

## TRANSCRIPT

### FEDERAL OPEN MARKET COMMITTEE CONFERENCE CALL

January 5, 1978

#### Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcript was not fully edited for accuracy at the time it was produced because it was intended only as an aid to the Secretariat in preparing the record of the Committee's policy actions. The edited transcript has not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

**Meeting of Federal Open Market Committee  
January 5, 1978**

A meeting of the Federal Open Market Committee was held on January 5, 1978. This was a telephone conference meeting, and each individual was in Washington, D. C. except as otherwise indicated in parentheses in the following list of those participating.

PRESENT: Mr. Burns, Chairman  
Mr. Volcker, Vice Chairman (New York)  
Mr. Coldwell  
Mr. Gardner  
Mr. Guffey (Kansas City)  
Mr. Lilly  
Mr. Mayo (Chicago)  
Mr. Morris (Boston)  
Mr. Partee  
Mr. Roos (St. Louis)  
Mr. Wallich

Messrs. Balles (San Francisco), Baughman (Dallas), Eastburn, (Philadelphia), and Winn (Cleveland), Alternate Members of the Federal Open Market Committee

Messrs. Black (Richmond) , Kimbrel (Atlanta) , and Willes (Minneapolis), Presidents of the Federal Reserve Banks of Richmond, Atlanta, and Minneapolis, respectively

Mr. Truman, Associate Economists

Mr. Holmes, Manager, System Open Market Account (New York)  
Mr. Pardee, Deputy Manager for Foreign Operations (New York)

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CHAIRMAN BURNS. The purpose of this meeting is to make sure that all members of the Federal Open Market Committee are reasonably well informed about recent developments in the foreign exchange market and what this government in conjunction with the Federal Reserve and other central banks has recently done. In line with that purpose, I am going to call first of all on Mr. Truman to review recent developments in the foreign exchange markets. Are you ready, Mr. Truman?

MR. TRUMAN. Actually, if Mr. Pardee is there, the Desk at New York probably--

CHAIRMAN BURNS. I am running this meeting in my fashion, Mr. Truman.

MR. TRUMAN. Yes, sir. Mr. Chairman, yesterday--

CHAIRMAN BURNS. No, I'd like to have you cover what has happened to foreign exchange rates during the past month in particular and secondly the scale of intervention by foreign central banks. Then I shall call on Alan Holmes to comment on the scale of intervention by the Federal Reserve and more recently also by the U.S. Treasury. And then I shall call on Mr. Gardner to review what has been done at this end. But first of all, [give us] the raw facts about foreign exchange rates and the scale of intervention by foreign central banks and then by the Federal Reserve.

MR. TRUMAN. Well, as you know, Mr. Chairman, since the early fall, the end of September, there has been fairly continuous pressure on the dollar, bringing the dollar's decline, on a weighted-average basis--at least through today--to close to 10 percent. Much of that decline, as you know, was against the Swiss franc, the yen, the British pound, and the mark. The decline has been general. Now, in the last several months, net intervention by foreign central banks has been something over \$12 billion.

CHAIRMAN BURNS. And what was it over the entire year [of 1977]?

MR. TRUMAN. Over the entire year it was close to \$35 billion.

CHAIRMAN BURNS. All right.

MR. TRUMAN. It was \$6-1/2 billion in October, about \$3.6 billion in November and another \$3.6 billion in December. That's about \$12 billion to \$13 billion.

CHAIRMAN BURNS. That's \$13-1/2 billion, according to my arithmetic.

MR. TRUMAN. It was \$13-1/2 billion for the fourth quarter compared with \$10 billion in the third quarter; it was \$4 billion and \$6 billion in the first two quarters of the year.

CHAIRMAN BURNS. All right. Thank you, Mr. Truman. Alan Holmes, are you there?

MR. HOLMES. I am not very well prepared for this. I think I would like to talk mainly about what happened yesterday and today when we started to do a little more aggressive intervention.

CHAIRMAN BURNS. Yes, you might tell the Committee the total intervention that has occurred thus far. It's something like \$900 million, is it not?

