession." There was going to be a recession in the second quarter of 1979, and it didn't appear. There was going to be a recession in the third quarter of 1979 and it didn't appear. There was going to be a recession in the fourth quarter of 1979 and it didn't appear. Well it eventually appeared, for a short period in 1980. All I am pointing out is that we know a lot about the economy, I think, but the ability to forecast precisely a quarter, and which a change in the cyclical direction will come about, has not been remarkable for its accuracy.

QUESTION: But March 19, 1980 you made it clear \_\_\_\_\_?

VOLCKER: Well we'll have to decide that, and I made an assumption in the analysis that it would be in M2, and it would probably be a minimum size check, and not too many. But your question illustrates the problem. It could be classified in either one. And the way you classify it will obviously effect the M1 figure. I revealed a little bias but if the thing was shaped a little bit differently or if the so-called super NOW account was introduced I think it logically belongs in M1. I think the question illustrates the point of the impossibility at this stage of saying growth of X percent in M1 is the right growth.

QUESTION: What is a fair characterization of what you have done? What would you recommend to us in asking a very basic question, since you said the M1 change has no policy \_\_\_\_\_ but yet you say you are encouraged that inflation is being \_\_\_\_\_ demands and so forth but you take the sum total of what you are describing to us here, how would you fairly characterize what that is that's happening?

VOLCKER: You want me to write your headline for you?

QUESTION: Yes, that's exactly right.

VOLCKER: I wouldn't put it in a banner headline on page 1, number one. I don't think it is that kind of a story. I think we have made a continuing kind of operational adjustment, of the kind you have to make in the conduct of policy, within the same general framework of maintaining appropriate restraint on the growth of money and credit. That's longer than a headline. But I'm not going to try to condense it into two words.

QUESTION: Why do you think that the stock market blasted off the day after you made this decision on behalf of the Board to continue \_\_\_\_\_ into the stratosphere of the \_\_\_\_\_?

VOLCKER: Well, the stock market has not heard an official explanation of it, as best I know so far.

QUESTION: \_\_\_\_\_ just reading the newspapers?

VOLCKER: The newspaper reports were totally inadequate. I mean you don't expect me to be pleased about newspaper reports based upon partial, selective and inaccurate information.

QUESTION: Can I ask you a question about your outlook for mortgage money? Obviously the rates are coming down. At what level would you sort of expect consumers to get back in, really think about buying homes?

VOLCKER: Well, I'm sure this is a matter of degree. My sense is that more are thinking about doing it right now. I talked to some builders the other day. I don't know if they were representative, because they surprised me that they had a sense that that very thing was happening now and the prospects were looking much better. I haven't seen it in the market particularly myself, but that was their story and it was not reflective in statistics yet,

but it is a matter of degree. There's certainly more availability of mortgage money and at appreciably lower rates today than there were two months ago.

QUESTION: \_\_\_\_\_?

VOLCKER: I would think, as I suggested in my statement, that both. It's not unusual to see interest rates decline in a recession, but I believe, to make this absolutely solid, we've got to persist in policy. I believe what we are seeing here is a reflection of basic progress on inflation, and expectations in that connection. An interesting thing in the market reaction this past week--and I don't want to read too much into it or going back a little further--is the sort term rates have not moved all that much, but long term rates have moved quite a lot, which is a typical reaction you would expect, reflecting confidence in the future interest rate outlook which in turn employs growing confidence in the inflation outlook. I hope that is a correct reading.

QUESTION: Mr. Chairman, do you see the Open Market Committee continuing its policy of restraint, but will allow M1 money supply growth to go above the target ranges?

VOLCKER: You say M1 above the target ranges. If my guess is right about a big impact in the new instrument depressing M1, it could well go down. If I may just repeat once more for the 18th time I get some flavor in reading the comment that this is all a big deal because you want M1 to go up. The likely impact of the new instrument will be to depress M1.

QUESTION: Well, the fact is that the M1 figures and others \_\_\_\_\_ apparently Open Market Committee \_\_\_\_\_?

