

APPENDIX

FOMC Notes

November 17, 1992

Margaret L. Greene

Mr. Chairman:

The dollar remains on the sidelines of market attention. But it has shown a tendency to strengthen almost continuously since early October, rising to a high of the period this morning of DM 1.6070, an increase of almost 13 percent against the German mark. It rose a more modest 4 percent against the Japanese yen. The U.S. authorities did not engage in any foreign exchange market operations during the interval.

At the time of your last meeting, the immediate pressures of September's European exchange market crisis had pretty much been dissipated and the Bundesbank had lowered both official and market interest rates. Since then, though questions remained about the durability of existing exchange rate relationships within Europe and the ultimate configuration of the European Monetary System, there has been a lessening of the active pressures in the exchange markets.

--The French have been able to recover all of the reserves they lost defending the franc, and then some. Their repayment of indebtedness to the Bundesbank has helped the German central bank absorb some of the liquidity that the September interventions had created.

--The currencies that departed the EMS--pound sterling and the Italian lira--have recovered some of the exchange rate depreciation against the mark that developed when these currencies were first floated.

--Impressively, these developments occurred at the same time that the EMS central banks other than the Bundesbank have been able to drop interest rates by varying degrees, but in every case to levels below those prevailing before the crisis. The countries with the largest changes in interest rates are those with the newly floating currencies--the United Kingdom and Italy. Most other EMS countries have also been able to narrow their interest differentials relative to Germany. France is one of the few countries where the decline in money market rates is not as great as that which occurred in Germany during September.

With interest rates in the United States tending to firm largely in response to evidence of somewhat better-than-expected labor market data and talk of fiscal stimulus early next year, the interest differentials against the dollar tended to narrow. The move was greatest for longer-term interest rates as they reflected not only the changes in short-term rates currently taking place but also expectations that these trends would continue. On 10-year government bonds, for example, German rates remain higher than those here, but the adverse differential has been squeezed down to its lowest level since early spring of this year. At the same maturity, the favorable interest rate differentials we enjoy relative to Japan widened to more than 2 percentage points.

Under these circumstances, market participants began to consider the possibility that the trend of dollar rates may have reversed. They were sensitive to any indication that the move to lower interest rates abroad would continue. In response, many who had either invested abroad or had allowed their foreign currency receivables to build up in anticipation of further dollar

depreciation moved to convert back into dollars. Thus, the dollar moved up steadily during most of the intermeeting period.

One of the reasons why the crisis conditions rolled back as much as they did during October and the first two weeks of November is that there were widespread expectations at that time that German interest rates would continue to be lowered. Data then being released drew market attention to a deteriorating outlook for German output, employment and exports. Also, Bundesbank officials appeared to dismiss the most recent accelerations of M3 growth, the Bundesbank's target variable, as an aberration reflecting the unusual circumstances of the huge interventions of September. Together, these developments encouraged the view that the Bundesbank was entering on a course of persistent, if gradual, easing of monetary policy that would open up room for the central banks of the other EMS countries to continue to lower their own interest rates.

As these other European countries did move their interest rates lower, some started to probe the limits the market would accept as far as a further narrowing of interest differentials vis-a-vis the German mark. At the same time, as perceived by the Bundesbank, the domestic environment has now turned somewhat less hospitable to an easing of policy than it was two months ago. The prospect for fiscal consolidation has deteriorated with the weakening economy, wage negotiations for next year are at a sensitive juncture right now, and the movement of exchange rates has rolled back about half of the mark's appreciation that occurred in September. The market has sensed that the Bundesbank has just recently become a little less generous in its money market

operations and, last week, the price of Euro-DM futures adjusted to eliminate an expectation of a further cut in short-term interest rates by year end. Under these circumstances, the dollar's rise seems to have stalled during the past couple of days and some other European currencies have met with some renewed pressure.

Meanwhile, the Bundesbank has quietly been unloading in the exchange markets some of the dollar reserves it received as repayment of credits extended to other European central banks during the September crisis. These operations have been aimed at helping the Bundesbank absorb the liquidity which the earlier interventions had created. For the most part, their dollar sales have been conducted in a quiet manner. But market participants are aware of the Bundesbank's actions.

