

Meeting of the Federal Open Market Committee

May 15, 1990

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 15, 1990, at 2:00 p.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Boykin
Mr. Hoskins
Mr. Johnson
Mr. Kelley
Mr. LaWare
Ms. Seger
Mr. Stern

Messrs. Black, Forrestal, Keehn, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. J. Davis, R. Davis, Lang, Lindsey, Promisel, Rolnick, Siegman, Simpson, and Stockton, 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. Keleher, Assistant to Governor Johnson, Office of
Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and
Statistics, Board of Governors
Mr. Slifman, Associate Director, Division of Research
and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of
Monetary Affairs, Board of Governors

Messrs. Balbach, Beebe, Broaddus, T. Davis, Ms. Munnell,
Mr. Scheld, and Ms. Tschinkel, Senior Vice Presidents,
Federal Reserve Banks of St. Louis, San Francisco,
Richmond, Kansas City, Boston, Chicago, and Atlanta,
respectively

Mr. Cox, Vice President, Federal Reserve Bank of Dallas

Mr. Guentner, Assistant Vice President, Federal Reserve
Bank of New York

Transcript of Federal Open Market Committee Meeting of
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CHAIRMAN GREENSPAN. Will someone move approval of the minutes of the March 27th meeting?

MS. SEGER. I'll move them.

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Cross, would you bring us up to date on Desk operations?

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

CHAIRMAN GREENSPAN. Questions for Mr. Cross? If there are no questions, would somebody like to move the ratification of his transactions since the last meeting?

VICE CHAIRMAN CORRIGAN. So moved.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Sternlight.

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

CHAIRMAN GREENSPAN. Are there any questions for Mr. Sternlight?

MR. HOSKINS. Peter, in March I asked about collateral to back the Federal Reserve notes. You thought there might be a problem in May, but I guess the Treasury balance situation solved that. Or do you see a problem coming up soon?

MR. STERNLIGHT. We had thought that there could be a problem in May. Our subsequent reviews suggest that it doesn't look as tight for the balance of this year as we had thought a month ago. That's not to say that the problem may not still be there; but it's not going to be as severe for the rest of this year as I might have thought some 6 or 8 weeks ago.

MR. BOEHNE. The change in sentiment in the market was an extraordinary swing in mood. Yet I found that in the previous couple of months or so the national statistics that we were getting didn't seem to coincide with what I was hearing from the business community. The current numbers seem to me to be more consistent with what I hear from the business community. My question is: Is the marketplace so dependent on these published statistics or is it also relying some on the kinds of ad hoc information that it gets from the business community generally? What a difference one number made! It just struck me as extraordinary.

MR. STERNLIGHT. There was an enormous change in sentiment just about the time of that one set of employment numbers in early May. I think more went into it than just that number. It wasn't just any single number; it was the unemployment rate as well as the flat

report on nonfarm payrolls and information that looked more comforting on employment cost measures all wrapped up together in that.

MR. KOHN. Part of the issue is what they think the Committee is looking at, President Boehne. They are trying to guess what the Fed is going to do and they think that the Committee pays a lot of attention to those numbers.

MR. PRELL. To add another two cents worth: My own impression from talking to people who are with dealer firms and looking for some insight into what the business community is saying is that the traders and even the economists in many of these firms don't have all that much exposure to anecdotal evidence directly from the business community. I have been disappointed regarding the paucity of such information, at least among economists in banks and industrial firms.

CHAIRMAN GREENSPAN. Further questions? If not, would somebody like to move approval of the actions of the Desk?

MR. LAWARE. I'll move it.

MR. JOHNSON. Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Prell.

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

CHAIRMAN GREENSPAN. [Pause.] There must be questions!

MR. BOEHNE. I have a couple of questions. On page 4 in the Greenbook, you have laid out the monetary policy assumptions about bringing inflation down over the next couple of years. We have an environment in which there is not very much support--certainly no national support--for this kind of firming in monetary policy, as best I can tell. But even besides that, going all the way out to the end of 1991 we have a 6-1/4 percent unemployment rate and then that slack continues into 1992. You don't indicate what the unemployment rate is in 1992. I presume it goes up another half point or three-quarters of a point?

MR. PRELL. No, we're thinking it's within a small fraction of 6-1/4 percent.

MR. BOEHNE. But even after we have done all of that [firming], we have not done much more than keep inflation from accelerating, at least in terms of the numbers that you have. There is some deceleration, but inflation is still largely in the 4 to 5 percent area that we have been talking about. Now, presumably, if you carry this [forecast] out to '93, '94, and '95, you begin to get some results. But to me that calls into question the whole logic behind this approach that we can gradually squeeze inflation out, as desirable as that goal is. Somehow this paragraph brought home (1) the difficulty of it, and (2) how unreasonable it may be even to think that we can pursue something like this in the kind of world that we live in. I don't know if that's a question or a comment, but I guess I'd like you to disagree with me.

My second question has to do with this credit crunch phenomenon. We've all looked into it; we've put together these anecdotal reports, and every report suggests that there's less of a credit crunch than is talked about popularly in the general press. I'm just wondering if you have any insights as to why we have this dichotomy between what is said loosely and what we find when we try to zero in on the extent of it. It doesn't seem to be the same problem that is often reported.

MR. PRELL. Well, on the latter question, I'll offer a little anecdotal information on anecdotes. I'll repeat one conversation I had with Bill Dunkelberg, who conducts the survey for the National Federation of Independent Business. That survey has shown very mild, if any, changes in the credit picture for that constituency. He related to me that he had been contacted by The Wall Street Journal before they published their lead story on the credit crunch and he had told them that. If you look at that story, he wasn't quoted. The reporter obviously thought it would be better to discuss the negative news than what Dunkelberg's survey suggested. That isn't to say the Dunkelberg survey is absolutely reliable. But I think one finds that sort of bad news orientation in the press reports. One also needs to look carefully at the geographic detail and the sectoral detail that is being addressed. Everything we have seen suggests that in the real estate area, particularly the construction side of the market as opposed to permanent financing of residential real estate, there has been a substantial change in the tenor of credit conditions. And I don't see any conflict with the anecdotal information in that area. As for small businesses, the senior loan officers opinion survey does suggest that there has been some tightening. It hasn't been just recently; it has been going on for the last year or so perhaps. And it's affecting small and medium size businesses, particularly in [unintelligible]. It isn't showing up in rates; it isn't showing up as businesses not having any access to credit, at least not in terms of figures [unintelligible] cut back existing customers; but it's showing up in the standards that are being applied and the collateral that is being used. The question is: What does that all amount to in the end? In terms of GNP we think that the only significant effects are going to be in the construction area. We would have had a marked weakening anyway in that sector, particularly in the commercial area, because of the overbuilding.

On the inflation front, I don't want to repeat the entire presentation that we gave a few months ago, but this is basically consistent with that. In fact, I'd say this could be regarded as a relatively favorable short-run sort of Phillips curve trade-off. We are getting a lot of disinflation for what we perceive to be the gap relative to the natural rate. It does presume that history is telling us that we can get there gradually, but the effects are not linear. In a sense, you have to get sharp absolute declines in activity in order to get these effects, but we can do it gradually over a period of time. I don't think we have historical episodes to go back to and say "Yes, we had periods where the economy moved slowly, the unemployment rate was perhaps slightly above the full-employment rate, and we got a gradual diminution of the rate of inflation." But the evidence that exists suggests that we ought to be able to get some progress over time. As I hinted here and said in my briefing, we'd like people to perceive that it's headed in that direction and that the Fed is persisting--accepting whatever slack there is, presumably

leading to some rise in the unemployment rate to 6, 6-1/4 percent. Frankly, people thought that was looking pretty good coming from where we were. Maybe we will get to see some of that developing and the tradeoff will look better.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. Did the recent numbers change your outlook any? I gather that you put a lot of this together before the most recent numbers.

MR. PRELL. The employment numbers led us to show a weaker second quarter than we might have otherwise. We didn't feel comfortable pushing the numbers much further than this. I must say that there certainly are arguments--looking at what's going on in the automobile sector--for a larger second-quarter number. But this is something we feel comfortable with.

MR. JOHNSON. The other question was on the budget. You implied that strong action on the budget would restrict the economy. Is that assuming that what goes with it is a drop in real interest rates? I just wonder: Wouldn't that be a source of stimulus to some degree too? How are you coming to this restraint view?

MR. PRELL. Well, this is a complicated question, obviously. Part of the issue would be whether this was just a one-shot effort to hit the Gramm-Rudman target for this coming fiscal year or whether it was something that would dramatically change the outlook for the next series of years and greatly change expectations. When you open up that latter door you're somewhat at sea in terms of an econometric model. One can come up with rather interesting results with that, such as long-term rates going down appreciably in anticipation of less pressure on credit markets throughout the coming years. But if that opened the door to a great deal of investment activity and it happened very quickly, we could even in the extreme get a net increase in aggregate demand in the short run; and short rates might even have to rise some in response to that to keep things on a desirable path. Falling short of that, if the Federal Reserve is accommodative in terms of trying to hold real GNP close to the path it would otherwise have been on, I think the fiscal shock has to be one that tends to lower interest rates. The degree would depend in part on how much forward expectation there was and how much bond yields move as well as short-term rates.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mike, if you pursued a gradual reduction in the rate of inflation, it's quite likely, isn't it, that the noise may at times obscure any trend of progress? That's more apt to happen in a gradual reduction approach than if there were a significant recession.

MR. PRELL. Well, in addition to that--

MR. ANGELL. So, even though in some ways this may not give the Committee a sense of a lot of achievement, you think it would be different than that if we did not pursue this course?

