

Business Council-Hot Springs, Va.
October 9, 1982

Collection: Paul A. Volcker Papers
Call Number: MC279

Box 13

Preferred Citation: Business Council - Hot Springs, Va., 1982 October 9; Paul A. Volcker Papers, Box 13; Public Policy Papers, Department of Rare Books and Special Collections, Princeton University Library

Find it online: <http://findingaids.princeton.edu/collections/MC279/c230> and
<https://fraser.stlouisfed.org/archival/5297>

The digitization of this collection was made possible by the Federal Reserve Bank of St. Louis.

From the collections of the Seeley G. Mudd Manuscript Library, Princeton, NJ

These documents can only be used for educational and research purposes ("fair use") as per United States copyright law. By accessing this file, all users agree that their use falls within fair use as defined by the copyright law of the United States. They further agree to request permission of the Princeton University Library (and pay any fees, if applicable) if they plan to publish, broadcast, or otherwise disseminate this material. This includes all forms of electronic distribution.

Copyright

The copyright law of the United States (Title 17, United States Code) governs the making of photocopies or other reproductions of copyrighted material. Under certain conditions specified in the law, libraries and archives are authorized to furnish a photocopy or other reproduction. One of these specified conditions is that the photocopy or other reproduction is not to be "used for any purpose other than private study, scholarship or research." If a user makes a request for, or later uses, a photocopy or other reproduction for purposes not permitted as fair use under the copyright law of the United States, that user may be liable for copyright infringement.

Policy on Digitized Collections

Digitized collections are made accessible for research purposes. Princeton University has indicated what it knows about the copyrights and rights of privacy, publicity or trademark in its finding aids. However, due to the nature of archival collections, it is not always possible to identify this information. Princeton University is eager to hear from any rights owners, so that it may provide accurate information. When a rights issue needs to be addressed, upon request Princeton University will remove the material from public view while it reviews the claim.

Inquiries about this material can be directed to:

Seeley G. Mudd Manuscript Library
65 Olden Street
Princeton, NJ 08540
609-258-6345
609-258-3385 (fax)
mudd@princeton.edu

Excerpt from Informal Talk of
Paul A. Volcker to Business Council
At Hot Springs, Va. 10/9/82

As you know, yesterday we made a further reduction in the discount rate to 9-1/2 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 a background of continued sluggishness in business activity, the exceptional recent strength of the dollar on the exchange markets, and indications of strong demands for liquidity in some markets.

In the light of all the potentially confusing comment in the press in recent days, which seemed to be based on a combination of partial information and reportorial speculation, it may be desirable to reiterate what seems to me 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.

In assessing economic and financial developments over recent months, I would also point out again what I have said on a number of occasions before: there is growing evidence that the inflationary momentum has been broken. Indeed, with appropriate policies, the prospects appear good for continuing moderation of inflation in the months and years ahead. Continuing progress toward restoring price stability is an essential part of building a solid base, not just for recovery but for sustaining expansion over a long period. Concern about inflation, and monetary discipline, is not something we can turn on and off; it will be a continuing priority concern of policy.

What does inevitably change is the financial and business environment in which we operate. Unfortunately from the standpoint of reporting and communication, the continuing thrust of monetary policy cannot be adequately measured by any single or simple symbol. Headlines can be misleading.

I hope we have all learned that the level or direction of interest rates is not, by itself, a reliable test of "ease" or "restraint" -- it all depends upon the circumstances. Lower interest rates in an economy in recession are not unusual, and are consistent with the need for recovery. But lower interest rates do not in themselves indicate a change in basic policy approach. Over longer periods of time, achieving and maintaining the lower level of interest rates we would all like to see must, in a sense, be a reward for success in dealing with inflation; artificially forcing the process would in the end be counter-productive. What is needed is market conviction that the fundamentals are consistent with lower interest rates, and I believe that is what we have been seeing for some months.

The emphasis on monetary and credit aggregates in conducting and interpreting policy during recent years is, of course, useful in part because of the unreliability of interest rate measures in gauging the necessary degree of restraint. We express policy in terms of broad targets for the various definitions of money on the basic thesis that, over time, the inflationary process is related to excessive growth in money and credit. But you have also heard me repeatedly express caution about the validity of any single measure, or even all the measures in the short run.

