TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE CONFERENCE CALL

June 27, 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.

Errors undoubtedly remain. The raw transcript was not fully edited for accuracy at the time it was produced because it was intended only as an aid to the Secretariat in preparing the record of the Committee's policy actions. The edited transcript has not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Transcript of Federal Open Market Committee Conference Call of
June 27, 1979

[Secretary's note: This call apparently began with reports by several staff members, including Messrs. Zeisel, Pardee, and Axilrod. The only statement available in the Committee's files was an update on recent economic developments by Mr. Zeisel, shown below.]

MR. ZEISEL. We have a number of indications that the current quarter and the remainder of the year will be weaker than we had been anticipating. Consumer demand has been particularly hard-hit. Retail sales have been sluggish all year; in real terms, they were down more than 5 percent from December to May. Major factors have been the weaker growth in employment and income and the effects of inflation. More recently, gas shortages appear to have affected demand adversely, with widespread reports of reduced sales. We don't have retail sales figures for June as yet, but domestic auto sales in the first 20 days were at a 7-1/2 million annual rate, down from 8-1/4 million in May and 9.1 million in the first quarter.

There are also signs that business fixed investment may be losing momentum. Shipments of capital goods in the past two months were below the Q1 average in real terms. Construction activity is generally less ebullient and truck sales have weakened substantially. Some of this may be strike- related, but the recent drops in capital goods orders and in commitments for commercial and industrial construction suggest something more fundamental.

Housing activity continues sluggish. Starts rose somewhat in May--by a little more than 5 percent to 1.8 million--but the slight rebound was entirely in the erratic multifamily category. Single-family starts edged down further and housing activity remains well below the 2.1 million rate recorded in the fourth quarter.

It appears that we may be getting some inventory backup as a result of weaker demand. Book value inventory figures were up sharply in April ($64.7b), particularly in manufacturing ($39b) and in autos and trade ($10b). Auto stocks rose sharply further in May--by about 6 percent. Again, some of this may have reflected strikes.

The price picture remains bleak. Despite a more moderate food price rise, the CPI was up 1.1 percent in May, with very sharp increases for gasoline and fuel oil--up 5 percent--as well as for homeownership costs and new car prices. The price of gasoline in May was 20 percent--not an annual rate--above the December price. With larger energy price rises now in prospect and upward pressure on grain prices as a result of crop conditions in the USSR, it appears that we can look for little easing of inflation later this year.

On balance, a small negative GNP appears in the cards for the current quarter. With the deterioration of consumer attitudes, further price rises, and a likely weakening of business spending, somewhat larger declines in GNP over the new few quarters have also become increasingly likely. That concludes my remarks.

[Secretary's note: The staff briefings ended with a report by Mr. Axilrod.]

CHAIRMAN MILLER. Thank you very much, Steve. I don't think Scott mentioned the trade figures that were released today at what--2:30 this afternoon, Ted? Would you just give everybody a--

MR. TRUMAN. Yes, they were just released at 2:30 p.m. For those who did not see them, the census basis monthly trade deficit for May was reported at around $2.5 billion as compared with $2.2 billion, rounded, for April. The two months together show a deficit of about $28 billion at an annual rate as compared with the first-quarter rate of $21 billion. That is in contrast with some of the other evidence that the trade balance is moving a bit in the other direction. Nevertheless, as for the outlook--given what Jerry has said--we would expect an improvement to resume.

CHAIRMAN MILLER. In addition to those factors, we still have to hear from OPEC. I don't believe they have announced their pricing yet.

MR. TRUMAN. No, they have not. They've gone into special session.

CHAIRMAN MILLER. So we will hear about that fairly soon.

Now, let me give you a personal reason why I thought this consultation was particularly necessary and appropriate. We have the usual [policy] dilemma between international and domestic conditions. We have a situation where our dollar policy of maintaining a stable dollar and an orderly market is [being tested], and so far we have responded to that solely with intervention. Another way to respond to it would be by monetary action that would open up the interest rate differentials in favor of the dollar. This could be done by a move to tighten by raising the federal funds rate and symbolically by an increase in the discount rate.

On the other hand, we have a domestic economy where I think as a result of the energy situation--with the revolution in Iran and the interruption of oil supplies--it appears that a very significant increase in inflation [is in prospect] for 1979 and 1980. And a corresponding decrease in real economic activity in the United States, which we probably could not have predicted last fall or earlier this year, [seems likely]. With that weakness, and particularly the inflationary aspects of [the current situation], the relation of money to nominal activity comes into question. So we have to consider what the appropriate course is for policy in order to [achieve] the economic [outcome] that we would like to see.