MR. PRELL. Correct. Our suspicion is that if you hold to the current money market conditions, economic activity will gradually pick up. You will not see the unemployment rate rise much, if at all, over the coming year or so. And since we believe that right now the pressures are such that the tendencies for inflation point up, we would make a new course and head in that direction. So, instead of heading south to 4 percent a couple of years from now, we feel the risk is that inflation would be heading north to 5 percent. That's a significant difference and I'd hate to make it more precise than that. But as we've said, we felt there was noise affecting the reading of the trends [unintelligible] a variety of special factors: the surprising strength of the dollar earlier in the year and so on. It's always difficult to read these [unintelligible]. So, that's the basic thrust of our assessment at this point.

MR. ANGELL. Well, I appreciate very much your laying out the policy options for us that you have.

MR. PARRY. My point was somewhat similar to Governor Angell's. The sentence on page I-3 [of the Greenbook] says: "The recent data reinforced the view long embodied in the staff forecast that restoration of a disinflationary trend is unlikely at current levels of resource utilization." The implication is that if we stay where we are for a very long time, there is only a very small chance of restoring the disinflationary trend and, in fact, it might even produce an increase in inflationary pressures. That's the implication.

MR. PRELL. That's what we are saying. Now, there's a second part to this and that is: Will the Federal Reserve obviously let financial conditions go, maintaining the historic growth path of resource utilization numbers where they are? And that's the second projection. One is the implication of the resource utilization level; the second is about what financial conditions are compatible with resource utilization levels. I guess I'd say I'm a little less sure about the second than I am about the first and there's a good deal of uncertainty on the first.

MR. PARRY. One gets the general feeling, though, that the public feels that if we were to stay where we are we would have a continuation of growth rates of around 2 percent and a gradual [reduction of inflation]. What you're basically saying is that if we stay where we are, growth rates are likely to pick up and we will not be able to restore [unintelligible].

MR. PRELL. My sense of the consensus of business economists is that the economy probably is going to run with 2, 2-1/2 percent growth going out the next year to 18 months and inflation is going to remain roughly in the 4-1/2, 4-3/4, 5 percent zone.

MR. PARRY. But they would not be assuming much in the way of interest rate pressures?

MR. PRELL. No. My sense is that they probably are expecting very little [change in] inflation, maybe some slowdown--

MR. PARRY. That's my point.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. I have two questions, Mike. One has to do with an earlier period--1988 and early 1989--when we raised the funds rate 300 basis points, I think. I'd like you to contrast how you view that tradeoff now. We raised interest rates a lot and not a lot happened. You have built into your forecast an increase of 125 basis points or so and are expecting to get some bang for that at the end of 1991. I'd like you to compare those two periods if you can.

MR. PRELL. Let me just go back to a factual matter. What we have built in here is a rise in the funds rate of about 200 basis points but then we have it coming off [some] in the latter half of next year as pressures begin to abate.

MR. HOSKINS. Okay, that narrows the tradeoff down a little. The point I'm making here is that we acted fairly aggressively at one point in time and did not get much, as viewed by some people, in terms of [lower inflation] rates. We did not necessarily get disastrous results either in terms of slowing growth, but also we didn't gain a lot. We kept the inflation rate roughly where it was. I guess it could have gotten a lot worse had we not done something. I don't know if you see any difference between those two periods that would enlighten us now--perhaps not. The second question has to do with the deficit issue. If you argue that we could get some benefit from a lower deficit in the future, and if you've revised your 1990 deficit up, then couldn't you argue that we might need to tighten to take account of that now instead of in the future?

MR. PRELL. Well, a large part of that revision is RTC-related and we don't think that's a real--

MR. HOSKINS. It's not real debt!

MR. PRELL. Our measure of this shows a shade less restraint in the current fiscal year than it did previously and that's mainly a reflection of our reading of the information on what occurs on the tax side. It does look like tax revenues are running a bit weaker than we had anticipated. What seems to have come out of tax reform, reading a lot into the 1989 experience, is that revenue falls a bit relative to what we previously had anticipated in our forecast. So, we do have a little less restraint but it's a marginal difference, although that's [unintelligible] factor. Looking back at the 1988-1989 experience, there are many things that are different; and one has to make very difficult judgments about the timing of various effects. At that point we were coming off a dollar depreciation that was causing considerable improvement in our export growth. Exports were growing much more strongly than they are now. That probably worked against that restraint. We didn't have, perhaps, quite the debacle we think we have now on the construction side, though office building has been going down significantly for a while now and it wasn't at that point. Perhaps we are closer to demographic requirements in housing construction [unintelligible] some cushion here on interest rate effects. The levels are somewhat different. I think there are parallels in the two periods, but there are differences; and I have a very hard time drawing a particular lesson. Our sense is, as you said, that we did contain the rate of inflation. Whether that slowing in the economy and leveling of the unemployment rate that occurred was

attributable to the rise in interest rates or to interest rates and other factors is difficult to say.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I hate to sound like Ginny Dimwit today, but would you walk me through one more time the sectors that in the next two to four quarters would be taking off, or would be much stronger, with a status quo monetary policy? In other words, exactly which sectors are the ones that we have to restrain? I'm having a problem finding such sectors out there.

MR. PRELL. I wasn't trying to characterize the current money market conditions alternative as one which led to a take off, but merely a gravitation back to the recent trend of potential output--a sort of natural tendency in the economy in any event unless there are countervailing forces. But in the short run we think that we could do a little better due to some pickup in inventory accumulation relative to the significant swing we have seen in a negative direction in inventories. And without that, the final demands in the economy should show through ultimately to output growth. If we didn't get the rise in interest rates, we would have in our forecast a stronger housing sector than we have. If we didn't have the restraint, we would expect investment to be stronger. So, if we start removing the restraint, the interest sensitive sectors would look a bit stronger across the board and we'd probably add on top of that some leaning toward a moderate, or higher than we have, level of inventory accumulation. And if the dollar were to be weaker than we have in there--

MS. SEGER. I would just as soon see us export more, but that's a personal bias.

MR. PRELL. Then, I'd begin looking for the fiscal policy--

MS. SEGER. Right.

MR. PRELL. That's the [unintelligible] shift.

MS. SEGER. What amount of attention are you paying, then, to the availability of credit in the housing situation? I just hear so often that it's not the price of money or the price of credit as much as it is strictly unavailability.

MR. PRELL. Well, as I suggested, the commercial real estate market may be more affected by this. We have built into this [forecast] some effect, showing the availability of credit to builders at a reduced level in the residential sector. I wouldn't say that it's large; it's not hundreds of thousands of starts in this forecast, but there is some mild effect. We think that would abate over time as builders make connections with new lenders and as lenders find ways of participating loans and some other arrangements. Over the next year or so we think we probably will see some abatement of these problems.

MS. SEGER. Thank you. I hope you're right.

CHAIRMAN GREENSPAN. Further questions for Mr. Prell?

MR. SYRON. Mike, just a technical question: The inventory situation seems to be depending on how one looks at it. Are we going through any sort of structural change over time? How much weight would you put on structural change toward just-in-time inventories and that sort of thing? Or are you thinking it's still a pretty accurate reflector of [unintelligible]? My own view of inventories is that we're likely to see a bounceback. But do you think there's an argument against that and that [businesses are moving to] permanently lower levels of inventories?

MR. PRELL. My judgment at this time is that I don't see inventories as an impediment to the growth of production. I'm not inclined to read it as a really strong bullish factor, in part for the reason that you suggested. I think there's still some effort, particularly in manufacturing but in other sectors too, to decrease inventories in relation to order/shipment ratios. And we view this as still having some way to go. An industry economist at a meeting I attended recently said: "Boy, these numbers look great; but my boss thinks these inventories are still too high." So, I think the target, in effect, is continuing to drift downward. That was one of the reasons why in the past year when we saw manufacturing inventory/sales ratios essentially just level out we didn't move up [our forecast] very much. I thought that was a concern and would likely lead to some effort to restrain inventories. And I think as [it turns out] that's the pattern we've seen. I think we're in much better shape now; but still, my enthusiasm for thinking we're on the verge of a boom is [unintelligible].

CHAIRMAN GREENSPAN. Actually, they are leaner than I think the numbers show because our conventional measure is inventories over domestic sales, whatever they are. But [unintelligible] the proportion of the inventories of imported goods. While one can't say that excess inventories of imported goods will have no effect on domestic production but only an effect on production at foreign facilities, there is an element of truth in [the latter]. So the estimates that we're making for wholesale and retail trade inventories, for example, have a rise in the ratio of imports to total, all at factory gate values, from 20 percent in 1980 to 25 percent now. Assuming you also have the data for manufacturing, if you make the adjustments to have some form of weighing toward imports and take them out or put final sales in or total imports in, the inventory/sales ratios are much lower [now] than they were on an historical basis. So, they are already pretty far down. But, as Mike says, when you speak to purchasing managers they still have a way to go because they still think that there is significant improvement yet [to be achieved] in the quality of production. So, if the reject rate can go down, which means they can bring the safety stocks back [down], well, it's really quite an extraordinary change.

MR. JOHNSON. Could this trend also be in addition to the improved efficiency? That would be a good sign on the inflation expectations side. It could imply that the real cost to carry is pretty high and that there's no speculative inventory built in. That would be consistent with--

CHAIRMAN GREENSPAN. Well, if you look at the lead times, the April lead-time numbers were the lowest in I don't know how many years. For production materials they're at the bottom of the chart.

MR. PRELL. That would suggest the need to stock up in order to have supplies, so that's the argument against the big boom. With the firming of materials prices in [unintelligible] sector, the carrying cost might not look quite as formidable as it did months ago, but it's still substantial.

CHAIRMAN GREENSPAN. The other issue is that there is increasing access to foreign facilities for materials, so that lead times don't have to be bunched up every time there is a contraction in excess domestic capacity. And it was the contraction in excess domestic capacity that used to trigger the lead time stretch-outs in inventory accumulation and [thus a] crash. At the moment one rather positive aspect of the big share of imports to domestic demand in this country is that it implies that we have access to facilities all over the world. That really makes a difference. Any further questions for Mr. Prell? If not, who would like to start our tour de table? Bob.

