Meeting of the Federal Open Market Committee

May 16, 1989

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, May 16, 1989, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Guffey
Mr. Heller
Mr. Johnson
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Melzer
Ms. Seger
Mr. Syron

Messrs. Boehne, Boykin, Hoskins, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Black, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Assistant Secretary
Mr. Gillum, Deputy Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Patrikis, Deputy General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Balbach, R. Davis, T. Davis, Lindsey, Ms. Munnell, Messrs. Promisel, Scheld, Siegman, and Simpson, Associate Economists

Mr. Sternlight, Manager for Domestic Operations, System Open Market Account
Mr. Cross, Manager for Foreign Operations, System Open Market Account

Mr. Coyne, Assistant to the Board, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Ms. Zickler, Assistant Director, Division of Research and Statistics, Board of Governors
Mr. Keleher, Assistant to Governor Johnson, Office of Board Members, Board of Governors
Mr. Wajid, Assistant to Governor Heller, Office of Board Members, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Thomson, Executive Vice President, Federal Reserve Bank of San Francisco

Messrs. Broaddus, Lang, Rolnick, Rosenblum, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of Richmond, Philadelphia, Minneapolis, Dallas, and Atlanta, respectively

Mr. Sniderman, Vice President, Federal Reserve Bank of Cleveland

Ms. Krieger, Manager, Open Market Operations, Federal Reserve Bank of New York

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CHAIRMAN GREENSPAN. Good morning, everyone. The first item on the agenda is approval of the minutes. Would somebody like to move the minutes?

MS. SEGER. I will move them.

VICE CHAIRMAN CORRIGAN. I'll second.

CHAIRMAN GREENSPAN. Without objection. Mr. Cross, would you bring us up to snuff on foreign currency operations?

MR. CROSS. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Any questions for Mr. Cross?

MR. BOEHNE. Sam, what is the sentiment in Germany and Japan about intervention? Are they cooperative, are they reluctantly cooperative, or are they more than cooperative? What's the feeling?

MR. CROSS. Well, it's not easy to give a generalized statement that covers all the situations. The Germans have intervened more or less throughout the period, although not in very large amounts. In part, the Germans tend to have a different attitude, tactically, about what is the best way to intervene and [believe] that the intervention is more effective if done in certain ways. As for the Japanese, views differ because the institutions are divided over there. The Bank of Japan has been much more interested in intervening to stop the decline of the yen than the Ministry of Finance. And the Ministry of Finance calls the tune. In the past several days the Japanese have begun to take a much more active role in the intervention and they have done against the dollar/yen in each of the past two days.

MR. HOSKINS. Sam, since our last meeting we have intervened in yen. [Prior to] that time, I think, we didn't do that. Do we have a change in policy?

MR. CROSS. No, we focus our intervention on what has been happening in the market and where the pressures have developed. This is the first time we've intervened in yen in a long time. But it is because the conditions were such that it seemed to us appropriate to intervene in yen. Before then the yen had not fallen so much. As I said earlier, the yen had risen substantially more than the other currencies. If you look back at the direction in which it has moved, the yen has not been as weak as the other currencies--and still isn't in a sense, if you compare it with where it started off at the time of the Louvre agreement. However, the yen did begin to slip more and we were concerned, looking at it from the other direction, about the rise in the dollar. The Japanese have been concerned about it too. So, we have been intervening as the yen began to slip more in the past three weeks.

MR. HOSKINS. Is there any discussion amongst the G-7 and your counterparts as to how much we're willing to do in terms of this intervention?

MR. CROSS. Yes. We talk to them every day, repeatedly. We talk about the activities that we're proposing and we work it out with them.

MR. STERN(?). Sam, given this significant increase, are the pressures, looking out a bit, still for a further rise in the dollar? Or are there some ongoing worries about a precipitous decline in the dollar and so forth?

MR. CROSS. Well, the dollar has been on this very strong upward [course]. As I said earlier, certainly there's no evidence that we have turned the situation around. As the dollar gets higher--and it has gotten above the levels that have been seen before--there is some greater apprehension and nervousness within the market, partly about what the response of the central banks is going to be and whether the market is going to face a movement in the other direction. But so far the pressures have continued to be on the upward side.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Sam, you mentioned a while ago that the Germans had some differences over the type of intervention. What is their preference on that?

MR. CROSS. Well, sometimes the Germans have a view that the way to get the market's attention is to   and kick it in the teeth very strongly. We get a little nervous about too much of that. I don't want to overstate it because we usually are able to work these differences out and reach an agreement.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. Sam, you mentioned that one thing that may be driving this is the expected capital gains, given the anticipation that the peak in interest rates is close. You may be right, but I guess one of the things that bothers me a little about that explanation is that the bill market and the bond market have been anticipating a turn of events for a while. That's why long bond rates are below short rates, or the funds rate, right now; and bill rates have drifted down on the expectation of lower rates. I guess my question then is: Are the capital gains already there? They are already taking capital gains; would there be a further advantage that would cause people to rush into bonds at this point?

MR. CROSS. Well, I think that's true. To some extent the capital gains already have been a factor. In my report I was talking about some of the factors that have been tending to put upward pressure on the dollar. Recently, as statistical reports have come out that suggest that the economy may be a little less robust, you do hear people drawing the conclusion that that makes the long bond an opportunity for some capital gains. But you're right: presumably, if they feel that way they have been acting on that, and that may be a factor that is already discounted to some extent.

MR. HOSKINS. Just one more question, please?

CHAIRMAN GREENSPAN. Yes.

MR. HOSKINS. In your discussions, is there any mention of the rates of monetary growth between the three countries primarily involved in this--that they have monetary growth rates roughly twice ours and that that might have some influence on it?

MR. CROSS. Obviously, we talk about whatever factors are affecting the directions of the currencies. Certainly, the Germans have been concerned at times about the fact that their money has been growing more rapidly than their targets. That is certainly a factor affecting their situation.

MR. HOSKINS. But it doesn't lead them to think that perhaps the way to rectify this problem is to slow the monetary growth rather than to intervene?

MR. CROSS. I think they're trying to; I think there are efforts to try to get their own situation under better--

MR. TRUMAN. President Hoskins, certainly their action in April to raise interest rates, which Sam reported on, was triggered in part by the continued rapid growth [above] their targets. And certainly the Bank of Japan, while maybe not excessively concerned about monetary growth per se, would be delighted--if I might put it that way--to raise interest rates. What will they do? In both cases, as far as the central bank is concerned, there is a concern about [unintelligible] monetary growth, inflation, and so forth.

MR. CROSS. Since the last meeting the short-term interest rate differential between the dollar and the mark has narrowed by 125 basis points and against the yen by 113 basis points. There has been--

MR. ANGELL. But the growth rate of the monetary aggregates has not narrowed.

MR. HOSKINS. In fact, it has gone the other way.

MR. TRUMAN. Well, I don't know about that.

MR. CROSS. No, I don't think it has gone the other way. Well, I'm not talking about ours, I'm talking about theirs. I think theirs has so much--

MR. HOSKINS. But it has relative to theirs. If we have--

CHAIRMAN GREENSPAN. That's roughly--

MR. CROSS. Well, if I assume that this manifests itself to a large degree in the interest rates, the interest rate movements have certainly been in that direction: 1-3/4 points is not an insignificant reduction in the margins for a 6-week period.

CHAIRMAN GREENSPAN. Any further questions for Mr. Cross?

MR. GUFFEY. Yes, Mr. Chairman. This may be to Sam or to you, I guess. I don't quite understand the objective of our intervention, particularly to the level that we have intervened over this intermeeting period. I understand that our objective is to moderate the movements. But the pressures are coming not from the speculators, as I understand it, but rather from those who see the dollar as a good investment at the moment. Maybe I didn't understand you totally, Sam, but I thought you said that we are intervening more heavily than the remainder of our G-7 partners and I don't know why we should have that big a burden, given the rest of the environment. My last question is: Who calls the shots on this? Is it the Treasury that believes that intervention at this level is appropriate?

CHAIRMAN GREENSPAN. The Treasury has the legal lead on these decisions. We discuss it with them but the ultimate decisions are theirs. I think the issue isn't so much a question of how much each does. The more critical question that you're asking, as I see it, is: Why do we think that intervention can make very much difference when all the various studies we've been involved in suggest otherwise? And what we're partly reflecting are views of the G-7 finance ministers who believe more in intervention than economists and central bankers do. But underneath it all is the very annoying concern as to why the dollar is strengthening in the face of our current account imbalance. You can look at the issue in one of two ways: either 1) that we are intervening for the purpose of trying to stem the rise because ultimately it has to adjust back downward; or 2) why not, because this very large potential capital gain is in process. That has not been the case in the last couple of days. There's something very odd--a puzzlement as to why the markets have moved as strongly as they have. Certainly, if they move from here it will take a lot of explanation. But I don't see it particularly on the surface at this stage. Sam, is that consistent with your judgment?

MR. CROSS. Yes.

CHAIRMAN GREENSPAN. If there are no further questions, Sam, would you mind reintroducing your recommendation so that we can put it in the form of a motion?

MR. CROSS. I recommend, with respect to the recent activity, that the Committee approve our operations since the last meeting which are just under $1.4 billion equivalent worth of sales of dollars. I would also like to raise with the Committee a point with respect to our foreign currency authorization limit, if I can present that at this time. That limit, which is a public figure, provides that the System can hold foreign currency balances up to a total of $12 billion equivalent. At present we have nearly $11 billion equivalent. As I mentioned earlier, since the Plaza agreement in September of 1985 when we embarked on this practice of a more active intervention role we have bought about $14 billion and we have sold about $14 billion. But the value of our foreign currency balances during that same period has doubled from about $5-1/2 billion to about $11 billion. The reasons they have doubled are really three-fold. One, we have made a profit in that we have sold the dollar when it was relatively high and we have bought the dollar when it was relatively low. About 40 percent of that increase in the value of our foreign currency holdings represents those profits. A second factor is that we have, along with the Treasury, bought yen--not through intervention operations but through some direct transactions between ourselves and the Japanese Ministry of Finance and other bodies. That, too, has added about 40 percent to the increase in the value of these foreign currency balances. The third factor is that we have our balances invested and we continue to earn interest on them; and the remaining roughly 20 percent represents the earnings on our balances. So, we now are getting up much closer to the authorized limit of $12 billion. I would like to propose that the Committee raise the authorized limit from $12 billion to $15 billion in order to provide more headroom so that if circumstances are such that the value of our foreign currency balances increases we will have room to accommodate that within the authorized limit. So my recommendation, Mr. Chairman, is that the Committee raise the limit in the Foreign Currency Authorization from $12 billion to $15 billion.

MR. ANGELL. Mr. Chairman, I would--

CHAIRMAN GREENSPAN. Hold the questions on this.

MR. ANGELL. I was just going to make a motion; maybe you don't want a motion.

CHAIRMAN GREENSPAN. Well, not yet.

MR. ANGELL. Okay.

CHAIRMAN GREENSPAN. Let's do this in two separate motions. Let's first have a motion to ratify the transactions since the last meeting.

MR. JOHNSON. So move.

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Without objection. Let's have a motion and then discussion on this level issue.

MR. ANGELL. I move it, Mr. Chairman.

CHAIRMAN GREENSPAN. Is there a second?

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Is there any discussion on this?

MR. FORRESTAL. Are the balances basically in yen or are they distributed more evenly?

MR. CROSS. No, they are much more heavily in marks.

MR. FORRESTAL. Marks.

MR. CROSS. We don't have very many yen at the present time.

MR. ANGELL. Mr. Chairman, it seems to me this is an issue in which dogmatic views really aren't that helpful. It seems to me we're going to deal with questions here as a matter of practicality. We are working with the Administration, and I'm somewhat pleased that we have an Administration that's willing to have some kind of exchange rate intervention versus one that says absolutely not. Sam, I would like a little better accounting--that is, I believe for our purposes you ought to keep track of the opportunity costs of those balances and not consider the entire gain to be in a sense out of the blue, because we would have had earnings on U.S. Treasury balances. Is that not correct?

MR. CROSS(?). Yes sir.

VICE CHAIRMAN CORRIGAN. Yes.

MR. ANGELL. So, it seems to me that the opportunity costs should be subtracted out. Now, I would say that I believe--as some of you know by my no vote last June--that exchange rate intervention ought never to go at cross purposes with monetary policy. I think it's always a mistake because we're going to demonstrate our ineffectiveness in one camp or the other any time we do that. It seems to me that there is some merit in going forward with this move because there are some necessary adjustments in monetary aggregate growth rates that will take place. That would mean, then, that the deutschemark interest rates would tend to move up relative to our own so the relative opportunity cost it seems to me is not unusually high. So, I support the proposal.

MR. BOEHNE. This is more of a question than a comment. I view this as follows: If we are going to play this game we need the ammunition and this is just a way of storing the ammunition. If we're going to go from $12 billion to $15 billion, is an increase of $3 billion enough? Would it make sense to go to $18 billion or another number? I ask that because I'm not sensitive enough to know what will be read into increasing the limit from $12 to $15 billion. So, if we're going to raise the limit might we not just raise it enough to last a while? Or do you think that $3 billion will last a while and that it doesn't make any difference whether we raise it once or twice or whatever?

