Federal Open Market Committee
Conference Call

July 17, 1981

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, Vice Chairman
Mr. Boehne
Mr. Corrigan
Mr. Gramley
Mr. Partee
Mr. Rice
Mrs. Teeters
Mr. Wallich

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

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

Messrs. Doyle and Forrestal, First Vice Presidents, Federal Reserve Banks of Chicago and Atlanta, respectively

Staff attendance at this session was not recorded in the Committee's files.

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

VICE CHAIRMAN SOLOMON. Murray, this is Tony Solomon in New York. When Paul gets there, I'd like to make a comment to give the FOMC members a bit of news. But I want to wait until he gets on.

MR. ALTMANN. All right. He's here now.

VICE CHAIRMAN SOLOMON. He's there?

CHAIRMAN VOLCKER. Yes.

VICE CHAIRMAN SOLOMON. I just want to advise the members of the FOMC and others, Mr. Chairman, as I've already advised you personally, that as of this morning Scott Pardee has resigned. He is taking a position as Executive Vice President with the Discount Corporation. And until his retirement day is effective, he'll basically be on vacation and straightening up his records. Of course, Gretchen will continue to run the Desk until a final resolution is made as to who will be in charge.

CHAIRMAN VOLCKER. Well, we will have to get on that. I'm sorry to hear it, but these things happen. Let me return to another unhappy matter of an apparent leak about part of our decision last week--it was last week, wasn't it?--in the Washington Post.

MR. COYNE. This week.

MR. PARTEE. The leak was this week.

CHAIRMAN VOLCKER. The leak was this week, but the meeting was last week. It's very frustrating to me personally. It's hard to know what to do about it but I'm thinking and will continue to think [about that]. As you have heard me say before, this kind of thing can be extremely damaging and I don't how we can operate with some confidence, given the necessary lapses between meetings and announcements, if we're subject to this kind of thing. I don't know what else I can say other than that I'm thinking about it further.

So far as the substance of the discussion is concerned, we agreed to have some consultation before any actual announcements were made, [given that] we were faced with some volatile money supply figures. We indeed have [new data] and they're somewhat different--Steve will go over them--than what we were assuming. I don't see anything here that casts any question about our decisions. And I don't propose to raise that, myself; the new figures don't require any decision of that nature in my view. I think they do have some implications, [with regard to] the operations that we agreed upon and the manner of conducting them. Why don't I let Steve describe where we are.

MR. AXILROD. Thank you, Mr. Chairman. The data for the week of July 1st that were published right after the FOMC meeting were about $2-1/2 billion higher than we thought at the time of that meeting, based on the preliminary figures. The data for [the week ending] July 8th that we are going to publish today will show an increase of $6.9 billion. As you probably recall, at the time of the

FOMC meeting we had projected, without any data in hand, an increase on the order of $4-1/2 billion, in part because of the accelerated social security payments. But the increase, as you see, is considerably higher. The preliminary data for the week ending this Wednesday, July 15th, suggest that part of this [extra bulge] will come out, and we are looking for a decline of $2-1/2 billion. But even with that decline, that would still leave the level of M-1B in the week of July 15th some $700 million above where the target path had put it last week. And it would leave the level for July 8th some $1.7 billion above where the target path for last week had put it. So, we're running somewhat stronger on M-1B. Without changing the nonborrowed path at all and given the shortfall in borrowing last week to $1.3 billion, this implies a borrowing level in the current week and next week of $1650 million. That's without without doing any adjustments to the nonborrowed path, just holding that and letting the natural course of the figures work through.

Meanwhile, because the Committee clearly indicated its concern about M2, I should update the Committee on that aggregate. The data we now have, which include preliminary data for the July 15th week, suggest to us that savings deposits are less weak than had been estimated as consistent with the path, that money market funds are considerably stronger, that overnight RPs are stronger, and that Eurodollars are stronger. We don't [calculate M2] weekly, but that would give us growth in July of close to 11 percent in contrast to the 8-1/2 percent path. In essence, the nontransactions components of M2, which had been targeted, so to speak, to grow at a rate of around 8 percent with M2 as a whole growing at an 8-1/2 percent rate given the greater growth the Committee was permitting in M-1B in that month, look as if they're expanding at about an 11 percent annual rate--similar to the way they had expanded earlier in the year. That's how they look at this moment. So, we have greater strength in M2 and we have not made any particular adjustment in the path as of this moment for that.

CHAIRMAN VOLCKER. One thing I don't understand. You said we were $1.7 billion [above] where you expected to be in some week--I wasn't sure what week. But it seems that we [published] a smaller decline last week than we anticipated when the Committee met and we have a much larger increase this week. Why aren't we much further above the path if you--

MR. AXILROD. Well, the confusion goes back [to how we constructed the path] and I should be clearer. The Committee met on Tuesday; we got new data on Wednesday; and we constructed the path on Thursday night on the basis of the new data. So, I should have added, Mr. Chairman--the numerology here just gets excessively complex--that the June level on which the current path is based is $400 million higher than the June level at which the Committee was looking. And that added a bit.