MR. BOYKIN. Mr. Chairman, it's not too often that anecdotal and statistical information seem to be pointing in the same direction, but in our case for the first time in over two years they are beginning to match. In contrast to previous reports that I've been giving, where District performance had been marked with some strong and some very weak sectors, there is now improvement and it's more broadly based. District manufacturing continues to outperform the nation. We had increases in manufacturing employment in the fourth quarter of 1989 and the first quarter of 1990 while it was declining nationally. In wholesale and retail trade, District employment increased at about a 4-1/2 percent rate in the first quarter. Employment in the services sector is still growing at a healthy rate, with particularly strong gains in the areas of finance, insurance, and real estate. In the energy sector, all field activities continue to improve; as for the long-term outlook, there is considerable optimism for continued improvement. District construction activity has been strong recently, though it's likely to slow some from its current pace of nearly 10 percent. Recent rains have improved the outlook for agriculture except, of course, in those areas where we've had some very, very severe flooding, which I'm sure you've seen on the news.

Our bottom line is that we do appear to be coming out of what we call our great recession in the District, and the improvement and growth seem to be widespread. Also, I think it's becoming quite evident that our economy is much more diversified. Having said that, I'm inclined to conclude that we may be getting away from the historical boom-bust type of activity that we've had. There may be some disappointment for those who are waiting for the next boom, having gone through the bust. But I'm inclined to think that for the longer term it's going to be a much more healthy situation economically.

With respect to the national picture, we're in substantial agreement with the forecast that you have, Mike.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, we think that the more restrictive monetary policy that the staff is projecting is going to be needed if we're going to generate greater projected disinflation as appropriate. What's striking and disappointing to us is that this assumed tighter

policy is expected to produce only a small improvement in the inflation outlook, at least through 1991, but a fairly substantial reduction in GNP next year. I think most of us would agree, and indeed this was an import of the excellent memorandum distributed to us sometime back, that there are different kinds of models on this: those that are forward-looking and those that are backward-looking. I assume that most of this is based on the MPS model. If you used one that is more forward-looking, I think that would suggest a better tradeoff, with more disinflation at a smaller cost. Of course, the staff readily acknowledges this in saying that the assumed tighter monetary policy could yield a much bigger payoff if it increased our credibility. And that, of course, is a very important issue from the standpoint of our policy decision later on. I don't think most of us would be willing to argue in favor of a tighter policy if we thought the payoff on inflation was going to be quite as small as what has been projected in the Greenbook.

My own feeling is that the payoff would be larger because I think people are becoming more and more forward looking. If we can demonstrate to the public that we really have a strong commitment to [reducing] inflation, then I think perhaps we could have much better results than the staff is projecting on the inflation side. Now, we wouldn't quarrel much with the staff's near-term projections for the second and third quarters. I would guess that the near-term risks might be skewed a little toward the down side because I think there really is something to this real estate credit crunch. We hear this from too many places. We had an interesting statement by a major regional developer who is a very astute man, I think. He said that funding has virtually dried up; he cited one large city in the country where only one out of eleven major real estate developers can get any credit at all. And if that is true, of course, then it could have some early impacts and would bias the next couple of quarters to the down side.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Thank you, Mr. Chairman. The Twelfth District economy remains pretty strong despite slower growth in recent months. Employment in the West grew 3.2 percent in the past year, which is somewhat slower than the kinds of growth rates in employment that we were seeing in 1989 when they averaged 4.1 percent. All of that slowing in growth can be attributed to the state of California. California's growth in recent months has been quite similar to that of the rest of the nation but the other states are doing extraordinarily well. For example, if you look at the seven fastest growing states in the nation, all seven of them were in the Twelfth District. The outlook for western agriculture is positive overall, although this summer's harvest is unlikely to be as profitable as those in recent years. Inventories of many agricultural products are higher than they were a year ago and the acreage that has been planted in the West is high as well. Even drought-affected crops such as cotton and rice are only going to be cut about 10 percent, so we'll see a large increase in output. At the same time, costs for some farm inputs are up dramatically. In California we're in the fourth year of drought. And in California that means you irrigate in a different way. Instead of using surface water, you go to well water or ground water; and that costs a lot more money and is going to cut substantially into the profits of farmers. In a state like Idaho where they also use a lot

of irrigation, they have a shortage of water and the difficulty there is in obtaining irrigation pipe. Apparently, it costs three times as much this year--if you can get it--than it did last year. So, the agricultural situation really isn't that bad overall, but it's quite likely that agriculture won't be quite as prosperous financially as it was in the last year.

I might note parenthetically on this issue of credit availability to farmers and to small businesses that we had two banks give us some very interesting observations, and I'd be interested if others ran into the same thing. One of the large banks said that there is a substantial restriction on credit to small businesses. Another banker said there were restrictions to agriculture, but he said it wasn't related at all to what has been happening with regard to regulators' views or associated types of events. He said it's related to environmental concerns. Banks, whenever they take over collateral when there's a default on a loan, are then responsible for the environmental consequences. So his bank, for example, which is a large bank, was no longer making small business loans to any gasoline stations, dry cleaning establishments, or any farms which had in-ground gasoline or diesel tanks. And any time they were doing large projects they would have to send out an environmental appraiser as well as a value appraiser. He said this was having a very significant effect on lending. My understanding is that apparently this is such a hot button with the industry that there are a couple of Congressmen who are now in the process of introducing legislation that will rectify this situation. It's a little different wrinkle that I hadn't heard before but apparently, at least among our bankers, it's very significant.

Turning to the national economy, our outlook for the year 1990 is very similar to that of the Greenbook. We do part a bit in 1991, but it's a result of the difference in monetary policy assumptions. We don't have the federal funds rate rising as rapidly, and we get a result which actually is quite consistent with the Greenbook's results. With an increase in rates of about half of that in the Greenbook we get growth in 1991 of 2 percent and, indeed, there is no basic drop in the underlying inflation rate until 1992. Thank you.

CHAIRMAN GREENSPAN. I think we have to find a way of producing excess crude oil and just [unintelligible] into the market; that did wonders in 1986. President Syron.

MR. SYRON. Thank you, Mr. Chairman. Well, you know where the strongest growing states are; I can tell you where some of the weakest growing states are.

MS. SEGER. It isn't Massachusetts any more?

MR. SYRON. No, it's New Hampshire, actually. The economy in the region continues soft, although it's not in a steep decline. Employment fell about 1 percent in 1989. We expect it to fall by another 1 percent in 1990 and we expect the unemployment rate region-wide to go north of 6 percent. These assumptions are based on a model that was run without incorporating a national model with as much credit tightening as the Greenbook has in it. Actually, it's interesting that by state, New Hampshire is by far the softest,

followed by Massachusetts and then by Connecticut. The reason for that, I think, is that construction has turned down so much. Construction [spending] region-wide has fallen about 10 percent, but it has fallen 25 percent in New Hampshire. This is really micro data, but with it being a very important industry in southern New Hampshire particularly, and becoming almost an economic [unintelligible] in its own right like a traditional manufacturing industry, that's a swing that couldn't be avoided. There is a substantial real estate overhang in the District. Housing sales activity remains soft; housing inventory stays high. I think housing remains soft in part because people are very unrealistic in pricing. We don't seem to be getting real price adjustments. Using the ultimate in anecdotal information-- what I am doing myself, and I just sold a house--I think you can move houses but you have to sell them for about 18 to 20 percent less than the price at the peak. And people just generally aren't willing to do that. I think it's going to be slow to come back because we're at quite a regional disadvantage now in terms of wages in light of the very strong growth that we had for some period of time. And, obviously, we have serious tax problems; they are worse in Massachusetts but there are tax problems in Connecticut as well as some in New Hampshire. To some extent, in a regional sense, there was no one to take the punch bowl away and what happened was that the region just got carried away.

Going to the credit crunch issue, we think there is something there but it's very specific to small-to-mid-size businesses and to the construction area. It's hard to say that in the construction area it's because of tighter supervision [of lending institutions]; we had other problems in that area. In the aggregate data a lot has been made of the System's preliminary data saying that lending in New England is down 8 percent over last year. We actually took that data and then adjusted it for two or three different things: the large volume of loan sales by some of our large banks that are in trouble; the sale of credit card portfolios; and the writing off of some of the other real estate owned and other adjustments. All that gets the reduction down from about 7.9 percent to about 1 percent. So, credit is growing more slowly but no way near as slowly as the data indicate. Outside the computer area, where I think we have specific problems, a large number of firms report that sales, while they haven't kept up their strength, are not off dramatically either, particularly in the national market. Interestingly, our large [unintelligible] producers--and by that I mean firms such as Ratheon, General Electric and United Technologies--are anxious about the outlook and they are planning for a slowdown; but given lead times, they haven't felt much effect on production. And they have had some success in converting plants to other products. Interestingly, they find their export business and even import substitution are actually quite good. For example, United Technologies just became a preferred supplier for--I guess we call them transplants--foreign-name plants producing modulars for doors and different things like that. So, the export business is becoming more important to us, both directly and indirectly. When we talk to people around the District, we're finding that inventories are quite lean. Again, it's hard to sort out exactly, but they are quite lean at the retail level as well as at the manufacturing level.