MR. CROSS. Well, I doubt that this is a very controversial or newsworthy issue; I don't know. It is a matter we report and I don't believe it has gained much attention in the past. I proposed a $3 billion increase on the grounds that that would provide some reasonable comfort and that if circumstances arose where something further were needed then we would have to reconsider the question. If the Committee proposes a higher figure, that's fine with me.

MR. TRUMAN. The last time we did this was after the Louvre Accord; we raised it by $3-1/2 billion when we had, in fact, less leeway than we have today. So if you want to look at it in that perspective it gives you quite a lot of leeway [unintelligible] giving your [Foreign Currency] Subcommittee some opportunity to revisit the issue from time-to-time.

MR. CROSS. It only becomes effective on the one side of intervention: when we're selling dollars, if we're selling any.

MR. TRUMAN. Unless we should go into debt.

MR. CROSS. Yes. But I must say that there is some value in having some marbles to play with if we're going to be in this game. And I think the level of reserves that we have, compared to almost anything, is really very modest. But I think the $3 billion I proposed would be adequate; if [the Committee preferred] $5 billion, I would be quite happy to see that.

CHAIRMAN GREENSPAN. President Hoskins, then Governor Heller.

MR. HOSKINS. At the risk of being dogmatic, the reasons that we--or at least the Chairman--discussed had to do with going along with our counterparts abroad. He also discussed the evidence that in large open economies intervention is not a very effective tool. If the reasons we intervene are really just reasons of cooperation and not of trying to affect the economic outlook it seems to me that we ought to limit that intervention. In other words, I think we ought to limit it and send a signal to our G-7 partners that we're thinking that they need to adjust some of their policies in a more formal way and speed the process along--in terms of making the monetary adjustments that you were talking about, Governor Angell. But if we have this latitude they have less incentive to make those adjustments. So, I think it depends on the reasons that we are intervening. If you believe that it's an effective tool, then sure, go up to $15 billion. If you believe that it is not effective--if you're doing it simply for cooperative purposes and you also want to send a signal to the rest of the G-7 partners to adjust their monetary policy--then I think you should not raise it.

CHAIRMAN GREENSPAN. Part of that cooperation is with the Treasury.

MR. HOSKINS. Well, you can also send the message to the Treasury.

MR. SYRON. The same message--which would be given to both, I think--is that a lot of us do have skepticism about the value of sterilized intervention over a long course of time. I understand the need to do it and I don't want to be terribly dogmatic. But the proposal for $3 billion makes a lot of sense: [it requires] coming back to the Committee again rather than having a very large increase, which possibly could be interpreted by people--even though they may not pay much attention to it--as saying that this is a change in the fundamental approach that's being taken.

CHAIRMAN GREENSPAN. Governor Heller.

MR. HELLER. Thank you. First of all, I think it is a good time for us to accumulate reserves. We are not--well, I don't want to speak about what's going to happen later today--but I certainly wouldn't think that we are ready to ease in a very major fashion at the present time. Neither are the Germans and Japanese ready to tighten. Those policy moves would be counterproductive as far as helping the international adjustment process is concerned, which is still a very major problem confronting the world economy. So, while the basic principle that one shouldn't undo with the right hand what the left hand is doing is certainly valid, I think we have a classic situation here where we have an external problem on the one hand and various domestic problems on the other hand that call for different policies. With intervention you can overcome some of those difficulties and try to reconcile those conflicting goals. But I do have also a very quick question. In the data, Mr. Cross, you have

Japanese yen holdings of $1.1 billion; does that include the special transaction with Japan? Is that already in there?

MR. CROSS. That includes it. That's all we have in yen. We used up our yen balances and have not acquired very much. So, we only have that amount; and a large part of that came from outside purchases, not from intervention.

MR. HELLER. Okay, thanks.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Well, I'm very sympathetic with President Hoskins' views and yet at the same time it seems to me that there's no particular disadvantage of having an international trade adjustment process in which United States exports grow more rapidly than our imports grow. I can't see that that's a disadvantage. Consequently, I favor having a bit of a gesture in the foreign exchange market prior to the time in which the needed change in monetary aggregate growth rates will emerge--because I have no doubt that the Bundesbank has a serious problem on its hands in regard to how fast they have been growing the monetary aggregates and that they will have to bring those in check. But it seems to me that it's somewhat to our advantage to have a divergence in these growth rates at this time. I'm convinced that the real moves will take place in terms of interest rates and their conversion into monetary aggregate growth rates. It's in that atmosphere that I don't mind our taking a bigger step.

CHAIRMAN GREENSPAN. Any further discussion on this issue?

MR. HELLER. Sorry, I meant to say also that I'm in favor of Ed Boehne's suggestion to give a broader limit.

CHAIRMAN GREENSPAN. Does anyone here have a strong view between $15 billion and $18 billion, for example? What's on the table is $15 billion. We have heard a couple of people say they'd like to go higher.

MR. HOSKINS. And one to stay at S12 billion.

CHAIRMAN GREENSPAN. Why don't I simply find out by requesting a vote on the--

MR. ANGELL. On that $15--

CHAIRMAN GREENSPAN. --on the motion on the table, which is the $15 billion. All in favor?

MR. HELLER. Mr. Chairman, what is the proper way to go for the $18 billion? Should we amend that motion now?

CHAIRMAN GREENSPAN. Well, if you would like to.

MR. HELLER. Okay, I'd like to amend the motion to $18 billion.

CHAIRMAN GREENSPAN. Is there a second on the amendment? That's what I was worried about.

MR. HELLER. Ed Boehne doesn't even second the amendment.

SPEAKER(?). He can't vote.

MR. BOEHNE. I can't vote. I'm sorry; you hooked up with the wrong guy. Try next year.

MR. BLACK. I can't now, Bob, but I'd give you--

MS. SEGER. I'll second it for you.

MR. HELLER. That's all right.

CHAIRMAN GREENSPAN. All in favor of the amendment to the motion say "aye."

MR. HELLER. Aye.

CHAIRMAN GREENSPAN. Noes?

SEVERAL. No.

CHAIRMAN GREENSPAN. That leaves us with the original motion on the table of $15 billion. All in favor say "aye."

SEVERAL. Aye.

CHAIRMAN GREENSPAN. Opposed?

MR. HOSKINS. No.

SPEAKER(?). I counted two noes.

MR. HELLER. Nevertheless, we got the votes.

CHAIRMAN GREENSPAN. This is a formal vote so we have to--

SPEAKER(?). It will be published.

CHAIRMAN GREENSPAN. It will be published so let's get a formal count. Why don't you call the role quickly?

MR. BERNARD. All right.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Guffey	Yes
Governor Heller	Yes
Governor Johnson	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	No
President Melzer	Yes
Governor Seger	Yes
President Syron	Yes

VICE CHAIRMAN CORRIGAN. I had a brief postscript, Mr. Chairman. I didn't want to confuse the discussion further. I just wanted to say, after Bob Heller's comments, that we're sitting here today discussing this in the context of concern about a strong dollar. I still fear the day will come when we'll be sitting here looking at this question from a very different perspective. I would simply like to add that quickly to the discussion.

MR. ANGELL. Well, Jerry, if you keep saying it, some day you'll be right!

CHAIRMAN GREENSPAN. I join in with the Vice Chairman on this issue. If we go a few more months with what's been happening I'll have to start to rethink my view of the world. Let's move on to the next item on the agenda, which is Mr. Sternlight on domestic open market operations.

MR. STERNLIGHT. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Sternlight?

MR. PARRY. I'd like to ask a question about the primary dealers. How many are Japanese owned?

MR. STERNLIGHT. There are 4 major Japanese securities firms that started their own operations in the United States. There are 3 other situations of existing firms that had been domestically owned and have been bought by Japanese banks within the past few years. So there are 7 in all.

MR. PARRY. One keeps hearing that that has changed the market somehow. Is that correct or not?

MR. STERNLIGHT. I think it has been part, and perhaps the most prominent part, of the whole move toward internationalization, but not the entire thing. We have had entrants from other countries as well and some additional new firms who have come in on the U.S. side. In the last 7 years we've had an increase in the number of primary dealers, primarily from foreign entrants but not exclusively. And I would say that the increased number of dealers, along with some slowdown in aggregate activity and just the way the markets have gone in the past few years, has tended to make it much more difficult to run a profitable operation. Last year more than half the dealers showed losses in their government securities operations.

MR. PARRY. Well, I guess it's just vicious rumor or whatever but one issue is that in Japan information is exchanged a lot among companies. One hears that that may be an issue in the United States. Is that just vicious rumor?

MR. STERNLIGHT. Well, there has been concern about that. There has been an allegation that officialdom in Japan seems to share information with Japanese firms, whether banks or securities firms. The Japanese realize that there is that criticism from the market, and I think they are trying to do things to change what has been their modus operandi. They seem to have a philosophy of not wanting the market to be surprised by new statistical reports or policy changes or whatever. So they apparently have some tradition of sounding out some market sources and word gets around from this kind of thing. That may be what you're referring to. And it is an issue that causes concern amongst U.S. firms operating in Japan.

MR. HOSKINS. Peter, I have a question about the mix of outright purchases and repos during a period of heavy seasonal activity. Would a larger volume of outright purchases rather than announced repos perhaps give a better mix so that the market has a better perception of where we are? I just don't understand how you decide that mix.

MR. STERNLIGHT. We had this large need, which in fact turned out to be bigger in the short run than we had thought it was going to be. But because of the way some other longer-term factors were operating, the longer-term need did not look as great as we went through the period. We kind of geared ourselves to doing through outright purchases approximately what looked like the long-term need--although we went somewhat beyond that and we're now in the position of having to do a little draining as we come up to this next reserve period. I would say we determine the mix on the basis of how we think we and the market can best manage those reserve adjustments. We knew we were leaving a lot to be done with repurchase agreements but we've had really good experience in doing heavy amounts of repurchase agreements, particularly if we give the market a few hours advance notice. Announcing to the market at 3:00 p.m. on a previous afternoon that we're going to look for propositions for repurchase agreements the next morning seems to give us very sizable propositions. That has worked well and I think took us, in pretty good shape, through a period like this one with a very heavy, but temporary, reserve need.

CHAIRMAN GREENSPAN. Governor Heller.

MR. HELLER. Going back for a second to the primary dealers: In total, how many are foreigners and do you have any idea about their rough market share as far as trading volume is concerned?

MR. STERNLIGHT. Thirteen are foreign-owned.

MR. HELLER. Associated or whatever?

MR. STERNLIGHT. Primarily foreign-owned. There would be some others with some partial [foreign-owned] shares. And 7 out of the 13 would be Japanese. This is a rough recollection, but I think the market share of the foreign-owned is in the low 20s--about 21 or 22 percent. So, 13 out of 43 would be about a third of the total; but they tend to be a little smaller, representing about 21 or 22 percent of the market.

CHAIRMAN GREENSPAN. Further questions for Mr. Sternlight?

MR. JOHNSON. Just one, related to the intervention activity. You may have mentioned it and I just missed it but have all the dollar sales had much of an impact on our open market operations?

MR. STERNLIGHT. Well, because we added through our intervention about $1.3 billion to foreign currency holdings, that was a long-term factor putting in reserves. Had that not happened we would have had that much more to be added through domestic Desk operations. I wouldn't say it's an impediment to our operations. We get notified immediately and fold it into our reserve projections. But in a sense, if you will, it is sterilizing the intervention.

MR. JOHNSON. I guess what I'm asking is: Has that added any uncertainty to the market in terms of what our reserve need is?

MR. STERNLIGHT. I think the market tends to take account of it although there may be a bit of a lag in comprehending fully the extent of it from one day to the next. It might be a minor factor adding to their uncertainty.

MR. JOHNSON. Okay.

CHAIRMAN GREENSPAN. Further questions for Mr. Sternlight? If not, would somebody like to move to ratify the actions of the Desk since the March meeting?

MR. JOHNSON. So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. We now move to the staff report on the economy. Mr. Prell.

MR. PRELL. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Prell?

MR. PARRY. I have a question, Mike, that is related to your final comment. In the Greenbook the comment was made that aggregate demand will still have to moderate further to relieve pressures and reverse the current upturn in inflation. And as you indicated, in the Greenbook forecast you've assumed additional restraint. What would be the impact of not implementing that restraint? In terms of an analytic exercise, what would it be costing us in terms of progress with regard to inflation and, for that matter, with regard to growth as well?

MR. PRELL. With our baseline Greenbook forecast--extending it informally at this point into 1991 and assuming that growth isn't so rapid as to move the unemployment rate back down in that year but that it will stay in the 6 percent or so neighborhood--our expectation would be that in that environment we'd see a fractional decline in inflation in 1991. But the trend would be turning discernibly downward. Using our quarterly model and not doing a particularly elaborate exercise but leveling out rates--or keeping the federal funds rate about where it is now--the result is that, in essence, we eliminate that downturn in inflation in 1991.

MR. PARRY. In 1991?

MR. PRELL. In 1991. In our current forecast we're talking about, in the greater scheme of things, a rather small further rise in interest rates. But it's enough to make a slight difference in output growth in the near term, building to something a little more noticeable in 1990. And we end up with a lower unemployment rate and eliminate most of that slack that would otherwise emerge.

MR. PARRY. So there's really no improvement in underlying inflation through the forecast period through the end of '91 unless one gets some further restraint?