We have to be alert to the possibility that relationships may be disturbed by technological or regulatory changes in banking, or more broadly by shifts in liquidity preferences and velocity.

We face over the next few months, not just the possibility but the virtual certainty of distortions -- distortions growing out of legislation and regulation -- in the M1 number that is so widely followed in the markets. Right now, and over the next few weeks, some \$31 billion of "All Savers Certificates" are maturing, and in large part will not be rolled over. As those funds move to other investments, some amount will temporarily pass through checking accounts, or be "parked" in those accounts for a time awaiting new investment decisions. We know M1 will be affected, but we simply have no way of measuring the degree of that shifting. And, just as that process is expected to unwind over the next month or so, the new "money market fund-type" deposit account for banks and thrifts will be introduced. Sizable transfers of funds into those accounts, which will have considerable checkable and transactions capabilities, are anticipated, including shifts from regular checking and NOW accounts. The result will probably be to depress M1 growth for a while -- assuming the new accounts are not included in M1. But again we have no way of anticipating the magnitude, or even the direction of impact should the new accounts be tied to existing NOW accounts. Both the "ups" and "downs" in M1 reflecting these regulatory changes will be artificial and virtually meaningless in gauging underlying trends in "money" and liquidity. The potential problems have been common knowledge in market circles.

In the circumstances, I do not believe that, in actual implementation of monetary policy, we have any alternative but to attach much less than usual weight to movements in M1, over the period immediately ahead. We will, of course, analyze the data carefully to assist us in assessing underlying trends, but it is likely to take some months before new relationships can be judged with any degree of reliability in a world of radically new deposit instruments with transactions capability.

Fortunately, while the M2 and M3 aggregates may also be affected by the new deposit instruments, the impact should be relatively much less. Those aggregates are not only much larger, but most of the shifts among financial instruments are expected to take place within those large aggregates. For instance, shifts by individuals among "All Savers Certificates," checking accounts, money market certificates, money market mutual funds, and the new account would all leave M2 unaffected because they are all counted within that aggregate. If the shifts are into (or out of) market instruments, such as tax-exempt bonds or Treasury bills, the totals would be affected, but probably to a limited degree.

The fact that, for the time being, underlying monetary growth and 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 is true that for some time (before the new distortions that will be induced by legislation and regulation) the various monetary aggregates have in general been somewhat above the growth

paths targeted for the year. I would also point out, though, that indications suggest an appreciable recent slowing in growth of both M2 and M3, and it so happens -- perhaps fortuitously -- that last week's M1 figure is very close to target. That is part of the setting of the discount rate change.

You may recall that, when reiterating our annual targets in July, I emphasized that "growth somewhat above the targeted ranges would be tolerated for a time in 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 judgment, 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 and interest rates." I believe reasoned assessment of recent developments in the light of those factors does suggest that preferences for liquidity have generally been relatively strong, reflected in part in some abnormal pressures in parts of the private credit markets. In that light, the fact that some of the aggregates have tended to run somewhat above their target ranges has been fully acceptable to the Federal Open Market Committee.

I believe I can speak for all members of the Committee in saying that those judgments have been reached, and will continue to be reached, in full recognition of the need to maintain the heartening progress toward price stability.

* * * * *

Excerpt from Informal Talk of
Paul A. Volcker to Business Council
At Hot Springs, Va. 10/9/82

As you know, yesterday we made a further reduction in the discount rate to 9-1/2 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 a background of continued sluggishness in business activity, the exceptional recent strength of the dollar on the exchange markets, and indications of strong demands for liquidity in some markets.

In the light of all the potentially confusing comment in the press in recent days, which seemed to be based on a combination of partial information and reportorial speculation, it may be desirable to reiterate what seems to me 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.

In assessing economic and financial developments over recent months, I would also point out again what I have said on a number of occasions before: there is growing evidence that the inflationary momentum has been broken. Indeed, with appropriate policies, the prospects appear good for continuing moderation of inflation in the months and years ahead. Continuing progress toward restoring price stability is an essential part of building a solid base, not just for recovery but for sustaining expansion over a long period. Concern about inflation, and monetary discipline, is not something we can turn on and off; it will be a continuing priority concern of policy.

What does inevitably change is the financial and business environment in which we operate. Unfortunately from the standpoint of reporting and communication, the continuing thrust of monetary policy cannot be adequately measured by any single or simple symbol. Headlines can be misleading.