As far as the national economy goes, we're in substantial agreement with the Greenbook. We had thought perhaps that inventories might affect us--that there was a chance for some breakout on the up

side in inventories because we think things are potentially a little stronger. We're inclined to discount the retail sales report because of the noise and just see what happens when we get the next PCE report. We're encouraged by the improvement in the PPI but it's still obviously [unintelligible] with substantial problems of inflation fourth quarter to fourth quarter. In looking ahead--and this was a question I was going to ask but it was asked by Governor Angell among others--if we assume essentially no change in monetary policy, our feeling is that an already discouraging Greenbook inflation forecast would be significantly worse with the prospect of being substantially worse. And in that context, we'd be concerned about labor compensation given some of the [upward] creep we've already seen in that area. This will be covered during our policy discussion, but it may be easier to take out an insurance policy now rather than to wait until we get into a situation where we really have to crunch significantly later on. I think it is true that credibility is important and can make it easier for us on the way down; but I'm starting to become concerned about losing credibility with inflation creeping up on us and our not having been able to change materially the direction of that. That will increase the cost of our ultimately having to deal with it, and I think we ultimately will have to deal with it. This is a speech, and I guess I should omit that.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, overall conditions in the District are pretty much unchanged from the last meeting. We seem to have stabilized at a level reasonably consistent with our outlook for the balance of the year, namely sustained growth at, say, a 2-1/4 percent rate. I have a couple of specific comments. First, on the auto sector, which Mike has covered: At this point it looks as if some of the uncertainties in the industry early in the year have been clarified, with the very large unsold inventories having been worked down now to I think reasonable levels, particularly for this time of the year. Production levels in the second quarter will be lower than last year by about 12 percent on average but significantly higher, of course, than in the first quarter. And the early outlook for the third quarter is that production levels will be higher than was the case last year, but last year's third quarter was comparatively a quite weak quarter. I think there's a slight change in sentiment among the auto dealers. They have gone from being very, very negative to at least being cautious. But my understanding is that on a national basis some 50 percent of them are still losing money. And clearly, it takes very big incentives to move cars at this point. The sales outlook for the year--adding cars and light trucks together--I'm told by the industry is about 14-1/2 million units. They think that's very disappointing. But having said that, they think their trend line is about 15 million units; so it seems to me that on a broader prospective 14-1/2 million in sales is a pretty reasonable year. A major uncertainty, of course, is the labor negotiation coming up in the fall. It is just far too early to tell how that's going to work out. It certainly does have the potential to have a big impact on production.

The steel business seems to be reasonably good; production levels are in the 85 to 86 percent area. Sales of some steel products are coming in at about 100 percent of capacity and backlogs have now moved up to 82 to 83 days. As a consequence, we are seeing some price

increases in the steel business and, given these kinds of pressures, those increases are sticking. The expectation is that prices will go up about 5 percent on average next year. In construction, surprisingly, both commercial and residential numbers in the District continue to move ahead of the national numbers. But I think we're going to see a big change and that there will be some reduction. Clearly, there is a curtailment of credit for commercial projects. But everybody I talk to says it's simply a result of having had far too much money going into too many projects and it's going to take a while for the absorption rate to dig into the vacancy rates. While the construction numbers probably will be a little lower than was our early expectation, offsetting that is our expectation that the opportunity for exports for the year will be a little better than we might have guessed. The level of the dollar has not been impeding sales and any reduction in the dollar along the lines that Sam suggested simply will add to a more positive outlook there.

In the agricultural sector, I was really pleased to hear that planting conditions have been excellent. In fact, in Iowa a number of people describe conditions as the best they've seen in a good many years. The corn crop is largely in; the soybean crop will go in within the next two weeks. These better conditions will be reflected in a good increase in the demand for agricultural equipment. Industry sales of large tractors and combines are running significantly ahead of last year.

On the inflation side, the outlook is certainly less clear; it's difficult to tell how the first-quarter aberrations are going to work out as we go along here. But we are still, I think, a bit more optimistic than Mike in that we see some improving trends in inflation as we get out toward the end of the year. Market pricing for manufactured products continues to be very, very competitive. There's a lot of pressure [to hold down] price increases, given capacity additions as well as foreign competition, [but] I think we're going to continue to see some price pressures. In the services sector, though, there are some increases that are more disturbing; that would be most particularly true in regard to health care. But on the wage side, basically increases seem to be continuing okay. One very unusual example: I talked to somebody who negotiated a six-year contract with the machinists union the other day, which provides for an annual cost increase of 2 percent and some unusual features. I think that's an indication that wage pressures continue to be pretty tight.

On a national basis, we think that the outlook for growth continues to be positive. But certainly we're going to need to see some improvement in the inflation rate. We continue to be optimistic, as I say, but pretty soon we're going to have to see that evidenced by better numbers on the inflation side.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Since our last meeting, Mr. Chairman, the economy in the Sixth District seems to be doing a little better. For example, the unemployment rate in March for all of the states combined was the lowest that we've had in 15 years. That was mainly attributable to better performance in Alabama, Mississippi, and Louisiana, resulting from stronger agri-business as well as offshore energy exploration and development. We're also benefiting in the

Southeast and particularly in Atlanta from job relocations, which are significant in some cases, to the area and to the city. Otherwise, the weaknesses and strengths in the District are pretty much the same as in the country as a whole, and I won't repeat those. We have very little real evidence to contribute from the credit availability survey last month to suggest that there were any major credit problems. But I must say that the bankers in the District don't miss any opportunity to remind me about the problem that they're having. They indicate that loan officers are increasingly reluctant to make commitments and to approve applications either because the bank has had, or is anticipating, an examination or because of the publicity. The data for District banks do show some deceleration in loan growth, but I would repeat that we don't find evidence of any substantial problem.

Business contacts, and this includes our directors, seem to me a little less concerned about a recession than earlier this year, but they are complaining that the deceleration in growth is placing them under pressure within their own businesses. For the most part they have not seen price pressures accelerating and from this point they don't see inflation as a problem. As I've said several times before, many of the people that I talk to are not convinced that there's anything wrong with the current inflation rate, and that continues to disturb me a little. And they are worried, too, about our reaction and what will happen if we seek to bring inflation down too aggressively.

Turning to the national economy, we did not as usual assume any policy change over the two-year time horizon, so our forecast is not especially comparable to the one in the Greenbook. But as I look at both of those forecasts, I think our forecast has a slightly more positive and optimistic view about the underlying rate of inflation. Some of the unanticipated increase in consumer prices in the first quarter we see as basically temporary and not so much of that is carried forward in comparison to the Greenbook. So, we're continuing to forecast the CPI to turn out between 4 and 4-1/2 percent over the next two years. Beyond that we see very little improvement and perhaps even a deterioration as we look past 1991; obviously, in the Board staff's forecast that improvement occurs later on. I think the Greenbook has done a very good and very reasonable job of distributing the weaknesses that result from a policy tightening.

I'm anticipating our policy discussion to some extent, but I think that a case can be made for some policy tightening at the moment. One argument would be credibility to be sure. Another argument that has some appeal is that it probably will be increasingly difficult to make a move later on this year. Having said that, I don't think the timing is really right at the present time. There are still enough pockets of weakness both nationally and regionally that the risk of a downturn could be fairly high. The April data suggest to me that there's a bit more weakness out there than is built into these forecasts and other forecasts. The current concern about credit availability adds to that concern. And finally, it seems to me that with the budget summit that is starting today, a tightening of policy before this meeting is concluded might very well reduce the pressures on the negotiating parties to actually restrain the budget, meaning less would be done. So, to me the arguments are persuasive that we ought not to move at the present time.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. The District economy looks largely like the national economy. There are distinct pockets of great weakness, although overall I think it's probably continuing to perform, as it has for some time, a bit better than the national economy--whether you look at the overall growth of nonfarm employment or at specific industries that continue to perform very well, such as paper and forest products, mining, and tourism. There are some other surprising bits of positive news that I'll just pass on. One is that major retailers, at least in the District, continue to post very good results. And home sales in the Twin Cities in the first quarter were running 15 percent above last year's first quarter and that had been a steady number month-by-month. So, there have been some pretty good numbers there. Also, the extent of the drought in the District has been narrowed as a consequence of some fairly heavy rains in March and April and so far in May. And there's some [unintelligible] number of good reports not only of crop prospects but about capital spending in agriculture for this year.

I might as well give you my two cents worth on the credit crunch. We're certainly hearing a lot fewer and a lot lower volume of concerns from agriculture and small business than we were hearing a few years ago when the Farm Credit System was in distress and when there were serious problems in agriculture and so forth. That's when we heard a lot about it. I must say today, relative to that period, it's absolutely quiet for the most part out our way. A major national developer that we're close to has reported difficulties--not his own but of competitors--in obtaining credit. In fact, he has reported that on a couple of deals where he was not the low bidder and did not get the contract initially the low bidder couldn't get financing so he wound up with the contract. In terms of economic activity, of course, there is no depressing effect. The project is going to get done; it's just a question of who is getting the credit.

MR. LAWARE. At a higher price.

MR. STERN. And he's rather happy.

CHAIRMAN GREENSPAN. In other words, tighter credit leads to higher prices!

SPEAKER(?). The high deal wins.

MR. STERN. Well, from the point of view of GNP you get a little more! As far as the national economy in concerned, I certainly agree with the underlying thrust of real growth as presented in the Greenbook. On the inflation side, I take that message to heart as well. Having said that, though, I must say that I don't have any anecdotal evidence suggesting that inflation pressures are building at the moment. It seems to be pretty much the status quo. And some business people at least are concerned that an effort to bring inflation down from 4 or 5 percent or wherever it is would be bad for their business because, of course, what they envision is that a recession would accompany it.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I would say that in terms of our broad view, we wouldn't be as concerned as the Board staff about monetary policy being somehow badly out of position here. Our outlook is for modest growth, containment of pressures in the short run, and gradual long-term progress. But we wouldn't envision the kind of tightening that's implied; in fact, I think it's much too early to tell. If you look at page 5 of the Bluebook and what has been happening to money, credit, and reserve aggregates over the last couple of months, you have to wonder whether there's a significant tightening going on already with the funds rate at a constant level. Again, having said that, I think a month or two is much too short a period of time to react to. In general I think we've been well served this year by not letting very volatile expectations whip us around. I think our "steady-as-it-goes" policy has been quite good.

