Transcript of Press Conference

with

Paul A. Volcker

Chairman, Board of Governors of the Federal Reserve System

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Question: Mr. Volcker, you mentioned twice in your speech that you thought that you are turning the corner with this program or that you have started to turn the corners with this program.

Chairman Volcker: I think we can turn the corner in two respects -- maybe that's why it appeared twice in the speech. I think this program certainly can help, and I hope it does turn the corner in terms of our financial discipline, and I hope it is recognized as doing so. But, looking at what is going on in the economy more generally, I do think there is some danger that we don't appreciate the extent to which energy, in particular, is contributing to the present rate of increase in the price level. I don't remember the exact figure, but there was an increase in energy prices in the Producers Price Index released late last week, something on the order of 6 to 7 percent in one month. That's not an annual rate; you have to multiply it by twelve, and then you've got an annual rate around 80. When you're getting that rate of increase in prices in an important sector of the economy, it has an impact on the overall index, which has been running at about 13 percent in terms of consumer prices. Now those rates of increases in energy prices are not going to continue, if we do our job elsewhere; that is, I'm not saying that energy prices are not going to continue to go up, but they are not going to go up at that rate of speed. And so, as those prices subside, we will give the appearance of turning a corner in the overall price index, if we do our job elsewhere. I don't think that's any occasion for relaxation, because what is important now is that that overall rate of inflation of around 13 percent doesn't become so embedded in our expectations -- in our wage bargaining, in pricing policies of business -- that it perpetuates itself. Inflation tends to perpetuate itself once it really gets started, and we have to break through that kind of expectation.

Question: Mr. Volcker, what you seem to be saying is that part of the economy of the United States is very heavily dependent on decisions made by a group of oil producing countries and the effects of fiscal and monetary policies at home could be very limited if the Opec nations . . .

Chairman Volcker: I don't mean to imply that it is limited at all. We are clearly impacted by those decisions. We are impacted by prices; we are impacted by a very large siphoning off of purchasing power, running in the neighborhood of $25 billion a year more this year than last year because of the increase in prices. That has an effect on the economy. I don't think that means we are impotent in terms of our financial policies, our own fiscal policy, our own monetary policy. And indeed, the better the job we do at home with the instruments within our control -- and there is a compelling need for a better job -- the more we strengthen our debate with the main suppliers of oil and what prices they will charge.

Question: Mr. Volcker, many of the bankers here have responded to the actions taken by the Federal Reserve over the weekend as putting the Fed way up front in what many characterize as a lonesome position in leading the fight against inflation. In your talk today you gave more of an impression as a balanced across-the-board approach . . .

Chairman Volcker: I don't think we're in that lonely a position, although I understand that is the perception of some. But look at the other instruments of policy: cast your mind back a couple of years and look at the budget deficits we had at that time; I think there has indeed been some very substantial progress in reducing the budget deficit. It's still big -- it's still much too big in some longer-term sense -- and we have to move ahead toward balance, and that goal has been very clearly set forth. But the fact that we're still in deficit -- by international standards, not a terribly large deficit as it turns out -- should not obscure the progress that has been made. The overall deficit, of course, is only one part of the equation. Federal spending in the last couple of years has been cut back to a slower rate of growth than for the economy as a whole. The change, perhaps, has not been dramatic, but it is moving in the right direction, and it is a reversal of earlier trends. We have recently had this national accord that I cited in my speech; while its effects can't be quantified precisely, it does seem to me to be a forward step in terms of recognition of the problem, and it offers the hope that that dimension of the problem -- the whole wage bargaining process -- will not proceed oblivious of the problems of inflation. It is quite startling to read the words that both the Administration and labor leaders committed to paper, in terms of their concern over the inflationary process and the responsibilities of all Americans to help deal with that. So I don't think this is a lonely fight.

Question:

Chairman Volcker: No, we did not discuss the details of this kind of program with them. We had very extensive and intensive discussions, as you might imagine, as to various aspects of the exchange market problem and other problems internationally. It is clear to me that this kind of program is not inconsistent with a general consensus internationally of what is desirable, but we didn't discuss the details of the program. We did discuss, in some detail, full coordination of our intervention tactics and strategy to make sure there was full agreement on that, but we didn't discuss the details of this program.