I hope we have all learned that the level or direction of interest rates is not, by itself, a reliable test of "ease" or "restraint" -- it all depends upon the circumstances. Lower interest rates in an economy in recession are not unusual, and are consistent with the need for recovery. But lower interest rates do not in themselves indicate a change in basic policy approach. Over longer periods of time, achieving and maintaining the lower level of interest rates we would all like to see must, in a sense, be a reward for success in dealing with inflation; artificially forcing the process would in the end be counter-productive. What is needed is market conviction that the fundamentals are consistent with lower interest rates, and I believe that is what we have been seeing for some months.

The emphasis on monetary and credit aggregates in conducting and interpreting policy during recent years is, of course, useful in part because of the unreliability of interest rate measures in gauging the necessary degree of restraint. We express policy in terms of broad targets for the various definitions of money on the basic thesis that, over time, the inflationary process is related to excessive growth in money and credit. But you have also heard me repeatedly express caution about the validity of any single measure, or even all the measures in the short run.

We have to be alert to the possibility that relationships may be disturbed by technological or regulatory changes in banking, or more broadly by shifts in liquidity preferences and velocity.

We face over the next few months, not just the possibility but the virtual certainty of distortions -- distortions growing out of legislation and regulation -- in the M1 number that is so widely followed in the markets. Right now, and over the next few weeks, some \$31 billion of "All Savers Certificates" are maturing, and in large part will not be rolled over. As those funds move to other investments, some amount will temporarily pass through checking accounts, or be "parked" in those accounts for a time awaiting new investment decisions. We know M1 will be affected, but we simply have no way of measuring the degree of that shifting. And, just as that process is expected to unwind over the next month or so, the new "money market fund-type" deposit account for banks and thrifts will be introduced. Sizable transfers of funds into those accounts, which will have considerable checkable and transactions capabilities, are anticipated, including shifts from regular checking and NOW accounts. The result will probably be to depress M1 growth for a while -- assuming the new accounts are not included in M1. But again we have no way of anticipating the magnitude, or even the direction of impact should the new accounts be tied to existing NOW accounts. Both the "ups" and "downs" in M1 reflecting these regulatory changes will be artificial and virtually meaningless in gauging underlying trends in "money" and liquidity. The potential problems have been common knowledge in market circles.

In the circumstances, I do not believe that, in actual implementation of monetary policy, we have any alternative but to attach much less than usual weight to movements in M1, over the period immediately ahead. We will, of course, analyze the data carefully to assist us in assessing underlying trends, but it is likely to take some months before new relationships can be judged with any degree of reliability in a world of radically new deposit instruments with transactions capability.

Fortunately, while the M2 and M3 aggregates may also be affected by the new deposit instruments, the impact should be relatively much less. Those aggregates are not only much larger, but most of the shifts among financial instruments are expected to take place within those large aggregates. For instance, shifts by individuals among "All Savers Certificates," checking accounts, money market certificates, money market mutual funds, and the new account would all leave M2 unaffected because they are all counted within that aggregate. If the shifts are into (or out of) market instruments, such as tax-exempt bonds or Treasury bills, the totals would be affected, but probably to a limited degree.

The fact that, for the time being, underlying monetary growth and 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 is true that for some time (before the new distortions that will be induced by legislation and regulation) the various monetary aggregates have in general been somewhat above the growth

paths targeted for the year. I would also point out, though, that indications suggest an appreciable recent slowing in growth of both M2 and M3, and it so happens -- perhaps fortuitously -- that last week's M1 figure is very close to target. That is part of the setting of the discount rate change.

You may recall that, when reiterating our annual targets in July, I emphasized that "growth somewhat above the targeted ranges would be tolerated for a time in 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 judgment, 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 and interest rates." I believe reasoned assessment of recent developments in the light of those factors does suggest that preferences for liquidity have generally been relatively strong, reflected in part in some abnormal pressures in parts of the private credit markets. In that light, the fact that some of the aggregates have tended to run somewhat above their target ranges has been fully acceptable to the Federal Open Market Committee.

I believe I can speak for all members of the Committee in saying that those judgments have been reached, and will continue to be reached, in full recognition of the need to maintain the heartening progress toward price stability.