On a District basis, I would say we're growing modestly better than the national economy. Even without auto workers coming back, we've had growth in manufacturing jobs. On the agricultural front, the flooding in Arkansas has created some problems, although I don't expect them to have national implications. I think some wheat crops will be plowed under and some cotton, rice, and corn crops will be late getting in. But basically at this stage, there hasn't been a major impact. On the price front, I haven't picked up much commentary about the minimum wage [increase]. I did pick up some comments in Arkansas where firms have below minimum wage employees; they are complaining about the compaction effect on their salary scales and the fact that it has a much broader implication in terms of their costs than just on the people below minimum wage. A couple of people said the way they are dealing with it is with gradual, phased-in price increases over the first six months of this year, so they aren't faced with a step increase in their prices around midyear. One final comment: Our large reporting banks in the three-month period ended in April have actually had a decline in loans outstanding. It's in other categories. There is still growth in real estate and C&I loans, but a decline in personal loans and big declines in some other categories.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. In the District, commercial real estate varies a good bit, but on the whole I think it's a major drag on the economy in some areas. I think the risks in the District are on the down side. In retail sales we're seeing some small increases, and capital goods continue to be a positive. Manufacturing generally is still slumping, but there's some sense that that slump may be bottoming out. Overall, I'd say we have modest growth.

On the national economy, I come out about where Tom Melzer just did. I think our "steady-as-you-go" policy has served us well. We've resisted being jerked around. My own sense is that the risks to the economy continue to be about even. There is a risk that inflation may accelerate, but I think there is a risk that the economy may not be as strong as it is currently. I sense that the business community still feels that we will avoid a recession, but I must say that I think it would not take a lot of monetary tightening to change that. My sense is that we ought to push the "steady-as-you-go" policy another couple of months.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. In the Tenth District, the economy continues to grow moderately slowly. Recent developments have been somewhat mixed. There has been a good deal of press given to the agricultural sector. The wheat crop, for example, has been estimated by the Agriculture Department as being near double last year's crop. That optimism isn't totally shared by some of the wheat growers themselves, although we're within probably 30 days of harvest in much of the Tenth District area. It does look very good, and I think the farmers are pleased with it. It's a question of how it comes out. We are always reminded that a wheat farmer has to lose his crop at least nine times; in other words, he's very pessimistic until it's in the bin. They're still not prepared to say it's going to be double what it was last year. The outlook for farm income for 1990 is very good not only because of the wheat but also other crops, so the last two-year drought will not affect the 1990 crops yet to be planted and harvested. On top of that, crop prices have firmed up recently and there's a good deal of excitement about red meat prices. For example, prices of cattle, including replacement cattle for the feed lots, are essentially at an all-time high. Inventories of the latter have not been rebuilt; they were run down over the last three or four years. So, if you combine not only a good crop year together with livestock prices, then the outlook for agriculture is very bright for our area. A somewhat damping effect is the rain that Bob talked about in Texas, which also has occurred through much of the Tenth District. That has restored the moisture level, but now farmers can't get the crops in [the ground], so it's uncertain. With respect to energy, despite the weaker oil prices, the District rig count did increase in April and remains above the year-ago level. We do have a good deal of auto assembly [capacity] in the District and that [activity] has been very sluggish, as has been detailed around the table. In the manufacturing sector that's laid against a very brisk business in aircraft manufacturing. In residential construction, contracts fell slightly in March, but nonresidential contracts increased, which doesn't tell the same story that apparently is told elsewhere in the nation. We do still have a large overhang of commercial properties in cities such as Denver, Oklahoma City, and Tulsa. But District-wide, the nonresidential commercial contracts have increased recently.

With regard to the national economy, I have little or no quarrel with the Greenbook forecast. We go through an exercise in which we hold monetary policy steady as it has been going into a meeting such as this. Then, after we receive the information with respect to how the staff has treated monetary policy in the Greenbook, we do another exercise and lay them side-to-side. This time they come out fairly close, with the exception that we have a little less growth in 1990. That may reflect your pattern of increased interest rates; that isn't clear to us, I guess, when we get your information. But on that we don't quarrel. We think there will be a little less growth in 1990. The growth and the inflation aspects of 1991 look to be about the same, given the staff's pattern of the interest rate levels.

We have found little evidence of a credit crunch, particularly in the agricultural sector. The agricultural banks are very liquid; they say they can't find the loans to absorb their liquid assets into loans. Where we do hear some evidence that credit is not available is in areas such as Denver that have just come off the bottom and where the larger banks have been hit and now have a rating that makes them very cautious about credit. I don't think it has

anything to do with examiners coming in and knocking them. It's simply a fallout of what they've been through in the last year or two. They are on the way up but they're very cautious in their credit terms. It is not price as far as we can tell.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, Mr. Chairman, the impression I get from business people, particularly on the manufacturing side, is more in line with Mike's forecast than it is with the last three weeks of data. I just don't have any sense that things suddenly fell out of bed on us here. Exports are holding up quite well. More generally, people are saying that business at least has stopped getting worse. The computer business appears to be showing a renewed spark, and I don't know what to make of that. Some of the commentary I hear even from suggests that maybe there's a little more to that than even they thought.

CHAIRMAN GREENSPAN. It's probably stock adjustment; it was so weak for so long.

VICE CHAIRMAN CORRIGAN. That's probably part of it; they sure feel better. So, as I said, the impressionistic information is much more in line with Mike's forecast than these very recent data. Our own forecast is quite similar as well, although the policy assumptions are different. We don't have a rise in short-term interest rates anything like what is in Mike's forecast and the results are about the same.

On this credit crunch question, I've read all the surveys and listened to all the comments around the table, and I still can't quite shake a sense of uneasiness that there may be something there that we just haven't seen yet. Of course, I have absolutely no evidence of that. But possibly, just possibly, the money supply, especially M3, may be saying something about that. But who knows? I'd like to dismiss it completely, but I can't quite bring myself to that.

As for inflation, I blow a little hot and cold on the question of whether the underlying inflation rate has changed. Where I am at the moment is that if it has changed, it has changed only a tad and maybe it is basically unchanged in core terms. But whatever conclusion you draw about what's happened to the core inflation rate in recent quarters, I think what you have to be impressed with, notwithstanding all this talk about credibility and all the rest of it, is that the only way that the core inflation rate is going to come down is if there's a lot more slack in the economy. With the structure of the economy today, there just doesn't seem to be much to suggest that that's going to change in a downward direction in any appreciable way, given the kinds of resource utilization patterns we have right now. But that, I think, is going to create an acute dilemma for this Committee very soon, and I'm thinking in terms of this budget package. I don't know whether they will get one or not. I suspect that there's probably a better chance of that today than at any time in the recent past. And then all of a sudden we will have what we have all said we needed--what we have all been pleading for, begging for, and cajoling for. And it seems to me that the policy dilemma that the Committee is going to face in those circumstances is going to be rather awesome even if long-term interest rates come down

by themselves, which I'm sure they will. But I think that is something that we're going to have to reflect upon a good deal. I don't think that's an urgent matter because I don't think they can cut a deal that fast.

CHAIRMAN GREENSPAN. I wouldn't hold my breath.

VICE CHAIRMAN CORRIGAN. I still think it has to be thought about a bit. If there is a deal of some substance, it's going to make things very difficult for us in an ironic kind of fashion.

CHAIRMAN GREENSPAN. I'd like to have that type of problem.

VICE CHAIRMAN CORRIGAN. You may. But, as I say, in the context in which that core inflation rate is either a tad higher or stuck, that's going to be a pretty difficult environment for us.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, on the local economy: Potomac, Maryland is generally doing quite well. However, the residential market is way overbuilt, overdesigned, and overpriced. But consumer confidence remains high and the public is generally blase about inflation as evidenced by the continued good business done by the Sutton Place Gourmet!

CHAIRMAN GREENSPAN. Is your wife the source of this?

MR. LAWARE. I continue to be concerned, though, about the ability of policy to deal with inflation. At the same time, I don't believe we have a lot of maneuvering room because we are in a precarious position. I believe on the one hand that we have the risk of higher inflation and on the other hand that we're very close to the possibility of tipping over into recession. I think the risk, if we go into recession, is greater than the risk of more inflation because I suspect that the underlying structure of inflation is not as firm or as high as may have been indicated by some of the recent statistics.

I think that the credit crunch is real, and I don't think it's necessarily confined to real estate. I'm convinced that it's going to get worse and that it is not necessarily the result of the regulators; I think it's a general concern on the part of lenders about lending, about capital ratios, as well as about tougher examination standards. So, I just don't see that going away, with all due respect for the regulators recently urging the lenders to lend more money. I think the real estate market is under identified pressure and also some that hasn't shown up yet. Included in the latter, I would say, is the RTC situation; if this accelerates, short term we're going to get an even further depression of real estate values. And I think there's some real buyer resistance out there with regard to the price structure, particularly with that RTC overhang. I don't think that has adjusted itself. And I'm concerned that in a recession situation, the change in revenue flows would really tank some of these [firms involved heavily in] junk [financing] situations and that the ripple effect of that kind of a credit problem would be very severe. On the whole, I think the downside risks are quite severe, and I'm frustrated about inflation on the other side. On balance, I just don't think this is the time to make a change.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. There is not much change in the Fourth District since the last time we met. There are high levels of economic activity. We had a meeting with 25 economists representing businesses located in the District. To make a short story out of it, they see no credit crunch within the District, continued export growth, no cutback in capital spending plans, and real growth in the neighborhood of 2 to 2-1/4 percent for next year.

CHAIRMAN GREENSPAN. In the District or in the United States?

MR. HOSKINS. They are District economists forecasting for the national economy. The only surprising or perhaps worrisome trend as reported by these forecasters is that out of the 25 none of them had a recession in the forecast horizon, which means they are probably wrong. My infamous stainless steel strip new order measure reached a 5-year high in April; that's seasonally adjusted. It indicated a very strong export side as well as domestic. It's muddied up a little by some inventory building by automobile companies in anticipation of a strike in the third quarter.

CHAIRMAN GREENSPAN. I thought we agreed that that [indicator] doesn't work.

MR. HOSKINS. It gets the direction right usually; the magnitudes are terrible.

CHAIRMAN GREENSPAN. I thought you were giving us a bearish forecast.