MR. HOLMES. It's about \$900 million--a little over--since the end of September, beginning of October. Since the last meeting of the Committee our total intervention has been \$295 million. Yesterday we took a more aggressive approach. It seemed that the approach was aggressive, but we spent no money and the mark went from around the 2.06 level to 2.13-1/2. Today, as we expected, we have been tested by foreign banks in particular and some of our own banks to see if this policy really means something. So today we have intervened to the extent of \$140 million--with half of that for the System account and half for the Treasury account under their new swap arrangement with the Bundesbank. Other intervention today--the main ones--[included] Germany, and Switzerland, in their market and on their behalf we did equivalent of Swiss francs for a total of . Meantime the dollar has reached a [unintelligible] in Germany today and [the mark] a 2.15 level. It went a little bit higher in New York and since then has dropped off to a little below the 2.15 level.

CHAIRMAN BURNS. All right.

MR. COLDWELL. Do you want us to ask questions now or--

CHAIRMAN BURNS. No, let's defer questions a little while. Thank you, Alan. I am going to call on Governor Gardner now to describe certain conversations of critical importance to the Federal Reserve System with the U.S. Treasury, and secondly, certain conversations with members of the Congress. Mr. Gardner, please.

MR. GARDNER. You can hear me, I hope. Last week we met with the acting Secretary of the Treasury. The Secretary was out of town so we met with the Under Secretary for Monetary Affairs. We discussed this problem and we reached some agreements with them which were later reduced to writing. We have a letter from the Treasury to the Federal Reserve referring to our interventions to that point, confirming that they were made in close consultation with the Treasury and that the Treasury was fully aware of and in full concurrence with what we were doing. Secondly, we asked the Treasury to begin the process of freeing the Exchange Stabilization Fund to participate with us. They also confirmed in writing that they would do that and would meet with the appropriate banking committee leaders on the Hill to explain our concern and to point out the need for the U.S. Treasury or the United States government to assist and to take a clear proprietary part in these operations.

I accompanied Tony Solomon, the Under Secretary, to Mr. Proxmire's office and we had an hour-long discussion about the dollar, the exchange rate difficulties of the dollar, and the disorderly markets. He pursued questions with the Under Secretary as to what effect might be expected by the

Treasury [in the event] of some action on energy matters and he reviewed the status of and expectations regarding our trade balance. The Under Secretary told Mr. Proxmire that the Treasury would like to join us in these activities. He said he would like to arrange his own swap [line] with the Bundesbank of upwards of \$1 billion. [He indicated] that this would not exhaust all of the ability of the Exchange Stabilization Fund; they perhaps could go further if the need was obvious. Mr. Proxmire agreed to that proposal and accepted the actions that we had done on our own as being appropriate. Prior to our talking to Mr. Proxmire jointly, the Under Secretary had attempted to arrange a meeting with Congressman Reuss of the House [Banking] Committee. He was unable to do that because Mr. Reuss was overseas. But Mr. Solomon was able to talk with Mr. Reuss before he left for overseas and received what he characterized as a general agreement with the conditions and principles that he had discussed with Senator Proxmire. The Under Secretary also contacted two members of key subcommittees in the House and Senate, Congressman Neil and Senator Stevenson, and they were fully advised of the process that was begun on that day. Following that development and with the clearance to go ahead, the Treasury arranged a billion dollar swap line with the Bundesbank--that was the genesis of the announcement that went out yesterday--and the Bundesbank approved it and they have been full partners [in the intervention operations] today, as you have heard.

CHAIRMAN BURNS. Thank you, Mr. Gardner. Let me supplement what Mr. Gardner has just told you by reading the precise announcement that was issued yesterday. I am not sure that each of you has had the opportunity to see it. The announcement was quite brief. Here it is:

The U.S. Treasury and the Federal Reserve Board today issued the following announcement.

The Exchange Stabilization Fund of the U.S. Treasury will henceforth be utilized actively, together with the \$20 billion swap network operated by the Federal Reserve System. A swap agreement has just been reached by the Treasury with the German Federal Bank and it is already in force. Joint intervention by the Treasury, the Federal Reserve, and foreign central banks is designed to check speculation and reestablish order in the foreign exchange markets.

Well, if you've heard all that has proceeded so far, I think this is now the time for questioning. Let me take this opportunity--I should have done so earlier--to wish each of you a happy New Year.

Who would like to raise a question first? When you do, I wish you would announce your name. I think I can recognize some of your voices, but not all of them; therefore, please state your name before you put forth your question.

MR. MORRIS. Mr. Chairman, this is Frank Morris.

CHAIRMAN BURNS. Yes, Frank.