Question: Mr. Chairman, if the actions of the Fed lead to a liquidity squeeze of thrift institutions and smaller banks, what would the Fed do, would it stand ready to lend in an emergency situation?

Chairman Volcker: The Federal Reserve is always ready to lend in an emergency situation, but I don't think I can hypothesize what our actions would be in general in terms of possibilities that I don't necessarily share as being probable. But the Federal Reserve is always available as a lender of last resort; that is one of our principal functions.

Question: The prime rate hit an all-time record today and you spoke today in your speech about turning the corner and so forth, how long do you expect it will be before interest rates will come down and did you expect the prime rate to go up as high as it did?

Chairman Volcker: We didn't undertake this program without some awareness that the initial impact might be reflected in short-term interest rates. I don't think I want to speculate on how long it might take to turn the corner. I would like to turn it as quickly as possible. As I suggested, I think this whole program brings that prospect about sooner, not later, and that is one of the merits of it in my view. But let's see how things proceed without speculating on any precise timing.

Question: Some bankers admit the fear that foreign banks lending from their own foreign offices might be forcing a way to get around your program and putting U.S. bankers at a disadvantage. Are you at all concerned about that?

Chairman Volcker: We live in highly integrated, international financial markets, and I think it is wrong to think that we can be a complete island unto ourselves on any measures of this sort. But, as you know, we did put the same reserve requirements on branches and agencies of foreign banks operating in the United States as on American banks, and we will certainly indicate to those institutions that we do not expect them to move around outside that perimeter by making loans from abroad that in the normal course of events would have been made from American offices. I do not see that as a major problem in defeating the purposes of the program.

Question: What about money market funds with their high interest rates being offered by the various . . . Are you considering any restraints on this type of (instrument?)?

Chairman Volcker: I have nothing in particular in mind there. This is happening in response to the competitive opportunities in the marketplace. The question has arisen about some aspects of those fund operations, in connection with the legislation that I mentioned at the end of my speech this morning. That legislation adopts the concept, for instance, that the primary thrust of reserve requirements should be on so-called transaction accounts -- demand deposits, NOW accounts, ATS accounts. The question has been raised by some, and I understand why, that if a fund of that sort permits check-writing privileges it could be said to be a form of transactions balance.

Question: Mr. Chairman, what is the target that you will use in determining your intervention, how will that target be set?

Chairman Volcker: I don't think it is appropriate to go into the technical details. The ultimate targets, in a very real sense, are the monetary aggregates that we have been using all along -- there is no change in that respect -- but those targets will, in effect, be translated into a family of reserve measures which we will use for guidance in our daily open market operations, which in turn affect the size of that reserve base.

Question: Mr. Chairman, you mentioned that part of the problem has been aimed at speculation in gold and in other commodity markets. Do you see any merit in the Fed having the authority to set margin requirements on commodity markets?

Chairman Volcker: No, I haven't thought about that. I don't see any merit in that at the moment.

Question: Since the Federal Reserve program is going to make the membership program a little more expensive now, do you expect a lot more banks to be dropping out?

Chairman Volcker: I wouldn't expect them to drop out for that particular reason. I think your observation is correct; it puts somewhat more of a burden on member banks, which is in some sense contrary to our longer-term objectives. We had a particular situation at this time that we had to meet. I think member banks will understand that, and there won't be an immediate reaction, but it does underscore the importance of the legislation to which I referred that deals with this problem very directly by spreading the burden of reserve requirements through the banking system or, indeed, through to any institution with transaction accounts. The problems in that sense are very much linked. But, in that respect, we're talking here about a program that has to last only as long as necessary for bank credit expansion to be brought under control, and I hope that is not a long period of time.

Question: Mr. Chairman, Mr. Miller indicated that in adopting the new operations policy the Fed has set limits on swings in the funds rate. I was wondering if you could tell us what kind of a spread there might be between the up and down side?

Chairman Volcker: I think those developments will have to be reflected in the market over a period of time. We do think in terms of a broad range. I don't want to reduce it to daily movements either.

Question: The dollar has been rising rather sharply in the last two days, is that partly due to intervention in the markets by the Fed?

Chairman Volcker: No, not at all.

Question: Does the Fed plan to step up intervention in the future?

