THE WHITE HOUSE

WASHINGTON

February 4, 1980

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MEMORANDUM FOR THE PRESIDENT

FROM : AL MCDONALD

SUBJECT: Discussions with New York Business Leaders

On Thursday evening and Friday, I met with three different groups of business leaders in New York to seek support for your economic and energy policies and to maintain active communications links with this frequently hostile community.

From these discussions, there were several disturbing notes that may be of interest:

1. Long Term Inflation Psychology: There is now the widespread assumption that we are in for a long period of inflation rates at or near the double digit level. There was even some talk of "patriotism now demands inflation," following your Afghanistan statements. This was disturbing since the group assumes higher defense expenditures (greater than in your new budget), a failure to make compensating downward adjustments in other spending programs, and therefore large federal deficits. As an example of this line of thinking in practice, it was upsetting to learn that General Motors has just floated a 10-year bond issue for $100 million at 11.75 percent interest and a 25-year series for $150 million at a rate of 12 percent (11.93). This is money intended for use by GMAC; that means these proceeds are intended as wholesale funds to be used for retail financing during the upcoming years at appropriate higher margins.

2. A High Interest Rate Policy Without Tight Money: We have been viewing the program of tight money and consequent high interest rates as a squeeze against inflationary pressures. The danger several pointed out is that we may be settling for simply a high interest rate policy without having much impact upon money availability. At the present time apparently creditors can find funds at banks in almost any quantities as long as they are willing to pay the high interest rates. This means that interest rates may be structurally supported at a higher level while not squeezing credit levels down as was intended. This could be dangerous economically and politically since interest rates of today's magnitude imply both a continuing high level of inflation and difficulties for our less advantaged citizens.

3. The Indexing Phenomenon: There were wide criticisms of the shortcomings in the CPI (particularly as it relates to mortgate interest handling) and the fact that these directly affect federal spending levels. Several questioners asked (1) if you will advocate a change in the CPI to reduce it to a more logical reflection of inflation, (2) if you will bar the addition of indexing to other spending items or recommend an indexing pattern below the CPI as a way to bring down inflation. If not, there was speculation that indexing may be almost irrestible to other sectors, therefore spreading and becoming a way of life that builds into our structure a continuing high level of inflation.

All of these points underline the importance of your fight against inflation. Our job of communicating restraint rates a high priority even among those who are the conservative economic thinkers in our society.

Other notes:

1. The bond market is "near chaos," they claim. Major investment houses have been shifting heavily out of bonds over the last few weeks. They had been deeply into bonds anticipating a recession, but now the general feeling is that the economy may well continue to skim along near the present level, thus making shifts into common stocks more attractive.

2. The volume of common stock trading is taxing the physical capabilities of everyone. There appears to be no danger of a repeat of the 1973 failure of the backroom systems, but with the New York Stock Exchange hitting its highest monthly volume in history last month, all elements are operating at maximum capacity.

3. The struggle to preserve capital is their focal point. This means prepayments on future delivery of goods and services, extensive use of credit at almost any price, and higher Return-on-Investment guidelines for new investments (assuming a high inflation factor in addition to the regular cost of money and compensation for risks).

On the positive side, the attitude of the business groups was more supportive of your positions than when I was there some 90 days ago. Their conversations were more positive and their suggestions more realistic with much less skepticism expressed about your motivations and intentions.