MR. MORRIS. Happy New Year to you. My question is: Why was there a delay between the President's announcement last week and the implementation of what I thought was the meaning of the announcement yesterday?

CHAIRMAN BURNS. Well, you might broaden that question and ask why there was such a delay in the President's balance of payments statement. Without going into detail, let me tell you that the Chairman of the Federal Reserve System has been very active in recent years and it could not be accomplished sooner. I will not elaborate over the telephone; I will not go beyond that. Let me just say one thing. The delay was not caused by anything at our end; that I can assure you. Next question. Mr. Coldwell has a question.

MR. COLDWELL. Alan, I believe you said in your comments that some of our commercial banks have been testing us on this announced policy. Would you clarify what you mean by that?

MR. HOLMES. I think it is more foreign banks that have fairly large positions, Phil. They seem to have taken a paper loss and they are now trying to protect themselves by building up those positions further hoping that they can eventually drive the rates back down and come out whole.

MR. COLDWELL. But it's not our own commercial banks?

MR. HOLMES. Maybe to a very small extent. We see no significant evidence of that.

CHAIRMAN BURNS. Do you have any direct evidence that foreign commercial banks are engaged in any such exercise?

MR. HOLMES. Only what we hear through the market, Mr. Chairman.

CHAIRMAN BURNS. You mean that you know by the grapevine but you have no direct evidence, is that correct?

MR. HOLMES. We hear it also from some of our foreign central banking friends, but there's no direct evidence. There are no statistics that are immediately available.

CHAIRMAN BURNS. Is there anything on the part of our commercial banks that is worth mentioning in this connection?

MR. HOLMES. I would think not, Mr. Chairman. I think they're out to make a profit like everybody else but their positions have been moderate.

CHAIRMAN BURNS. Their positions are not abnormal.

MR. HOLMES. Not to the best of my knowledge. But we will be checking as soon as we get some numbers.

CHAIRMAN BURNS. Well, as for their positions, we have numbers through the middle of December, do we not?

MR. HOLMES. That's right.

CHAIRMAN BURNS. And have you noticed anything really abnormal in their positions up to that time?

MR. HOLMES. Let me ask Scott to answer that question because he is a little more familiar with the numbers than I am.

MR. PARDEE. Mr. Chairman, we have been following the positions of the banks very carefully. There is a lag of about two weeks in getting the numbers on positions. We do not have access to all of the numbers.

CHAIRMAN BURNS. I know, but the dollar has been depreciating for a number of months now.

MR. PARDEE. We have been [seeing] small [moves to] larger positions than normal. But the banks do not take large positions so that they can turn them very quickly.

CHAIRMAN BURNS. Well, I'll tell you, I've been examining this evidence. I must do some further work on it but my preliminary examination does not indicate anything abnormal. And I say that because we want to be very careful about what we say on this subject. My own studies on that are continuing.

VICE CHAIRMAN VOLCKER. I agree with that, Mr. Chairman. This is Paul Volcker. I've looked at these figures and they are obviously fluctuating. They have tended to be on the strong side [in marks], which is natural in a declining market, but I haven't seen anything that indicates positions of a magnitude or character that are at all threatening to the banks. There isn't anything that's out of order with their normal trading instincts.

CHAIRMAN BURNS. I can be more specific. I have examined the evidence for the second half of 1977 to arrive at something like a firm conclusion. I will now be looking at the evidence for the first half of the year and see if some sort of a trend developed. My preliminary conclusion is that we have no problem in this area and that I take it is the substance of your remark, Paul. Is that correct, Paul?

VICE CHAIRMAN VOLCKER. Yes.

CHAIRMAN BURNS. All right, any other questions now? Mr. Gardner has a question or comment.

MR. GARDNER. Alan and Scott, on this question of foreign banks, is it likely that these banks are operating facilities both in the United States and overseas or are you looking at them from an overseas standpoint?

MR. PARDEE. Basically, the decisions are being made overseas. They are still dealing with us--or were until this meeting. We are now out of the market. They either are dealing directly with the New York Reserve Bank or through their branches and agencies here. It is a service task as far as they are concerned.

CHAIRMAN BURNS. Mr. Partee has a question now.