* * * * *

Excerpt from Informal Talk of
Paul A. Volcker to Business Council
At Hot Springs, Va. 10/9/82

As you know, yesterday we made a further reduction in the discount rate to 9-1/2 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 a background of continued sluggishness in business activity, the exceptional recent strength of the dollar on the exchange markets, and indications of strong demands for liquidity in some markets.

In the light of all the potentially confusing comment in the press in recent days, which seemed to be based on a combination of partial information and reportorial speculation, it may be desirable to reiterate what seems to me 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.

In assessing economic and financial developments over recent months, I would also point out again what I have said on a number of occasions before: there is growing evidence that the inflationary momentum has been broken. Indeed, with appropriate policies, the prospects appear good for continuing moderation of inflation in the months and years ahead. Continuing progress toward restoring price stability is an essential part of building a solid base, not just for recovery but for sustaining expansion over a long period. Concern about inflation, and monetary discipline, is not something we can turn on and off; it will be a continuing priority concern of policy.

What does inevitably change is the financial and business environment in which we operate. Unfortunately from the standpoint of reporting and communication, the continuing thrust of monetary policy cannot be adequately measured by any single or simple symbol. Headlines can be misleading.

I hope we have all learned that the level or direction of interest rates is not, by itself, a reliable test of "ease" or "restraint" -- it all depends upon the circumstances. Lower interest rates in an economy in recession are not unusual, and are consistent with the need for recovery. But lower interest rates do not in themselves indicate a change in basic policy approach. Over longer periods of time, achieving and maintaining the lower level of interest rates we would all like to see must, in a sense, be a reward for success in dealing with inflation; artificially forcing the process would in the end be counter-productive. What is needed is market conviction that the fundamentals are consistent with lower interest rates, and I believe that is what we have been seeing for some months.

The emphasis on monetary and credit aggregates in conducting and interpreting policy during recent years is, of course, useful in part because of the unreliability of interest rate measures in gauging the necessary degree of restraint. We express policy in terms of broad targets for the various definitions of money on the basic thesis that, over time, the inflationary process is related to excessive growth in money and credit. But you have also heard me repeatedly express caution about the validity of any single measure, or even all the measures in the short run.

We have to be alert to the possibility that relationships may be disturbed by technological or regulatory changes in banking, or more broadly by shifts in liquidity preferences and velocity.

We face over the next few months, not just the possibility but the virtual certainty of distortions -- distortions growing out of legislation and regulation -- in the M1 number that is so widely followed in the markets. Right now, and over the next few weeks, some \$31 billion of "All Savers Certificates" are maturing, and in large part will not be rolled over. As those funds move to other investments, some amount will temporarily pass through checking accounts, or be "parked" in those accounts for a time awaiting new investment decisions. We know M1 will be affected, but we simply have no way of measuring the degree of that shifting. And, just as that process is expected to unwind over the next month or so, the new "money market fund-type" deposit account for banks and thrifts will be introduced. Sizable transfers of funds into those accounts, which will have considerable checkable and transactions capabilities, are anticipated, including shifts from regular checking and NOW accounts. The result will probably be to depress M1 growth for a while -- assuming the new accounts are not included in M1. But again we have no way of anticipating the magnitude, or even the direction of impact should the new accounts be tied to existing NOW accounts. Both the "ups" and "downs" in M1 reflecting these regulatory changes will be artificial and virtually meaningless in gauging underlying trends in "money" and liquidity. The potential problems have been common knowledge in market circles.

In the circumstances, I do not believe that, in actual implementation of monetary policy, we have any alternative but to attach much less than usual weight to movements in M1, over the period immediately ahead. We will, of course, analyze the data carefully to assist us in assessing underlying trends, but it is likely to take some months before new relationships can be judged with any degree of reliability in a world of radically new deposit instruments with transactions capability.

Fortunately, while the M2 and M3 aggregates may also be affected by the new deposit instruments, the impact should be relatively much less. Those aggregates are not only much larger, but most of the shifts among financial instruments are expected to take place within those large aggregates. For instance, shifts by individuals among "All Savers Certificates," checking accounts, money market certificates, money market mutual funds, and the new account would all leave M2 unaffected because they are all counted within that aggregate. If the shifts are into (or out of) market instruments, such as tax-exempt bonds or Treasury bills, the totals would be affected, but probably to a limited degree.