MR. PRELL. Yes, I think that's right. And we're reading these numbers very finely. That's probably the predicament that we face, in general, in interpreting the incoming information. If we are on the kind of track that we have projected, I think every meeting here we're going to go through a sort of Chinese water torture in trying to judge whether the latest data are suggesting that we're moving up or moving down. To use these econometric models to come up with some precise notion of whether we will go up a little or down a little on the inflation rate from the current level is probably pushing things. I think the uncertainties are greater than that. But running it through [the model] in a straightforward way, that's the kind of conclusion we get.

MR. PARRY. That's what I thought. Thank you.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. I have a technical question, Mike, that you raised when you talked about the inventory behavior. In the Greenbook forecast you have a fairly noticeable decline in the change of business inventories over time. I was wondering, looking at traditional relationships between sales and price expectations and that sort of thing, whether that reflects some judgment on your part about structural changes--more just-in-time inventory kinds of patterns on the part of manufacturers? Or, are there other reasons that are more fundamental for the decline in the change of business inventories?

MR. PRELL. Basically, we need to have a decline in order to see the kind of moderation in final demand that we feel is necessary, in essence, to diminish inflationary pressures. Unless there is a substantial slowing in the rate of inventory accumulation, inventory/sales ratios are going to move up. With what we have been seeing we're going to get a growing imbalance. In terms of structural changes I'm reasonably impressed by what I read and hear--particularly in the manufacturing sector but in the trade sector as well--about the kind of inventory management changes that have occurred. It's clear that there are efforts underway and that manufacturing firms have been quite successful to date in reducing inventories relative to their shipments. I think they will try to maintain those trends. So in that sense, even a leveling out might imply in some cases some undesired accumulation relative to plans. So, we feel we really need to see a substantial slowing here if we are to avoid an imbalance that will create the need for even bigger production adjustments in the [future].

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. Mike, I can't resist asking this question again that I've been asking every time. I'm not just looking at the Blue Chip forecast but I'm reading the financial markets and what they seem to be saying. They have been giving us a slightly different picture for some time now and I've been asking this question. You have been saying basically that you think the market will come back to the forecast--that the market is probably wrong and that you are sticking to your forecast. I just wondered if you're still willing to say that; it sounds like you're hedging a little more. The Blue Chip forecast has the funds rate peaking this quarter and then going down, but they have about the same GNP forecast. You suggest that the data available recently are showing maybe a slightly weaker case, although what will happen over the next few quarters is uncertain, of course. But I just wondered if you feel any differently about the market's reading of the outlook as compared to the forecast?

MR. PRELL. Well, I think there is a diversity but the central tendency of the private forecasters, as I read it, is for a softening that is probably at least as great as what we have in this forecast. My sense is that the disinflation payoff that is seen is fractionally greater than what we have. I think many of those people as they look out into 1991 also see the likelihood of a pickup and, in essence, an impatience with any Federal Reserve [forecast] that looks like the possibility of a recession. In a sense, we may have a smoother track in our forecast than some of them. But I think we are, on balance, a little less optimistic about the inflation payoff of the slack that is predicted to emerge, and we're expecting interest rates to have to stay a bit higher.

MR. JOHNSON. Yes. As a follow-up to that, I think maybe you're a little less concerned that this slowing relative to the forecast is a permanent feature. You think it might bounce back some and, therefore, you've got this further rise in interest rates built into your assumptions. But--

MR. PRELL. Indeed, that's really more an end of this year/early 1990 story. We feel that even if things did slow to a rate somewhat less than we have in the second half--barring some major inventory imbalance or something like that--we probably are not going to continue on a slow enough track to open up the kind of slack in the economy that we still think is necessary in order to really turn the inflation rate down.

MR. JOHNSON. I think I know what your answer would be, but let's just assume that the economy is running below your forecast. It seems to me that an additional 75 basis points or so on the funds rate, if you project that against this weaker forecast, puts you in the recession category. Now, I don't know what you think, but it seems like that would clearly tip the economy over; maybe it wouldn't.

MR. PRELL. We're very close to recession in this forecast in the first part of 1990. So an error of that dimension, so to speak, could make that kind of difference as to the sign--whether we're in slightly positive territory or slightly negative territory. I wouldn't want to suggest that we think we can predict these things with that precision. We have tried to raise the flag repeatedly that we feel this is at least a growth recession. In essence, we have a fine-tuned forecast. Whether policy can be so finely tuned is another matter.

MR. JOHNSON. Sure. I'm simply suggesting that if the data continue to come in weaker than the forecast, I think your interest rate scenario would go with a stronger interpretation.

MR. PRELL. Sure.

MR. JOHNSON. But that interest rate scenario would be, I think, somewhat tougher to follow.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Governor Johnson just covered exactly the points I wanted to raise, Mr. Chairman, so I pass. Thank you.

CHAIRMAN GREENSPAN. He's a good mind reader. President Stern.

MR. STERN. Is that what you have in here--a further increase in interest rates of about 65 or 75 basis points late in the year or something?

MR. PRELL. We put the federal funds rate by the end of the year up to or approaching the 10-3/4 percent level.

MR. HELLER. Mike, what did you say? I didn't hear you. By the end of the year--

MR. PRELL. I said we had the federal funds rate somewhere in the 10-1/2 to 10-3/4 percent range.

MR. HOSKINS. Maybe this is better directed to Don but, given that interest rate forecast, what is the growth rate of M2 running at year end?

MR. KOHN. We have projected about a 4 percent growth of M2 for the year. But we would be running closer, even with that upward nudge in interest rates, to the 5 to 6 percent area in the second half of the year. Part of that is the bounceback from what we see as the shortfall with the taxes. But that additional rise in interest rates, particularly coming later in the year, doesn't have that much effect on M2 for the year 1989.

MR. PARRY. Half a percent more than [unintelligible]?

MR. KOHN. Probably, yes.

MR. KELLEY. May I come back again?

CHAIRMAN GREENSPAN. Yes.

MR. KELLEY. Don, could you explain that? From where we are right now on M2, given the prospect of perhaps a 3/4 of a percentage point higher funds rate, it's a little unclear to me how we'll wind up at a substantially higher M2 for the year than we're running now.

MR. KOHN. I'll actually be covering this in my briefing to some extent, Governor Kelley. But, very briefly, we think we'll get a little extra push as people rebuild what we see as depleted cash balances after the [tax] season. We see that adding about a percentage point, at an annual rate, to the growth over the next quarter or two. We also see most of the interest rate effects gradually drifting behind us. After all, most of it happened by

February, right? Those effects should be easing off over the balance of the year, even with this relatively small further increase in interest rates near the end of the year. So, in our view, given the movement of opportunity costs, we'll see M2 pick up and start to run closer to nominal GNP.

MR. KELLEY. Am I hearing you say that part of that depends on this 3/4 of a percentage point increase coming late in the year?

MR. KOHN. Well, it doesn't affect the year that much if it comes in the second half.

MR. KELLEY. If it comes late in the year it clearly won't.

MR. KOHN. If it comes in the second half or at year end.

MR. KELLEY. Okay, thank you.

CHAIRMAN GREENSPAN. Any further questions for Mr. Prell? If not, we are ready for the roundtable discussion. Who would like to lead off? President Boehne.

MR. BOEHNE. There has been some definite slowing in the Philadelphia District. I think the economy there is slower than it is in the nation. Until the last few months that slower rate was mostly due to supply constraints--tight labor markets and that sort of thing. But in the last several months I think there has been a slowing on the demand side as well. Housing is clearly weak; retail sales and manufacturing are flat. Capital spending is slower in the second quarter than it was in the first, although it's mixed by industry. Housing-related petroleum, gas, and electric utilities are still not going very far on new projects whereas chemicals and pharmaceuticals continue to have some expansion projects. The steel industry--at least that part in my District--seems to be feeling a little better than a couple of months ago. I think they feel better now that some of the labor negotiations are behind them. And they feel that they'll get this voluntary restraint package on steel renewed in Congress, so they released some projects that they were holding. On the whole, I think capital spending is definitely slower now than it was three months ago. As for the future in the District, I think the outlook is for flat to slow growth with unemployment rates still on the low side.

As far as the nation, I think what's happening is about as good as we could hope for. We ought to be reasonably pleased with what we're seeing on the growth profile. My sense is that the risks between recession and inflation have shifted. Until fairly recently, I was thinking that the risks were clearly on the side of more inflation. I think the risks are more even than they were. The most likely outcome is a period of slow growth with inflation higher than we would like but not accelerating significantly. But if we're wrong, I think we have about as much chance of being wrong on the inflation side as on the too-slow-growth side.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, in the Eleventh District our economy continues to grow. Even in Louisiana, where for the first time in quite some time the unemployment rate has slipped down to single digits, it's looking a little better. Growth is getting increasingly closer to the national rate; part of that, of course, is some of the slowing of the U.S. rate. We are seeing more and more signs that we are looking more like other Federal Reserve Districts; we're not quite the outlier that we were. Labor shortages of specific types are cropping up. Engineers, for example, are in very short supply. We're even seeing help wanted signs appearing throughout Dallas. Unemployment rates in many Texas cities are now in the low 5 percent area. Nonetheless, the greatest strain still is centered along the Gulf Coast area--Houston in particular--and in the lower Rio Grande Valley. We still have problems in some of the other areas of the District. Banking and real estate are still dragging us down a little in Dallas, Austin, Shreveport and similar areas. Manufacturing continues to grow above the national rate. And in the services sector employment was matching the national growth. In sum, Mr. Chairman, we feel a little more optimistic about our area. Having been burned as badly as we were, we don't want to overstate that. We are coming from a fairly low figure but people really are feeling better.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. The Tenth District is continuing to improve but rather slowly. The strong farm income last year has positioned the agricultural sector to withstand probably the impact of the drought, given otherwise good weather throughout most of the crop areas. In Kansas, for example, which is a very large red winter wheat producer, the latest estimates are for production of about 200 million bushels and that's down from about 325 million the year before. That's the latest official forecast. However, in talking with some of the producers and some of the grain people throughout Kansas, their projection is that if they get no further measurable rain in the next couple of weeks they would be very happy with 150 to 180 million bushels. But the interesting aspect of that is that, given the drought conditions in the high plains areas producing red winter wheat--basically Kansas, Colorado, Wyoming and Oklahoma--the total production would be down about 8 percent. But if you look at wheat totally, which includes spring wheat, the total wheat production would be up about 13 percent. As for the rest of the small grains: corn, for example, will be up about 60 percent from last year; beans will be up 27 percent; and oats will be up 100 percent. They are projecting a very strong farm production year given, of course, that the drought doesn't affect it measurably. So, in the agricultural sector things are looking pretty good. That does not mean, however, that spots such as Kansas won't feel the impact of this drought; but the nation as a whole probably will not. As a matter of fact, given those projections, we would see very modest increases in food costs, not unlike what I think the staff has projected--about 3-1/4 percent.

CHAIRMAN GREENSPAN. Do the crop estimators at this time of the year assume normal rainfall for the rest of the period?

MR. GUFFEY. Yes, with the exception of whatever damage has already occurred to the winter wheat crop, which is large in the high plains states as I just mentioned. Ninety percent of that winter wheat crop, by official estimate, is rated poor or very poor as a result. But that's only a part of the wheat production for the nation as a whole.

CHAIRMAN GREENSPAN. What I'm trying to get at is this: When they estimate 200 million bushels for the winter wheat crop is that on the assumption of normal rainfall from here until harvest?

MR. GUFFEY. That's correct--some further rainfall.

CHAIRMAN GREENSPAN. They don't factor in the rainfall forecasts that they now have in estimating the actual outcome and yield per acre, do they?

MR. GUFFEY. I guess I don't understand your question.

CHAIRMAN GREENSPAN. Well, at the moment, the crop estimators looking at the condition of the crop can judge its outcome either on the basis of an expected rainfall that is normal from mid-May through harvest or they can use the forecasts of rain that they have now developed over the years as a factor in making that judgment. It occurs to me that I don't even know whether there's an official way they do that. They used to do it, as I recall, years and years ago on the average. But I don't know whether they've changed.

MR. GUFFEY. Well, I don't think I know that. Maybe Governor Angell does. The fact of the matter is that the 200 million bushel estimate for the state of Kansas is based upon the damage that has already occurred to the wheat. Given further normal rainfall from here until harvest they come out with 200 or 202 million bushels.

CHAIRMAN GREENSPAN. That's what I mean--the normal rain from here until harvest.

MR. GUFFEY. Normal--that's right. But you see we're only about 2 or 3 weeks away from the start of the harvest of that crop. That's an early June start in Oklahoma.

CHAIRMAN GREENSPAN. Does Kansas start in early June?

MR. GUFFEY. Kansas will be when, Wayne?

MR. ANGELL. Normally, it will start the first of June but this year it's going to be a little later--probably around the second week in June.

CHAIRMAN GREENSPAN. Yes, it starts down in the Panhandle, usually, in June.

MR. ANGELL. Well, actually, they start around the south of Wichita first.

CHAIRMAN GREENSPAN. They do?

MR. ANGELL. Yes, and it moves in a line to the northwest.

CHAIRMAN GREENSPAN. I'm sorry, I didn't mean to [interrupt].

MR. GUFFEY. Yes, let me just proceed. In the energy sector there's a bit of an uptick. For example, just in the last month the rig count within the District has moved from 211 to 245. That's still well below year-ago levels, but nonetheless there is some exploration taking place. The manufacturing sector continues to improve and that's largely related to the commercial aircraft and high-tech industries. On the other side, the construction industry--both commercial as well as residential--is very weak.