MR. PARTEE. Alan, I just got back from vacation, so I'm really not very well up-to-date. I'd like you to discuss briefly, if you would, your operating rationale in intervention. You are still under the dollar limits, I presume; on the other hand, with this announcement you must have a new rationale. You said we were being tested by the banks. I presume that means that they weren't covering but they were deepening their short positions in dollars. At some point they ought to cover, it would seem to me, if they were convinced that in fact there was a defense of the dollar going on. And when they cover we could have quite a sharp increase in the dollar rate.

MR. HOLMES. That is certainly what we are hoping for, but in the meantime we are being tested. The banks try to assure themselves that this is a meaningful policy move on the part of the United States.

MR. PARTEE. Well, does that mean that you'll be inclined to move in on any weakening of the dollar during the day?

MR. HOLMES. On any weakening of the dollar, no. I think we want to make sure to be clear that we are not trying to establish a rate. We are trying to maintain an orderly market and to shake out some of these speculative positions that we think are around the world.

MR. PARTEE. What are your notions as to possible volume?

MR. HOLMES. That is very hard to judge. As I said, yesterday we were very active in placing orders in the market but we had no takers; today we did have takers.

MR. PARTEE. That was the cover yesterday, I guess. And today you get the testing.

MR. PARDEE. It depends entirely on the approach. If we approach the market forcefully, then the market responds favorably. But if we start falling back and act defensively, as we have over the last three or four months, then we will spend a great deal of money and perhaps lose what credibility we have regained.

MR. PARTEE. Well, it's a very difficult situation without an awful lot of precedent. It's hard to say exactly what will occur. But as I read the statement coming home on the plane yesterday, I was inclined to think that it might mean there will be very large scale operations. I haven't spoken to any of the other Board members about it yet and I just wondered if that was your view, Alan. Do you think that we might in fact be talking about big money here?



VICE CHAIRMAN VOLCKER. If I can interject here, it's Paul Volcker. I don't think that question is completely answerable by any means.

MR. PARTEE. I don't either, Paul.

VICE CHAIRMAN VOLCKER. Well, [we were] talking about banks in the earlier discussion and I think maybe that gets this a little out of perspective. We're talking about the psychology of the whole market--banks and other people.

CHAIRMAN BURNS. I'm glad you said that, Paul, because I think that much of this talk about banks is pure gossip. We have millions--[at least] thousands--of individuals involved in these transactions around the world quite apart from bankers. And the notion that it is speculative bankers who are testing us and they are the only factors in the market is simply wrong. I don't like it--it makes absolutely no sense to me--and I'm grateful to you, Paul, for restoring perspective a bit.

MR. PARTEE. Well, I assume the orders are placed through the banks.

CHAIRMAN BURNS. Banks act as agents or they act as principals in the same way that they do in the over-the-counter market.

VICE CHAIRMAN VOLCKER. You don't know sometimes whether they are acting as agents or principals. But we've had a great psychological wave against the dollar and we hope to repair that.

CHAIRMAN BURNS. All right, any other questions or comments?

MR. WALLICH. This is Henry Wallich. I'd like to ask Alan what he has heard in the way of reports and testimony.

CHAIRMAN BURNS. Reports on what?

MR. WALLICH. Anything on corporate treasurers or on foreign official [holders] who might have been in and out of dollars.

MR. HOLMES. Well, we have heard mainly that corporate treasurers are trying to make up their minds, if they do have a long position in marks, whether they should shorten it or if they should establish a new position. I don't have anything very concrete, but definitely I could say on that point that we know a lot of thinking and discussions are going on. And that's why we think it is very important to maintain a stable momentum as far as the psychology is concerned. I certainly agree, Mr. Chairman, that it is not only banks that are at fault.

MR. WALLICH. Is there anything in movements at the year-end--for instance in connection with the financial accounting standards or rules about taking exchange profits and losses into earnings--that could have influenced what has happened and will have an effect on the beginning of the year?

MR. PARDEE. In my judgment that should be favorable for us now. Many of the corporations that had a loss before the end of the year actually sold dollars to take those losses to their balance sheets. So we could have either a buying of dollars or an absence of offerings of dollars early in this year, once we get the change in market psychology that we are looking for.

CHAIRMAN BURNS. Any other questions?

VICE CHAIRMAN VOLCKER. May I inject just one other thought, Mr. Chairman? I think the success of this whole operation is not going to hinge on intervention entirely in the short run, although that's the motivation for the immediate change. I think all those things that we worried about before--oil and even domestic monetary policy--are very relevant here and I don't think we ought to lose sight of that.

