

Federal Open Market Committee  
Conference Call

June 17, 1981

PRESENT: Mr. Volcker, Chairman  
Mr. Boehne  
Mr. Boykin  
Mr. Corrigan  
Mr. Gramley  
Mr. Partee  
Mr. Rice  
Mr. Schultz  
Mrs. Teeters

Messrs. Balles, Black, Ford, Timlen, and Winn,  
Alternate Members of the Federal Open Market  
Committee

Messrs. Guffey, Morris, and Roos, Presidents of the  
Federal Reserve Banks of Kansas City, Boston, and  
St. Louis, respectively

Mr. Doyle, First Vice President, Federal Reserve Bank  
of Chicago

Mr. Altmann, Secretary

Mr. Kichline, Economist

Messrs. Ettin and Truman, Associate Economists

Mr. Davis, Associate Economist (New York)

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

Ms. Greene, Deputy Manager for Foreign Operations,  
System Open Market Account (New York)

Mr. Meek, Monetary Adviser, Federal Reserve Bank of  
New York (New York)

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Notes:

Mr. Gramley and all participants from Reserve Banks (except those noted from New York) participated on this call at the Kansas City Reserve Bank where they were attending a Conference of Presidents.

A complete record of staff attendance at this meeting was not available in the Committee's files.

Transcript of Federal Open Market Committee Conference Call of  
June 17, 1981

MR. ALTMANN. Hello.

MR. GUFFEY. Hello, this is Kansas City with a full contingent of Presidents.

MR. ALTMANN. This is Murray Altmann. Good morning or afternoon, as the case may be. As usual, for the sake of the record, I would like to call the roll. [Secretary's note: The roll was called to determine attendance at the Reserve Banks.] Thank you. In the Board Room we have all members of the Board except Governors Gramley and Wallich, as well as Ed Ettin, Jim Kichline, Ted Truman, and other members of the staff. In New York we have Peter Sternlight, Gretchen Greene, Dick Davis, and Paul Meek.

CHAIRMAN VOLCKER. Gentlemen, I just thought it was a logical time to review things. The money supply, M-1B anyway, has been rather weak. We have reduced the reserve path to some extent, as [M-1B growth] got below whatever number we put in the directive. What was that--3 percent for--

MR. ETTIN. For April to June.

CHAIRMAN VOLCKER. It was 3 percent or lower, as you recall. Up until now we've reduced the reserve path somewhat to reflect the "or lower" part of the directive. There is a question of whether we should continue doing that, given the current situation, and I don't think we should. I'm not sure we require any decision on a directive here in a formal sense--I'm not inclined to think we do--but I thought it would be useful to have an exchange of views and a mutual updating. So, why don't we have Mr. Ettin bring us up to date on where the aggregates lie and where interest rates lie and then we'll have Mr. Sternlight comment on the market situation.

MR. ETTIN. Thank you, Mr. Chairman. Our current estimate for M-1B shift-adjusted is for a decline of about 4.3 percent in May and [growth of] around 1 percent in June. For the April-June period, where the target was 3 percent or less, our current estimate would be about minus 1-1/2 percent at an annual rate, shift-adjusted. That would mean that for the March-to-June period, growth in shift-adjusted M-1B would be about 3-1/2 percent.

CHAIRMAN VOLCKER. As compared to the 5 percent or somewhat less that we specified [in March]?

MR. ETTIN. 5-1/2 percent or somewhat less.

CHAIRMAN VOLCKER. Okay, 5-1/2 percent or somewhat less.

MR. ETTIN. If that June level held, M-1B would be somewhat below the lower end of its longer-run range. Our current estimate for the 10th of June, which will be published this Friday, will only be a couple hundred million above the large reduction that has already been published for the week of June 3rd. M2 has also weakened, mainly because of the reduction in M1. We have a 4-1/4 percent rate of growth in May and are anticipating a 6-1/4 percent rate of growth in

June. If that June level held, that aggregate, Mr. Chairman, would be just above the upper end of its longer-run range. M3 has been running considerably stronger, as banks have issued large-denomination CDs in order to accommodate the credit demands that they have been facing. M3 in May rose at an 8-1/2 percent rate; in June we're expecting it to rise at a 10-1/2 percent rate. That aggregate would continue to be considerably above the upper end of its range. On the basis of the June projection, and making various multiplier adjustments, the staff would anticipate that borrowing would fall to a level of about \$1800 million. If money weakened further in June, borrowing could fall to as low as perhaps \$1700 million. In the intermeeting period to date virtually every interest rate is below its level at the time of the FOMC meeting and also below the highs for the intermeeting period, of course. Corporate rates, for example, are off about 85 basis points since the FOMC meeting and the three-month bill rate is down about 2-1/2 percentage points.

CHAIRMAN VOLCKER. Mr. Sternlight.