On the national level we have no real difference in our projection for the upcoming period from the staff's forecast. I have a little problem--the question has been raised and there will be further discussion--with respect to the current status of this weakening or not weakening. And it bothers me a little when we talk about another 3/4 or full percentage point increase without some fairly good evidence. I would be not very happy with that.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. At our last meeting, Mr. Chairman, I think Governor LaWare said he thought the economy was probably a little mushier--if I remember his words right--than most people were thinking.

MR. LAWARE. Exactly.

MR. BLACK. I understand words like that.

CHAIRMAN GREENSPAN. That's a technical term!

MR. SYRON. Recognized only by commercial bankers.

MR. BLACK. Well, I think the national data that have been released subsequently support that, and we see confirmation of that in our District. The Beigebook report showed that consumer spending and manufacturing activity were moderating a good deal in March and April and the comments of our directors at the last couple of meetings have been noticeably less bullish than before. At our meeting last Thursday several of the directors who live in what they like to call the golden crescent, which reaches from Baltimore through Washington and Richmond down to the Tidewater area around Norfolk, said activity actually has slowed up somewhat. And this has been a boom area for some time.

So far as the outlook is concerned, I think the Board's staff has made a solid case in the forecast that they have in the Greenbook. And I think Mike made a further solid case by modifying that in the direction that he suggested when he drew on the later numbers. This means essentially a soft landing. Of course, everybody hopes that's what we will have. It has been so long since we've had one that I don't think I would even remember. Like Ed Boehne, up until recently I've been thinking that the risk of error was on the up side and now I think it has become more balanced between the up side and the down side. I do think, however, that it would be premature to conclude that the risk is definitely on the down side at this point. It's still possible that the sluggishness we have seen in the economy could turn out to be temporary. A lot of it comes from the weakness in automobile sales and the incentives there are pretty sizable; so it's quite possible that that will turn around. I remember so many times in the past when we thought we saw signs of weakening and they turned out not to have materialized. For example, in the face of the weak employment reports that we had back in July and August we were really worried about the economy for a while; and then they shot back up in the fall. Don't misunderstand me: I'm not suggesting that there is going to be a reacceleration. As a matter of fact, I think that's unlikely. The only point I mean to make is that I think it's a little premature to conclude that the economy really has turned downward at this point. I would hold off a little on that judgment, although we certainly can make a better case for that now than we could have at the last meeting.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I think there is increasing evidence that the economy is moderating. Mike has gone over all the indicators that I would have suggested would substantiate that. At the outset a couple of months ago we may have been seeing these trends because we wanted to, but at this point I do think they are becoming much more tangible. The question is: Will these moderating trends be sustained? My hunch is that they will and that they can be sustained without further tightening.

From a District perspective, though, the moderation that we're seeing nationally is not quite as apparent. Many of the industries in our District are doing pretty well--indeed, very well. The auto industry is a mini exception to that but it's not a dramatic change. They are reducing their forecast for the year; commonly, the sales forecast for cars is 10 million and for trucks 5.1 million. Inventories at the dealers are very high and for the first time in years the dealers are beginning to resist the delivery of new units. Therefore, production is probably going to come down. The second-quarter number looks to be a reduction of about 3 percent. The production risk in autos is clearly on the down side, not on the up side. But as they reduce production it's going to come out of overtime; therefore, the reduction in production will not result in layoffs. But the sales level of, say, that 10 million on cars and 5.1 million on trucks can only be maintained with the incentives that they're running. As I hear it, the incentives are the richest that they have ever offered since they initiated these programs. As a result of this, the steel business, at least in our District, is expected to be down--not anything significant but down certainly from last year, which was very, very heavy. Other parts of the District are doing very well. The demand for industrial machinery is high; chemical products demand continues to be high; construction activity, despite higher rates, also continues to be at much higher levels than the national numbers would suggest; and our employment numbers are continuing to come in quite strong.

In the agricultural sector, though, we have a little different outlook than Roger's. At this time of the year it's always uncertain but this year is particularly uncertain. Parts of the District--specifically western Illinois, southern Iowa and southern Wisconsin--are really very dry. As a consequence, the planting this year is slower and is running behind the normal schedule. Also, in Michigan we've had a very cold spring and we've had some frost damage to the fruit crops. There is plenty of time to recover from this before any permanent damage is done, but the next month or so is going to be pretty critical.

On the price side, I don't see any particular changes. At least as I see it there is no further deterioration. Some prices--aluminum and steel, for example--are continuing to go up but prices of other products are coming down. For example, there's some weakness on some chemical products. On the labor front, despite very tight labor conditions as I've reported in the past, I continue to be impressed by how well some of the contracts come out. I did talk to a chief executive officer last week of a company that just concluded a very major three-year contract which calls for increases of 3-1/2 percent over the three-year period. So, certainly, those numbers are coming in better than I might have expected. While I see no further price deterioration, on the other hand, there's no improvement either. I think the overall situation is a bit better than at the time of the last meeting. It's too early to be conclusive but the outlook, at least as I see it, is more constructive.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Thank you, Mr. Chairman. Recent information from the Twelfth District suggests that the growth may be slowing. Some sectors that have been contributing strength now are limited by capacity or supply constraints. For example, in the forest products industry they are facing severe constraints in obtaining logs, and that has actually resulted in some shutdowns of mills. In the aerospace industry you've heard a great deal about the situation among commercial aircraft producers: orders continue to build but the capacity is slow to respond and, consequently, they're not getting much growth at all. Other indicators throughout the District are suggesting somewhat slower growth even though capacity constraints in those areas are not a factor. As an example, the recent data on employment in California indicate significantly slower job growth during the past two months. In manufacturing, employment growth also has slowed. Construction activity may be slowing in the District but the picture is not all that clear. The weakness is principally centered in Alaska, Arizona, and Utah; we still see rather strong growth, particularly in residential construction, in Seattle, Oregon, and especially California. Anecdotal evidence does suggest that there is increased caution on the part of small businesses, with many of them reporting--at least in the cases that we were told about in Oregon and California--that they are holding off expansion plans and are also in the process of trying to keep inventories at lean levels.

Our outlook for the national economy is really fundamentally similar to that of the Greenbook. The slowdown appears to be more convincing now than it looked when we had our last meeting. It also seems as though slow growth could persist for a number of quarters. I would agree, however, that the risks of recession don't seem all that great. Moreover, even with the slowdown, real GNP will remain above its full employment potential with continuing upward wage pressures into next year, as was indicated by Mike Prell. The pace in underlying employment costs and unit labor costs is likely to rise. We do not have much evidence of increases in contract settlements in the Twelfth District but the L.A. school teachers went on strike on Monday. That's the second largest school district in the United States. They had on the table a 21 percent three-year package and they rejected that and are on strike. And everyone is beginning to speculate about what's going to happen in the aerospace industry. When you're bringing people in from Atlanta and other places and you've got a contract coming up there's not a lot of optimism about what that contract might result in. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, the Sixth District seems to be running counter to the rest of the country: at the end of last year we had a slowdown; but now, when the rest of the country is slowing, we seem to have relatively strong economic activity, although obviously it varies from sector to sector. Industrial construction remains pretty healthy and that's being bolstered by declining vacancy rates and some relocations from the northeast part of the country. Some of our key industries like steel and textiles are showing really quite robust health. Even the apparel industry, especially women's clothing, has begun to pick up. The tourism and business travel industries also are doing very well despite the impact of the Eastern Airlines strike in certain areas, particularly south Florida and Atlanta. The transportation sector also is showing increased shipping activity, and activity at our District ports is quite healthy. I was interested to learn that our contacts in south Florida are reporting substantially increased trade with Latin America, both on the import and on the export side. Louisiana is the weak spot--our part of Louisiana anyway, Bob. Oil drilling continues to lag; the number of rigs is down and is still trending lower. Our contacts down there report substantial uncertainty about OPEC plans after June; also, we find that there is a shortage of drilling pipe due to strong replacement and export demands. So that is having an adverse effect as well. On the other other hand, we are getting some good news from Mobile Bay where there has been an expansion of natural gas production. That's working to offset the weaknesses in the other energy sectors in the District. The Mobile gas find, in fact, is the largest in the United States since the discovery of the Prudo Bay fields in Alaska. Agriculture in our area is also reporting a pretty bright outlook. We've had normal rainfall this year. I don't know what the projections are for the future but I think we're looking for relatively good agricultural conditions. The market for farm equipment is also very strong. Retail sales are about the same as in the rest of the country. Automobile sales are especially poor and I might say that for the first time in a long time I am getting telephone calls from people about the economy--unsolicited complaints about the level of automobile activity. They are really crying about terribly distressed conditions, which doesn't seem to follow from the incentive pickup that we've had. So, in general in the District, things are looking pretty good. There isn't a great deal of evidence of a substantial slowdown; in fact, it's fairly robust. Having said that, the people that we talk to, including our directors, are concerned that the evidence of deceleration in the rest of the economy might turn into an outright recession. Also, they are not seeing much relief on the price side and they feel that they're not going to see any relief on the price side in the near future.

With respect to the national economy, I was somewhat skeptical about the degree of the slowdown in the economy, but my skepticism has been converted to some degree by the latest data. However, our forecast in Atlanta is somewhat stronger than the Greenbook forecast. Even taking into account the assumptions about policy, we think we're going to have stronger investment and stronger net export growth in 1989 than is shown in the Greenbook. More importantly, as we look out to 1990, we see the expansion continuing at a pace only a bit slower than the present one. Our unemployment rate is lower throughout, although that's probably due to labor force growth, which will slow. Now, I realize that our forecast is an outlier, if you look at not only the Greenbook but the Blue Chip forecast and others. But to me what is suggested by this forecast is that the inflationary momentum is still rooted in the economy and it's rooted rather deeply. So I'm still inclined to think, notwithstanding the recent data, that the risk of recession is relatively low and that the risk of inflation is still relatively high. Just one other anecdotal piece of information: one of our contacts recently discovered that his managers are stockpiling linerboard in inventory in anticipation of price increases. So, I think that this price fear is still there and that the inflationary danger is still there. And I think that is really what should guide policy over the near term.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In the District we continue to see some relative strength in the most recent three-month period that we have numbers for, both in nonagricultural employment and particularly in manufacturing employment. But a lot of that strength was in the early part of the period and some weakness has started to show through in the last couple of months. In autos, which is a big industry in Missouri, both GM and Chrysler have announced four- or five-week shutdowns when they do their retooling in the June-July period as opposed to a normal week or two. Also, a consumer durables manufacturer, an appliance manufacturer, apparently eliminated a third shift some time back and now there is talk of going to a four-day workweek because of softness in that market. Residential construction has been flat, a bit better than nationally. We've had particular weakness in nonresidential construction. There was recently a strike of operating engineers in connection with which 20,000 of 30,000 construction workers in the St. Louis area went out. That strike was settled in about two weeks with total compensation increases of about 2 to 3 percent in salary and benefits.

In terms of our broader view, our forecast for the year is very similar to the Board staff's in terms of the outcome, although it is based on 4 percent money growth. We've become increasingly concerned that, with virtually no M1 growth since July of last year, the risks of recession either later this year or early next year are becoming considerably greater. Also, I have the same impression that Manley described before: many of the private forecasters who use interest rate-driven models really have an interest rate scenario of rates coming off in the latter part of this year to achieve the soft landing that's in the Board staff's forecast.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. First of all, I think the New England economy, like most of the Northeast, is slowing markedly. In the past I think we've seen some slowing for a few months that has largely reflected idiosyncratic kinds of factors of mix; the difference now is that there is some more evidence that the slowing reflects a big system with national kinds of trends. Retail sales are soft really across the board, particularly in the durables area. I don't think it's largely because of interest rates; it's because of excesses of the past. Housing is very soft and we have very, very substantial overhangs, particularly in the condominium market. As a matter of fact, the headline in last Sunday's Boston Globe--I would say it was greatly overdone--in 3/4 inch black type on the business page was the word "bankruptcy." It was about a number of developers and others who had gone into bankruptcy, and it was saying that the rate of increase in bankruptcy in the New England District and the cost were now greater than they had been in Dallas. The level is still extremely low. But we have had negative commercial space absorption in the greater Boston area for the first time since--

CHAIRMAN GREENSPAN. Negative absorption?

MR. SYRON. Negative absorption of commercial space is where, because of consolidation of firms and cutbacks, less space was rented in the most recent period than in the period before that, leading to an increase in the vacancy rate in the suburban areas.

MR. BOYKIN. We're familiar with that term.

MR. SYRON. Really, we have a few [unintelligible]. Our manufacturers have reasonable backlogs but they say their new orders in many cases don't look very good, particularly in defense and in the computer areas that tend to be very defense-dependent. One reason I asked Mike the question earlier about inventories is that some of our manufacturers in the aerospace business--particularly those in the business of supplying parts to jet engine manufacturers--say that, given the backlogs they understand the manufacturers have, they are not seeing as much in orders as they were earlier. The large jet engine manufacturers, particularly General Electric and Pratt and Whitney, seem to be going more to just-in-time types of inventory practices. So, as I say, we think some of these things reflect earlier excesses, a deterioration of our competitive position. Bob [Forrestal] mentioned some expansion in the Southeast of firms based in the Northeast. Some of those are our firms because they decided not to expand [in our region]; generally, when they close the plant here they don't open a new one because of labor costs and other factors.

