

Federal Open Market Committee

Conference Call

January 9, 1991

PRESENT: Mr. Greenspan, Chairman  
Mr. Corrigan, Vice Chairman  
Mr. Angell  
Mr. Black  
Mr. Forrestal  
Mr. Keehn  
Mr. LaWare  
Mr. Mullins  
Mr. Parry  
Ms. Seger

Messrs. Guffey, Hoskins, Melzer, and Syron,  
Alternate Members of the Federal Open Market  
Committee

Messrs. Boehne and Stern, Presidents of the  
Federal Reserve Banks of Philadelphia and  
Minneapolis, respectively

Mr. Bernard, Assistant Secretary  
Mr. Gillum, Deputy Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Prell, Economist

Messrs. Lindsey, Promisel, Siegman, Simpson, and  
Stockton, Associate Economists

Mr. Sternlight, Manager for Domestic Operations,  
System Open Market Account  
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Mr. Coyne, Assistant to the Board, Office of Board  
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Mr. Wiles, Secretary of the Board, Office of the  
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Transcript of Conference Call of  
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CHAIRMAN GREENSPAN. Good morning, everyone. This is an update on actions that the Desk took yesterday. On the basis of a very significant downward revision in the money supply since the last Federal Open Market Committee meeting, it was decided that action was required yesterday under the asymmetric directive, and the borrowing requirement [was moved] down to the equivalent of 25 basis points on the funds rate. I now read the directive as being symmetric. I would like to call on David Lindsey to update everyone on the rather disappointing data that have been coming in over the last couple of weeks. David.

MR. LINDSEY. Thank you, Mr. Chairman. The broader monetary aggregates were somewhat weaker in the latter part of December than allowed for in the FOMC's path and, based on partial data, were decidedly weak in the first seven days of January. I should stress both the partial nature of those data and the difficulties of sorting out seasonal patterns in the weeks surrounding year-end. Even so, the information in hand suggests declines in M2 and M3 of \$8 billion and \$8-1/2 billion, respectively, in the week of January 7. Indeed, these preliminary data for the January 7th week would put M2 at a level \$2 billion below its fourth-quarter 1990 average level, which serves as the base for the 1991 growth range, and some \$14 billion below the path implied by the FOMC's shorter-term expectation of a 4 percent growth rate for November to March. We now place M2 growth in December at a 1-1/2 percent rate and project a similar growth rate for January. That compares with the expectations just after the FOMC meeting of 2-1/2 and 4-1/4 percent for those two months. A little of the unexpected weakness in M2 is in the M1 component and in the overnight RP and Eurodollar components that we have in hand. But the bulk of the weakness is in nontransaction retail deposits and particularly in MMDAs and small time deposits. This weakness is especially surprising in the case of small time deposits in light of the further declines in market rates to below deposit rates. I think there is some question about whether depositors are becoming further concerned about the safety of banking institutions. For M3 the preliminary estimate for the week of January 7 is \$12 billion below both its fourth-quarter average level and the level consistent with the FOMC's 1 percent path from November to March. M3 was virtually flat in December and seems likely to decline at about a 1/2 percent pace in January compared with a positive 3/4 percent average pace implied by the FOMC's path. There was some strengthening in institution only money funds in December but, even so, the non-M2 component declined at a 6 percent rate. Large time deposits and term RPs at banks continued to run off in association with further moderate expansion in both retail deposits at banks and in bank credit in December. We are now estimating bank credit growth for that month at just below 3 percent.

CHAIRMAN GREENSPAN. Any questions for David?

MR. BOEHNE. Dave, Ed Boehne here. What's happening to the cash component?

MR. LINDSEY. Do you mean currency?

MR. BOEHNE. Currency, yes.

MR. LINDSEY. We are projecting a considerable pickup for January--on the order of a 13-3/4 percent rate of growth--based on a strong performance early in the month. That follows growth at a 6 percent rate in December, which itself was nearly double the November pace.