MR. STERNLIGHT. Well, Ed has summarized what has happened to a number of the market rates. That has developed essentially as the market has taken heart from observing the weakness in the narrow money supply. The market is in somewhat of a suspended state of animation, though. They've observed the funds rate hanging at what they regard as a high level--in the 18-1/2 to 19-1/2 percent range--and they're somewhat puzzled about that. And that tends to temper what might even be a stronger positive reaction to the weakness in money supply and to some of the numbers in the economy that suggest softening as well. We are winding up this week, because the banks tended to borrow rather lightly early in the week, with some tightness. Funds were trading around 20 percent today after averaging around 18-1/2 percent earlier in the week. I would think that there might be a considerable bulge in borrowing shaping up for today.

CHAIRMAN VOLCKER. Mr. Kichline, why don't you review the feel and tone of the business situation as well as the statistics.

MR. KICHLINE. Well, it feels as though there's relatively little growth in the current quarter, following the exceptionally rapid pace of expansion in the first quarter. The principal monthly indicators of activity rather consistently suggest a sluggish pace of activity. Retail sales were revised downward in April and are now on a preliminary basis indicated to have been about flat in nominal terms in May. Auto sales were very weak in April and May, although they've shown a slight uptick in early June. Nonfarm employment adjusted for strikes has been unchanged for about the past three months. And housing starts for May are reported to have declined. On balance, we believe that we would not be making much of a change in our projection of real GNP for the current quarter. On the price side, the numbers coming in continue to point to a rather favorable performance, judging from the PPI and the CPI. A good deal of the more favorable outlook in the recent past has been attributable to developments in energy and food and, in the CPI, the homeownership component. Other prices have not shown much movement, although on average they seem to be doing rather well under the circumstances. For the deflator, we would probably be making somewhat of a small downward revision in our forecast for the current quarter.

CHAIRMAN VOLCKER. Well, the overall situation seems to me not entirely unsatisfactory. We're within no target range, if you take those literally. Some [aggregates] are low; some are high. The M1 numbers, of course, are somewhat fragile in terms of their meaning with everything that is going on. M2 is just above the range, M3 is further above the range, and bank credit is somewhat around the top of the range. We're going to be above the ranges for the second quarter, quite clearly, on all the aggregates except M1 on a quarterly average basis. Interest rates have been coming down. The economy seems to be softening a bit. I don't think that's wholly undesirable in terms of the speed of growth we had before and in terms of expectations. And I guess we're a little more believable than we were earlier in the light of recent trends in both interest rates and the aggregates. Just in the normal course what we would do is to follow the path that Ed suggested falls out of the numbers, which means somewhat lower borrowings for these coming weeks--not too much lower if the money supply is not weaker than projected. But if it comes out weaker than projected--and I guess this last figure is somewhat on that side--we'd have borrowings down in the \$1-3/4 billion area fairly easily. That would develop, I suppose, in the next week really. And in my judgment, that doesn't require any change in the directive or anything else; that's just what we're following in the normal course of events. Let's just have your reactions to that.

MR. STERNLIGHT. Mr. Chairman, this is Sternlight. May I just get in a clarification of what Ed Ettin laid out as the borrowing prospect for the next three weeks? We were talking about it earlier and when he said \$1.7 or \$1.8 billion for borrowing, that was before the downward adjustment for the weakness we've been getting in M-1B.

CHAIRMAN VOLCKER. Yes. This implies no discretionary downward adjustment. It says that we're happy with where the aggregates are and we're not encouraging any further downward adjustments, so to speak.

MS. TEETERS. May I ask a question? How much have you taken out of the nonborrowed reserves to date, Ed?

MR. ETTIN. We've taken out \$180 million in the first four-week period, reflecting the weakness in the monetary aggregates that the Committee was permissive toward, and another \$200 million for overshooting borrowings in the first week when there was a very high demand for borrowing. That was offset by a multiplier adjustment of about \$350 million that went the other way.

CHAIRMAN VOLCKER. Yes, the \$200 million was somewhat of an artificial adjustment.

MR. ETTIN. That's right.

CHAIRMAN VOLCKER. It's the \$180 million that you've really taken out.

MR. ETTIN. Yes.

MR. PARTEE. And the multiplier is standard, so that--

CHAIRMAN VOLCKER. The multiplier is the normal thing.

MR. ETTIN. So, essentially, it's \$180 million for the weakness in money growth.

MR. STERNLIGHT. That \$180 million applies just to the first four weeks; I don't think that it carries through.

MR. ETTIN. That's right. It's in the first four-week period. We've made no adjustments for the second three-week period that starts tomorrow.

MS. TEETERS. Does that imply that you're putting the \$180 million back?

MR. ETTIN. No.

CHAIRMAN VOLCKER. No.

MR. ETTIN. There are no further adjustments.

MR. PARTEE. There are no further adjustments. This is Chuck Partee. I might just say, Paul, that I think your proposal is very sensible. If I understand it, we now are looking at M-1B for April to June of 3-1/2 percent, did you say? And that is assuming that there is no more shortfall.

MR. ETTIN. March to June is 3-1/2 percent.