OPEN MARKET DOMESTIC DESK OPERATIONS

FOMC MEETING

November 17, 1992

William J. McDonough

Monetary policy was unchanged throughout the period since the last meeting and the Desk sought to maintain the degree of pressure on reserves consistent with Federal funds trading in the area around 3 percent. To reflect decreases in seasonal borrowings typical of this time of year, we lowered the borrowing allowance five times in installments of \$25 million from an initial level of \$200 million to the present level of \$75 million. The assumed path for excess reserves held by the banking system was maintained at \$1 billion.

Actual seasonal borrowings did decline through the period from \$143 million the first day to \$38 million last Friday. Adjustment borrowings averaged \$26 million--even that relatively low level was caused by three tightish days when adjustment borrowings were over \$100 million. The banks held excess reserves above the assumed \$1 billion level in the first of the three maintenance periods, just about right on it in the second period, and somewhat below it in the final one.

Managing the reserve needs was not particularly problematic.

We stayed out of the market the day after the last FOMC meeting even though funds were a bit tight in order to underscore the unchanged stance of policy. Once steady policy was established, we added reserves several times when funds were trading slightly below the 3 percent target when there were reserve add needs.

The BIS and the Bundesbank complicated things somewhat by asking on very short notice to hold large deposits over a weekend as they sought to manage unusually large dollar positions coming from the September turmoil in European FX markets; we were able to take care of a substantial share of their requests.

To help meet the growing seasonal need for reserves, the Desk bought \$3.9 billion in Treasury bills in the market on October 27 and \$980 million in securities from foreign accounts. On 19 of the 26 business days in the period, either system or customer repos were used as well.

The average effective Fed funds rate for the period was 3.02%.

In the Treasury market, coupon securities increased in yield by 25 to over 85 basis points, with a flattening of the yield curve. The 30-year maturity yield rose by 26 basis points, whereas the 10-year rose by 59 basis points and the 3-year by 84 basis points. The increase in rates reflected in part a removal early in the period of an expectation of Fed ease. A more important factor was a discounting of Governor Clinton's electoral victory and a continuing concern before and after the election regarding a

possible fiscal package early next year.

For the most part, economic data played a limited role in rate movements as the reports continued mixed. Market views of the outlook shifted modestly during the period from an initial concern that the economic recovery could stall to a view that, if anything, growth may be picking up at least slightly.

Against that background of uncertainty, Treasury auction results were uneven. Some auctions, particularly the 7-year early in the period, met relatively weak demand, but others did relatively well as investors found maturities they preferred. The midquarter refunding went rather well. With rates having adjusted upward before the auctions, the ten- and thirty-year issues attracted a strong response. For the first time, the Treasury made the judgment call that an acute and protracted shortage existed when it chose to reopen the 10-year issue. The shortage, in our technical assessment, was indeed acute and protracted, not because of any inappropriate market practices, but because of investor demand and particularly heavy use of the issue by the street firms as a hedging device against long positions resulting from heavy calendars of corporate and municipal issues and customer sales of mortgage-backed securities.

The second monthly "Dutch" auctions of the 2-year and 5-year Treasuries, in the year-long experiment with that method, went reasonably well as the dealers seem to be getting more familiar with how to bid. They like the removal of the winner's curse, but are seeking to avoid bidding so strongly that the issue comes at a

yield so low that it makes retail distribution difficult without a loss.

Market participants, at this juncture, expect the Fed to maintain a steady posture. The structure of short-term rates and futures could be interpreted to suggest anticipation of firming, but we think that this bit of tightness really comes from some pressure on funding over the year-end.

Looking forward to the period between now and the next FOMC meeting, it appears to us that the reserve needs arising primarily from seasonal increases in the demand for currency and required reserves are going to be of such magnitude that the normal intermeeting leeway of \$8 billion could well require temporary transactions of excessively large size. Therefore, we request that the Committee authorize an additional \$3 billion for this period, bringing the intermeeting level to \$11 billion.

Michael J. Prell
November 17, 1992

FOMC BRIEFING

As you may have discerned in reading the Greenbook, the staff struggled a bit in developing a projection for this meeting. This wasn't the first time we've been confronted with a possible change in fiscal policy, but in this instance, the task of producing a coherent and useful analysis was complicated by the fact that everybody already thinks something is coming but nobody knows what it will be. Although Mr. Clinton outlined a program in his campaign booklet Putting People First, it is only an outline and it still has to be fleshed out. Moreover, the program he described was not aimed primarily at achieving short-run aggregate demand stimulus, and there is considerable talk of altering or augmenting it so as to give the economy a quick boost. In the end, we performed a variation on the classic two-handed economist routine, saying here's a forecast, but take it with several grains of salt because the assumption of no fiscal policy shift is dubious.