MR. BOEHNE. Can you see any differences in trends among Districts or are these trends [widespread]?

MR. LINDSEY. The recent weakness in demand deposits and also in the retail components for the week of the 7th was quite widespread by District.

MR. BOEHNE. What about the currency pickup?

MR. LINDSEY. I really don't have very recent information on that.

CHAIRMAN GREENSPAN. There is a problem in the numbers in that they were--

VICE CHAIRMAN CORRIGAN. This is Jerry Corrigan. Let me just say something on currency. In December, and especially in the last few weeks of the current period, there has been a very large amount of currency being shipped to the Middle East. Based on what we know here and based on what we know about a couple of the major banks that are engaged in this, I wouldn't be at all surprised if virtually all of the net increase in currency that we're seeing in this period is going to the Gulf states.

MR. SYRON. This is Dick Syron. David, could I add something just as an observation on Ed Boehne's question about what is happening in terms of the Districts? I know this is happening somewhat nationwide but we have the comparative data by District and, as you might expect, we have seen a very, very substantial increase in noncompetitive tenders [for Treasury] securities here. We have been following this, obviously, on an issue-to-issue basis and it is really quite [wild] on a year-over-year basis. I think it is consistent with your hypothesis that to some moderate extent increased concern about holding funds at various institutions may account for some of this, at least in some parts of the country.

MR. LINDSEY. Yes, we did see a turnaround--a \$70 million net change--in noncompetitive tenders at the Treasury bill auctions this Monday. I think that's consistent with that.

CHAIRMAN GREENSPAN. Any other questions for David?

MR. MELZER. Dave, how about reserves? Have you been able to restate the path data? Do you have any sense of how reserves are growing?

MR. LINDSEY. Well, of course, there have been complications both because of the year-end and the reduction in reserve requirements. Peter Sternlight may wish to comment on the implications of that for the federal funds market. As you know, our

interpretation of reserve movements, given the funds rate objective, is that reserves tend to be demand determined and, therefore, even before the reduction in nontransactions reserve requirements, primarily follow movements in transactions deposits. I could give you some estimates that we have. For December we are showing an increase in total reserves of \$19 [percent]. Now, that is break-adjusted, abstracting from the change in reserve requirements. That is followed by a comparable change projected for January, though that is last week's projection and it may be somewhat lower with the new money numbers.

MR. MELZER. Could you just tell me again what the bottom line is?

MR. LINDSEY. The growth rate in both December and January for total reserves is around a 19 to 20 percent pace.

MR. STERNLIGHT. If I could interject: I think you have to consider that those standard reserve growth measures are very distorted by what has been happening over the year-end. The standard series that the staff works up on that makes an adjustment for the lower reserve requirement but it doesn't, as I understand it, make any adjustment--we wouldn't know what adjustment to make--for desires to hold excess reserves. That, of course, has been tremendously distorted as we have dealt with the year-end problem and the desires of banks to behave very cautiously over this period.

CHAIRMAN GREENSPAN. Peter, could you take a minute to outline the forces that are creating the extraordinary volatility in the funds rate in recent days?

MR. STERNLIGHT. Well, Mr. Chairman, it has been a little like trying to ride a roller coaster without a track ever since the period just before year-end. We haven't known what allowance to make for excess reserves, given the complications of the year-end and the phase-in of the reserve requirement reduction. [We have been] making allowances but they're very rough estimates. Somewhat by default we might place more guidance on, of all things, the federal funds rate; but that rate has been exceptionally volatile--soaring and plunging as combinations of year-end pressures and the inflexibilities of unusable excesses did their work. When we were facing these heavy year-end pressures, rates were quoted way up there around the turn of the year, particularly rates being paid by foreign, and especially Japanese, institutions. I did get some very large repurchase agreement operations. We did finally subdue the pressures for financing over the year-end date but in the process we built up a mountain of excess reserves that had [produced] at that time, although not all that consistently, abjectly easy money market conditions.