CHAIRMAN BURNS. I want to endorse that completely. Actually, our intervention so far has demonstrated to my mind the futility of the exercise pretty much. Now, we are getting some psychological benefit out of the recent announcement and I hope it lasts. We are intervening more actively and I think we should up to a point, but I don't want to see this overdone. This problem will be handled satisfactorily--the dollar will regain strength--if and only if we have in place, first, a definite and credible energy policy and if we have in place a definite and credible anti-inflation policy and a tax policy designed to stimulate foreign investment as well as domestic investment in this country. Now, these are the fundamental aspects of the problem and unless we attend to these problems, the dollar in my judgment will remain weak. But for the sake of better relations with foreign countries and on the chance that we may sustain psychology for a while, I am in favor of moderate intervention but I don't want to see the Desk overdo it. And I think members of the Committee should know that I, and in my absence, Governor Gardner, have been rationing the New York Desk and not permitting the Desk to [proceed] on its own entirely.

VICE CHAIRMAN VOLCKER. We have accomplished quite a bit with what we had, Mr. Chairman.

CHAIRMAN BURNS. Well, you say you've accomplished it. I'm willing to give you the credit.

VICE CHAIRMAN VOLCKER. I don't mean me, personally.

CHAIRMAN BURNS. I'm not talking about you personally. By we you mean, I know, the Federal Reserve and the Treasury and the New York Desk and the Federal Reserve Board. Just take credit and enjoy it while it lasts.

Any other questions or comments? The silence is ominous. Are any of the Bank Presidents and Governor Wallich still there?

CHAIRMAN BURNS. Well, Governor Wallich is there and Paul Volcker is there. Who else is there?

MR. MORRIS. I'm here, Mr. Chairman, Frank Morris.

CHAIRMAN BURNS. Frank Morris is there. Who else is there?

MR. MAYO. Bob Mayo is here.

CHAIRMAN BURNS. Bob Mayo is there, who else is there?

MR. GUFFEY. Roger Guffey at Kansas City.

CHAIRMAN BURNS. Roger Guffey is there. Who else?

MR. ROOS. Larry Roos, St. Louis.

VICE CHAIRMAN VOLCKER. Happy New Year.

CHAIRMAN BURNS. Happy New Year to all of you. We're all shouting Happy New Year. If we had banners, we'd just let them fly but then you wouldn't see them. Any other questions or comments? Mr. Alan Holmes, do you have a last word for us at this meeting?

MR. HOLMES. I only hope that we can be lucky as well as wise.

CHAIRMAN BURNS. Well, we can all join you in that hope. Do you have any recommendations to the Committee?

MR. HOLMES. I think the one thing we need, Mr. Chairman, is an authorization, at least from the Subcommittee, so we will have at least some money for intervention tomorrow.

CHAIRMAN BURNS. I am sorry I asked that question!

MR. LILLY. Let tomorrow take care of itself.

CHAIRMAN BURNS. You know, your best day was yesterday when you didn't spend a penny.

MR. HOLMES. Those are the days we like, Mr. Chairman, but we can't expect to do that every day.

CHAIRMAN BURNS. No, but you don't have to intervene every day. I like the question that was put to you, I think by Mr. Partee: Do you expect to intervene every time the market declines? After the kind of rise that we had yesterday in the market, today in the foreign [exchange] market a little reversal in the New York market is only to be expected. That's the way the markets function.

MR. HOLMES. Mr. Chairman, we have had that reversal today. The rate is now 2.1435.

CHAIRMAN BURNS. And what was it before?

MR. HOLMES. It has been as high as 2.1575

CHAIRMAN BURNS. Well, considering the movements we've had that's hardly a movement at all. What do you think it would have been if you had stayed out of the market?

MR. HOLMES. I think it would be back to 2.06 to 2.07.

CHAIRMAN BURNS. I don't believe it for a minute. I don't believe it for a minute and I say it loud and clear.

VICE CHAIRMAN VOLCKER. Compromise on 2.10.

CHAIRMAN BURNS. Well, I think we're in a trading range, almost. Gentlemen, unless there is some further question or comment, I want to thank you all for participating in this meeting and I look forward to seeing you at the next meeting of the FOMC. I hear no question or comment and therefore this meeting is at an end. I am informed that this is not a meeting, it is a seminar. The seminar is at an end. Goodbye.

END OF SESSION