So, let me attempt to make some amends this morning by suggesting how one might go a step further in pulling together the material presented in the Greenbook with an eye toward making a policy decision.

First, I think it is useful to ask where the economy would be headed if there were no fiscal action. You can view this as simply an analytical device--setting a baseline, as it were; or you can view it as a reasonable approximation of at least one potential reality, one in which the fiscal measures enacted don't net out to much in terms of short-run macroeconomic impetus.

I won't repeat all that was said in the Greenbook to describe our forecast. Basically, we indicated that it seemed likely that the economy would maintain a moderate growth path in the near term despite the recent jump in interest rates and appreciation of the dollar. Then, later in 1993, there should be a gradual acceleration, encouraged in part by an easing of bond rates.

Focusing on the near term, it is worth noting that the 2 percent growth of real GDP that we've projected through the first half of 1993 is about half a point slower than what occurred over the first three quarters of this year, and that the projected 2-1/4 percent growth of domestic demand is a full percentage point below the pace thus far this year. It is conceivable that, in arriving at this forecast, we have been unduly negative in interpreting the incoming data: there's a danger that, having been burned in the past, we may become excessively skeptical about good news and miss the strengthening we've been expecting all along. For example, the recent decline in initial claims could mean that employment is doing better than all of the corporate downsizing announcements would suggest; or the early November jump in the University of Michigan sentiment index could mean that consumers already have become more willing to borrow and spend, their spirits lifted by the prospect that a new administration will be more active in engendering job growth.

But, as I suggested, we've seen false starts previously--the short-lived Desert Storm euphoria comes immediately to mind--and we believe that a degree of caution is warranted. To be sure, some progress has been made in reducing the financial impediments to expansion, but they have not been eliminated, and there are still major segments of the domestic economy experiencing strong contractionary pressures. Moreover, while we have anticipated a

significant drag from the external sector, we can not rule out the possibility that foreign activity will continue to disappoint--as occurred earlier in the U.S. And then there is the hopefully remote risk that the current trade squabble will be allowed to degenerate into a trade war.

All told, my assessment is that the economy has at least a modicum of forward thrust at this point, and while the risk of a shortfall from the Greenbook output path for the near term is not negligible, there also is a chance that we'll continue to do considerably better than 2 percent growth, under stable money market conditions.

If that is so, how should one view the outlook in light of the possible changes in fiscal policy? Your guess is undoubtedly as good as mine with regard to what legislation will be forthcoming. But I'll offer a few random observations, for what they're worth.

First, there are some significant barriers to enactment of a big fiscal stimulus package. There is still a concern about the size of the federal deficit--and not just among bond traders. Mr. Clinton and his advisors have noted repeatedly the need to reduce the deficit over time, and this was echoed by many Congressional candidates during the campaign.

The nuts and bolts of the legislative process seem also to point in the direction of fiscal moderation: even if the current budget rules are scrapped to accommodate the deficit levels and the kinds of trade-offs between taxes and expenditures that Mr. Clinton's program would require, there is the additional hurdle of the public debt ceiling, which must be raised early next year. A frequently heard view is that the Balanced Budget Amendment will rear its head again at that point, and that, in an effort to counter that

initiative. it will be necessary to pass some multi-year deficit-reduction legislation with credible teeth.

There undoubtedly is room in all this for a package to emerge that has as its base longer-range investment- and equity-oriented components involving little net deficit expansion, but that adds in some temporary stimulus. This might be achieved by adjusting the timing of various pieces of the basic program or by adding on some extra expenditures or tax cuts. Depending on their nature, such short-run stimulus measures might, or might not, have an appreciable impact on aggregate demand; for example, a one-time income tax rebate would be expected to have a rather weak effect, but a one-year extra investment tax credit could have a considerable transitory bang for the buck by shifting spending forward in time.

Obviously, it is impossible to reach any firm conclusions about what will happen once the give and take of the legislative process is put in motion. But let us consider what the risks may be, in terms of the possible economic outcomes.