The fact that, for the time being, underlying monetary growth and 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 is true that for some time (before the new distortions that will be induced by legislation and regulation) the various monetary aggregates have in general been somewhat above the growth

paths targeted for the year. I would also point out, though, that indications suggest an appreciable recent slowing in growth of both M2 and M3, and it so happens -- perhaps fortuitously -- that last week's M1 figure is very close to target. That is part of the setting of the discount rate change.

You may recall that, when reiterating our annual targets in July, I emphasized that "growth somewhat above the targeted ranges would be tolerated for a time in 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 judgment, 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 and interest rates." I believe reasoned assessment of recent developments in the light of those factors does suggest that preferences for liquidity have generally been relatively strong, reflected in part in some abnormal pressures in parts of the private credit markets. In that light, the fact that some of the aggregates have tended to run somewhat above their target ranges has been fully acceptable to the Federal Open Market Committee.

I believe I can speak for all members of the Committee in saying that those judgments have been reached, and will continue to be reached, in full recognition of the need to maintain the heartening progress toward price stability.

* * * * *

Excerpt from Informal Talk of
Paul A. Volcker to Business Council
At Hot Springs, Va. 10/9/82

As you know, yesterday we made a further reduction in the discount rate to 9-1/2 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 a background of continued sluggishness in business activity, the exceptional recent strength of the dollar on the exchange markets, and indications of strong demands for liquidity in some markets.

In the light of all the potentially confusing comment in the press in recent days, which seemed to be based on a combination of partial information and reportorial speculation, it may be desirable to reiterate what seems to me 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.

In assessing economic and financial developments over recent months, I would also point out again what I have said on a number of occasions before: there is growing evidence that the inflationary momentum has been broken. Indeed, with appropriate policies, the prospects appear good for continuing moderation of inflation in the months and years ahead. Continuing progress toward restoring price stability is an essential part of building a solid base, not just for recovery but for sustaining expansion over a long period. Concern about inflation, and monetary discipline, is not something we can turn on and off; it will be a continuing priority concern of policy.

What does inevitably change is the financial and business environment in which we operate. Unfortunately from the standpoint of reporting and communication, the continuing thrust of monetary policy cannot be adequately measured by any single or simple symbol. Headlines can be misleading.

I hope we have all learned that the level or direction of interest rates is not, by itself, a reliable test of "ease" or "restraint" -- it all depends upon the circumstances. Lower interest rates in an economy in recession are not unusual, and are consistent with the need for recovery. But lower interest rates do not in themselves indicate a change in basic policy approach. Over longer periods of time, achieving and maintaining the lower level of interest rates we would all like to see must, in a sense, be a reward for success in dealing with inflation; artificially forcing the process would in the end be counter-productive. What is needed is market conviction that the fundamentals are consistent with lower interest rates, and I believe that is what we have been seeing for some months.

The emphasis on monetary and credit aggregates in conducting and interpreting policy during recent years is, of course, useful in part because of the unreliability of interest rate measures in gauging the necessary degree of restraint. We express policy in terms of broad targets for the various definitions of money on the basic thesis that, over time, the inflationary process is related to excessive growth in money and credit. But you have also heard me repeatedly express caution about the validity of any single measure, or even all the measures in the short run.

We have to be alert to the possibility that relationships may be disturbed by technological or regulatory changes in banking, or more broadly by shifts in liquidity preferences and velocity.

We face over the next few months, not just the possibility but the virtual certainty of distortions -- distortions growing out of legislation and regulation -- in the M1 number that is so widely followed in the markets. Right now, and over the next few weeks, some \$31 billion of "All Savers Certificates" are maturing, and in large part will not be rolled over. As those funds move to other investments, some amount will temporarily pass through checking accounts, or be "parked" in those accounts for a time awaiting new investment decisions. We know M1 will be affected, but we simply have no way of measuring the degree of that shifting. And, just as that process is expected to unwind over the next month or so, the new "money market fund-type" deposit account for banks and thrifts will be introduced. Sizable transfers of funds into those accounts, which will have considerable checkable and transactions capabilities, are anticipated, including shifts from regular checking and NOW accounts. The result will probably be to depress M1 growth for a while -- assuming the new accounts are not included in M1. But again we have no way of anticipating the magnitude, or even the direction of impact should the new accounts be tied to existing NOW accounts. Both the "ups" and "downs" in M1 reflecting these regulatory changes will be artificial and virtually meaningless in gauging underlying trends in "money" and liquidity. The potential problems have been common knowledge in market circles.