CHAIRMAN VOLCKER. If I may just interrupt. In a sense, that's the only change that should bear upon the Committee's decision, it seems to me. And it doesn't seem to me enough to make much difference. It's just that the base is $400 million off from where we thought it was.

MR. AXILROD. That's right.

CHAIRMAN VOLCKER. That in itself doesn't seem to me to call into question what the growth trend should have been in this quarter.

MR. AXILROD. That's right.

MS. TEETERS. Can we have the levels of M-1B starting with the last week in June, Steve?

MR. AXILROD. In the last week of June, the week ending June 24th, it was $428.3 billion; in the week of July 1st, which is the last week [published], it was $427.3 billion; in the week of July 8th, which is the number we're now going to publish, it is $434.2 billion; and for July 15th our preliminary estimate is $431.7 billion.

MR. CORRIGAN. Steve, what's your current estimate for the shift adjusted growth of M-1B in July?

MR. AXILROD. Well, the projection is based on assumptions.

CHAIRMAN VOLCKER. You still haven't told me how far we are above what we assumed at the time of the meeting for July 8th or 15th, or whatever the week is for the latest data.

MS. TEETERS. We're $1.7 billion above.

MR. AXILROD. Well, at the time of the meeting, we guessed that the number for July 8th would be $429.4 billion. Shortly after the meeting, we constructed a path based on a number of $432.5 billion because the [higher] June base got reflected in that week. And we now have $434.2 billion. So, relative to the number we used in constructing the path, given the increase in the June base, you're $1.7 billion above. And our staff projection for July is a 9.2 percent rate of growth. But that assumes that there is no further increase form this preliminary estimate of the July 15th level, on average, in either the week of the 22nd or the 29th. If there is any further increase, that 9.2 percent will, of course, be higher.

MR. PARTEE. And June was a decline of about that same magnitude?

MR. AXILROD. The June decline as it worked out is 9.4 percent.

CHAIRMAN VOLCKER. I don't know who is around from the Desk. Paul, do you want to say anything?

MR. MEEK. Well, I would say that during the last week the market has gradually [reduced] its estimates of the funds rate that is consistent with the Committee's objectives to somewhere probably around the 18 percent level from 19 percent or thereabouts. The estimates in the market of the numbers that we will publish today range from an increase of about $2 billion to $6 billion, with most of the expectations around $3 billion.

CHAIRMAN VOLCKER. Clearly, we seem to be getting a figure here that's much higher than--

MR. PARTEE. --than the market is thinking.

CHAIRMAN VOLCKER. --than the central tendency of the market thinking. It's obviously a very big figure, partially and hopefully [to be] offset next week. But the arithmetic, as Steve suggested, is for no further increases or decreases beyond next week, which [means the July increase] about balances the June decline. We're not very far above where we want to be, but the risks look a little different at this point. And M2 seems to be running high. In the normal course of events, I would be inclined to make one of the operational adjustments we talked about at the last meeting and lower the nonborrowed reserve path. The presumption is that borrowings will go up; we'll go toward the position Mr. Rice expressed at the meeting, and toward what the staff saw as consistent. I would think something in the neighborhood of $1.8 billion is probably about right, which is where we were just a couple weeks ago.

VICE CHAIRMAN SOLOMON. Do you think that will put the funds rate up around 19 percent?

CHAIRMAN VOLCKER. Who knows at this point? I think the market is going to be very strongly affected in coming days simply in reaction to the money supply figure. Borrowings ran low last week with no excess reserves and have been running very low so far this week, so presumably the market would tighten up even if we did nothing.

MR. PARTEE. Might I ask Steve or Paul about the July M2: Do you have any updated figures for the thrifts? There could be a run-off from the thrifts that is contributing to that increase in money market funds.

MR. AXILROD. All I have is that the small time component is running weaker, but the savings deposit component is running less weak. The two together are just a shade stronger than we'd allowed for.

CHAIRMAN VOLCKER. What do you have for thrifts just in absolute terms? Are they having a run-off or not in their deposits?

MR. AXILROD. I don't have the raw data for early July here. But in June that seasonally-adjusted annual rate--

CHAIRMAN VOLCKER. I know June was up a little, but I--

MR. AXILROD. It was up only around 2 percent for S&Ls and 3 percent for mutual [savings banks]; and I don't have a July projection here. It's running weaker in terms of the total. In small time and savings deposits we still have a small increase projected.

MR. PARTEE. For the combined banks and thrifts?

MR. AXILROD. No, for thrifts alone.

MR. PARTEE. For thrifts alone. I see.

MR. AXILROD. But that's only the small [time and savings deposits]. We don't really have an estimate for the large CDs--whether they are running off and offsetting that.

CHAIRMAN VOLCKER. What other observations do we have?

MR. GRAMLEY. Well, I would wonder about the wisdom of making an immediate adjustment in nonborrowed reserves given just a couple of weeks' numbers. My own reading of the economic numbers that have been coming in since the last meeting suggests that the situation, if anything, is a little weaker than we were looking at. We've had car sales continuing very low. We had a pretty good increase in inventories in May and the inventory/sales ratio is rising. Industrial production is down; it now looks as though we're going to have a decline in industrial production in the third quarter rather than an increase. I would hope we might wait another week and see what the figures show before we jump too fast.