The fiscal simulations in the Greenbook were intended only to provide some rough idea of the potential effects of a range of tax and spending measures. They suggest that, if you accept our baseline forecast, it probably would take a substantial fiscal stimulus package--well beyond what Mr. Clinton signaled in Putting People First--to push output growth up to such a point that we would put major pressures on resources within the next two years. Of course, if you believe that we have understated the underlying thrust of the expansion--which prior business cycle experience certainly suggests is not a possibility one can afford to ignore--then the risk is greater. If, for example, real GDP growth were to average 4 percent over the

next two years--versus the 2-3/4 percent in the Greenbook baseline-- pressures toward greater inflation might well emerge by 1994, though quite possibly still starting from a rate of price increase somewhat below 3 percent.

However, weighing against a big boost from fiscal policy are not only the political considerations, but also the potential reactions of the financial markets. Though the recent backup in bond yields likely had several causes, concerns about the fiscal outlook are generally perceived to have been a significant factor. That said, one still must be careful in assessing the implications of such rate movements. If, for example, the rate increase reflects primarily inflation fears, then the real cost of capital perceived by potential borrowers may not have risen much and the damping of aggregate demand may be limited. But if the rate rise reflects an anticipation of stronger economic activity down the road, then at least some potential borrowers may be willing to incur higher real capital costs to finance investment goods. And if it reflects simply expectations of greater federal debt growth over time, then it may represent a hike in real rates that will crowd out private borrowing and investment in the near term.

In arriving at our baseline forecast, we've leaned substantially toward this last interpretation, and we've viewed the higher bond rates as imposing a drag on activity--partly through the channel of exchange rate appreciation, partly through the traditional domestic demand channels. Similarly, as we also noted in the Greenbook, the effects of a deficit-expanding fiscal stimulus measure could be considerably smaller than our model simulations suggest if concerns about an expanded national debt were to hold intermediate- and long-term rates above our baseline path.

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Michael J. Prell

To sum up briefly, then, it appears that the economy is growing moderately at this time and that the chances of sustaining at least moderate growth over the next few quarters are good, absent a significant further deterioration in the financial environment. But with such a growth path, unemployment probably will remain high and maintain the pressure on the Administration and the Congress to take some action. The odds do not obviously favor a large boost to aggregate demand flowing from fiscal policy, and even if there were such a boost, the amount of slack in the economy provides some cushion against an immediate reversal of the disinflationary process--and provides you some time to monitor developments. However, the room to maneuver is not unlimited, and it doesn't take a stretch of the imagination to envision a combination of fiscal impetus and revived animal spirits that might make it necessary to tighten money market conditions sooner or more than we've anticipated, to head off an eventual reacceleration of wages and prices.

November 17, 1992

Long-run Ranges
Donald L. Kohn

In July, when the FOMC considered ranges for money and debt in 1993 it chose to carry over the 1992 ranges on a provisional basis. The Committee recognized that the relationships among money, interest rates, and income were evolving in unanticipated ways, and felt that it did not yet have sufficient information about these relationships to establish a new range for M2 that it could confidently predict would be compatible with its longer-run objectives for the economy and prices. At that time, the Committee also decided that it might well reconsider the ranges before its regularly scheduled revisit to this subject in February, after additional information and analysis became available.

The information received since late June does show continued unusual increases for M2 velocity. V2 increased at about a 4 percent annual rate in both the second and third quarters. Although a considerably smaller increase is projected for the fourth quarter, velocity should grow around 2-1/2 percent over the year. Substantial upward movements in M2 velocity are evident when this measure is calculated with M2 lagged behind GDP as well.

The surprise, of course, is that velocity increases have occurred with declining short-term market interest rates--a circumstance heretofore generally associated with decreasing velocity. The analysis done for the July meeting, and revised and refined since then, sheds some light on this unusual occurrence. That study, by Josh Feinman and Dick Porter, looks at a broad array of returns on M2 and its competitors for savers' dollars, and allows the response of M2 to changes in those rates to be estimated in an innovative way. It

turns out that rates on important alternatives to M2 also declined, but not by nearly as much as short-term market rates, which had been used to compute opportunity costs. Long-term market interest rates and rates on consumer loans, for example, have remained high relative to short-term market and deposit rates. At the same time, yields on M2 itself fell fairly smartly with short-term market rates--especially returns on funds likely to be highly interest sensitive. As a consequence, the effective opportunity cost of holding M2, broadly conceived, actually rose in 1992, despite the drop in short-term market interest rates, explaining much of the weakness in M2 and the increase in its velocity.