In the circumstances, I do not believe that, in actual implementation of monetary policy, we have any alternative but to attach much less than usual weight to movements in M1, over the period immediately ahead. We will, of course, analyze the data carefully to assist us in assessing underlying trends, but it is likely to take some months before new relationships can be judged with any degree of reliability in a world of radically new deposit instruments with transactions capability.

Fortunately, while the M2 and M3 aggregates may also be affected by the new deposit instruments, the impact should be relatively much less. Those aggregates are not only much larger, but most of the shifts among financial instruments are expected to take place within those large aggregates. For instance, shifts by individuals among "All Savers Certificates," checking accounts, money market certificates, money market mutual funds, and the new account would all leave M2 unaffected because they are all counted within that aggregate. If the shifts are into (or out of) market instruments, such as tax-exempt bonds or Treasury bills, the totals would be affected, but probably to a limited degree.

The fact that, for the time being, underlying monetary growth and 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 is true that for some time (before the new distortions that will be induced by legislation and regulation) the various monetary aggregates have in general been somewhat above the growth

paths targeted for the year. I would also point out, though, that indications suggest an appreciable recent slowing in growth of both M2 and M3, and it so happens -- perhaps fortuitously -- that last week's M1 figure is very close to target. That is part of the setting of the discount rate change.

You may recall that, when reiterating our annual targets in July, I emphasized that "growth somewhat above the targeted ranges would be tolerated for a time in 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 judgment, 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 and interest rates." I believe reasoned assessment of recent developments in the light of those factors does suggest that preferences for liquidity have generally been relatively strong, reflected in part in some abnormal pressures in parts of the private credit markets. In that light, the fact that some of the aggregates have tended to run somewhat above their target ranges has been fully acceptable to the Federal Open Market Committee.

I believe I can speak for all members of the Committee in saying that those judgments have been reached, and will continue to be reached, in full recognition of the need to maintain the heartening progress toward price stability.

* * * * *

Excerpt from Informal Talk of
Paul A. Volcker to Business Council
At Hot Springs, Va. 10/9/82

As you know, yesterday we made a further reduction in the discount rate to 9-1/2 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 a background of continued sluggishness in business activity, the exceptional recent strength of the dollar on the exchange markets, and indications of strong demands for liquidity in some markets.

In the light of all the potentially confusing comment in the press in recent days, which seemed to be based on a combination of partial information and reportorial speculation, it may be desirable to reiterate what seems to me 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.

In assessing economic and financial developments over recent months, I would also point out again what I have said on a number of occasions before: there is growing evidence that the inflationary momentum has been broken. Indeed, with appropriate policies, the prospects appear good for continuing moderation of inflation in the months and years ahead. Continuing progress toward restoring price stability is an essential part of building a solid base, not just for recovery but for sustaining expansion over a long period. Concern about inflation, and monetary discipline, is not something we can turn on and off; it will be a continuing priority concern of policy.

What does inevitably change is the financial and business environment in which we operate. Unfortunately from the standpoint of reporting and communication, the continuing thrust of monetary policy cannot be adequately measured by any single or simple symbol. Headlines can be misleading.

I hope we have all learned that the level or direction of interest rates is not, by itself, a reliable test of "ease" or "restraint" -- it all depends upon the circumstances. Lower interest rates in an economy in recession are not unusual, and are consistent with the need for recovery. But lower interest rates do not in themselves indicate a change in basic policy approach. Over longer periods of time, achieving and maintaining the lower level of interest rates we would all like to see must, in a sense, be a reward for success in dealing with inflation; artificially forcing the process would in the end be counter-productive. What is needed is market conviction that the fundamentals are consistent with lower interest rates, and I believe that is what we have been seeing for some months.

The emphasis on monetary and credit aggregates in conducting and interpreting policy during recent years is, of course, useful in part because of the unreliability of interest rate measures in gauging the necessary degree of restraint. We express policy in terms of broad targets for the various definitions of money on the basic thesis that, over time, the inflationary process is related to excessive growth in money and credit. But you have also heard me repeatedly express caution about the validity of any single measure, or even all the measures in the short run.

