Federal Open Market Committee

Conference Call

April 12, 1991

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Black
Mr. Forrestal
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Parry

Messrs. Guffey, Hoskins, Melzer, and Syron, Alternate Members of the Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis, respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Prell, Economist

Messrs. Lindsey, Promisel, Siegman, and Simpson, Associate Economists

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

Mr. Wiles, Secretary of the Board, Office of the Secretary, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Stockton, Associate Director, Division of Research and Statistics, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Transcript of Telephone Conference Call of
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CHAIRMAN GREENSPAN. Good morning, everyone. It has been 2-1/2 weeks since we had our last FOMC meeting and I had tentatively planned to have a telephone conference sometime next week just for a general review. But an event is occurring today that may push us into an uncomfortable position and I think the guidance of the Committee overall is going to be quite important as to how we behave. The CPI that will be released this morning is going to be better than market expectations. That, obviously, will not be reported until 8:30 this morning. That is probably going to cement expectations, which are pretty general at this stage, that we are in the process of moving [to an easier policy]. And there is a sense that market participants increasingly are saying that they are less and less concerned about the consequences of our moving and more and more comfortable. Twenty-four hours ago, as Tom Melzer knows, I frankly would have preferred not to do anything. But we are potentially in a position at this stage where if we don't move, the markets could break. Having stiffed them several times in the last week, it's the type of situation that raises the degree of risk. But the point at issue here is: Are we willing to take that risk? And more importantly: What are the broader aspects of the underlying economic structure?

On the positive side, clearly, are the initial claims data that came out yesterday. While the BLS figures were extremely exaggerated, even our adjusted data, which pick up Good Friday, show an important turn. And even though the retail sales figures for March were weak, the revision for the February data was clearly significant. Yesterday, I thought the markets would view that as a significant turn and when the markets rallied as they did I was of the impression that what we were looking at was an economic cycle rally and not a Fed expectations rally. When I got back here in the evening and looked at all the reports, it was clearly the other way around. What I'd like to do is briefly review my impressions of what has been happening over the last several weeks--and there have been a number of changes--and then go around the table, so to speak, to get the impressions of the rest of the Committee.

On the positive side, the fact that unit labor costs clearly have been subdued is now being verified by prices. M2 has slowed its rate of increase again, although we may be running into seasonal problems. The exchange rate obviously has moved up. On the side of the economy overall, I think we have a divergence: We still get some anecdotal evidence that residential real estate is moving up but industrial orders, as best I can judge, are continuing to sag and are getting increasingly gloomy, if one can put it in those terms. It's important at this stage to make judgments, if we were to move, about what the costs of moving are. It's obvious that if we were to move and we didn't need to move--in other words if the economy clearly started to pick up significantly--we would have to be prepared to reverse and reverse fairly early in the recovery. If we're prepared to do that, frankly I don't see very much in the way of downside market risk in moving. But it really rests upon how people view the markets, the changes in confidence, and whether or not the economy is in a process of stalling. My increasing impression of recent days is that we are making very little progress in the industrial area, in the capital goods area. And I do get the impression, having spoken to a number of industrialists in the last number of days, that they are getting increasingly nervous. Whether or not that is a change of significance is not clear, but what is very clear is that nothing very much is happening.

So, what I'd like to do is to start off by going around the table and getting the first input on recommendations of how we think we ought to respond to these statistics this morning. Our choice, as best as I can see at this stage, is to do nothing or concurrently to move the discount rate down by 50 basis points with probably a 25 basis point federal funds rate passthrough. I'd be curious to get people's views. Vice Chairman, could you add to anything I said?

VICE CHAIRMAN CORRIGAN. I don't know about other Banks--

MR. LAWARE. I'm getting a lot of static trying to hear you from the West Coast.

MR. BOEHNE. The same on the East Coast.