Through virtually all of this the market has clung to its belief that we were aiming at, or that somewhere lurking in the background was, a normal 7 percent funds rate that they saw us as having pretty clearly moved to just after the December FOMC meeting. But that perception changed yesterday, as you've already mentioned. Funds were trading early yesterday at 7 to 8 percent and there was a widespread view in the market that we had overprovided reserves earlier in this maintenance period, which included the year-end. So, there was a general expectation that we would come in and drain

reserves, consistent with something like our 7 percent central expectation for the funds rate. We didn't go in and drain because we were on the verge of this policy shift that you outlined. We also had a bit of concern that we were looking at a deep reserve shortage for the day and that funds would tighten up just because of the reserves of the day and what we were looking at for the period. But we were well aware that by staying out we would [foster the] expectation in the market that there had been a policy move, and that is what seems to have taken place. They aren't 100 percent convinced but they're pretty close to 100 percent convinced that there was a policy change, probably to a 6-3/4 percent funds rate. Some of this volatility should shake itself out once we get past this year-end period, but we may end up with somewhat more volatility than we are accustomed to in the funds rate just because the reduction in reserve requirements has reduced the level of reserve balances that banks need to keep at the Fed to meet their reserve requirements. And they have to be more careful just on a day-to-day basis to avoid overdrafts on their reserve accounts. So, that diminishes their flexibility for averaging out ups and downs over the reserve maintenance period.

MR. BOEHNE. As I read yesterday's wire, there really was no hint that we were on the verge of a change in policy. As a matter of fact, the wording was such that it said you were concerned that the market might think later in the day that we had changed policy when in fact we hadn't, and you made a judgment as to whether it made more sense to go in or not to go in. The next time I heard anything about a change in policy was in The Wall Street Journal and The New York Times this morning. Clearly, something happened between the call yesterday--or at least when the wire went out--and press time of The Wall Street Journal and The New York Times. I'm wondering if we're in one of those situations where we changed policy because of market confusion or if this was a policy change that was well designed.

CHAIRMAN GREENSPAN. The timing resulted from the fact that at very close to the time for a decision to act in the market we got our preliminary money supply data for the week. Following a significant downward revision of the previous week, they were revised down further in the current week. Regrettably, the choice that we had to make at that particular point was to do matched sales, indicating no change in policy, and then subsequently respond to the money supply figures, or to do what we did yesterday. I don't think we had very much choice. I think the alternatives that we had were really limited and locked in by time. However, I'm surprised that the notification of the change was not communicated. Why was that?

MR. LINDSEY. We didn't communicate a final decision to alter the path because my impression from talking to Don was that it was still somewhat tentative as of Fed time yesterday. So, we didn't communicate a final decision to change policy until this morning on the conference call.

CHAIRMAN GREENSPAN. Yes. That, in effect, led to an acceleration of the evaluation of the M2 data--bringing them up several hours [before] we usually would get harder information. And that harder information confirmed the earlier data that existed. But I was not aware that that had not been communicated. I think in the future that--

MR. LINDSEY. Peter can speak to this, but my impression was that we did communicate to Peter before Fed time a very strong predilection for a final decision to be made to ease but not a final decision itself.

CHAIRMAN GREENSPAN. No, I think that is correct.

MR. STERNLIGHT. That was certainly my understanding, and I put in the program [wording that we had] every expectation that our absence from the market could very well be interpreted as a move.

CHAIRMAN GREENSPAN. It's really rather unambiguous from what I could see of the [news clips].

MR. STERNLIGHT. Well, I think some of the papers talked about the market having a measure of uncertainty. I'd say they're 90 percent convinced; they're not absolutely convinced.

MR. ANGELL. Mr. Chairman, I think your words were that we had no choice.

CHAIRMAN GREENSPAN. The choice, basically, was [to act or] not to act and then act subsequently. Now, the point at issue was whether one believed those data or not. And if we are going into a period when we probably are going to get into some military hostility, then I think we obviously will have to withdraw from the scene. My judgment is that whatever action we have to take we have to do right now and freeze. And, frankly, I found those money supply figures quite disturbing.