MR. HOSKINS. No; the other anecdotal information surrounding this particular firm is that in two lines they are already sold out through the end of year and most of these sales are export oriented. So the steel side, at least the stainless steel side, seems to be doing quite well. They tend to argue that it's a proxy for the economy. We've tested it, as the Chairman has indicated, and it does less well than the [leading indicators] over time. They did post price increases a month ago of 4 to 7 percent, and they had no problem making that stick.

In terms of the national outlook, I want to thank Mike again for making, I think, a real attempt to show us what we need to do if we want to tackle the inflation issue. Most of the risks in the forecast, it seems to me, are weighted toward having a little more inflation or perhaps having it stay the same. I understand that there are always going to be risks of fragility in financial markets; we've talked about that now for six months. And there is always a potential budget deficit deal. But I think we have to gear our monetary policy to the objective that we can achieve. I agree with Dick Syron that credibility is important, and I'm not sure we're maintaining it. I'm not unduly pessimistic about inflation, but we do have an objective of bringing it down and not much seems to be happening. I might quibble on the cost of bringing it down, though.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Well, Mr. Chairman, when Mike finished his presentation a little while ago he made the remark that there are a lot of jokers still in the deck to be turned over. I certainly agree with that. But when you're playing a hand of cards there are those things that you know and those things that remain to be seen. If we look at the things that we know, they don't look that bad. Obviously, as the cards turn over, things could change a lot. But we know, looking at interest rates, that we lowered the federal funds rate in December and interest rates have been up ever since then. We have had some tightening done for us by the market. Along with that, the aggregates have now slowed down a lot. I don't want to prejudge or put words in Don's mouth--he hasn't made his presentation yet--but I suspect he thinks they're likely to speed back up. But if they keep doing what they're doing now, then we're going to have a pretty slow rate of growth in the aggregates in 1990. Looking at the gross national product, the best guess is that its growth is now running around 2 percent and the two preceding quarters before that were 1.1 percent and 2.1 percent. That's clearly slow; it could reaccelerate. There has been talk around this table that at a 2 percent growth rate we could make slow progress, but nevertheless progress, on inflation. If you look at inflation as measured by the CPI, we had an appalling first quarter but the two quarters before that were both under 4 percent; and I think the increase is probably slowing down substantially from that bad first quarter now.

John talked about the credit crunch. I think everybody would agree that there's something going on out there and we don't know what effect it's liable to have. Nevertheless, there is some constraint and it could be substantial. So, the things that we know, taken all-in-all, suggest that the state of the world is not terribly unsatisfactory. I think our policy pretty much has done what we desired it to do; it's too early to say that it has been ineffective in making some progress on the core rate of inflation. Core inflation could certainly change on the up side and, if it does, we undoubtedly will have to react. But I think that's far from sure. As a consequence, for now "steady-as-you-go" makes sense to me.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Yes, Mr. Chairman, we do have some good news out there that I think we ought to talk about. We only did \$50 million in foreign exchange intervention during the intermeeting period and I'm most grateful for that. In fact, I'm so grateful that I didn't even talk about the ESF after having an antagonizing document in front of me. But there's more good news than that. I counted out about 15 segments of industries in which expansion seems to be the order of the day. Quite often, I think we become somewhat impacted by those that are having the pain; those industries having a slowdown are more vocal than those in which things are looking up. I was used to that with farmers always describing things as mediocre or middling during times when we had boom conditions and most of the rest of time describing conditions as poor. In terms of the small business outlook, I think we had a diffusion index this morning that demonstrated the same sort of thing: that is, if you have as many people saying the outlook is positive as you have saying that it's negative, then it's really boom conditions. So, I think we have to steel ourselves to the fact that there is going to be some pain out there. And, of course, when that pain involves people getting used to house prices not rising as in the

past, and in some cases coming down, we're going to feel that and see that. But that may be better news in regard to attitudes about money than we realize. When people see house prices going up 15 percent per year, I'm not sure whether that in some ways undermines their sense of value for money. And when all of a sudden the peak on selling their house passed, a lot of people said: "My goodness! Why didn't I sell it earlier?" It's sort of an attitude of: I want money; I'd like to have dollar balances.

So, I think this kind of pain may be a precursor for some better inflation numbers. The fact of the matter is, however, that there are some troublesome things on the inflation front. Basically, commodity prices are still rather troublesome, as far as I can see. I don't care what index you look at, unless you get into some very specialized ones, there does not seem to be the kind of improvement that you'd expect to see. Look at corn prices, soybean prices. Wheat prices went up because there was an announcement of a large increase. But it really is a troublesome indication to see commodity prices move up as much as they did and then not move back down. I would agree that at a time when the pain seems to be pervasive in many households, and when M2 and M3 seem to be growing very, very slowly, that information ought not be ignored. I'd like to close by suggesting, when we are talking about a soft landing, that in any way the landing occurs it certainly has been soft but there is an element in which an airplane wing as it approaches the ground gets what we call "ground effect." Ground effect means that you have an opportunity to have more lift than you otherwise would have because of the proximity of the ground. As we're approaching the 90th month of this expansion, we haven't had any abrupt pullups that might result in stalled spins because after a stalled spin the wind does not produce much ground effect as the plane comes crashing in.

CHAIRMAN GREENSPAN. It gets too much ground effect!

MR. ANGELL. But the implication is that I think we have to be prepared to understand that our economy may have more ability to operate below 2 percent for longer periods of time without getting into negative numbers. To me that's an encouraging bit of news. I, for one, do not believe that there are factors out there that are producing a recession in the immediate horizon.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. John LaWare gave my talk, so I'll just piggyback on his. Thank you.

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. Actually, I feel a little better today about the inflationary risks than I did maybe a couple of weeks ago, with some of these more recent data. But once again, you can't tell much from one or two months of numbers. I still am generally concerned about the outlook, but these recent numbers cloud it up a bit. Consumption has been fairly modest, but the first-quarter real GNP number looked stronger than I would have expected. We see investment plans running at 7-1/2 percent, which is pretty strong; I don't know if that will actually materialize, but the plans are running fairly strong. My concern is that with inventories fairly low--and I realize

that there are incentives to keep them that way--demand seems to be sufficient both on the investment side and the consumption side that the economy is poised to pick up if demand pressures develop. And my concern is that they might develop from external sources. I didn't hear too many people that concerned about export demand, but having just been overseas and having talked to people there I still have some concern about that. I feel more comfortable that the Bundesbank is going to deal with the inflation risk in Germany. Still, we see rates coming down in France and other European countries; and in fact, even though I think East Germany and other east European countries are going to be facing recessionary-type conditions, I think all their consumption is going to turn to the West. Even if it's lower than in the past, they're going to be buying goods. The outlook for the Soviet Union is grim because I don't think they're going to be able to sell anything. They may be able to barter a few things and they will be able to sell energy and some of their raw materials, but nobody is going to buy any consumer goods from the Soviet Union. All industrial countries are strained in terms of their productive capacity. Japan is still growing strongly in spite of their financial shake-out. And Europe continues to show signs of strength. So, I'm fairly optimistic about our export prospects and the improvement in our external position. But I do worry about what kind of pressure that's going to put on the inflationary situation going forward. So, I do think there are some risks. Some of the financial indicators suggest it. Even though long-term interest rates have come down more recently--almost a half percentage point from where they were--they are still up over the intermeeting period. And as Governor Angell pointed out, commodity prices have been under some upward pressure. They look a little milder now, depending on which index you look at, but still they are up. What worries me the most is that the trade-weighted dollar is turning down. Even though the dollar had shown strength against the yen, a lot of that has changed recently. As someone reported, the trade-weighted dollar is down 14 percent from its peak last year. If that kind of trend continues, we may be faced with some pretty significant external strength, and I don't know how much room we have for that. So, that's a worry.

I'm not as concerned about the credit crunch issue; I have heard a lot of anecdotes and I think it is a potential risk, but just listening to what people have said around here it seems like some of that is [unintelligible]. The aggregates have turned weaker, but I would argue that that has to do with some portfolio shifts that have occurred with the change in interest rates more recently, and I think that will subside and we will see a return to more significant growth. So, I think we have to be very watchful and cautious. I think the risks are on the inflation side, but given the more recent data I don't know if it's worth pressing immediately.

CHAIRMAN GREENSPAN. Okay. Why don't we break at this stage for coffee and come back?

[Coffee break]

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

CHAIRMAN GREENSPAN. Questions for Mr. Kohn?

MR. HOSKINS. Don, if we have credibility in the marketplace with respect to our [commitment to] price stability, why would the markets have any problem with alternative C?

MR. KOHN. I'm not sure I understand. Alternative C would--
MR. HOSKINS. Would be a tightening in policy.

MR. KOHN. Right.

MR. HOSKINS. All I'm suggesting is that, if we were credible, that would mean we would see a drop in longer-term rates.

MR. KOHN. If alternative C increased our credibility and reduced expected future inflation, that's correct. My guess, as noted in the Bluebook, would be that the initial response to such a policy probably would be a rise in bond yields. But, as I think the Bluebook also noted, to the extent that this was seen as the Federal Reserve giving extra emphasis to its inflation objective over time, those bond yields would move lower in nominal terms. Now, it's also fair to say that the real bond yield might be higher in that case because I think there would be a higher path of expected future real short-term rates than perhaps is built in now. But nominal rates could be lower after a bit, especially if the dollar firmed up after our tightening.

MR. HOSKINS. Let me follow with just one question on the aggregates. If we didn't do any tightening through the rest of the year, what would be your estimate for fourth quarter-over-fourth quarter [money growth]?

MR. KOHN. We have a 5-1/2 percent estimate now for M2; that's down from around 6-1/2 percent at the last meeting. The reason for the decrease is two-fold. One is the incoming data, which were weaker than we expected, and we scaled down for that; the other is the change in the interest rate path, which is worth probably about half a point. So, if you told me to change only interest rates, and I suppose there really wouldn't be much feedback on the economy in 1990 from assuming a different level of interest rates, I'd probably tell you M2 growth will be around 6 percent. But it also probably would be strengthening a bit as the year went on, or toward the end of the year, if the economy were picking up a little more speed than we have projected.