VICE CHAIRMAN CORRIGAN. Well, let me try to be heard as best I can. I, for one, would favor a 1/2 point discount rate cut and a 1/4 point funds rate reduction. I feel that way for three reasons. First of all, I just don't see much at all in terms of the economy presently, especially in the industrial sector. If anything, I get the feeling from people that attitudes in the industrial sector actually have slipped. The second reason--and this is something I mentioned at the last Committee meeting but it was very strongly confirmed this weekend at the BIS meeting--is that activity in the industrial world is clearly slipping across the board. And that has quite important implications for net exports. Going around the table at the BIS on Monday, for example, 6 of the 11 countries, including Switzerland, reported that as of right now their GNP was declining. And all of the other five, including Japan and Germany, reported what I consider to be significant slowing relative to what they had to say four or five months ago. The third factor that is lodged in my mind is this market expectations issue. Peter Sternlight tells me that, given the CPI, there will be a virtual crescendo of opinion that we will be [easing] and that if we don't move, people will say that the reason we haven't moved is because of all these press reports of dissents. So, in all those circumstances and given the much better price numbers, I do very much favor a 1/2 point reduction in the discount rate and a 1/4 point reduction in the funds rate. As to the Chairman's last point, I wouldn't be the slightest bit hesitant about reversing, and reversing early, if that were necessary.

MR. SYRON. This is Dick Syron. If I could just report: We had our directors' meeting late yesterday with some other business to consider. I was quite struck, I might say not just at the margin, by a shift in people's feelings back to [the views they held] previously, maybe a couple of meetings ago. People were beginning to see some [signs of improvement] but I think there's a stall in that feeling. We do have some capital goods producers and this view is very strongly reflected there, particularly in the electronics area. Also, there is a change in concerns obviously on the consumer side, and a real softening in exports, including exports of defense goods, was mentioned by a couple of people. So, I think that we do have a [shift] here in that some of the immediate postwar euphoria that we thought was going to provide a bit of a kick may be waning and we may really be at a very tender point in terms of whether [the expansion] catches on or not. So, I would favor moving in the direction that you recommend; your point is very well taken, though, that all of us should make a rather explicit commitment to each other that we have a willingness to shift quickly as things do catch on. In my own view that move would be most appropriate not by moving the discount rate back up but by moving the funds rate up to maintain some spread between the discount rate and the funds rate as we go ahead.

CHAIRMAN GREENSPAN. Okay.

MR. KEEHN. Mr. Chairman, this is Si Keehn in Chicago. I agree completely with the proposal that you've made. My sense of it is that attitudes were somewhat better after the ceasing of hostilities but that some of that euphoria is now beginning to dissipate. And certainly the underlying economic data coming out of the industrial sector have not yet begun to show the improvement that we would expect. Specifically, I might comment on the steel industry. We had a meeting of our local economists yesterday and the representatives of the steel industry reported significant and new weakness in their industry. They are now operating at rates of about 70 percent and that's down quite considerably from levels a little earlier in the year. Their expectation is that shipments in the first quarter will come in about 9 percent lower than last year. So, clearly, in that area there is continuing weakness. And I sense from talking to other people that that's a fairly pervasive comment.

MR. FORRESTAL. Mr. Chairman, this is Bob Forrestal. Based on what I've been saying at the last couple of meetings, I'm sure it won't be any surprise to you that I agree entirely with your prescription for a drop in the discount rate and a contemporaneous 25 percentage point drop in the funds rate. Everything that I hear confirms what has been said by others this morning. The industrial sector in this part of the country continues to be quite weak. We're not seeing any particular increase in consumer spending. In fact, consumers seem to be worried about the future, about the employment situation. As I mentioned at the last meeting, I, too, am quite concerned about the performance of our trading partners abroad and the effect on our export sector. So, I think the time is right and I see really very little risk in moving at this time. With the inflation numbers that have come out, we have this window of opportunity to move. We have the foreign exchange situation on our side as well at this particular time. So, I would hope that we would be able to move promptly. Just going back to what Jerry said--and this perhaps is a gratuitous comment that I shouldn't make--I would very strongly hope that in this particular circumstance, given all the publicity, that we would be able to move in a fairly united way.

MR. ANGELL. Wayne Angell [in Ottawa, Kansas]. I'm very interested in what I'm hearing. I guess I'm going to express a [note] of caution and a real preference not to move as the rest of you [unintelligible.] It seems to me that for the last six months we have made considerable [easing] moves in anticipation of these numbers that we're getting. What we're doing today is really in anticipation of where the economy will be in the third and fourth quarters. And I'm somewhat troubled by the notion that we respond both in anticipation and then we also respond on an economic announcement, which I find--can you hear?