MR. ANGELL. I'm presuming that we are talking ex post about a decision that has been made.

CHAIRMAN GREENSPAN. Oh, the decision has been made, yes.

MR. ANGELL. This discussion is really reflecting on a decision that already has been made. And it seems to me that there ought to be no thought whatsoever of not supporting that decision. I did want to suggest, however, that I feel you had a choice in that the directive does not list money growth as the first item. If the directive had had money growth as the first item, then I think you would hardly have had any choice. But with price stability as the first item in the directive, I guess I feel you did have a choice.

CHAIRMAN GREENSPAN. Well, if you're concerned about any of the elements involved in the process, it is a process by which one has to make a judgment as to what is crucial and what is not. And I inferred from the discussions that we have had within the FOMC that there is concern about the money supply, and I think rightfully so. To the extent that these data [are accurate], you'll see very shortly when they come out in chart form that [the weakness] is clearly a problem that we're going to have to confront. And I'm not at all convinced that we're not going to have this issue as a major concern as we move through the early months of this year.

MR. ANGELL. I wasn't speaking so much in terms of the pros and cons of the policy that's there; it just seems to me that you, the Chairman, had the prerogative, given the directive. And I think we

understand what it was that you were wishing to accomplish by that move. I do believe that the uncertainties in the Middle East already have made reading what we do somewhat more difficult than it otherwise would be. That is, looking at the price of gold or the foreign exchange value of the dollar or the bond yield right now is much more difficult in this environment. As to what took place yesterday, [we have no way] of knowing what we were seeing from our moves versus what the effects were of all the concentration on war or no war.

CHAIRMAN GREENSPAN. I think that's going to get increasingly unstable over the next number of days depending, of course, on what comes out of this meeting.

MR. ANGELL. Yes, but I don't have the feeling that monetary policy is so tenuous. There really are quite a few days left in the year for us to make monetary policy moves. No matter what the money growth is showing on a week-to-week basis, I think we can afford to take a somewhat longer view. So, I don't feel quite as alarmed about what I would expect to be a rather short war period, although I don't know when it will start.

CHAIRMAN GREENSPAN. I certainly [hope] that your view prevails because if it doesn't, I think we will have some real difficulties.

MR. BLACK. Mr. Chairman, this is Bob Black. I was on the call yesterday and I did not know at the time of the call that Peter had had conversations with you and that Don had talked with you. But when they told me they were not going to drain reserves, I told them I thought that was an appropriate policy in view of the extreme shortfalls in the money supply. Peter subsequently phoned me following the call and told me about the conversations, indicating that he did not have time to tell me ahead of time. I think you did exactly the right thing and I applaud your gracious act in moving when you did.

CHAIRMAN GREENSPAN. Thank you. Are there any further questions or comments?

VICE CHAIRMAN CORRIGAN. Yes, Alan, let me just add a comment. In one sense, Governor Angell is right when he says the year is long. [Unintelligible] but I have to say that I am getting increasingly concerned--not, as I said before, because I'm a monetarist but because there is a pattern of things that seems to me to be [systemic] and that could be very troublesome indeed. That includes the point that Dick made about individuals and institutions shying away from faith in the banking system in a context in which the money creation part of the banking system was already under some pressure due to the credit crunch phenomenon that we discussed earlier. So, apart from the timing of any particular policy move, I think this is a situation that we are going to have to look at very, very carefully because it may be telling us something far more fundamental than just the fact of anemic money supply growth rates. But I think that's not something that can be dismissed lightly even though subsequent events may begin to reverse some of the pattern we're seeing right now. I think it's at least possible--I didn't say probable, but at least possible--that we are seeing something quite extraordinary here in terms of what is going on in the real world.