As far as the national economy goes, our view is very similar to that contained in the Greenbook. While I have some sympathy for what people have said, I'm inclined to think that there is more slowing going on than I would have thought a month ago. I find that somewhat heartening in that what we're seeing really is consistent with the Greenbook forecast and what we'd expect, given the rise that we've seen in rates thus far. Looking at the employment numbers, while last month's number was a little low it wasn't enormously below what one might think of as a sustainable rate of growth in employment, especially when one looks at strike-adjusted data. Given where we are in the labor market right now, I think Bob Parry's remarks on that score are very apt. I don't know a great deal about the details, but we're somewhat concerned about what we're seeing in the Bethlehem Steel settlement, though that might be taken care of over time by competitive factors with USX or something. But I think developments in labor markets still indicate that some inflationary pressures are built in there that will take a while to work out.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, Mr. Chairman, I am encouraged by recent business statistics and recent business developments in that they suggest the kind of adjustment that I thought was needed. It's also true that, broadly speaking, the statistics and the anecdotal comments we get from business people are more or less compatible with each other, which isn't always the case. The one exception to that may be a bit more concern on the anecdotal side about near-term inflationary prospects. But like Ed Boehne, when I look out at the profile over the next six or seven quarters, in some ways I conclude that it is indeed about as good as one could hope for. On the question of risks, I'm still impressed on balance with the resiliency of the economy. Far more often than not the surprises tend to be on the plus side rather than on the negative side. And I guess that's where I would hedge my bets.

Having said that the outlook in Mike's forecast in some ways is about as good as one can hope for, I think it's worthwhile to then ask: Where does that leave us? What does it look like out there at the end of 1990--keeping in mind that these point estimates are not worth a darn? Nevertheless, where are we by the end of 1990? Well, even in Mike's forecast the underlying inflation rate is still 5 percent, maybe a shade higher. The external situation is terrible. In the staff forecast the current account deficit in the fourth quarter of 1990 is $135 billion; in our forecast it's more like $155 billion. I would stipulate that if that combination of numbers is anything near right the economy at the end of 1990, if not sooner, will be a good deal more vulnerable in many respects than it is right now. In addition to the kind of recession--financial and other types of things--one thing I'm quite sure of is that the protectionist problem will be a heck of a lot greater if we get out that far and we're still looking at external imbalances of the type that are built into the forecast.

Then I start to ask myself the questions: What's going to change that? What might produce a better result than those 1990 point estimates? And I start to go down the list: U.S. fiscal policy, not likely; U.S. monetary policy, well, which way? Do we want to ease monetary policy? That might help stimulate domestic demand a bit but that's going to hurt on the trade side. It might help net exports a little but that will be offset partly in terms of domestic demand. And both are going to be inflationary. So, I don't see much help there. We could tighten U.S. monetary policy, but that's going to make the dollar go up, among other things, and I don't see much help there. If you look to foreigners, there's very little excess capacity abroad for the industrialized countries, so we're not going to see much there. Indeed, while they may tighten monetary policy for domestic price inflation reasons, that in turn is going to restrict the growth in their own domestic demand, which in turn is going to hurt in terms of the adjustment in trade and exports from the U.S. point of view. In short, I don't think you can fix it either way with the exchange rate. And I think there are great risks on both sides of that, especially in a context in which the protectionist problem is likely to get worse, not better. That's a long-winded way of saying that I don't mind at all running the risk prospectively that the economy will slow; indeed, I wouldn't even care if it slowed a bit more than Mike's forecast as long as I do not see signs of a recession, which I do not see right now.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I agree with those who like what they see in terms of the conditions that are out there right now. It is good news to have consumer spending running at a much lower level and to have more room for the hoped-for capital spending and for exports. It's a little scary to me to see that we're in a place that we'd like to be; it's scary because you ask yourself how we got there. And you say we got there by slowing down. But I don't think we're that good that we can actually pin it down just exactly as to what we might want to have on consumer spending. So, rather than look at the far out [time horizon] I would look at the monetary aggregates at this stage. I think they are our best guide in terms of where we may be in 5 to 6 months. Restraint is indeed the proper course, but it probably ought to be a measured restraint not an increasing restraint. Increasing restraint, if shown by continued deterioration of the growth rates of those monetary aggregates, I think can increase the risks. I don't think that exists now but it could be there in the near future. I just do not recall, Don, seeing any item like checkable deposits year-over-year being negative. I just do not recall the possibility that M1, if it remains soft for another month, could also be flat for an entire year. I just do not recall M2 declining as much as it has declined and then, in a sense, having the bottom drop out of it in the tax-paying season. All that, it seems to me, would say that there's a high degree of risk in letting those aggregates deteriorate further. And we ought to be mindful of that. We ought to avoid extremism on that which we know about rather than worry so much about that which we do not know about. It seems to me that declining monetary aggregates in the face of an economy that shows some signs of slowing actually could give you a tightening of monetary policy while interest rates appear to be stable. You can have stable interest rates and a tightening of policy in that kind of environment. And I think we need to be cautious in that regard because the long-run inflation problems are indeed great and we need to be able to maintain a posture of slow growth into the future. But the way to do it is not to get caught up in the extremism of letting the monetary aggregates fall out of bed. So that's what I want in terms of caution.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I, too, like most of what I see at the moment. To review the District economy briefly: in the rural areas we have had for some time now, and it's continuing, an expansion led by recovery in copper and iron ore mining, specialty mining, strength in the forest products and the pulp paper business--strength limited mainly at the moment by environmental concerns and some shortages of raw materials. The agricultural situation is shaping up in a very positive way, at least at the moment, because moisture in most of the District has been pretty good. And people are optimistic about the upcoming tourist season. With regard to the diversified metropolitan areas, those economies have been strong for a long time and generally remain so. There have been some layoffs in some of the high-tech areas but those economies seem to absorb that pretty readily. There is concern about the pace of automobile sales. That's maybe the one major new element on that side of things. There are also, though, labor shortages; both skilled and unskilled labor has been tight for some time. What I'm picking up now is growing concern about the militancy of both organized and so-called disorganized labor. There is some concern about that translating into further wage pressures; businessmen seem to be divided at the moment as to whether they will be able to pass those wage and cost increases through fully or not.

With regard to the national economy, our model forecast differs in many particulars with the Board staff's but the overall picture isn't very different at all. It looks to me like things are unfolding about as well as we could hope for at the moment. Having said that, I do think the risks have changed since we last met. But I wouldn't want to exaggerate that. One of the things we routinely do with our model is calculate the probability of recession, conventionally defined, going out the next 7 or 8 quarters. While that probability has gone up a bit recently it hasn't gone up very much; it's not far from where it has been most of the last two years. So, I take that to mean that things have shifted a bit but not a great deal.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. In terms of the national economy, I'd like to associate myself with Governor Angell's views on the risks with respect to the aggregates. I think policy is tight as judged by the aggregates, perhaps appropriately so right now. I'd also like to emphasize the point he made that even with interest rates being held steady, if the aggregates continue to shrink, [that's a] tightening of policy. That's something that hopefully Don Kohn can relieve our concerns about shortly. I'd like to compliment the staff, Mike's group, for putting right out front in the forecast what I think is realistic and appropriate, and that is that we could have a quarter or two of negative growth.

In terms of the District--although I'm a little hesitant to draw conclusions from the District about national economic conditions --we see a rather worrisome trend. It starts with the willingness of management, looking at Bethlehem Steel, to sign off on relatively higher rates of increase for pay--8 percent the first year, a 5 percent average over 50 months, and a 3 percent trigger on cost of living indexes, or COLAs. We called a couple of other steel people. indicated that it was likely they would follow Bethlehem in a similar type contract. Again, they're not at the top level. said they would not do it; they thought it was a bad practice in that it was short-term oriented to avoid the strike but didn't fit in terms of the long-term health of the industry. It's particularly worrisome for us because of our unemployment levels and also the tendency for some manufacturing to follow the steel model. Now, unemployment rates are very low relative to where they have been in both Pennsylvania and Ohio. There is a lot of tightness in the labor market. Looking around the District, we had an Ohio manufacturing index that came out at 4.4 percent for the first quarter. The only softness that we could dig up--and again we focused on capital goods and steel [producers]--was in certain steel products. The stainless strip indicator that one of the companies uses is running about 20 percent below its 5-year average for that same time period, in terms of new orders.

CHAIRMAN GREENSPAN. Did that ever work out as a good indicator? I remember we discussed that.

MR. HOSKINS. I was afraid you were going to ask that. We haven't examined it as thoroughly as we should. It's one of those things that I tend to watch. The answer is that in terms of direction I think it has been all right; in terms of magnitude you can't read much from it. So, it would tell me that the quarter should be softer than it would have been if the indicator were higher; but I don't know whether that's 0.1 percent or 2 whole percentage points. But in March and April that indicator was running 20 percent below the norm. We asked other firms, particularly the capital goods firms, about the impact of rising interest rates and it has been almost nil. They have internally generated funds; they don't see a recession or at least sufficient signs of recession to concern them. They're going ahead with their normal production plans. So, really, the District continues in some sense to be an outlier; relative to what I hear around the table it has been strong with some softening in certain steel products. That's about it.

CHAIRMAN GREENSPAN. Governor Heller.

MR. HELLER. Thank you, Mr. Chairman. I don't have much to add on the U.S. economy but let me just call your attention to developments abroad because they do have a significant impact. Overall, I think you can say that after a surprisingly strong 1988 foreign economies are now slowing down as well. In particular, you see a significant weakness in industrial production in our major trading partners where about half the monthly changes now are in the negative range among the 10 leading industrialized countries. At the same time inflation abroad has been higher than expected, which is leading to a tightening of policies by many of our trading partners. And that is partly due to the oil price increases and partly due to the exchange rate deterioration that they have seen in the past. Add to that weakness abroad the rather strong dollar at the present time and I think we will see a significant slowdown in export growth. While last year we were comfortably in the double-digit range as far as real export growth was concerned, it is probably going to slip to something in the 3 to 5 percent range by early next year. So, that means that our strongest single sector in the economy will be a lot weaker than it has been in the past. Combine that with the tight monetary policies and low M growth and I think we'll see a very, very shallow expansion indeed.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. I'd like to associate myself with those people who generally view the current environment as satisfactory. The evidence clearly is showing a slowing in economic activity. In my opinion it has gone beyond the stage where this might be a temporary situation. I think it is [likely to be] sustained. And I think the slowdown in domestic demand or consumer spending is a desirable feature that we've been looking for. Like Governor Angell, I think getting that excess demand out of the economic system with our policy frees up our capacity for other uses in our export sector and capital goods, which is something we've desired. The inflationary picture looks more promising than we might have expected, although I don't want to make too much of any one month's number. But going beyond just the April CPI, I think the wage patterns are better than what we might have expected, even taking into account the Bethlehem Steel [settlement]. I've seen some reports--as a matter of fact I asked the

International Division to report on this because I wanted to know if the VRAs had anything to do with the wage pattern. The report I got back was generally "no"--that basically this wage settlement involved some catch-up on big productivity increases in the past and some of the very slow wage growth or even give-backs that had been imposed earlier. So I think there are some one-time features in there. The actual change of the wage base, I think, is very small. At least the report I got back was that that was not a discouraging wage negotiation. There are a lot of good signs. The April PPI, of course, was a real positive feature. If you add that one month in, the trend in the PPI, excluding the [volatile] components like food and energy, so far this year is below last year. I think that's an encouraging sign. At the very least you can say that ex-food and energy the underlying producer price growth is not accelerating. It may even be a bit more modest than last year.

As others have said, the risk has certainly shifted from being on the up side to being more balanced. I put myself in that camp and maintain more of a neutral position at this point. But I do want to emphasize what Governor Angell and others have said: It would be a risk to perceive a neutral policy, and one that is balanced, as one with a steady funds rate. To me the great success of our actions last year in achieving what we wanted has been our ability to move the funds rate. Some people want to talk about this in terms of the aggregates; but my view is that our willingness to be flexible on interest rates and to move them subject to changing conditions has been the reason we have been able to stay ahead of this process and contain inflationary pressures. That means that we show flexibility with respect to interest rates rather than targeting some interest rate level. And I think that is important to keep in mind. That means that a neutral policy in a weaker situation or a slowing situation is not a steady interest rate, just as steady interest rates weren't the answer when we were restraining policy. We need to keep that in mind because as credit demands start to slow we could easily see maintaining the same level of interest rates as a drain on reserves and ultimately on the monetary aggregates--if you want to look at it from the point of view of the monetary aggregates. Anyway, that's my point of view.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. As so often happens, Governor Johnson has made most of my speech for me. I would only like to add that I think further tightness may only aggravate some of the problems that we have. In the first place, I don't feel that the wage and price pressures that are already there are going to respond or be damped by higher interest rates. I think the pressures for wage increases were built in a year ago. And some of the price pressures are really not part of a controllable environment because they are related to oil prices or to drought-increased food prices. It doesn't seem to me that further restraint helps those pressures; on the other hand, [additional restraint] may be counterproductive in that it discourages further investment and may result in further price increases because of the higher cost of capital. So I think this is not the time either to ease up on the brakes or to stamp down on them any harder. I agree with your balance concept.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I agree with the thrust of most of what I'm hearing said around here. But at the risk of becoming a bit of a Cassandra of the FOMC, which I certainly don't want to do, I think that we're probably getting to the point where it should be on the table for us to keep a weather eye out to the possibility of a substantially worse result than anyone has heretofore addressed. Governor Angell and others have talked about the aggregates and their slowness; that has been going on now for two years with a little hiatus in the winter a year ago when we had the stock market problem. It has probably been more severe most recently than it has at any other time over that period. With that as a background, we now see an economy that is slowing to an extent that I think surprises all of us a little, compared to where we were at the last meeting or even compared to the Greenbook that was written hardly a week ago. How far and how fast can this go? I'm not sure that we can be very confident that we're not beginning to see the first of some downside momentum here. I'm not predicting that; that's not where I am, but I do think that we've reached the point where we need to keep a weather eye out for that. Governor Heller points out that the prospects for exports are getting a little less rosy. It's hard to see housing and construction coming back. I don't think there will be any fiscal stimulus; we may actually get some reduction in the deficit but I certainly wouldn't anticipate any further stimulus from that. I hope that fixed investment will hold up; I will keep my fingers crossed on that one. That puts it all back on the head of the consumer and we all know the consumer can be very fickle. Again, I would emphasize that that's not my forecast and it's certainly not my hope. But I do think that it's worthwhile for us to begin to keep that on the table as a part of the consideration.