Obviously, thoughts have been [expressed about] whether we should try to defend the dollar by taking monetary action and what the price and other consequences of that would be on domestic activity. That could send us into more serious difficulties. Let me just go around and ask each of you whether you have any suggestions or thoughts on this. Do you feel that we should stay on an even keel, [maintain] a daily and hourly watch, and keep in close touch or that we should be doing something now? I'll start down the list of members and then call on all the other participants. Paul Volcker, do you have any particular thoughts?

VICE CHAIRMAN VOLCKER. Well, I have some scattered thoughts, yes. I am impressed by the fact that looking ahead for a period of time we are working in the context of an oil-constrained rather than a money-constrained economy. I think the oil situation is affecting the potential for economic growth in a lot of ways at the moment, whereas I don't see much restraint from the monetary side. And, of course, we have the inflation problem you just referred to. When I look at the aggregates, in the short run they're high. As Steve pointed out, in a 6-month perspective, they're pretty close to the target we set for ourselves, which at least at that level of analysis is comfortable. And obviously we have this extremely sensitive situation with the dollar. I can well see the case for, let's say, a small gesture of the kind that you suggested in view of both the inflation and the international concerns. But in sum, given the general business outlook, I would be reasonably content with standing pat for the time being, remaining in touch, and watching this dollar situation closely.

CHAIRMAN MILLER. Thank you, Paul. Phil Coldwell

MR. COLDWELL. Well, Mr. Chairman, I think you and Paul have [described] the problem here--the rising inflation, the economic decline in prospect, the monetary aggregates being somewhat unsettled on the high side at the moment after having been unsettled on the low side, and the dollar problem. I've asked myself what we can do that might be a reasonable thing to do that would impact all of this and yet not damage our domestic situation. I don't find anything in our kit of tools other than the intervention we've been using to do much about this. I'm a bit unhappy that we didn't do more before but that's water over the dam so there's no point in going over that. The one thing I would like to see done is not in our kit of tools to do. I would very much like to see the President forward immediately a new gasoline rationing plan to the Congress, and see it adopted and put into effect right away. I think that would have a salutary impact on our friends abroad who don't think we've done anything to conserve gasoline; it might also [reduce] some of the gasoline lines and related problems in this country. But that isn't something we're going to settle in Federal Open Market Committee meetings so it's merely a suggestion that maybe somebody could get done.

As far as intervention is concerned, I am bothered a bit. I don't know what the staff's prognosis is for the dollar, but if it were to continue weak or if we were to get back into the kind of situation we had in late October of last year, we could spend a whole lot of money on intervention. And we might spend our entire kitty. I suspect, like it or not, that that kind of crisis would call for some action [by us] so maybe we ought to be developing some contingency plans in the event this [situation] does turn bad on us.

CHAIRMAN MILLER. Thank you, Phil. Monroe Kimbrel.

MR. KIMBREL. Mr. Chairman, I personally would subscribe to the idea of trying to maintain our posture for a reasonable period and try to observe the effects as they develop. I would be reluctant to move too quickly at the moment. I am very mindful though of the troubling news in the consumer price information [released] yesterday and the weakness of the dollar that you [mentioned]. But like Paul Volcker, I think much of this is related to OPEC pricing and the difficulties associated with that. So I guess I'd prefer to wait a few days and observe [developments] very carefully and hope that stability may come along.

CHAIRMAN MILLER. Thank you, Bones. Bob Mayo.

MR. MAYO. Mr. Chairman, I think I would subscribe completely to the Volcker thesis. We are within the M1 longer-term target ranges that we set for ourselves. I find the projection of a weak July-August for M1 a little reassuring to the extent that any of these M1 figures can be reassuring. I feel that we have to recognize the limitations of monetary policy here and save our ammunition--for the moment anyway--but I certainly would watch carefully. I'd stay where we are.

CHAIRMAN MILLER. Thank you, Bob. Chuck Partee.

MR. PARTEE. I guess I'd agree with Bob Mayo. It's very difficult to know what is happening but it seems easy to conclude that monetary policy isn't having much influence on it. The economy is moving down. Jerry didn't mention the [apparent] leak of the second-quarter real GNP figure, which may or not be right, but it's quite negative. The economy is going to move down further. I don't know how fast or how far. We could be in for a quite deep recession. But the downturn has been caused by energy or energy prices and the income redistribution that has happened because of that. And I don't think either the rate of inflation or the rate of real growth is much affected by minor differences in monetary policy in this environment. My feeling is that over time in a situation like this we are best guided by the aggregates and not by interest rates. And although we've had these two blips [in money growth] in April and June, we don't quite know what accounts for them. It could be a change in the patterns of handling money. Over a longer interval we're really very much within our growth ranges for both M1 and M2. And I think M3 probably is below the lower end of the range for this interval. So I don't think there is anything at the moment to signal the need for a tightening in order to try to restrain the growth in the aggregates. Indeed, I would say that market rates have dropped relative to a funds rate that has remained unchanged. That in itself will tend to make reserves less available so there has in fact been some tightening. I think we have to guard against a serious weakness in the aggregates but that isn't our immediate problem. So I think we ought to stay right where we are.