MR. PARTEE. Yes, March to June, the three-month period in our original directive, which we keyed back to last time and for which the objective was 5-1/2 percent or somewhat less. Well, 3-1/2 percent is certainly somewhat less than 5-1/2 percent and may be a little more than somewhat less. So, it seems to me that we are at the lower end of the agreed upon path that we talked about and, therefore, that the growth in nonborrowed reserves should be permitted to show through in lower borrowings, to the extent that that occurs. I would note that my sense of the [situation] is that we've had a period of several weeks--it's not just this week--in which we have had downward revisions in the expected money supply numbers. As I recall, at the meeting we were talking about May growth that was considerably higher than -4.3 percent and June growth that was considerably higher than +1 percent. So, we are beginning to develop this somewhat ominous pattern of shortfalls from staff expectations that has run for a period of weeks. And I agree with the point that you've often made that those revisions often indicate something as to what is happening. So, our problem as we look into the next month or two, may in fact be rather low-looking money numbers, lower than the staff is now expecting. I don't think this has any of the dynamic characteristics of last year when [money growth] went off so very sharply in April, but it does seem to be pretty pervasive and it's a fairly extended period of weakness in the money behavior. Of course, the market rates are reflecting that by coming down, although we resisted or didn't pay much attention to that market development in March and early April because we sensed that there was considerable strength in the business picture. Now it seems to me that the market is probably right because there is developing weakness in the business picture. So, I think we ought to do what you say. But we ought to be rather sensitive now to significant shortfalls in the monetary aggregates because they're probably going to be reflecting shortfalls in the economy.

CHAIRMAN VOLCKER. Well, I agree with a lot of the technical analysis you provided. I don't consider what is happening very ominous; I think it's rather happy.

MR. PARTEE. To this point I'm not bothered, but I'm worried about what the next couple of months may show.

CHAIRMAN VOLCKER. Any other comment? How many people do we have out there? Somebody must be commenting.

MR. ROOS. Mr. Chairman, Larry Roos. You're doing things beautifully; just don't change what you're doing. I agree with you, Mr. Chairman.

CHAIRMAN VOLCKER. Let me point out a couple of things. I did some calculations--or rather I had some calculations done. If we don't look so carefully at these cones that we're so fond of examining but at how we're doing in terms of trend, one way is to look at year-to-year changes. We are running high this year relative to last year. We have had a couple of years of decline in annual average aggregate growth. It's going to be very difficult to get a decline in the annual average this year. If we ended up at the midpoint of our M1 target--almost in a straight line from here on out, but only at the midpoint--it would look fine in terms of the way we arbitrarily set these targets. On a fourth-quarter-to-fourth-quarter basis, we would end up with 6-1/4 percent year-to-year growth or something like that. And last year it was only--I haven't got the figure in front of me-- 5.9 or 5.7 percent, something like that. And it's almost certain that the M2 and M3 numbers are going to be significantly higher in year-to-year terms than they were last year. I think that has some significance apart from presentational. If we really are working toward lower growth, it may be more meaningful to look at annual averages in some sense than to put all the weight on particular quarters, which is what the targets do somewhat inadvertently. I don't like the feeling myself of coming out for the year with a higher average growth in all these aggregates than we had last year. But that's the way we're headed.

MR. BALLEES. Mr. Chairman, this is John Balles. In talking with Lyle here, I'm trying to recall whether our published minutes for the [March] meeting indicated, as I seem to recall, that we would be putting more weight on M2.

SPEAKER(?). Yes.

MR. BALLEES. Is that [recollection] correct?

MR. SCHULTZ. Yes.

CHAIRMAN VOLCKER. I'm not sure the formal directive did that, though. I don't remember the wording, but I think it was reflected in the tone of the discussion. I just don't remember precisely how it came out in the directive itself.

MR. BALLEES. The only reason I bring this up [unintelligible] scrutiny with our current policy. [Unintelligible] in spite of the fact that M2 is [above its] range [unintelligible] end of June

probably will take some of the sting out of the fact that M1 is coming in weak.

CHAIRMAN VOLCKER. Yes. I don't know about the wording "take some of the sting out." It may take some of the joy out.

MR. PARTEE. But, of course, M2 is fairly weak for May and June, too, isn't it?

CHAIRMAN VOLCKER. Yes, if you look at it just in the narrowest perspective from the last meeting, M2 is slightly below the limit that we put on it. But if you look at it in the broader perspective of the year as a whole, it is high and is running above the range. M2, according to the current projections, is only slightly below the figure that was put in the directive.

MR. GUFFEY. Thank you, Mr. Chairman.

CHAIRMAN VOLCKER. End of conversation?

MR. GUFFEY. That's the end from Kansas City.

CHAIRMAN VOLCKER. Okay. Any more here in Washington? Well, we will proceed. Thank you very much.

MR. ALTMANN. Is anyone left on the line?

MR. PARTEE. Was there anybody there in the first place?

CHAIRMAN VOLCKER. Okay, that's it.

END OF SESSION