CHAIRMAN GREENSPAN. Governor Seger, incidentally, had to go up to the Hill to testify on a consumer issue. She should be back by the time we are completed with our coffee break, which starts now.

[Coffee break]

CHAIRMAN GREENSPAN. Mr. Kohn.

MR. KOHN. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Kohn?

MR. JOHNSON. Don, that was an interesting briefing. What did you say in the beginning about the yield curve? I didn't quite hear that.

MR. KOHN. Looking at the first chart, Governor Johnson, we continue to have this rather mild overall downward slope running from the federal funds rate to the 30-year bond.

MR. JOHNSON. Is that the dotted line?

MR. KOHN. Virtually, in the upper panel, that's the cross.

MR. JOHNSON. Oh, I see. I'm sorry.

MR. KOHN. That represents the most recent week in each of these charts.

MR. JOHNSON. Okay. I've got you.

MR. KOHN. I was interpreting that as not nearly as steep, certainly, as we've come to before past recessions and more indicative of a slight downward slope--well, it is a slight downward slope of the yield curve. Then, in the bottom panel, I was noting the fact that that hump was no longer there, which suggested that the market certainly wasn't expecting the Fed to tighten over the intermediate run. These are all difficult interpretations, given uncertainties about term premiums.

MR. JOHNSON. Wouldn't you say more that they're expecting some easing?

MR. KOHN. I was discounting the upward slope in the short end there as being supply-related and term premium-related. Looking at various expected federal funds rates, term federal funds rates and related shifts among 30- 60- and 90-day rates in the short-term market, I do think they are expecting a mild easing over the next several months--not necessarily next week, but sometime in the next couple of months.

MR. JOHNSON. Okay. Also, one other thing on these inflation expectations measures: those were April surveys?

MR. KOHN. That's correct, both the Michigan and the Hoey. The Hoey you see on the next page.

MR. JOHNSON. So they don't really contain any of the April data?

MR. KOHN. They don't contain the information that became available in May; that's correct.

MR. JOHNSON. Okay.

MR. KOHN. So that increase from 5.3 to 5.7 percent that you see in April from February in the first column of chart 5 could very well have been reversed in May.

MR. JOHNSON. Yes, I see.

MR. KOHN. The Michigan survey, I believe, had 5 percent in April inflation expectations. That may have dropped in May also; it's hard to tell. But in any case, it remains at a fairly high level.

MR. JOHNSON. Okay, thanks.

CHAIRMAN GREENSPAN. Questions for Mr. Kohn? Governor Angell.

MR. ANGELL. On Chart 11, Don, is the V* your long-run V*?

MR. KOHN. Yes.

MR. ANGELL. If you take the short-run V*--

MR. KOHN. If you take the short run, then P* is further below P and would be exerting a little more downward pressure on inflation than you see in that bottom panel.

MR. ANGELL. I guess I'm surprised that you used the long run rather than the shift adjusted one. From the staff study I thought there was a slight preponderance of evidence on the side of the shift adjusted. Didn't the numbers come out a little more accurate on the shift adjusted?

MR. KOHN. I think the numbers--well, do you mean adjusted for the shift in the--

MR. ANGELL. In the monetary aggregates.

MR. KOHN. In 1983? Is that what you're referring to?

MR. ANGELL. Yes.

MR. KOHN. But that wasn't adjusted. Yes, the shift adjustment begins in 1983. But the numbers didn't come out better if we lowered the whole V* to the average of the last few years, extracting from that one quarter or two of shift adjustment. I think you were suggesting that we go with the lower V* all along or at least have some 1982 floor.

MR. ANGELL. Yes.

MR. KOHN. That did not prove to be better.

MR. LINDSEY. Right, the staff did a statistical test in which they tried the average of velocity since 1982 as opposed to the average since 1955. And, as Don has indicated, the regression analysis suggests no statistically significant difference between the two. So, in this chart we went with the simpler longer-term average.

MR. KOHN. I can give you the results for the quarter.

MR. ANGELL. Okay. Well, I heard the answer.

MR. KOHN. It's curious that running it with the shorter-term velocity I get 3-3/4 percent inflation in 1990 instead of 4-1/4 percent inflation in 1990.

MR. ANGELL. Thank you. The second question, Don, relates to the bounceback in M2 that you're forecasting on Chart A, which seems to me ample, or maybe strong. If it did not turn out that way, or if the second half was by and large a continuation of the 2-3/4 to 3 percent range, would you have a different policy prescription than you do with the present forecast?

MR. KOHN. I think I'd have to analyze why it wasn't bouncing back. If it wasn't bouncing back because of some special factors that meant that the relationship between opportunity cost and velocity had gone off track--that is, that there had been a shift in money demand--obviously, I would be much less worried. If it wasn't bouncing back because this scale variable, the underlying income growth, was weaker than we're projecting then I think that would be cause for concern. So I'd have to think a little about why it was happening before I could give you a reason. The other reason for it not to bounce back would be an even stronger rise in opportunity cost. That implies even more of a rise in interest rates than the Greenbook forecast has there. I don't think that's what you were thinking.

MR. ANGELL. No, no.

MR. KOHN. So, I'd have to think carefully about why it wasn't bouncing back--whether the relationship was going off track or the underlying income--

MR. ANGELL. But you really expect this phenomenon to begin to show itself in the next three to four weeks, is that correct?

MR. KOHN. I expect by the time we get to the middle of June that we would have some sense of things, hopefully, bottoming out in the middle of May. Without getting too tied into week-to-week money projections--

MR. ANGELL. Oh, I understand.

MR. KOHN. I'm very skeptical of week-to-week money projections, but I'd want some sense of it moving up at least toward the end of May.

MR. ANGELL. I would agree with that. Thank you.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I have three questions. I may have missed the answers. On the technical adjustment of the borrowing target from $500 to $600 million for alternative B, what do you think the fed funds rate would be if you didn't make that adjustment and you stuck with the $500 million that we currently have?

MR. KOHN. I think funds would tend to trade a bit below 9-3/4 percent. Peter?

MR. STERNLIGHT. Yes, I think the rate would be in the area of 9-3/4 or 9-5/8 percent.

MR. KOHN. We're running above $500 million--

MS. SEGER. Sure.

MR. KOHN. --in the early part of the maintenance period, which is unusual, and partly it's the seasonal borrowing that's rising. In the past I've argued that the seasonal borrowing doesn't affect things very much but I think the level of adjustment borrowing is so low that the increase in seasonal borrowing is showing through more; it's not covered up by the noise in adjustment borrowing.

MS. SEGER. Do we have an alternative for no change in policy? It seems to me that what we have is: an easing, which is "A;" a slight tightening, which is "B;" and more tightening, which is "C."

MR. KOHN. Well, I interpreted alternative B as maintaining about the same funds rate level as we've been running over the last intermeeting period. If what you're referencing is what might happen to market rates I agree, as we stated in the Bluebook, that the markets now have an easing built into that. It's quite possible that if the data continue to come in weak the markets will continue to expect an easing and rates may not move very much. But if the data strengthen a little and we don't ease, I think these short-term rates could back up a bit--retracing some, but by no means all, of the decline that occurred over the last intermeeting period. We do have, I think, some sense of a further easing--

MS. SEGER. But without even looking forward, doesn't the fed funds assumption in alternative B, at least in a relative sense, represent some tightening? I say that because we've already seen, as I read the numbers anyway, quite a significant decline in short-term rates. And if you--

MR. KOHN. It doesn't represent a tightening in the reserves market. It may represent a tightening in other markets. It wasn't intended to represent a tightening in the reserves market.

MR. BLACK. Martha, you've raised an interesting question about whether the borrowed reserve target or the federal funds rate is the better indicator of policy. Earlier Governor Angell raised the question as to whether the behavior of the aggregates or the federal funds rate was the better target. And I think we all--

MR. HOSKINS. You want to start that again?

MR. BLACK. I'm saying there are three ways we can measure it that have been discussed here today, and I like Governor Angell's way best. I like the federal funds rate second best and the borrowed reserves third best. And they are all incompatible with one another. We had a pretty interesting discussion earlier.

MS. SEGER. I'm sorry; I was up [on the Hill], having had a date with a couple of my Congressmen.

MR. BLACK. Yes, I know what you were doing.

MS. SEGER. I think you answered my third question when you talked about what the market impact might be in the future if they, in fact, are expecting an easing. If it doesn't materialize--or I guess even more importantly if they're expecting an easing and then something registers as a slight tightening--I would imagine there would be even more of a market impact.

MR. KOHN. Peter, please correct me if I'm wrong, but my sense is that the market doesn't have us easing out of that 9-3/4 to 9-7/8 percent range now. But they're looking for signs that it may happen.

MR. STERNLIGHT. I think that's correct. When they talk about their views they don't expect any overt or active policy move toward ease. But what emerges from the rate relationships, as your earlier statement suggested, does seem to imply--looking out over a few months--some slight easing just in the existing market relationships.

MR. GUFFEY. But that has only been in the last 10 days.

MR. STERNLIGHT. Yes.

MR. GUFFEY. Before that they did not.

MR. STERNLIGHT. That's about right.

MR. KOHN. Well, as Peter said in his presentation, coming out of the last meeting they expected us to tighten.

MS. SEGER. Right.

MR. KOHN. When we didn't tighten, short-term rates came down. And then they fell further when they started to--

MS. SEGER. Thank you.

CHAIRMAN GREENSPAN. Governor Heller.

MR. HELLER. Excuse me for asking the question maybe in a slightly different way from the way it has been asked before. The Greenbook built in a 3/4 percentage point increase in the fed funds rate.

MR. KOHN. That's correct.

MR. HELLER. You're putting in a $100 million technical adjustment in the borrowing.

MR. KOHN. Right.

MR. HELLER. And yet you are projecting a rather significant turnaround in monetary growth. Would you tell me what brings that about? I don't quite get it. Maybe that's an easier way to answer the question about what caused the very significant drop in the Ms, especially M1, that we were seeing before and the flatness and more recent drop in M2.

MR. KOHN. I think there are a couple of things going on. The most fundamental factor was the rise in opportunity costs in interest rates over the period from March of 1988 through February of 1989. That has particular impacts on M1 not only because demand deposits as compensating balances tend to be very, very sensitive to movements in interest rates but also because NOW accounts serving as savings deposits tend to be extremely sensitive to interest rates when time deposit rates adjust and NOW account rates don't. Essentially, NOW account rates have crept up but not very much so we've seen huge growth in time deposits--in the last month we're talking about 25 percent at an annual rate. I think, in part, that's a shifting from NOW accounts. So we've had very, very weak growth in M1 just because of the past tightening in policy and the rate relationships among bank and thrift deposits that have emerged. On top of that, you add the tax situation. I put that chart 10 in there to try to underline my point that this drop in M2, which had a counterpart in M1, seemed to fall off a cliff after a certain point. And the timing of that drop is tied very, very closely to the timing of the overage in the tax payments and the increase in Treasury balances. We only projected 3 percent M2 growth last time under alternative B; so on top of that rather weak projection, given the increase in interest rates, we had the tax effects, and that's what reduced M2 and M1 as well.

MR. HELLER. I'm sorry, that still is my question, in a way. Now we're going to increase the fed funds rate more.

MR. KOHN. No, alternative B is intended to keep the fed funds rate where it has been.

MR. HELLER. The Greenbook--

MR. KOHN. The increase of borrowing [in the path] is not expected to have an effect on the funds rate. In fact, borrowing has been running above $500 million.

MR. HELLER. The Greenbook is the same as the "C" alternative.

MR. KOHN. The Greenbook is not tied that specifically to an alternative that really only stretches to the next 6 weeks. In fact, the Greenbook's interest rates, as Mike said, really increase in the second half of the year. In essence, the Greenbook is--

MR. PRELL. We're neutral.

MR. HELLER. Endogenous, right?

MR. PRELL. We're neutral at this meeting.

MR. ANGELL. Well, the Greenbook is "B," "B," "C," "C".

MR. HELLER. What?

MR. PRELL. The Greenbook doesn't slice it that thinly, but we didn't assume anything in the next few weeks.