MR. PARTEE. I would agree with that, Mr. Chairman.

VICE CHAIRMAN SOLOMON. Mr. Chairman, this is Tony Solomon. I tend to feel that Lyle and Chuck are probably right--that it's worth waiting a few more days--because even with the 10 percent growth that the Board staff is now estimating for shift adjusted M-1B for July, we're still running substantially below the lower end of the range. And we will get anyway an automatic increase--

CHAIRMAN VOLCKER. I believe right now we're not below the lower end of the range but well into the range.

VICE CHAIRMAN SOLOMON. Not on the shift adjusted number.

CHAIRMAN VOLCKER. I don't know. I'll ask Mr. Axilrod.

MR. AXILROD. Well, I think we're below through June--

CHAIRMAN VOLCKER. I'm just looking at the figures we know.

VICE CHAIRMAN SOLOMON. I have figures in front of me up here and they indicate that we're still significantly below.

MR. AXILROD. Well, we have to estimate our July figure and plot it.

MR. BLACK. We're still above the short-run range but below the long-run range.

MR. PARTEE. Yes, I think that's right. It's above the short-run path that you constructed.

MR. BLACK. Right.

MR. PARTEE. But it's below the cone.

CHAIRMAN VOLCKER. I don't know. Is it below the cone? I looked at these figures the other night and I thought we were--

MR. PARTEE. Yes.

MR. AXILROD. Yes, as nearly as we can plot it fast, if you plot the shift adjusted number that we have for the week of July 8th--the one we're going to publish--it's below the cone and also below--

CHAIRMAN VOLCKER. We are below the cone. Let me see that. I looked at it the other day and I thought we were above.

MR. AXILROD. Well, I think you were looking at that more special one you use.

CHAIRMAN VOLCKER. I thought we were [unintelligible]--

SPEAKER(?). You mean he has his own?

CHAIRMAN VOLCKER. Okay, I guess we're below. I'll take it back.

VICE CHAIRMAN SOLOMON. Paul, I was going to say that even without reducing the nonborrowed reserve path, we are going to get the effects of the automatic adjustments, which bring the borrowing up to $1.65 billion. There will be some upward pressure on the fed funds rate anyway, as well as the psychological reaction to the figures. And it seems to me that July is still so unclear that it might be worth waiting a few more days.

MR. BLACK. Mr. Chairman, this is Bob Black. Under ordinary circumstances, I would agree with Chuck and Lyle and Tony. But bearing in mind what happened last year, I think the market is watching pretty closely. And some little move now, even if we have to reverse it shortly, would probably be pretty wise, much as you suggested.

MR. WALLICH. This is Henry Wallich. Usually waiting has turned out badly for us. We have established some reputation now for moving in a timely way, and I wouldn't be very happy about delaying. Maybe we could wait for the funds rate to respond and see if there is a substantial response. But in the absence of that, I think we have to move on the nonborrowed path.

VICE CHAIRMAN SOLOMON. I think Henry has a good point. If we wait and see how much the funds rate goes up--it would be by tomorrow and Monday--then we would have a better feel for the situation.

MR. BOEHNE. This is Ed. I think Governor Wallich has a good point, too. We may get a substantial market reaction here and the funds rate may go up anyway. On the economy, the tone and feel type of information that we're getting here and from our directors, [whose sources] are pretty well spread out, suggests a fairly rapid and significant weakening in the economy on a rather broad front. That itself isn't going to be cleared up over the next couple of days, but I think we may be facing a weaker economy than we thought a week or two ago.

MR. CORRIGAN. This is Jerry Corrigan. I feel a little between a rock and a hard place. It's hard for me to ignore these money numbers, but I guess a couple of days doesn't matter that much.

CHAIRMAN VOLCKER. In a couple of days we're not going to know anything more than we know now.

MR. PARTEE. No, it has to be next Wednesday; we can't know anything more 'til Wednesday.

MR. CORRIGAN. [We'll know] the reaction to those numbers this afternoon, but I think that's going to point in the direction of making the adjustment anyway.

SPEAKER(?). I think we're going to have to act, so I'd just as soon do so now.

CHAIRMAN VOLCKER. Well, not hearing any other comments, we will make a decision in the light of all the comments that have been made, which is somewhere between not changing, changing in a couple of days, and going to $1.8 billion right now. We'll be someplace in between. I don't think we can wait very long. We're just operating in the context of the decision that was made. We'll maybe look at the M2 numbers a little more closely and see how they look. Any decision we make now doesn't imply any operations today or Monday or probably Tuesday anyway.

MR. PARTEE. That's probably right. We're talking about the next reserve week.

CHAIRMAN VOLCKER. We're talking about where we lean in this reserve period and where we set our next reserve period. So, we will leave it at that. I will commune with my soul and interpret all the random comments that I have heard. I guess that's all we have.

MR. PARTEE. Did you want to [reaffirm] the long-run range?

CHAIRMAN VOLCKER. I think we'd only need a vote if we were going to change something. I have not heard any sentiment to change anything. So, this is just an updating, if that's acceptable. Thank you.

END OF SESSION