CHAIRMAN MILLER. Thank you, Chuck. Roger Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I was going to say "me too" in the sense that I don't think we have anything in our arsenal that we should use at the moment. The possible exception is that in a situation in which the dollar has worsened somewhat it seems to me that it might be appropriate to consider a bit of a jump in the discount rate if only to give a signal internationally--for that reason only. Still that's a concern. I know that the discount rate is not a matter for the Committee's consideration but it should come into play someplace down the road if conditions [warrant] it.

CHAIRMAN MILLER. Thank you, Roger. Frank Morris.

MR. MORRIS. Mr. Chairman, I think we're agreeing for different reasons. The evidence suggests to me that the economy peaked in March and that we're now in the third month of a recession, the depth of which will be influenced by the energy problem. But I don't agree with Chuck Partee that it was caused by the energy problem. I think the seeds of the recession were sown before the energy issue reached its current prominence. But quite clearly the energy problem means that there is a potential for a more severe recession than anyone is currently forecasting. Therefore, I think the next move for monetary policy ought to be toward ease, but given the kind of growth rates we're seeing in the aggregates and the weakness of the dollar in the foreign exchange markets obviously now is not the time. But if my feeling about the economy turns out to be correct, the strength in the aggregates will likely be a short-term phenomenon. As a growing perception of weakness in the economy develops, the dollar will strengthen in the foreign exchange markets. And when these two things happen, then I think we should turn our attention to mitigating the severity of the recession.

CHAIRMAN MILLER. Thank you very much, Frank. Ernie Baughman.

MR. BAUGHMAN. Mr. Chairman, I'm inclined to think about the same as the preponderant views that have been expressed. Given the uncertainties on both sides of the picture here we probably should just stay pretty much where we are and observe [ongoing developments] but be ready to take some action as soon as it becomes clear that such action needs to be taken. And I would share Roger Guffey's view that there might be some possibility in the fairly near term of getting a little mileage out of a change in the discount rate. Aside from that, I would not see a very specific move [for us to make] in the near term.

CHAIRMAN MILLER Thank you, Ernie. Larry Roos.

MR. ROOS. We don't view the slowdown in the economy that we're presently experiencing--technically caused by the small rate of money growth or the decline in the growth of money since October--as an almost certain signal of some economic softening. We view the decline of the dollar in the past week essentially as a reflection of the recent dramatic strengthening in the growth of the aggregates. We think that a prudent slowdown in money growth would not cause any significant further economic downturn, especially in view of the recent strength in the aggregates. And we think that a definite and consistent slowdown in money growth would have a salutary effect on the dollar in international exchange markets. The conclusion we reach is that a moderate increase in the fed funds rate could be expected to have a beneficial effect in terms of our dollar problems. And we don't believe that increase would be the straw that would break the camel's back in terms of contributing materially to any further, continued slowdown in the domestic economy.

CHAIRMAN MILLER. Thank you, Larry. Mark Willes.

MR. WILLES. Mr, Chairman, Chuck Partee gave my speech even better than I wrote it, so I have nothing to add.

CHAIRMAN MILLER. Thanks, Mark. I don't know what we're going to do with a short report! Walter MacDonald.

MR. MACDONALD. We would agree that little would be gained by [giving] any signals at this time in foreign markets. Frank Morris said inflation has been the problem all along and gasoline is the problem now just added to that. Borrowings have been considerably less this month than last and money market rates have lessened the need for [action].

CHAIRMAN MILLER. Walter, did we get all your comments?

MR. MACDONALD. Yes, that's all.

CHAIRMAN MILLER Thank you very much. George Rankin from Richmond.

MR. RANKIN. Mr. Chairman, our concern is oriented more toward the inflationary picture than the apparent increasing recessionary tendencies that we see. It seems to us that the markets both here and abroad will no doubt be watching carefully to see whether our recession fears will wear down our determination to do something about inflation. Our position here at the Richmond Bank is that we should continue to give a high priority to the inflation problems; even though the economy may be moving into a recession, we think it's important to hold a tight rein on the aggregates at this time. And in view of the recent rapid growth in the aggregates we think we should be prepared to demonstrate a readiness to resist any further short-term bulges by allowing the funds rate to move up another notch. We think that decision should to a large extent depend on what the figures for the last two weeks of June look like. Apparently we have a fairly good projection but if the figures between now and the week ending with the 27th show any increase in the aggregates, we would be inclined to recommend moving the fed funds rate up to

10-1/2 percent. That's all, sir.