VOLCKER: As I said in July, and I suggest you look at the statement again... we've been deciding all along. It was in last month's policy record of the Federal Reserve.

QUESTION: \_\_\_\_\_?

VOLCKER: That is not true. Since the last meeting we have had exceptionally slow growth in M2 and M3. That figure hasn't been published yet for September in the whole. We had a low M1 figure from April to early August, mid August. It grew more rapidly in September. The last M1 figure, the figure published yesterday, was I think roughly was within a billion dollars of the target. You don't come much closer than that in this world.

QUESTION: \_\_\_\_\_ continuing the policy of restraint?

VOLCKER: You have trouble characterizing, and I have trouble characterizing. It is a policy of continuing to restrain the growth of money and credit to appropriate levels in the interests of encouraging a continuing decline in inflation. A little long for your headline. That policy does not imply continuing pressures on interest rates.

QUESTION: But interest rates are high, somewhat to the discount rate. What factors would you all take into account to drop the discount rate from 9.5 to 9? Next week, next month, or whatever? What kinds of factors will you be watching for?

VOLCKER: I would refer you to the statement.

QUESTION: Well \_\_\_\_\_?

VOLCKER: I will let that be merged with the fullness of time. I'm not about to predict the discount rate and whether it will go up or down or sideways.

QUESTION: \_\_\_\_\_?

VOLCKER: Well, one always looks at interest rates, in helping to explain what's going on in the market. There was a question about the private credit markets earlier and I answered it in terms of interest rates. That is input. My statement in July noted that. Yes, we will be looking at M2 and M3. Obviously we've got partial information as the months progress

and we arrive at a judgment within this framework, which I tried to outline in the statement.

QUESTION: Specifically would you gain more or less for the same amount  
\_\_\_\_\_?

VOLCKER: I would say the same. We always observe the federal fund rate as one indicator as to what is going on.

QUESTION: How accurate do you think that your forecast would be in determining the targets given these distortions? Is there a possibility \_\_\_\_\_?

VOLCKER: The target is irrelevant--for a short period of time we are talking-- if you think the figure is truly distorted. Now I said less emphasis, we will be analyzing that figure as best we can to see whether we can glean from it some sense of whether the unrelying trend is up or down. I have some skepticism in the next few weeks as to how accurate that kind of judgment will be, but I assure you we will be analyzing the data that arrives to the best of our ability. We'll try to distinguish between the froth and the trend. What we are saying is we suspect that there is going to be a lot of froth.

QUESTION: But what kind of impact could that have.

VOLCKER: If we think it is froth, we don't pay attention to it.

QUESTION: On a weekly basis will you be changing the emphasis on total reserve nonborrowed reserves, monetary base?

VOLCKER: We will be changing the emphasis, in a sense, in tracking the M1 figure. We will continue to have a reserve path for basically nonborrowed reserves in the short run when you look at total reserves. But you will adjust for aberrations in M1.

QUESTION: \_\_\_\_\_?

VOLCKER: I think it's certainly easier to finance the deficit in a time of recession, but that's not the way to get the deficit financed in the most satisfactory way. Yes, indeed, I remain concerned about the impact of financing the deficit during the period of recovery. I think that some of the sharp edge has been dulled by the actions taken last summer. But clearly the problem remains. Prospective deficits are very large and it will be a continuing large challenge to the Congress, and the administration.

QUESTION: Mr. Volcker, there are those who may not \_\_\_\_\_ technicality \_\_\_\_\_?

VOLCKER: I am beginning to write your headline for you. Federal Reserve Policy Remains Consistent, Reward is Declining Interest Rates. How do you like that headline?

COYNE: Does someone have one more succinct question?

VOLCKER: He didn't quite finish his.

QUESTION: I was not exactly, but then people look at direction of short term rates in the last few weeks. How do you respond to those cynics who say that Federal Reserve policy is sometimes \_\_\_\_\_?

VOLCKER: Well, let me give you one factual point and one philosophic comment, I suppose. This is somehow part of the American folklore. I would remind you that just about at the same time relative to the election in 1980 the discount rate was raised. I understand a certain amount of cynicism exists on this point. You're tempted to go in a hole and hide until the election is over. But I decided in the end we better do what we thought was right anyway.