MR. HOSKINS. That 5-1/2 percent was with the Greenbook interest rate path?

MR. KOHN. Yes, with the assumption of rising interest rates. So, it would be 6 percent with steady interest rates and nominal GNP as in the Greenbook.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Don, if you go back to the period before the latest period, there was a sharp increase in long-term rates. I know you can't answer this specifically, but in your view what explains that rise mostly? Was a change in inflationary expectations mainly what caused that? Or was it some development worldwide or here that caused the real rate to go [up]?

MR. KOHN. Well, I guess I'd have to say it was a combination of both. Certainly, the inflation data were far worse than people expected. When the March CPI came in, I think that caused an upward revision in expected inflation. On the other hand, the incoming economic data continued to suggest that the economy was chugging along at least at a moderate pace and wasn't weakening. I think it was a combination of those two things. Because the dollar was firm through that period, although a lot was going on in Germany and Japan at the same time, I'd be hard pressed to argue that inflation expectations had picked up to such an extent as to overwhelmingly explain the increase in nominal rates. I think real rates at least held steady or probably were a bit on the firm side through that.

MR. PARRY. But through this period, then, if most of it was due to expectations of higher inflation, there has not been a tightening in monetary and financial conditions. There was a discussion here that implied that this was a tightening and that hasn't occurred to the extent that it's--

MR. KOHN. Well, if instead of just focusing on the last couple of weeks or month or so you go from the end of the year, I think it's true that some of that increase is definitely an increase in real rates. But the equilibrium real rate--where real rates need to be to keep the economy in check--is higher. So, that increase in real rates would be restraining, but only relative to a lower level of real rates. It was an endogenous response, I think, to what has been going on. And the previous increase in rates did embody an expectation of Federal Reserve tightening. That was very clear in the structure of rates until the most recent employment report.

MR. PARRY. Right. Thank you.

CHAIRMAN GREENSPAN. Any other questions for Don? If not, why don't I get started on the round table? Reflecting what I'm hearing among the Committee, I think what we're observing is something that I suspect has not been evident in recent decades. I never recall a set of economic forces precisely that goes with what is developing here, and I've been trying to forecast the economy for well over 30 years. On the expansion side, I think the evidence is very clearly mounting; we are past the maximum durable goods squeeze and I think we're beginning to see some flattening of profit margins at this particular stage [after earlier declines]. As a consequence, capital investment is clearly showing some quickening pattern, and I think that shows up in the orders and the appropriations and in various qualitative measures. On top of that is this extraordinary inventory situation, which continues to squeeze down--the issue Dick Syron raised. Of course, what that implies is that if we ever get to the bottom when we're getting a squeeze and there is any evidence of tightening worldwide--so that there are shortages not only in the United States but elsewhere--then the lead times will begin to move and we really will begin to get the type of classic acceleration that we've seen many times in the past. At this stage the evidence on the orders side is that they continue to improve gradually although they are by no means accelerating; the orders levels are just creeping up. The backlogs in real terms probably are flat to down, but that is a major improvement from a year or so ago when the economy was deteriorating in the total durables and manufacturing areas. If

anything, I would say the evidence of all of this is [that economic growth is] probably mildly accelerating.

The trouble, however, on the other side is that we have something more than a merely minor financial disturbance. I think there may well be more to this credit crunch than we're looking at; or to put it more exactly, I don't think we're through it yet. The concurrent data that we pick up all over the place suggest that there has been, as has been stated, a mild pulling back. But there is no evidence that it has stopped. For example, all of the evidence about forward commitments, specifically on real estate projects and loans, is that this phenomenon is nowhere near over on the real estate side. And we don't know at this stage to what extent it has spilled over in any other direction. I find the money supply data--specifically M3, as Jerry has pointed out--mildly disturbing because they say in effect, even if you take out the thrift part of M3, that there really is something that is constraining financial capacity even though the underlying orders patterns suggest that there's something of a [unintelligible] considerably more forward momentum here. The data we have on the credit crunch are, except for anecdotal evidence, not forward-looking. They are all historical--all basically something in the past. The trouble with the past is that as we continue to pick it up [in these data] it gets worse. And before we're out of this, this has to stabilize and turn around--or at worst just stabilize, even if it stabilizes at pretty low levels--because it has to be having a fairly significant contractionary effect out in the distance through the late spring and into the summer on a lot of construction projects, which are a very substantial part of the goods markets.

So, where this all leads me is to the same type of dilemma that I found myself in at the last meeting, where clearly there are dangers on both sides. When we look ahead, the probability is that our next move will be on the up side because I do think one has to presume that this credit crunch is limited. The trouble, however, is that at this point it is still growing; and to move to tighten at this stage while the evidence is that the credit crunch is still occurring I think would be a mistake. Also, despite the fact that I think we probably will be required to move up before we move down, I wouldn't be inclined at this stage to be asymmetric on the up side. This might seem an odd way to put it, but although the odds suggest that that's the direction we will be going in, I'm not sure that we should position ourselves in that manner until the credit crunch matter has stabilized. Nonetheless, I do think that the inflation problem is very troublesome. And while I would feel comfortable with "B" either symmetric or asymmetric, I must say I would prefer symmetric and would have the policy record relate the concerns that have been expressed around this table on the issues of inflation and the instabilities that they create. But, like the last time, I think it's a tough call; and I suspect it may be no less easy as we get further on into the year. So, my bottom line at this moment is "B" symmetric, but with extensive language in the policy record on the issue of inflation.

MR. PARRY. Mr. Chairman, I could support your position but for somewhat different reasons. It seems to me that the uncertainties about the direction of the economy are perhaps the greatest reason to support alternative B at this point. I must admit that looking at the data and hearing the discussion today, I would never use the term "credit crunch" in the classic ways that I've heard that term used.

CHAIRMAN GREENSPAN. I'm using it as a forecast.

MR. PARRY. Okay. Then I would hope that we can in our separate Districts and here at the Board find a way to monitor that very closely. A credit crunch has real implications.

CHAIRMAN GREENSPAN. It does, and I would say that the money supply will tell us perhaps as much as anything. If you look at the way the numbers have flattened out--I don't care what you say--that has come as a big surprise to me. There's something wrong about those numbers. And that's what bothers me.

MR. PARRY. Well, we have [unintelligible] than last year. If you recall at this time--

CHAIRMAN GREENSPAN. I wish that they could be explained by the April phenomenon. I'm uncomfortable with that explanation.

MR. PARRY. Well, it seems to me it is something that we ought to monitor very closely.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I'd like to reiterate my view that the progress we make toward achieving our long-run objective and the transition cost of moving to that are going to be affected a great deal by the credibility of our policy. --the large regional real estate developer who told me that only one out of eleven developers in a given city could get credit--said that he thought our credibility as an inflation fighter had all but disappeared. He could find nobody who thought inflation was going to come down, and he was obviously disappointed that we didn't And that made me think about it somewhat differently than I otherwise would have because I think this fellow is unusually perceptive.

MS. SEGER. He's also about ready to retire.

MR. BLACK. No he isn't; he's even younger than I am, Martha, if you can conceive of such a thing! So, I think we ought to pay a little more attention to the long-run issues in the position we take today than we typically do, instead of our perceptions of what is going on in the short-run part of the economy. And we [ought] to focus on what this is going to do to our credibility. So, I would favor "B" for now, but I would go asymmetrical. You've taken care of a good part of my concerns by suggesting that you really favor asymmetry but that you're not quite ready to put that language in the directive. I think we need a signal out there that we really haven't abandoned our quest for price stability. I'd like to see us put that asymmetry in the directive. But the behavior of the aggregates is a concern to me to some extent. I would be alarmed if they don't pick up before long, especially M2 and not so much M3, because I think we might have squeezed too much. But overall some kind of signal--not a discount rate increase but something from this Committee--really would be very helpful right now, because I agree with you that our next move will be to tighten. Of course, like everybody else, I'm guessing on that.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I favor "B" symmetrical. I think the risks are about even. I'm not willing to concede at this point that the next move is up. It may very well be, but I think we're in an uncertain enough situation that I'd like to stay symmetrical and make a judgment as the information comes in and as we learn more about the kind of situation that we're in.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I think there are enough uncertainties in the economy that we should not move at this time; we ought to stay where we are. So, I would support alternative B. But I tend to agree with you that our next move is going to be on the up side and, therefore, I would have a slight preference for asymmetric language.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, for the reasons you stated, I'd also be in favor of alternative B and would have a preference for symmetrical language. The only other thing I would add is a question of timing. Now, [unintelligible] I would not expect a lot to come out of the budget negotiations. But it does seem to me that this could be an awkward time to be adjusting policy if in fact there is at least a possibility that something could come out of the budget discussions.

CHAIRMAN GREENSPAN. President Guffey.

MR. GUFFEY. My preference would be alternative B, asymmetric, given that I believe we're going to have to have some greater restraint in the period ahead if indeed we're going to make any progress toward lower inflation rates. However, I don't see anything on the horizon that would urge us to move in the intermeeting period--between now and early July, for example. I can't imagine that these numbers are going to reverse so quickly that they would trigger a further increase in the intermeeting period. There are ways, however, to get the message to the market for the credibility argument. One is, as you've suggested, that it be stressed in the policy record which is read by the market; on the other hand, we could have an asymmetric directive. Either would give the view that we're still interested and concerned about our credibility and will move against inflation. As I say, I would prefer "B" with an asymmetric tilt simply because of the communication. But I could, and would, accept your proposal that it be stressed in the policy record.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Some people expressed the view prior to the coffee break that "steady-as-you-go" has served us tolerably well--at least so far--and I think that's true. For the time being, I favor a continuation of that policy. That would be "B" symmetric, in my judgment. I do think, though, that it's a matter of timing. I don't pretend to have any special insight about this, but it does seem to me that at best we can argue that the core rate of inflation remains stuck in the 4 to 5 percent neighborhood in which it has been for some time. And at the same time, as I think Manley was describing, the

world more generally has become a somewhat more inflationary place. Some of the European countries in particular have taken advantage of what's going on in Germany to stimulate their economies and so forth. And I think that does raise the odds, as you expressed, that we are going to have to tighten at some point in the future if we're going to unstick inflation.