CHAIRMAN MILLER. Thank you, George. Dick Smoot, Philadelphia.

MR. SMOOT. Yes, Mr. Chairman. We have no bold thrust to put forth at this point. We are impressed by the continued softness in the domestic economy but we're not ready to suggest an easing in policy at this point. On the other hand, we're not inclined to suggest that we tighten policy at this time either. Thank you.

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

MR. WILLIAMS. We would agree with Frank Morris's position that there's a fair case for suggesting that we should [orient] our policy on the side of ease. We would [build on the action] that we took at the last FOMC meeting.

CHAIRMAN MILLER. Well, thank you. All this has been extremely helpful. I gather that, with two possible exceptions, the overall consensus was that we stand pat but be prepared [to move as we] continue to watch the situation carefully. We should continue to stay in close touch and I think we should do that in this coming period and not plan to take any particular action until we all consult again. We'll decide whether or not we should have another go-around on the telephone, depending on how the aggregates look and what happens in the markets in the next week and then we'll be in touch with you. Would anyone else like to make a further comment or make any further suggestion before we end this particular session?

MR. MORRIS. Mr. Chairman, this is Frank Morris. I wonder if Steve can give us any enlightenment on the nature of the bulge in M1 and particularly in demand deposits.

MR. AXILROD. Well, President Morris, I'm afraid I can't be very enlightening. [The bulge] has been very widespread [across M1 components] in June and we don't have any particular special factor that would literally account for it in that particular month. U.S. government deposits have risen and have not declined [subsequently]. At least in April they declined a little but in June they're showing a rather substantial increase. So that factor, which you and I have disputed over the years as to whether it has any effect, if it had an effect it is in the wrong direction.

CHAIRMAN MILLER. Frank, let me interrupt for just a moment. There is perhaps one extraneous factor I know of on M1 when it jumped $6.9 billion in one week. That I believe was the week where social security checks went out [earlier than usual given] the payment date over the weekend. So we may have had up to perhaps $2 billion that was accounted for by carrying those deposits over a weekend and averaging them in the totals. Even if we knock those back down, we still have a big spike but not quite as big.

MR. AXILROD. I think that's right. Except that we're facing [a situation where] only about that much is all that has disappeared. [M1] went from $371 billion to $368-1/2 billion on the 13th and has been staying there. That's about the extent of the special factors. The other thing I would mention, President Morris is that when we have these large numbers and they don't go away, we tend to average them out over a longer period; that's why I mentioned the second-quarter average. What we're beginning to fear is that this so-called demand shift that we have been pointing out to the Committee--which was very prevalent in the fourth quarter and the first quarter--may be abating and getting smaller. While in retrospect the demand shift that occurred in 1975-76 seemed to have lasted 2 years or a little more, we thought the one that seemed to have begun in November of this [past] year might last a smaller length of time. That's because it was in effect the second round within a period of five years. [As a result] many of the large cash holders had already economized on cash to the extent they could with the existing technology. They didn't have that much left to do. And it's quite possible, while we can't explain special weeks or months in a way, that we can explain it over the long run in that we may be beginning to see the abatement of the demand shift. In that case we would begin to get more money growth on average than we have experienced since November--not necessarily because the economy is stronger or weaker but simply because we're getting a [return to a] more normal relationship of money to nominal GNP recurring. And even with a weak economy I would remind the Committee that inflation is very strong, so nominal GNP is running pretty strong at the moment.

CHAIRMAN MILLER. Well, gentlemen, thank you very much. I must say that the telephone system worked well this time. At least here we heard all of the discussion very, very well indeed. I would close by saying come prepared for an interesting FOMC session. We not only have to deal with these problems but with setting any mid-course correction for our longer-term aggregate growth ranges this year and taking our first glimpse of 1980, which will keep us busy for more than a half hour probably!

I am reminded that we did have one unfortunate case in the past where a reference to our having a telephonic session seemed to make its way into the newspapers. I hope we'll all recall that it's better not to have reports that we have such meetings. There will be misinterpretations as to whether we took action or didn't take action. So I hope for your cooperation there.

All right. Thank you very much and we'll either be in touch by phone or see you on the 11th of July. Have a nice 4th of July. Bye-bye.

END OF SESSION