MR. HELLER. Okay, thanks.

MR. BLACK. But what the Bluebook did assume was that the best measure of the degree of reserve pressure was the federal funds rate, because you've adjusted your borrowing target to influence that rate.

MR. KOHN. It is the case that we adjusted our borrowing targets last year as borrowing came in weak relative to the targets, in order to keep the funds rate from deviating very, very substantially from what we thought [it would be if the borrowing function had not shifted]. Yes, we are indexing, basically, on the funds rate.

MR. STERNLIGHT. Or even earlier this year, when we had that cut of $200 million in mid-February, we did not consider that an easing but a technical adjustment.

MR. BLACK. All the worrying about viewing the borrowed reserve target flexibly was designed to give preference to the federal funds rate which [unintelligible] was probably given--

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. I think you've answered this question but let me put it forth one more time. We usually hear about uncertainties around tax time--the seasonals, for example. And yet the Bluebook seems to read with a degree of certainty that is higher than I would have expected that that was a factor in the slowdown in M2. You've answered part of it by saying you looked at the calendar--

MR. KOHN. Fundamentally, that's correct. I think there could have been a little slowing in addition to that. I don't want to slice this analysis to oversell my ability to track every dollar or even every billion dollars of M2 or M3, so let's--

MR. HOSKINS. Well, the thrust of the question really is the confidence you have in a bounceback.

MR. KOHN. It's our best guess. We think we've analyzed the situation.

MR. HOSKINS. Yes, I bet on the Caps too, so--

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Don, two questions. One: If you look over the last year or so how good have we been at projecting future M2 growth?

MR. KOHN. Not too bad, taking into account--

SPEAKER(?). You were ready for that!

MR. HOSKINS. They worked it out at the coffee break!

MR. KOHN. --taking into account where the interest rates have ended up. There have been some Bluebooks where the actual has come in under, say, alternative B in the Bluebook. I haven't done this for a couple of months but I did look at our projections and the errors we had in 1988. Basically, we had captured the fundamental slowdown in the second half of the year pretty well--not to the last percentage point, but we had the basic structure.

MR. MELZER. My second question is: As people rebuild their balances, what implications do you think that will have for the real side?

MR. KOHN. I think it depends on how they do that. The presumption here is that most of the rebuilding comes from redirecting savings flows, perhaps a little asset portfolio shuffling. That wouldn't really affect their spending. It's possible that some people may cut back on their spending temporarily to rebuild their balances. The question [hinges on] what the element of surprise was for you. You could have been surprised by the fact that taxes relative to your income came out higher; but you could have been surprised because your income was a little higher--say, you had more interest receipts or capital gains were higher. It's not clear that that would affect your spending in the same way as other things. So, the effects on spending are very ambiguous, whereas I think the rebuilding of cash is less ambiguous.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. I don't have a question but an observation. I find the charts to be very helpful. I wouldn't advise necessarily having you send them out in advance, but I do find having these kinds of charts as you go through your presentation to be a very useful part of the presentation.

CHAIRMAN GREENSPAN. Anybody else have any questions on this? If not, why don't I just start off with the round table. As I hear the basic comments on the outlook it strikes me that there is a fairly central tendency in this group's evaluation, which says in a sense that the economy clearly has slowed and probably will stabilize without going into a recession. I think the evidence at this stage is fairly solid on that conclusion but probably needs to be audited with some degree of sensitivity. The crucial pieces of evidence that we have that suggest the economy is not cumulatively going down are the initial claims data and the level of insured unemployment. Both, after having weakened in the period when we got the pickup in the unemployment rate, have since eased off to levels that suggest a period of much stronger employment growth, certainly, than we've seen in the data of the last two or three months. Similarly, we're looking at an industrial price pattern that would not be consistent with an erosion of orders in the materials area. As a consequence, I think we have very little indication that the softening which has been so patent is cumulatively deteriorating, at least at this particular stage. The one element that still seems to be reasonably solidly in place is the inventory situation, which as yet doesn't appear to be creating problems. The increases in inventory investment, I suspect, are to a large extent still in work-in-process; and probably a very substantial part of that work-in-process pattern is in the civilian aircraft area, which is not suggestive of inventory backing up. So, we don't have evidence of what I view as the crucial danger--namely that when you go from tightness to softness that you then just continue on. That evidence at this particular stage is lacking. The one negative, which I must say bothers me as much as it has bothered a number of people around here, is the money supply data. The evidence suggests, as Don points out, that the money supply is coming back rather quickly. And I think that that's the most likely outcome. But if it fails to do so, then I think we'd better be looking very closely for other forms of evidence that may be signaling that the stability in the system which now seems to be in place is in fact lacking. Wages clearly have slowed down. The Bethlehem [Steel] case probably is an aberration. I didn't like the L.A. teachers turning down that contract; that seemed to imply a much more aggressive attitude, which may be a delayed effect of the unemployment rate falling as low as it did and staying as low as it did earlier in the period.

So, it's not a clear-cut balance of risks, as I see it. We have moved, as best as I can judge, from a tilt toward inflation being more probable and are now closer to some form of symmetry. I would conclude that probably the sensible thing to do at this stage is to have alternative B symmetrical. I would be careful specifically to watch the money supply more closely than we usually do, although I'm not sure I would recommend that we move it up in the directive. But certainly I think that is crucial to what we are doing and we just need to watch it. I have the impression that even though we didn't have a telephone conference in the last intermeeting period--there was nothing that really happened that deviated substantially from our general expectations as far as policy was concerned--that we ought to have one just on general principles this next time. I'm pretty sure we should have one if for no other reason than to try to get a sense from all of you whether you see any [need for an] alteration in the policy. So I would suggest that we do have a telephone conference just for the purpose of auditing what's going on. Roger, do you have a question?

MR. GUFFEY. It's not a question. I just want to follow up on your comments, Mr. Chairman.

CHAIRMAN GREENSPAN. Okay, go ahead.

MR. GUFFEY. Okay. Sticking with "B," with the $600 million, seems to me to be appropriate. I'm not sure, however, that going to a symmetrical directive at this particular meeting is what I would recommend. It seems to me that the data we are relying on as [indicative of] a slowdown are nothing more than three weeks' to a month's data. To be sure, the aggregates are slow; but the projection by the staff is that the growth of M2 will return to the 6 to 7 percent area within the next 30 days. Given the attention that the markets pay to the directive, it seems to me that a directive very much like that adopted at the last meeting--that is, [with a tilt] toward restraint--would be appropriate this time. It would give us flexibility; if we want to go the other way that's available via a telephone call. I can't remember how it was but it was something like "somewhat and would" and "somewhat and might" in the language of the directive itself. I would prefer asymmetrical toward restraint as it was last meeting.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Yes, I wanted to ask a question in regard to the aggregates. I agree with your position. You used the word "evidence" --evidence that the money growth is coming back. I don't think we have any evidence yet and--keying on Governor Seger's suggestion--I'm wondering whether we could make that adjustment from the $500 million to $600 million with some discretion on the part of the Chairman as those numbers come in. Would that be a problem, Don?

MR. KOHN. It's not a problem; it would be a phenomenon. That is, I think you'd have an easing of the funds rate and then you'd have a tightening if you went back to the $600 million. So, it would depend on how you felt about things.

MR. ANGELL. Well, my view on the aggregates is that the problem with the aggregates is right now. If we're ever going to be concerned about the aggregates we should be concerned right now. I don't know whether they are going to come back or not come back; if growth does come back I'm going to feel very comfortable. If they come back as much as you suggest I think I'm probably going to want to restrain them too. But--

CHAIRMAN GREENSPAN. Well, that's what we have to worry about. The worst thing we can do right now is to whipsaw. That would really do damage.

MR. ANGELL. You think the markets would interpret our staying at $500 million as an easing?

MR. KOHN. I think if you get to $500 million [on borrowing] federal funds would trade noticeably below where they have traded over the last intermeeting period. They averaged 9.83 or 9.84 percent over the last intermeeting period.

MR. ANGELL. But then, Mr. Chairman, let me ask you another question. Do you believe that under a symmetric directive, if the aggregates do not come back, that you would not hesitate to have a conference call or to act?

CHAIRMAN GREENSPAN. That's correct.

MR. ANGELL. Okay; on that basis I agree.

MR. JOHNSON. I have a technical question, though, that I need to ask as a follow up on what you said. Going back to the open market operations report and looking at the borrowing, we've been operating under a $500 million [borrowing assumption] for a while and borrowings actually have been running close to $600 million since mid-April. Is that right?

MR. KOHN. They were--

MR. JOHNSON. The weekly averages here are $612, $612, $582, and $581 million. What I'm saying is: If we didn't concern ourselves with the borrowing target then, why should we be concerned about it now? We ran at $500 million and didn't worry about it [coming in higher].

MR. ANGELL. What is this new deal you're introducing?

MR. JOHNSON. All right. Just for the record I wanted to make it known.

CHAIRMAN GREENSPAN. Let the record show. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I seem to be the only one around the table who is forecasting a stronger economy over the forecast horizon. But I think that things are sufficiently uncertain at the moment that we ought to stay where we are. For that reason I would opt for alternative B, which I too interpret as no change. But I do feel fairly strongly that we would be sending the wrong signal to the market if we went with a symmetric directive. If the economy is in fact at the point where we have been working to get it, then we ought not to move from our position prematurely. And I think a symmetric directive would send that kind of signal to the markets. So, I would much prefer to keep these--

CHAIRMAN GREENSPAN. It's not published for six weeks.

MR. FORRESTAL. Right. I understand, but still I think it might have that effect. We need to underline our commitment even in the future to price stability and I think that's what the asymmetric directive has done and will do even six weeks from now.

CHAIRMAN GREENSPAN. The other thing I would say on that is that the markets look at the forward position in the federal funds futures market or the position in the Treasury bill market, for example; yet the implicit funds rate that the Treasury bill rate is in fact indicating for 90 days from now is something like 9.3 percent. In other words, what I'm saying is that if we were to stay where we are, symmetric, that is actually tighter than I think the markets perceive us to be going, at least as I read the various--

MR. JOHNSON. That's what the markets say.

MR. FORRESTAL. Well, I guess what I'm basically concerned about is that we not move from the position of restraint that we have had. If we have had some success I think we ought not to back off from that on the basis of some data that really have not been confirmed. The data are fairly recent.

CHAIRMAN GREENSPAN. It's a question of interpretation. If we moved toward ease and backed off, frankly, I think that would be most premature and probably very counterproductive. I'm not sure what is happening in the market is read that way. If we move that's a different issue. But I don't disagree with the concern that you have. I must say "hear, hear." President Keehn.

MR. KEEHN. Mr. Chairman, I'd agree with your analysis of the situation very, very closely. I would support your recommendation without change. It seems to me that it would be appropriate to maintain [the current] policy under alternative B and that this is a time that we could shift toward the symmetric language.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I would agree with your recommendation with regard to Bluebook alternative B, but I would very much favor retaining the asymmetric language for the simple reason that I think we ought to impress on the markets our longer-term resolve with regard to inflation. I think symmetric language could be, and probably would be, misinterpreted. I'm afraid that if we went to symmetric language they would think we have a greater tolerance of current rates of inflation than I think we really do. I just don't like the message it communicates at this point.

CHAIRMAN GREENSPAN. Governor Heller.

MR. HELLER. I'm a little confused about what current restraint means. Does it mean the fed funds rate or does it mean the money growth that is currently underway or does it mean the borrowing, which it has been suggested should be revised upward? I favor alternative B if it means keeping the fed funds rate at about 9-3/4 percent, with symmetric language. I would not throw in the $100 million more [on borrowing] if it could possibly be interpreted as meaning a move up in the fed funds rate.

CHAIRMAN GREENSPAN. We don't publish that.

MR. HELLER. No, but I mean if it could be interpreted by the Desk as leaning toward restraint. Mr. Chairman, you indicated earlier in your remarks that this was the time to watch the Ms carefully. You also said that you didn't want to change the order [in the directive]; but if the order means anything, then I think this is the time to give the aggregates a little more prominence, maybe.

CHAIRMAN GREENSPAN. Well, we can do it; and we can do it in the order in the directive itself. What do we knock out if we move the order? What's the--

MR. HELLER. It goes: inflation, then expansion, then the Ms.

CHAIRMAN GREENSPAN. Surely we don't want to move it in front of inflationary pressures.

MR. HELLER. How about adding--

MR. ANGELL. Intervention.

MR. HELLER. How about adding "and in particular the behavior of the monetary aggregates"?

CHAIRMAN GREENSPAN. That puts it number one.

MR. HELLER. Well, but you keep the order and then give it some additional emphasis.

CHAIRMAN GREENSPAN. Would it be satisfactory to you if we put something about the interest of the Committee in monitoring the aggregates in the language prior to the directive ?

MR. HELLER. Sure.

CHAIRMAN GREENSPAN. I think that's probably the same thing.

MR. HELLER. But that doesn't get published, right?

MR. KOHN. Yes, we publish the Policy Record.

MR. HELLER. Oh, that. Okay.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I find your suggestion, Mr. Chairman, eminently sensible. It reflects what's going on in the economy. And I think the timing on moving to a symmetrical directive is just right. I think our success to date has been that we have stayed ahead of the risk curve. When the risks were heavily on the side of inflation we moved in a series of small steps. And I think staying ahead of the risk curve at this point does mean taking that small step to symmetry; it's quite consistent with what we've done over the past year.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman: "B;" $600 million; symmetry.