CHAIRMAN GREENSPAN. Yes.

MR. ANGELL. Okay. I find it to be somewhat disconcerting that we would in a sense let market expectations drive us on days of announcements. [Unintelligible] the stock market moves up. But I don't see how we can afford to time our moves on [the discount rate] or the fed funds rate based upon when the markets expect us to move. The bond markets obviously haven't moved. Now, this does not mean that I would not favor looking again in a couple of weeks to see what the M2 numbers are. I know that April seasonal adjustments are very suspect. But if we were to move based upon the fact that either a three-month growth rate or six-month growth rate of the M2 is [unintelligible] but I do not see exchange and commodity prices or otherwise that would indicate a price [unintelligible]. Commodity prices really are more horizontal than anything else; and it seems to me that the wholesale consumer price moves that we're seeing for the first [time] are the first indication of what we hope will be there in later months. I just have some real reluctance to go ahead and steepen the yield curve as much as this may do. But I may indeed be in a minority.

MR. BLACK. Mr. Chairman, this is Bob Black. What did M2 do earlier this month? Do we have an estimate for April?

MR. KOHN. Bob, we're estimating about 2-3/4 percent growth in April. We've had some minus weeks in the first half of the month and, as the Chairman noted, it's a very difficult month [to adjust] seasonally. But it is coming in weaker than we had projected at the FOMC meeting.

MR.BLACK. If it weren't for that, I'd be very much with Governor Angell on this. We had a meeting of our directors yesterday and the optimism of one director was off the charts. for example, 78 out of 80 firms were reporting big increases in sales; we heard very little in the way of negative comments. However, I do think you're right, Mr. Chairman, in your assessment of the industrial sector: That hasn't done much yet. But unless there is real weakness in M2, I think we've done everything to provide all that we need for a recovery. And unless this slowdown we think we see in April is permanent, I think we will regret a move now.

MR. PARRY. This is Bob Parry in San Francisco. I don't think that in the last couple of weeks I've detected much variation from the general pattern that we have had in the West, which would seem to suggest that things are just going along at a fairly modest pace. I think it's a bit early to expect much of an effect in the published statistics. When we talk to our directors we still get a fairly mixed bag--I'd say somewhat [along the lines] of what Bob said.

MR. STERN. We can't hear you in Minneapolis.

MR. PARRY. Anyone else?

SEVERAL. Yes, we can hear.

MR. PARRY. We had some indication of a pickup in the retail area but not much pickup in the residential housing area. [On balance,] it's hard to say. My preference would be to stay where we are, although I really wouldn't raise serious objections to this move.

MR. BERNARD. Excuse me. Bob Parry, could you repeat that last sentence, please?

MR. PARRY. Yes. I said that my preference probably would be not to do anything and to wait and see how things develop. But I would not raise serious objections to the proposal of the Chairman.

MR. BOEHNE. This is Ed Boehne. This is the time in the business cycle when we always have the dilemma of overdoing ease versus buying the necessary insurance to make certain that the recovery takes hold. And one can never be sure which is the right choice. My sense is that things are still turning around. There clearly was a euphoria at the end of the war. My sense is that we're still getting the kinds of signals that one would expect, even though they're mixed, at the early stages of a recovery. So, I'm cautious about making a major move at this point. I think one of the reasons that we have been successful in monetary policy--more so in recent years than I think in recent decades--is that we have tried to anticipate at moments like this. Rather than making dramatic moves, we have tended to make more modest and more frequent moves. If we do move, I would be more comfortable with just a 1/4 point drop in the federal funds rate and no change in the discount rate. I don't think the technical reasons are so overwhelming that we can't run a penalty discount rate for a while. I think that kind of move could very well have a favorable effect on the bond market in that it would show that we want to buy a little more insurance but we're cautious about further moves. It would demonstrate that we're sensitive to the current situation but we're also conscious of some of our past mistakes of overdoing the easing at this point [in the cycle]. So, my preference would be either to do nothing or, if you feel like doing something, to limit it to a 1/4 point on the federal funds rate.