We have to be alert to the possibility that relationships may be disturbed by technological or regulatory changes in banking, or more broadly by shifts in liquidity preferences and velocity.

We face over the next few months, not just the possibility but the virtual certainty of distortions -- distortions growing out of legislation and regulation -- in the M1 number that is so widely followed in the markets. Right now, and over the next few weeks, some \$31 billion of "All Savers Certificates" are maturing, and in large part will not be rolled over. As those funds move to other investments, some amount will temporarily pass through checking accounts, or be "parked" in those accounts for a time awaiting new investment decisions. We know M1 will be affected, but we simply have no way of measuring the degree of that shifting. And, just as that process is expected to unwind over the next month or so, the new "money market fund-type" deposit account for banks and thrifts will be introduced. Sizable transfers of funds into those accounts, which will have considerable checkable and transactions capabilities, are anticipated, including shifts from regular checking and NOW accounts. The result will probably be to depress M1 growth for a while -- assuming the new accounts are not included in M1. But again we have no way of anticipating the magnitude, or even the direction of impact should the new accounts be tied to existing NOW accounts. Both the "ups" and "downs" in M1 reflecting these regulatory changes will be artificial and virtually meaningless in gauging underlying trends in "money" and liquidity. The potential problems have been common knowledge in market circles.

In the circumstances, I do not believe that, in actual implementation of monetary policy, we have any alternative but to attach much less than usual weight to movements in M1, over the period immediately ahead. We will, of course, analyze the data carefully to assist us in assessing underlying trends, but it is likely to take some months before new relationships can be judged with any degree of reliability in a world of radically new deposit instruments with transactions capability.

Fortunately, while the M2 and M3 aggregates may also be affected by the new deposit instruments, the impact should be relatively much less. Those aggregates are not only much larger, but most of the shifts among financial instruments are expected to take place within those large aggregates. For instance, shifts by individuals among "All Savers Certificates," checking accounts, money market certificates, money market mutual funds, and the new account would all leave M2 unaffected because they are all counted within that aggregate. If the shifts are into (or out of) market instruments, such as tax-exempt bonds or Treasury bills, the totals would be affected, but probably to a limited degree.

The fact that, for the time being, underlying monetary growth and 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 is true that for some time (before the new distortions that will be induced by legislation and regulation) the various monetary aggregates have in general been somewhat above the growth

paths targeted for the year. I would also point out, though, that indications suggest an appreciable recent slowing in growth of both M2 and M3, and it so happens -- perhaps fortuitously -- that last week's M1 figure is very close to target. That is part of the setting of the discount rate change.

You may recall that, when reiterating our annual targets in July, I emphasized that "growth somewhat above the targeted ranges would be tolerated for a time in 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 judgment, 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 and interest rates." I believe reasoned assessment of recent developments in the light of those factors does suggest that preferences for liquidity have generally been relatively strong, reflected in part in some abnormal pressures in parts of the private credit markets. In that light, the fact that some of the aggregates have tended to run somewhat above their target ranges has been fully acceptable to the Federal Open Market Committee.

I believe I can speak for all members of the Committee in saying that those judgments have been reached, and will continue to be reached, in full recognition of the need to maintain the heartening progress toward price stability.

* * * * *

Excerpt from Informal Talk of
Paul A. Volcker to Business Council
At Hot Springs, Va. 10/9/82

As you know, yesterday we made a further reduction in the discount rate to 9-1/2 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 a background of continued sluggishness in business activity, the exceptional recent strength of the dollar on the exchange markets, and indications of strong demands for liquidity in some markets.

In the light of all the potentially confusing comment in the press in recent days, which seemed to be based on a combination of partial information and reportorial speculation, it may be desirable to reiterate what seems to me 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.

In assessing economic and financial developments over recent months, I would also point out again what I have said on a number of occasions before: there is growing evidence that the inflationary momentum has been broken. Indeed, with appropriate policies, the prospects appear good for continuing moderation of inflation in the months and years ahead. Continuing progress toward restoring price stability is an essential part of building a solid base, not just for recovery but for sustaining expansion over a long period. Concern about inflation, and monetary discipline, is not something we can turn on and off; it will be a continuing priority concern of policy.

What does inevitably change is the financial and business environment in which we operate. Unfortunately from the standpoint of reporting and communication, the continuing thrust of monetary policy cannot be adequately measured by any single or simple symbol. Headlines can be misleading.