CHAIRMAN GREENSPAN. Governor Seger.

MS. SEGER. I would support your position of "B" symmetrical. I don't think the condition of the economy is that clear. Also, I'm very concerned about the fragility of the financial system. I'm not just talking about the credit crunch angle, although that's part of it. But there are many, many financial institutions out there--S&Ls and banks alike--that are pretty shaky, and there are more on the list of those that will be getting shaky. I would like to support Si Keehn's point about the timing. If we tighten today, the day of the budget summit, I think we'd look like we had no sense at all. So, all that means that I would support your position.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, I think this is a matter of timing and I don't think [unintelligible] from one meeting to another is going to make a lot of difference. We are always going to work and live in a world that has a great deal of uncertainty. As the meetings go by the calls get tougher and tougher, and I'm not sure we can make it any easier. I understand what people are saying about perceptions being important at this time; the budget issue is one that I think is very important. But that can almost play both ways. I would favor alternative B. When we come to the matter of symmetry or asymmetry, I think the credibility issue is very important. For that reason I would tend to favor asymmetric language--though that's almost splitting hairs, depending upon what the policy record says. If the policy record is strongly worded enough and if it indicates the same thing--essentially that if economic data start to come in and lean more strongly than this most recent information and we don't see any improvement on the inflation front and the credit crunch really doesn't develop into something that's equivalent to the market tightening for us, then we understand that we are going to have to tighten in the future. With that kind of language, I could more than live with symmetry, though I prefer the asymmetry.

CHAIRMAN GREENSPAN. President Hoskins.

MR. HOSKINS. Our goal is to achieve long-run price stability. We have to make those decisions in the context of short-term policymaking and there is always lots of noise in the data when we do that. M2 is slowing; the yield curve may be flatter than it was; maybe commodity prices always give us conflicting signals in the short run because of the noise there. I asked Don Kohn questions about where M2 was likely to be at year-end if we do nothing; his answer was 6 percent or higher. We have done a good job. I'm not pessimistic about the long-term inflation outlook in the sense of it rising. We have had three years of 4-1/2 percent or so growth in M2. To give that away by producing a 6 percent growth in M2 this year is not an acceptable policy to me if our goal is long-run price stability. In terms of where I'd like to come out at year-end--and

that will condition the way I would vote today--I would like to see M2 come in at 4-1/2 percent or below, fourth quarter over fourth quarter. It seems to me that then we would be making progress toward price stability. In terms of what M2 means right now, it's positive from my point of view in that it's slowing. But I'm not sure that it's going to stay there. Somebody already has used the expression that insurance may be appropriate at this point in time. It's a lot easier to lower rates if we make a mistake in this environment than it is going to be to raise them down the road. In terms of the short-term outlook, one can just simply look at the Greenbook, which also supports the notion that if we do nothing at best we'll stabilize the inflation rate and at worst we will have a rising inflation rate. So, I prefer alternative C.

CHAIRMAN GREENSPAN. President Boykin.

MR. BOYKIN. Mr. Chairman, I am obviously more uncertain today than I have been in the past couple of meetings. I could support alternative "B." I would have a fairly strong preference for asymmetric language. Your prescription of a narrative in the policy record reflecting inflation concerns and that sort of thing is okay, but if we're talking about credibility and sending some signals, that brings in a lot of nuances and subtleties it seems to me. I think an asymmetric directive would give credibility to the verbiage that would be in the policy record and for that reason I think we would have some opportunity to strengthen at least the credibility [of our inflation effort].

CHAIRMAN GREENSPAN. Governor Johnson.

MR. JOHNSON. My preference is for "B" asymmetric. But I certainly wouldn't make a big deal over that, given your preference for statements in the policy record showing our concerns. It's splitting hairs to make that point. However, like Dick Syron, I'm a little worried that if over the intermeeting period we get a few stronger numbers, our credibility could slip rapidly. I was very concerned for a few weeks before this meeting that we were right on the edge of totally losing our credibility when we got the CPI and purchasing managers' survey results; all the data were coming in strong. Of course, the more recent numbers have to some extent bailed us out. Maybe that's an indication that there was an illusion in the data. Still, even if we go for symmetric with a slightly stronger record of our concerns, we should be prepared--if these numbers slip in the intermeeting period--to be able to swing all the way to an intermeeting move. I think we're in a situation where if, say, the credit crunch concerns start to dissipate and all of a sudden we get one or two strong numbers, we may not make it to the next meeting with our credibility intact. We ought to be flexible enough to be able to react to that.

CHAIRMAN GREENSPAN. Well, you know, what we react to and act on is not [just] what we write down.

MR. JOHNSON. I understand, and I agree.

CHAIRMAN GREENSPAN. What we act on is basically what--

MR. JOHNSON. The facts.

CHAIRMAN GREENSPAN. No, not on facts, but the attitudes of everyone. Essentially, what we put down on a piece of paper is what the Committee obviously wants to do, but I think the reality is a lot more subtle than that. And it depends on how events unfold.

MR. JOHNSON. Sure.

CHAIRMAN GREENSPAN. There's nothing that says we can't move with symmetrical language.

MR. JOHNSON. Sure, I understand. That's why I'm saying I agree with what you're proposing.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. "B" symmetric.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I'm somewhat tempted, Mr. Chairman, to counterbalance by having a governor vote for tightness to offset Mr. Hoskins' dissent so that we don't continue this issue about presidents versus governors on the tightening side. But I guess that really wouldn't be a logical basis for me to cast my vote. I would note that of the presidents who are voting only two out of five of them could muster a tightness in their [policy stance]. But of the ones who are not voting, four out of five can muster tightness, which I think probably is what gives the presidents the reputation for being hawks. You presidents really are hawks when you don't have a vote!

MR. SYRON. We want you to tighten now so we won't have to tighten later when we do vote!

MR. ANGELL. It seems to me, Mr. Chairman, that you are correct that there is some uncertainty right now. And that uncertainty is such that, even though I'm in the mood to tighten and I was hoping we would be tightening, I do believe that it would be much better for us to wait a couple of weeks and see what happens in that time. We could act at that point in time rather than run the risk of tightening and then have conditions go in such a direction that our credibility is lost on the other side and that we would not be able to do what we need to do when we have to do it. So, in that sense, I'm very sympathetic with your position, Mr. Chairman. I certainly understand why prudence is in that direction. I would prefer that the directive would read tighten now, but I can vote in the affirmative with the understanding that we're very close together with some consensus here which says: that we deem this attack against inflation to be a very high priority; that we think following that priority gives the economic expansion more of an opportunity to develop and to strengthen and to lengthen than not to do it; that we are steeled to be ready to do what has to be done some time in the future; and that that is not to be deterred because there's a little bit of pain [involved]. I had been hoping we could get there in a painless way but, frankly, what I have learned in 4-1/4 years tells me it's tougher than I thought. I know from the experience in 1986 that once we've eased it sometimes takes a lot longer for us to change direction to tighten than it does to stop tightening and ease, because everybody likes to ease. I just have a very strong compulsion at this point to

be looking for an opportunity to get the fed funds rate up to where I think it ought to be. I'd be much more satisfied with an 8-3/4 percent fed funds rate than with an 8-1/4 percent rate. I just don't think today is the time to do it. I certainly hope we'll be ready to do it when we need to.

MR. HOSKINS. That sounds like alternative "C" to me, Wayne.

MR. ANGELL. Well, I don't get credit for it. Alternative B, asymmetric.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. "B" symmetric, please sir.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Just to come full circle, I find myself quite sympathetic with Governor Angell and Governor Johnson. But I can associate myself with the prescription that you put on the table, Mr. Chairman. I also think, though, that this "beefed up" language--if I can put it that way--in the policy record is very important. And even though I have an uneasiness about this credit crunch issue, I would agree with Bob Parry that it would be a mistake in this key part of the policy record to frame this position on those grounds, partly because I'm afraid that that is susceptible to the interpretation that we intend [unintelligible]. I would be inclined to take that beefed up language and couch it more in terms of the economy, as you did a few moments ago, and the concern about the inflationary process.

CHAIRMAN GREENSPAN. I also think that Wayne Angell said something which is important: that the surest way to get a recession is to allow inflation to take over.

VICE CHAIRMAN CORRIGAN. No question.

CHAIRMAN GREENSPAN. I think that's an important issue. The presumption that we are caught between inflation and recession is a misunderstanding of the way the system works. We are always against recession. The question is: How do we avoid it best--by tightening [or] easing? Sometimes it can be either.

VICE CHAIRMAN CORRIGAN. As I said, if that language can have some of that flavor and stay away for that purpose from this credit crunch matter, I'd be a lot happier.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I wanted to go last so I didn't feel the pressure of others wanting to speak after me: "B."

CHAIRMAN GREENSPAN. I don't feel the pressure. Let's try a vote on the recommendation that I made, which is "B" symmetric with appropriate policy record language indicating the concerns about inflation.

MR. BERNARD. "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 progress toward price stability, the strength of the business expansion, the behavior of the monetary aggregates, and developments in foreign exchange and domestic financial markets, slightly greater reserve restraint or slightly 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 through June at annual rates of about 4 and 3 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 6 to 10 percent."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Boehne	Yes
President Boykin	Yes
President Hoskins	No
Governor Johnson	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Seger	Yes
President Stern	Yes

CHAIRMAN GREENSPAN. The next meeting is scheduled for July 2-3.

END OF MEETING