Chairman Volcker: In some sense, the less intervention the better; if you don't need to intervene, so be it. I don't think intervention can be thought of as an instrument that replaces the need to do what's necessary at home to deal with the fundamental inflationary factors. That's what fundamentally affects the exchange markets, and intervention is not a substitute in any sense. But from time to time intervention can be useful in dealing with particular market situations.

Question: In your speech this morning you said that banks should practice fencing of their loans. It would seem to me more of a matter of responsible judgment than of following a set formula. Can you elaborate a little more on that?

Chairman Volcker: What I have in mind, principally, as I think the speech suggests, is that we may be living with more volatility in the money markets. By the way, I don't think that it is absolutely certain, by any means, that there really be a great degree of volatility as people get used to this approach. The function of many people working in banks is to smooth out fluctuations, to take advantage of arbitrage opportunities that develop from day to day. They make their own guesses, assumptions, strategies, in effect, buying funds when they're relatively cheap and selling them when they're relatively dear. So we'll see how much volatility develops. But if, indeed, some volatility develops, it seems to me that there should be some caution in translating these short-run movements into what are somewhat more significant and basic lending rates.

Question: It has been a couple of days now since the launching of this package, can you tell us anything about the reaction that you received to it. Has it measured up pretty much to your expectations?

Chairman Volcker: I read the same newspapers you do, I guess. Yesterday was a holiday in Washington, and I was busy writing a speech so I don't have anything more to add. I have seen nothing happening that is outside the range of my expectation.

Question: Is there an expectation of any particular adverse impact of your decision on the housing industry, homebuilding, mortgage rates, etc.?

Chairman Volcker: Let me put it this way. There was a reference earlier as to the pressures that might come on savings institutions. There already have been such pressures; higher interest rates tend to bring those pressures. But I think we can say two things about that. Housing has held up quite well, and the level of mortgage lending has remained quite high. Although there has been some reduction in housing, it has not been anything like what we have had in earlier periods of expansion. But there are difficulties there. There is pain that could be involved in this kind of a program for a period of time. But what you have to keep in mind is that the thing that is worse for those institutions over any period of time is the continuing climb in the rate of inflation. That is the ultimate cause of their difficulty, and dealing with that is obviously the purpose of this program. I think we can reasonably say that in a reasonably short period of time, if the program is successful, those institutions in the housing industry and those mortgage rates are going to be better off than they otherwise would have been.

Question: Mr. Chairman, along that line, what would be the short-term and long-term effects for the consumers?

Chairman Volcker: I think the long-term effects are clearly favorable if we are successful in dealing with this inflationary process. What this program does is enhance the chance, as I just indicated, that interest rates will come down over a period of time, to the extent that we can improve confidence in the performance of this economy over a period of time. Consumers can't help but benefit whether in their role as consumer or in their role as workers. We are attempting to deal as forcefully as we can with the problem at hand. To the extent that we turn the corner -- to use that phrase once again -- on the inflationary process, I think the benefits will become evident.

Question: What about the short-term program?

Chairman Volcker: In the short-term, we're in a difficult situation, with or without this program, and I don't want to deny that. We wouldn't need a strong program of this sort if we didn't have a difficult situation.

Question: Is your program going to make things a little bit worse in the short-term?

Chairman Volcker: It depends on what you call short-term. I'm not ready to accept that analysis. We've got to get away from thinking about what's good in the next two months. Suppose we had a great further increase in inventory accumulation, larger than what otherwise would have taken place without this program, in the next month or two. Now for a short while that might make business look better -- look as though it has a little red in its cheeks -- but what it would really indicate I think, is a flush of fever, because what happened would be a kind of speculative movement which we're moving to counter. If that happened, the foreseeable results are rather obvious: any business downturn would be that much greater. So I think we have to look a little bit beyond the next month or two for any evaluation of the effect of this kind of program.

Question: Would you say, six months?

Chairman Volcker: I'm not going to put a date on it. The sooner the better, as far as I'm concerned.

Question: Are there any new complementary moves the Carter Administration could make to bolster the strength of your initiative here?

Chairman Volcker: The Carter Administration has, on the fiscal side, I think, been preaching and carrying out the kind of restraint that is complementary to our program in this particular situation. I referred to their deliberations with labor earlier.

Question: Mr. Miller was talking yesterday about complementary moves that the Administration might be able to make to assist or somehow -- are there any new . . .

Chairman Volcker: I don't know in what context he was speaking. Was it domestic or international?