I hope we have all learned that the level or direction of interest rates is not, by itself, a reliable test of "ease" or "restraint" -- it all depends upon the circumstances. Lower interest rates in an economy in recession are not unusual, and are consistent with the need for recovery. But lower interest rates do not in themselves indicate a change in basic policy approach. Over longer periods of time, achieving and maintaining the lower level of interest rates we would all like to see must, in a sense, be a reward for success in dealing with inflation; artificially forcing the process would in the end be counter-productive. What is needed is market conviction that the fundamentals are consistent with lower interest rates, and I believe that is what we have been seeing for some months.

The emphasis on monetary and credit aggregates in conducting and interpreting policy during recent years is, of course, useful in part because of the unreliability of interest rate measures in gauging the necessary degree of restraint. We express policy in terms of broad targets for the various definitions of money on the basic thesis that, over time, the inflationary process is related to excessive growth in money and credit. But you have also heard me repeatedly express caution about the validity of any single measure, or even all the measures in the short run.

We have to be alert to the possibility that relationships may be disturbed by technological or regulatory changes in banking, or more broadly by shifts in liquidity preferences and velocity.

We face over the next few months, not just the possibility but the virtual certainty of distortions -- distortions growing out of legislation and regulation -- in the M1 number that is so widely followed in the markets. Right now, and over the next few weeks, some \$31 billion of "All Savers Certificates" are maturing, and in large part will not be rolled over. As those funds move to other investments, some amount will temporarily pass through checking accounts, or be "parked" in those accounts for a time awaiting new investment decisions. We know M1 will be affected, but we simply have no way of measuring the degree of that shifting. And, just as that process is expected to unwind over the next month or so, the new "money market fund-type" deposit account for banks and thrifts will be introduced. Sizable transfers of funds into those accounts, which will have considerable checkable and transactions capabilities, are anticipated, including shifts from regular checking and NOW accounts. The result will probably be to depress M1 growth for a while -- assuming the new accounts are not included in M1. But again we have no way of anticipating the magnitude, or even the direction of impact should the new accounts be tied to existing NOW accounts. Both the "ups" and "downs" in M1 reflecting these regulatory changes will be artificial and virtually meaningless in gauging underlying trends in "money" and liquidity. The potential problems have been common knowledge in market circles.

In the circumstances, I do not believe that, in actual implementation of monetary policy, we have any alternative but to attach much less than usual weight to movements in M1, over the period immediately ahead. We will, of course, analyze the data carefully to assist us in assessing underlying trends, but it is likely to take some months before new relationships can be judged with any degree of reliability in a world of radically new deposit instruments with transactions capability.

Fortunately, while the M2 and M3 aggregates may also be affected by the new deposit instruments, the impact should be relatively much less. Those aggregates are not only much larger, but most of the shifts among financial instruments are expected to take place within those large aggregates. For instance, shifts by individuals among "All Savers Certificates," checking accounts, money market certificates, money market mutual funds, and the new account would all leave M2 unaffected because they are all counted within that aggregate. If the shifts are into (or out of) market instruments, such as tax-exempt bonds or Treasury bills, the totals would be affected, but probably to a limited degree.

The fact that, for the time being, underlying monetary growth and 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 is true that for some time (before the new distortions that will be induced by legislation and regulation) the various monetary aggregates have in general been somewhat above the growth

paths targeted for the year. I would also point out, though, that indications suggest an appreciable recent slowing in growth of both M2 and M3, and it so happens -- perhaps fortuitously -- that last week's M1 figure is very close to target. That is part of the setting of the discount rate change.

You may recall that, when reiterating our annual targets in July, I emphasized that "growth somewhat above the targeted ranges would be tolerated for a time in 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 judgment, 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 and interest rates." I believe reasoned assessment of recent developments in the light of those factors does suggest that preferences for liquidity have generally been relatively strong, reflected in part in some abnormal pressures in parts of the private credit markets. In that light, the fact that some of the aggregates have tended to run somewhat above their target ranges has been fully acceptable to the Federal Open Market Committee.

I believe I can speak for all members of the Committee in saying that those judgments have been reached, and will continue to be reached, in full recognition of the need to maintain the heartening progress toward price stability.

* * * * *