MR. SYRON. Ed, I'm sorry to butt in. This is Dick Syron. Let me just ask you a question for clarification on that. I share your view that we're at a point where it's usually--but maybe more so in this case--hard to know exactly what to do. Still, the concern I would have, and I would be interested in your reaction, is about changing our procedures at this point, particularly given all the brouhaha that has been going on about having to change. I'd be a little concerned about whether that gives off more confusing signals. In other words, a penalty discount rate at this point--

MR. BOEHNE. No, we've had penalty discount rates in the past. I don't happen to be in my office right now, but I looked it up a few weeks ago and we have had situations in recessions, at the turning points, where we've had this kind of situation. As far as all of this most unfortunate publicity that we have gotten, I don't think it has anything to do with what we think is right for the economy. One issue here is that there are only three or four Reserve Banks that are in for a discount rate drop. And I would think that if we are sensitive about that sort of thing and we have a discount rate cut this morning when we only have three or four Reserve Banks in, we're going to play more to that kind of unfortunate press. If we dropped the federal funds rate and we did it in the traditional way where the Chairman simply uses his prerogative, it seems to me that that would be more conducive to an easing that we could explain. But if we did both, I'd be terribly concerned.

MR. SYRON. I guess I would be more concerned about these expectations because it seems to me on the substance, Ed, that the first direction we'd go in would be the discount rate even if [the funds rate] didn't mirror the first 25 points or so, which I happen to favor doing. I'll leave it at that.

MR. BLACK. This is Bob Black again. I think Ed Boehne has made an excellent speech and I would join him on the discount rate.

MR. STERN. This is Gary Stern. I have some deep reservations about the action you're proposing at this point. As Ed Boehne pointed out, the number of Banks is one issue. But beyond that, my view of the economy is that the news we've received since the last meeting is no worse and may be a bit better than I might have expected. The attitudes out here are clearly better. Home sales in the Twin Cities in March, for example, were the highest in any month going back to some point in 1988. I'm not sure that the bond markets [unintelligible]. And beyond that, I think we have to be a little careful about the price data [unintelligible] that it would be quite a bit of working its way into other price measures. I'm not precluding at this point that it is going to turn out to be a durable phenomenon; it may even--

MR. MELZER. This is Tom Melzer. Alan, I heard the same anecdotal information you heard out here yesterday and I would agree with your [assessment]. The question I had in my mind is: Has there really been time for the rebound in housing to show through to the industrial sector? There are other people on this call who would know the answer to that much better than I. I'd also say that I wouldn't rule out the possibility somewhere along the line here for us to have to ease further, although I wouldn't be inclined to do anything now. Most of my reasons have been expressed. First of all, I'm not inclined to react to one piece of weekly or monthly data; I think that's dangerous. Secondly, I think it could be a trap of letting market expectations lead us around. Finally, and most importantly in my view anyway, the cumulative thrust of monetary policy over the last three or four months has been quite stimulative. I think that has been very appropriate. But all the aggregates, whether you look at reserves or money or whatever, have been slowing at pretty rapid rates. And in general that [slowing] has been accelerating. I don't know how to interpret M2 and I'm a little reluctant to rely on our projections of what an aggregate will do in the future. Anyway, for those reasons, my preference would be to do nothing right now.

MR. GUFFEY. Mr. Chairman, Roger Guffey. I had the opportunity over the last couple of days to have discussions with directors from across the District as well as to meet with regional businessmen and bankers. It's fairly clear that, at least in this District, there is a continued modest improvement in our economy and very little sentiment for any further ease. It does seem to me that past monetary policy actions perhaps have not worked themselves through. As a result, on balance, I would not prefer the action that you have proposed. On the other hand, another 1/4 percentage point doesn't bother me much, provided we are clearly committed to moving the rate back up promptly when we find that the turning point has indeed begun to surface. I'm really concerned, I suppose as much as anything else, about our acting because the market has expectations that we should act. We should do what we think is appropriate. And if we're going to move, I would prefer to wait until maybe sometime toward the end of next week.