QUESTION: Can you just tell us what your estimate is and how long \_\_\_\_\_

VOLCKER: I think what you would expect is that the All Savers Certificate distortion that I referred to, first, would be a matter of weeks in my opinion. That's going on, to the extent it's going on, in full force right now. It should be washed out then in a couple of weeks. That would be my expectation. If that was the only problem you faced, you could just say forget about a couple of weeks and see how it looks at the end of the month. The trouble is--just about the time you would expect that to wash out--the other change comes in, and that is harder to judge an impact...

Now the problem is that the change introduced immediately may be the first in a series. Suppose we go from this limited transaction account--three checks a month and three other transfers and a minimum account size and a minimum check number and that's put in place, and three months later you come along with a complete transaction oriented account, with a market interest rate, unlimited transaction powers, with no minimums. That would have another impact on the figure. I would remind you, too, that I alluded in July to another kind of problem which does not affect the validity of the aggregates over a period of time but a note of caution that the relationship between the economy and the aggregate may change. Without this technical change, I would expect that in a world of declining inflation, a world of return toward price stability and what amounts to the same thing a return to a world of much lower interest rates, you are going to see over a long period of time a different relationship between M1 and economic activity than has been characteristic of the past twenty years of inflation. You have

to make a judgment as to that change in trend or in more technical terms change in the trend of the velocity if it appears. I'm not sure it's appeared and I'm now speculating. But I say you have to make a judgment on that matter. Among other things, if interest rates go down the way you would like to see them, the distinction between the NOW account and the savings account disappears.

QUESTION: How would the relationship be different between the M1 and the economy?

VOLCKER: What I would expect is that this long trend we have toward higher velocity would stabilize or perhaps reverse itself. There have been changes before in economic history, it tends to maintain a trend and then changes. It is important to realize when that's going on.

QUESTION: Are you not now able to control the money supply because of these new changes?

VOLCKER: In the short run, we can't control it anyway. I repeat once more-- in the very short run and what goes on this week and next week we cannot control anyway. The point is to the extent you know that's distorted you don't want to try to control it because you distort the economy to achieve a statistic. The statistic doesn't mean anything in the middle of these changes. It does not make any sense to say I will adjust the economy to a money supply figure, that doesn't mean what it meant yesterday when you got a new change. If that's all clear to you.

QUESTION: How do you create \_\_\_\_\_?

VOLCKER: How do you create a new bird. Do you think we pull these things down out of the sky. The problem you have is that you have a bybred instrument here. Do you put it in M1 or do you put it in M2? We could make a

fancy adjustment the way we did last time if we knew, if we had a way to do that we'd do it. We don't feel that we have a way we have any confidence it

COYNE: The young lady here has a last question.

QUESTION: How do you expect Joe Sixpack should react?

VOLCKER: I don't think Joe Sixpack should be concerned in the least about the fact that M1 is distorted by All Savers Certificates and the introduction of a new instrument. I think if you give Joe Sixpack that impression you are doing him and the country a disservice.

QUESTION: But you are saying lower interest rates \_\_\_\_\_?

VOLCKER: Terrific. I like to think of that as being consistent. As I say, with the progress we are making on inflation and, as I say in the statement, as a reward for that progress. We can't force the process.

If we force the process, it's going to be counter productive.

QUESTION: If that is happening know why \_\_\_\_\_ consumers \_\_\_\_\_?

VOLCKER: We can get off into a whole lot of other questions there.

There clearly are uncertainties in the economy but I think the important thing to say is the consumer's financial position, as best we can measure, his indebtedness is less than it has been for years, his liquid assets position is better, his overall financial position looks stronger, the savings rate is rising. All those are developments that in a fundamental way, I think, should support consumer spending and growth in consumer spending over time. Whether it develops this month, next month, in the Christmas season or what, economists aren't very good at pinning down. But I think we can say with some certainty that the underlying financial position of consumers is improving.

COYNE: Thank you gentlemen, and ladies.