Some of the unusual behavior of opportunity costs in recent years has reflected circumstances that are not likely to be repeated soon--such as the extraordinary steepening of the yield curve and changes in the tax law that raised the cost of consumer debt. However, some also resulted from changes in the structure of financial flows related to the efforts both of depositories rebuilding capital and adapting to new costs and regulations and of their customers strengthening balance sheets. While we expect these latter processes to taper off next year, they are likely to persist for some time, contributing to further declines in offering rates on liquid deposits and to a continued channeling of credit flows around depository institutions. Moreover, velocities of both M2 and M3 next year will be further boosted by new institutional influences--such as features of FDICIA implemented starting in the latter part of 1992 and the revival of the RTC.

Taking account of these factors, of the assumed flatness of short-term market rates, and of anticipated declines in long rates in the absence of a fiscal stimulus package, we are projecting M2 growth

of 2 percent in 1993 associated with the growth of nominal income of the greenbook forecast of about 4-1/2 percent. This implies another rise in M2 velocity of around 2-1/2 percent. The M2 projection for next year is 1/2 point lower than was forecast in July, partly reflecting a substantial downward revision in projected nominal GDP growth for 1993 since then. M3 is projected to increase less than one percent in 1993, and its velocity to rise around 4 percent. An easier fiscal policy would tend to keep long-term interest rates higher than otherwise and raise nominal GDP, with roughly offsetting effects on demand for M2. M2 velocity would tend to be higher as more funds flowed to capital market investments.

The Feinman/Porter study, by quantifying some of the effects we had been speculating about, and the recent experience with velocity give us a little more confidence in our projection that increases in M2 velocity will in fact persist for some time. However, predicting M2 velocity over the short- or intermediate-terms always was a hazardous business, because it required a sense of what interest rates would go with what GDP. The study underlines those hazards by bringing into the process a much wider array of interest rates than previously thought necessary. Thus, the extent of the increase in velocity remains highly uncertain, even if the assumption of a flat federal funds rate proves correct.

Against this background, the Committee would seem to have a number of choices open to it with respect to decisions on the long-term ranges at this meeting. First, it can chose to do nothing. The deadline for informing Congress of our final ranges is February, and action could simply be postponed until that time. Postponing the decision would seem an apt choice if the Committee did not intend to revise the tentative ranges, especially if that decision arose from a

desire to await the additional information that will be available in February. By then, we will have a better approximation of fourth quarter velocity and some sense of whether the recent strength in M2 and more damped velocity behavior is persisting into the new year. The current discussion could be seen as a prelude for the February meeting, perhaps helping to clarify some of the issues and facilitating a decision at that time.

A reason to vote to reconfirm the tentative ranges at this, the November, meeting might be that the Committee intended to put some weight on having money growth within these ranges early in the year. In the context of a projection that money growth is likely to continue on the sluggish side over coming months under the greenbook forecast, a reaffirmation of the ranges at this time would seem most appropriate if the Committee was not satisfied with the outlook for economic expansion, or felt that velocity was not likely to continue to increase as rapidly as projected, and wanted to signal its intention to take any needed actions to boost money growth and spending.

The case for reducing the ranges rests on the information and analysis that suggest that velocity is likely to continue to increase, so that relatively damped M2 and M3 growth rates should be compatible with satisfactory outcomes for spending and inflation. If the staff assessment of the forces continuing to boost velocity is close to on track, money growth within lower ranges would be consistent with the greenbook nominal GDP outlook or something even stronger. At the same time, the reduction in the ranges would signal limited tolerance for a very rapid pickup in spending and money demand, and thereby suggest an intention to consolidate gains on inflation and lean against any incipient tendency for price pressures to build again that might occur as the expansion continued.

Of course, the Committee could lower the ranges by less than the one full percentage point suggested in the bluebook, say 1/2 point to 2 to 6 percent for M2 and 1/2 to 4-1/2 point for M3. The less-abrupt decline, especially given the already-low target ranges, might be seen as a more temperate response to the new information and less likely to raise concerns about whether the Federal Reserve is prepared to allow sufficient monetary expansion to support more robust economic growth.

As to the timing of reductions in the ranges should the Committee desire this approach, action at this meeting could be justified on the grounds that new information does allow the cleaning up of unfinished business from last July. Just since the last Committee meeting, we have had third-quarter GDP with its confirmation of rapid velocity increase, as well as release of the study. Any change in ranges would need to be communicated to the Congress, presumably by letter from Chairman Greenspan to the Chairmen of the Banking Committees explaining the action. On the other hand, next February is the natural time to re-examine and vote on the ranges. The new ranges would be announced and explained at that time in the normal report and testimony, and in the context of the Committee's new projections for the economy and inflation. This might make it easier to discuss the expected compatibility of lower ranges with sustained economic expansion and damped inflation; interactions with any fiscal policy proposals could also be explained at that time. Even if no vote is taken at this meeting, the policy record would note that the ranges were discussed and would summarize the considerations raised by Committee members.