CHAIRMAN GREENSPAN. Period. President Syron.

MR. SYRON. Mr. Chairman, I have a lot of sympathy for your view of staying where we are. The problem we seem to be having is defining just where we are. I think policy has been pretty successful. Where I am, to try to use Governor LaWare's approach, is: "B;" $600 million; but asymmetrical.

CHAIRMAN GREENSPAN. Asymmetrical in which direction?

MR. SYRON. The way it has been. I would keep it the way it has been, but I think to some extent that asymmetry is muted by moving up the emphasis on the Ms within the directive, because people know what has been happening to the Ms.

CHAIRMAN GREENSPAN. Well, I'm hard pressed to find the difference between where I stand and where you stand.

MR. SYRON. My only point is that I would leave the language on the "mights" and "woulds" the same.

CHAIRMAN GREENSPAN. I understand what you're saying. But you would put language [unintelligible] with respect to the Ms.

MR. SYRON. On the Ms.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I'm for no change and, again, I'm trying to figure out what that is. To me it's either "B" with $500 million borrowing or something between "A" and "B" anyway, with symmetric language. The main reason I feel this way is that, as I read the economic statistics for the last couple of months, I think there are growing signs of some sluggishness or slowing, particularly in housing and auto sales. The first-quarter figures for real GNP are expected to be revised downward, according to the staff's briefing yesterday. The second-quarter [growth rate] is expected to be coming in below 2 percent, which I don't view as particularly strong. Also, we've done quite a bit of tightening over the past year or so but I don't think the tightening moves--particularly those taken at the beginning of this year--have been completely felt by the real economy. I think there's some chance that fiscal policy is going to move at least modestly in the direction of restraint. As for the monetary aggregates, Don Kohn yesterday told me that I can start paying attention to them, so I'm going to; and I think they look sort of weak, both currently and looking forward, based on their growth from the fourth quarter of 1988 to date. Also, I haven't heard a lot of discussion of it, but I'm very impressed with the terrifically strong dollar--the fact that it's at its highest in over two years. I'd like to see some manufacturing survive in this country and, therefore, I would hope that we don't do anything ourselves to make [the dollar] still stronger. Thank you.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I would favor "B;" $600 million; symmetrical language with "slightly" and "might." I'm not really worried about abandoning that asymmetrical directive because by the time it comes out it will be after our July meeting and you will have testified before the two Congressional Committees. The market, I hope, has the wisdom to look back and [recognize that] when we removed the tilt [the outlook] was very uncertain and that tilt was justifiably removed at that time. It may subsequently have been reversed by whatever actions we take, but I think that a rational market observer--and there are a number of them--would think that was the logical thing for us to have done.

MR. SYRON. Excuse me, a point of information: Are you suggesting "slightly" and "might" on the second part or "somewhat/would" and "slightly/might" in terms of symmetry?

MR. BLACK. I was suggesting "slightly/might" on both of them.

MR. SYRON. "Slightly/might" on both?

MR. BLACK. Yes. That predisposes us not to move unless we have some evidence that we don't now have. It's a stronger vote to remain where we are than "somewhat" and "would," I think. We may be getting into minutia here but--

CHAIRMAN GREENSPAN. I wish policy were that--

MR. BLACK. If I were voting I would [accept] "somewhat" and "would;" I even toyed with the idea of "somewhat" and "might" and other permutations and combinations of that.

MR. SYRON. "Slightly/would," I suppose.

MR. BLACK. That's possible, too, but I thought that would drive Don and his associates crazy.

MR. LAWARE. That's really symmetric.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I strongly support your suggestion. In the light of the surprisingly weakening economy that we see now, I think that is eminently called for. On the borrowings, Governor Johnson noted that we've been running pretty much at $565 million for some time now, so I could support either $500 million with leeway up $65 million or $600 million with leeway down $35 million.

MR. BOEHNE. You're really broad minded!

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I support your basic recommendation, Mr. Chairman. It seems to me that this is a good time to go to the symmetric language, both to recognize the change that has occurred in the circumstances but also because I have a hunch that--as a practical matter both for our own internal purposes and from the perspective of market participants--the nuances involved in asymmetry and so forth are not likely to matter a lot. People know the general structure of this directive and they know that they're looking at the same incoming information we're looking at. They know pretty much where we are.

And I think this is a good time simply to remove the asymmetry and let the evidence tell the tale.

CHAIRMAN GREENSPAN. I think it's possible to remove the asymmetry and put it back without danger. I don't think it's possible to ease and then tighten without danger.

MR. ANGELL. Well, Mr. Chairman, we did in January of '88.

MR. JOHNSON. '87.

CHAIRMAN GREENSPAN. No, I think that's correct.

MR. JOHNSON. Oh, '88.

CHAIRMAN GREENSPAN. Well, we didn't really start to tighten at that particular point; that was the beginning. But it's [unintelligible].

MR. ANGELL. I think the markets don't have to worry that one move is necessarily a great--

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. "B;" $600 million; symmetric. I wouldn't dare try to add to the nuances of this.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. This is tough one. I looked back before I came to the meeting; since December, I think, I've been expressing my concern about the aggregates. What I am struck by at this meeting is this sudden shift in the outlook and perceived risks and so forth that even 6 or 8 weeks ago didn't seem to be very apparent. And what I worry about is that if we wait to see signs of recession, given the lags in the impact of monetary policy, it's basically going to be too late. In terms of money, we've talked a lot about the short-term aberrations; but we're really looking at a pattern of monetary restraint that has been very tight for a long period of time. Certainly, the technical aberrations may add to that somewhat; but I don't suspect that's the whole issue. To sit here hoping for a bounceback--I don't know. That to me sort of smacks of looking at current indicators and making the judgment; and I think ultimately we're going to get trapped.

Now, I continue to think that the major problem we face is inflation. But I don't think it's going to be any easier to deal with if we destabilize the economy through a monetary policy that's too tight. In fact, I think the response will be such in terms of monetary growth that it will make the long-term problem even tougher. I don't believe in strictly targeting monetary aggregates but I do think in the extreme we've got to observe them, in some sense. And I think we're at an extreme at this time. So, where I come out is that I would favor slightly less pressure on reserve positions. In other words, I wouldn't move all the way to "A" but I'd be willing to let, say, 25 basis points show through here. I think that's really quite consistent with the approach we've taken to policy. We haven't been taking a big risk approach such as "We're going to wait until we're sure that we're at an inflection point and, boom, move it 100 basis points, or whatever." We have been gradually adjusting. I think the risks of recession as they relate to the inflation problem are really quite significant; and I think we ought to be moving earlier to try to get those aggregates growing again. In terms of market expectations, there's no question that there are risks involved if we move slightly in one direction and then have to reverse. That could create some confusion. But I think we ought to put some weight on the long-term monetary targeting procedure that we go through each year; we could point out that we're falling below the range and we're taking some action to try to get in the lower end, but we intend to run money for a long period of time near the lower end to contain inflationary pressures. So, I think it's doable. I wouldn't view a move like this as an irreversible move that somehow says: "That's it; we've thrown in the towel on inflation." I personally think we could deal with that.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. I have some sympathy for what Tom is saying. However, I certainly support the Chairman's view for symmetric language. My concern is also: Exactly what does no change in policy mean and what do we really mean by symmetry? But I basically support "B." Again, I'm not hung up on the borrowing number whatsoever. I would define "B" as a 6-3/4 percent funds rate--I mean 9-3/4; I hope that's not a Freudian slip--a 9-3/4 percent funds rate and I would like to be more clearly focused on centering it there rather than letting it edge towards the upper end of that. I am concerned about this neutrality issue; if bill rates and other short-term interest rates stay down over the intermeeting period and don't show a tendency to bounce back toward the funds rate, I certainly would think that trying to remain neutral would imply bringing the funds rate more in line with those rates. I would like to think that symmetric language would mean that the Chairman would have the discretion during the intermeeting period to make some adjustments there. I certainly think that that fits into a symmetric and neutral policy. But for the purposes of listing my position it would be: "B;" 6-3/4--rather 9-3/4 percent; and symmetric. I wrote that 6-3/4 percent down for some reason!

CHAIRMAN GREENSPAN. It is Freudian. President Hoskins.

MR. HOSKINS. I don't think I can contribute much to what has been said here already other than to say that the long-term objective ought to remain consistent, and that is to bring down the rate of inflation. The reason I gave Mike Prell's staff credit for putting the notion that we might have a recession into the Greenbook is that if we don't walk up and take a look at one we'll end up always having higher rates of inflation than we anticipated and, therefore, less output and employment than we expect. Given the way we operate policy, I think we have to be prepared to face the possibility that we could slip, at least for a short period of time, into a contraction. Having said all that, I am uncomfortable suggesting that we ought to ease at all. I did dissent on the long-term target; I wanted it centered around 2 to 3 percent. We're slightly below that right now. Don Kohn assures me, however, that we'll be back on target shortly. In fact, if we are, we probably won't have to tighten policy down the road. So, my view would be to accept "B." I don't feel strongly about the language because I don't think the market will misinterpret it. The Humphrey-Hawkins report will be in front of them when that language comes out; I don't know what we're going to want to say at that point in time. My bias would be to leave it asymmetric as we have been doing.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, I would agree with "B" and the $600 million. My preference really would be to remain asymmetric or "as-symmetric," as Mr. Syron says. The [weak] money growth is troublesome; but the forecast is for some rebound and if that holds true, that's fine. But it seems to me that more or less what I'm hearing is the commitment for a conference call before the next meeting, which gives the opportunity to make any slight adjustment if that's wrong. But I would still lean toward "B," asymmetric.

CHAIRMAN GREENSPAN. As best I can judge, the critical mass is for "B," symmetric. That is $600 million borrowing but, listening to enough of the people here, I think the Desk is going to have to be sensitive to the issue of whether in fact $600 million really will represent what is essentially a no-change environment. We will try to be cautious on that question.

MR. HELLER. Mr. Chairman, why don't we change it to $550 million?

CHAIRMAN GREENSPAN. Well, because that starts to get to a degree of fine tuning about what these numbers represent, which I think we shouldn't do. I think the numbers should be--

MR. HELLER. I think the Committee's exactly down the middle.

VICE CHAIRMAN CORRIGAN. I'm not sure about that, because I have a potential real problem here.

MS. SEGER. With $600 million?

VICE CHAIRMAN CORRIGAN. No. My definition of unchanged policy from a market perspective is that the market views that policy as the funds rate in the 9-3/4 to 9-7/8 percent area.

CHAIRMAN GREENSPAN. But that's what the $600--

VICE CHAIRMAN CORRIGAN. Yes, but there has been some effort to try to define that at 9-3/4 percent. I promised not to get into the semantics of this but at that point it's more than semantics to me.

CHAIRMAN GREENSPAN. The issue is "unchanged." Basically, the funds rate has averaged 9-3/4 to 9-7/8 percent and there's a technical question as to whether or not the borrowing target that effectively created that was $600 million or slightly less.

VICE CHAIRMAN CORRIGAN. That I can--

CHAIRMAN GREENSPAN. That is what I'm arguing for.

VICE CHAIRMAN CORRIGAN. That can be dealt with and finessed. But that's not--okay.

CHAIRMAN GREENSPAN. That's all I'm saying. I would propose that halfway through the period, or if the data or any other evidence suggest it sooner, we schedule a call. If nothing has changed significantly, the basic purpose of that call will be to review what it is that we all see in the outlook and try to find out whether there's any alteration of the view of this Committee. I think we are in a very sensitive period at this point and we have to be more than attentive to specific evidence that begins to emerge in various areas to see if we can catch any evidence of deviation from what appears at this moment to be a reasonably good path. Yes sir, [Mr. Guffey].

MR. GUFFEY. Just a point of clarification: Is it implied from what you just stated that there will be no change in policy absent a telephone call?

CHAIRMAN GREENSPAN. Correct.

MR. ANGELL. "Somewhat/would."

MR. SYRON. "Somewhat/would."

CHAIRMAN GREENSPAN. "Somewhat/would"?

MR. ANGELL. It seems to me we have never used "slightly" with symmetric [language].

MR. GUFFEY. "Somewhat/might."

MR. ANGELL. So, I suggest that we not introduce that nuance. Let's stay "somewhat/would" balanced.

CHAIRMAN GREENSPAN. Anybody object to that?

MR. BERNARD. It would read: In the implementation of policy for the immediate future the Committee seeks to maintain the existing degree of pressure on reserve positions. Taking account of indications of inflationary pressures, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, somewhat greater reserve restraint or somewhat lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from March to June at annual rates of about--

MR. KOHN. 1-1/2 and 4.

CHAIRMAN GREENSPAN. 1-1/2 and 4.

MR. BERNARD. --1-1/2 and 4 percent, respectively. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of--

CHAIRMAN GREENSPAN. 8 to 12.

MR. BERNARD. --8 to 12 percent.

VICE CHAIRMAN CORRIGAN. 6 to 12 percent.

MR. HELLER. [Unintelligible.]

CHAIRMAN GREENSPAN. Call the role.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Guffey	Yes
Governor Heller	Yes
Governor Johnson	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
President Melzer	No
Governor Seger	Yes
President Syron	Yes

CHAIRMAN GREENSPAN. Our next meeting is on July 5 and 6.

END OF MEETING