MR. ANGELL. Jerry, given what we've seen with regard to the banking industry, with certain banking supervisors appearing on every talk show highlighting the industry's problems and the Congress almost in a panic over not wanting the banking industry to be like the thrift industry, it would seem somewhat likely that in such an environment households and corporations would choose to hold their liquidity balances at different institutions. And I would presume that the commercial banking industry would begin suffering in regard to their proportion of liquidity balances just as the thrift industry has. Consequently, what I always like to rely upon in regard to measures of liquidity [is] M2 and I have to say that the information value for me has disappeared. I'm in no position to [argue with] those who consider this to be a sign of economic weakness. I have no way of knowing that that's not precisely correct; but I don't have any way of knowing that it is correct.

MR. MELZER. Along that line, given the concerns Wayne just expressed about the informational value of M2 and M3, it seems to me that we may want to consider in February whether or not we might want to look at a broader array of reserve and monetary aggregates. We could conceivably get way out of position by acting on the wrong data.

VICE CHAIRMAN CORRIGAN. I share that concern, Tom. It's hard to know what the heck these things are telling us right now.

MR. MELZER. But we may want to look explicitly at a broader range so we don't get locked into a course of action that in retrospect we may not be happy with. I'm not saying that we have to do that at this point; I'm just saying that's something to think about in February.

CHAIRMAN GREENSPAN. I think we have to raise the obvious questions: What are the money supply data telling us and to what extent is that flowing through into economic decision-making? At this particular stage, while we see considerable evidence that there is some pulling back from holding commercial bank claims, it is by no means clear what that is in fact saying, for example, about the household balance sheet and the propensity to spend. And I think the broader issue of the transmission of monetary forces through the economy is something that is different in the current context than at any time I recall. I think something quite extraordinary is going on and I think we're going to grapple for a while to understand it. It's not clear that we're going to learn very much over the next several months either. So, I think we're going to have some very difficult analytical problems in constructing monetary policy.

MR. LAWARE. Mr. Chairman, I'm of the opinion that this situation tends to compound itself in the sense that concerns about the banking system and the general economy and also the overhang of the Middle East situation have consumers so scared that they are not going to spend. Businesses are holding back on moving forward with any kind of investment. And the banks, in the face of apparent movements in deposits and liabilities and so forth, compounded by concerns about capital levels and examination results, are not going to lend no matter how much [money] we put out there for them to use. That's the sense of frustration and uniqueness about this situation that I get.



MR. CORRIGAN. That's one of the reasons why [understanding] the behavior of excess reserves--if we can figure it out--would be very important. If we have unambiguous evidence of a [marked] increase in excess reserves targeted for year-end, apart from the reduction in reserve requirements, that to me would be prima facie evidence [in support] of the hypothesis that you just stated. One of the things that's so frustrating right now is that for the reasons Peter and others described earlier, it's hard to make that judgment one way or another right now. But, prospectively, it seems to me that the behavior of excess reserves could be a very important variable because, as I said, if we did have evidence of a large autonomous increase in excess reserves, it would indeed be compatible with the hypothesis that you just stated: that banks just aren't going to lend to anybody for anything.

CHAIRMAN GREENSPAN. Any further questions or comments?

MR. GUFFEY. Mr. Chairman, Roger Guffey. I have been listening to all of the comments and I do have some concern about the aggregates, although it seems to me that it is pretty soft information to be taking a policy action on. But beyond that, it seems to me that almost everything that was expressed this morning by the various participants was based upon uncertainty. And I don't think we should be making policy [based] on uncertainty. So, I hope that we hold steady for a period of time in the future.

CHAIRMAN GREENSPAN. Any further comments or questions?

MR. BLACK. Mr. Chairman, Bob Black again. Just briefly, I think this does raise the question of whether the discount rate ought to be one of the things [the Board] may have to address just as a matter of alignment [with] the federal funds target. I guess the discount rate really doesn't have much role, but it's still something I think we have to look at even if we don't allow any of that change to show through in the federal funds rate. I feel it's the proper course right now.

CHAIRMAN GREENSPAN. Further comments? If not, thank you very much, everyone. We will look forward to seeing you at the next meeting.

END OF SESSION