MR. LAWARE. This is John LaWare [in San Francisco]. I'm not convinced in my own mind that the effects of all the things we've been doing here for the last several months have been fully reflected in the market in the first place. In the second place, I find it almost embarrassing to seem to be reacting to market expectations unless we are truly convinced that the economy is on dead center and that there is some effect that is going to take place with another 1/4 point move in the funds rate--that it is going to suddenly stir the economy to action.

CHAIRMAN GREENSPAN. John, may I just interrupt a minute?

MR. LAWARE. Yes.

CHAIRMAN GREENSPAN. I forgot to mention--and I think you mentioned it yourself at one point--that if we move down again, the general consensus is that the prime rate will move.

MR. LAWARE. Yes, I noted you had mentioned that at one point. I don't know whether that is going to be what jogs things loose. Certainly, the banks now have some margin opened up for them and it would be logical for them to move by 1/4 point finally. But, again, I'm not sure that that's going to be the magic thing that's going to change the economy or bring it to life with more vigor. On balance, I am still rather reluctant to make this kind of move. On the other hand, I think it's important that we seem to be in concert. So, I'm willing to go along if the feeling is that this is the kind of signal that we ought to be sending. But I'm skeptical about the effects of the signal.

CHAIRMAN GREENSPAN. Okay.

MR. KELLEY. This is Mike Kelley in Portland, Oregon. I'd like to come in at this point because that exactly expresses my sentiments, John. I'm with you on that. I ask myself if this combination of factors that we've been running through here this morning is not exactly what one would expect at about this sort of an inflection point [in the cycle]. And I ask myself if it's not too early to [decide] that the economy requires further stimulus. We have one good bunch of inflation numbers and I wonder if that's enough of a robin's flight to assure us that we have spring. I think we should have had better inflation numbers before now and we haven't; and I would very much like to have their better tone verified a little more than by having just one set of them. As I listen to the presidents about the real economy, it seems to be very mixed, not definitely down. Again, I suspect that that may be about what one would expect in the way of a report at this point. We always feel that we need more data; but to me this is one time when we really do need more data. I would prefer that we wait to see how things are verified in one direction or another. However, I do agree with John that it's important--and others have said this--that we show a level of togetherness here if we possibly can do so. So, I would not be completely opposed to making a move at this time if that seems to be the way that we should go.

MR. HOSKINS. Mr. Chairman, Lee Hoskins. We had a board meeting yesterday and we had some talk about the fact that we don't have much strength on the industrial side in our District, as you pointed out. We don't have any appreciable weakness or deterioration either. But beyond that, I have a very strong disagreement with moving either rate at this point in time. We have put into place what I consider to be a good monetary policy. And I don't believe that we can alter that based on market expectations. We have trained the markets to react to monthly numbers, whether it's employment numbers or CPI numbers. And I think that's a bad precedent to continue to set. What we ought to do is to let the policy that we've put into place--which, as I said, is a good one--work its way out. If it proves down the road that in fact things were weaker than we thought, we could reassess at that point. But I really feel strongly that we should not train the market to react because of numbers and then react to their expectations [based] on those numbers. I just think that's a wrong-headed policy.

CHAIRMAN GREENSPAN. Gary Stern, I don't know if you had a chance to comment.

MR. BERNARD. Yes, he has. President McTeer [hasn't].

CHAIRMAN GREENSPAN. Okay, I'm sorry. Bob McTeer.

MR. MCTEER. Mr. Chairman, we had a board meeting yesterday and it was neither very positive nor negative. As you know, our directors have been submitting a proposal for a reduction in the discount rate for some time now, and I would feel uncomfortable arguing against that in view of their position on it. But nothing was said in our board meeting yesterday that indicates any further weakness. As a matter of fact, things are better in our part of the world than they are in the rest of the country.

CHAIRMAN GREENSPAN. Okay. Does anybody else have any other comments? Can the Board Members stay on? We have another issue that we have to discuss. So, gentlemen, what I hear at this particular stage is a mixed view or willingness to do perhaps a 1/4 point and possibly go further. In the Board meeting I think we ought to discuss the other issue and see if we can all come to a general conclusion before the day is out either to move or not to move. In any event, can the Board members stay on?

MR. ANGELL. Yes.

MR. KELLEY. Yes, sir.

MR. LAWARE. Yes, indeed.

END OF SESSION