Question: He wasn't even that specific. We're trying to find out if there have been discussions to try to -- can we expect additional new moves by the Administration to bolster what you have started?

Chairman Volcker: I don't know, as I said, the context in which he was speaking. On the international side, the possibility of particular moves to bolster our fund availabilities are always under review, and it may have been that area that he was thinking of.

Question: I understand that there was a report Friday that you either had resigned or were threatening to resign. Do you have any comments on that?

Chairman Volcker: I think that it's an indication that our markets have reached -- I don't know what to call it -- either a silly or a frantic stage. There was nothing to the report at all. The subsequent report was that I had died and, as you can see, that didn't have much validity either; at least it's premature.

Question: In your speech I noted that you thought that there was an exaggerated concern that there would be an excessive growth in money and credit. Do you feel that part of that concern might be due to the fact that the money supply figures are not accurate?

Chairman Volcker: Unfortunately, the money supply figures are not as solid, shall I say, as we would like to see them, because there has been a lot of innovation in the money market fund area that was mentioned earlier. There have been other innovations within the banking system. We're going to be reviewing the statistical base for that series in the next few months, and we may have a re-definition to offer around the end of the year, or early next year. But I don't think that rather technical matter should obscure the fact that the growth in the money supply, however measured, has been rather rapid in recent months. Now I referred to possibly undue concern: the previous six months or so there had been an exceptionally slow rate of growth in the supply of money. Look at the longer perspective: money growth has been rather moderate, but there is no question that, in the past four or five months perhaps, the projectory of growth has been excessive, and we have acted since late July to bring that under control. I think that the measures that we have already taken would have begun to show their effect in any event. This new program reinforces that prospect.

Question: Mr. Chairman, are you going to issue any guidelines to banks to tell them how to tell if a loan is nonproductive and in what way can you enforce that kind of request.

Chairman Volcker: No, I don't plan to issue any guidelines of that sort. The definition of what's productive and unproductive, as you know, is an obscure one, but I do suggest that banks, in their own interest, are going through a difficult period in discharging their responsibilities to their own existing customers. However difficult, their job is the important responsible job of sorting out the supply of credit.

Question: I heard that you're going to look at nonborrowed reserves primarily, will you elaborate on that?

Chairman Volcker: I won't elaborate any further than I have elaborated. There are various measures of nonborrowed reserves. When one looks at total deposits in the banking system, in some sense it is the total reserves that basically control expansion potential in the banking system. The reserve base enters into the calculation because it includes currency which is part of the money supply.

Question: How much will available credit be reduced by these programs?

Chairman Volcker: It is not our intention to reduce the outstanding amount of credit at all. In fact, this program is designed to permit quarterly growth in credit. The country needs growth in credit over the period ahead, as it always does, and there is nothing in this program that cuts off that growth in credit. The hope is to bring the growth in bank credit and the expectation -- which is far in excess of the continuing needs of the economy in recent months -- to a rate of speed that does seem more commensurate with the needs of the economy.

Question: It can reduce the amount of available credit, doesn't it then?

Chairman Volcker: The total of credit will go up; it will continue to go up. A growing economy needs more credit, but more slowly.

Question: How much more slowly?

Chairman Volcker: I'm not capable of giving any exact calculation, but I'm trying to recall the figure. Total bank credit has been running in the

20 percent area, as I recall, and certain categories of lending have been faster than that in recent months; and that is excessive in terms of the continuing needs of the economy.

Question: Mr. Chairman, what are the political realities of the prime of 14-1/2 or 15 percent?

Chairman Volcker: You're anticipating beyond me, but the political reality, as I understand it, is that the country is facing up to this very difficult task of coping with the inflationary pressures that have developed, and that when you have inflation -- the kind that we have -- there is no way that you can avoid higher interest rates than we've been used to. While that psychology continues and mounts, we could attempt to control rates, I suppose, but that attempt to control would mean we would pour more money into the economy. The ultimate result of that -- the result that wouldn't be very far off -- would be still more inflation and still more pressure on interest rates. Interest rates are going to come down when expectations begin to change and when confidence returns in our ability to deal with this inflationary problem. That is what we are attempting to do. So as I indicated earlier, I think the broad thrust of this program should be interpreted as hastening the day when these very high levels of interest. rates come down.

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