November 17, 1992

Short-run Policy
Donald L. Kohn

In thinking about policy options at this meeting, the FOMC would seem to be faced with something of a dilemma: the incoming information on the economy and on money supply has been a bit stronger than anticipated; however, as Mike noted, the backup in interest and exchange rates resulting in part from this information has weakened the outlook--contributing in the Greenbook forecast to growth in real and nominal GDP for 1993 somewhat below the central tendencies of the Committee's forecast in July, though this is without any added fiscal stimulus.

The rise in interest rates has been substantial, and is accounted for entirely by increases in forward rates out to seven years. These increases apparently represent upward revisions to expected credit demands over the next few years, resulting both from firmer private credit demands and possible fiscal stimulus. And they seem to consist of increases in real rates, rather than in inflation expectations, given the firmness of the dollar and the relatively flat or even declining commodity prices. To the extent higher interest rates reflected optimism on the economy resulting from and leading to a greater willingness to spend, they wouldn't be a problem for the economy and monetary policy. In this regard, the rise in the stock market over the intermeeting period should give some reassurance.

But we have also experienced several episodes in recent years--the first few months of 1991 and of 1992--in which long-term rates rose in anticipation of a stronger economy, and in the process apparently helped to short-circuit the very strength they anticipated.

In each case rates subsequently retreated, falling well below their previous lows, as economic activity turned out to be far less robust and the path of short-term rates considerably below that which had been imbedded in the structure of rates. And this is assumed in the greenbook to happen again, absent appreciable fiscal stimulus.

The current situation is complicated, relative to earlier such episodes, by the uncertainties about fiscal policy. To the extent markets are reacting to the uncertainty itself or are anticipating fiscal stimulus that does not occur or is effective only with a long lag, the rise in rates could have a more adverse effect on aggregate demand for a time than the previous responses to increases in spending. This circumstance eventually will self-correct--either through actual stimulus or through rates coming back down when fiscal policy is not changed.

The risks at the current time are compounded by strength in the dollar in the context of economic weakness abroad. A portion of the dollar's increase is a response to actual and anticipated further monetary policy ease overseas. That ease seems to be offsetting a deteriorating situation abroad, rather than producing a noticeable net stimulus to economic growth. From the perspective of our forecast, relative to the last FOMC we have a higher dollar and about the same projection of growth abroad--a net negative in terms of demands for U.S.-produced goods and services.

In the past, added uncertainty about real side forces might have argued that more attention be paid to money supply developments. However, as we have already discussed today, there is considerable uncertainty about money-income relationships. Still, unusual behavior of money and credit in months ahead might be one signal of how some uncertainties are being resolved.

Money growth in October and early November was somewhat stronger than we projected at the last FOMC meeting. In part, this likely reflects a higher path for spending over the second half than anticipated at that time. But special factors also played a role as mortgage refinancings turned out to be somewhat greater than expected. Moreover, the public's appetite for bonds seems to have slackened, perhaps reflecting uncertainties or anticipated increases in interest rates. We are not projecting the strength in money to continue. Indeed, we foresee a deceleration over coming months, which would keep M2 from reaching the lower bound of its range in 1992, and keep it below the 2-1/2 percent lower bound of the current tentative range through March of 1993, under the unchanged interest rates of alternative B. A portion of this slowdown reflects the absence of the special factors that have been boosting money growth in recent months, and indeed we anticipate some drawdown of demand deposits associated with a slackening in mortgage refinancing. In addition, depositories look like they still have some way to go in reducing rates on liquid deposits, and we expect the continuation of this process to discourage M2 holdings. With nominal spending projected to expand at a modest pace, and the forces boosting velocity still in place, we see underlying money growth of only 2 percent--the alternative B growth rate from October to March.

On the credit side, recent data suggest some strengthening of private demands--but very limited. Bank credit seems on a somewhat firmer trend than through the summer, but growth in October was below that of September, with business loans leveling out. In our quarterly survey of lending officers, few institutions reported easing of terms or conditions or a noticeable pickup in credit demand. Moreover, in

securities markets quality spreads, while still quite low, have widened a little since this summer, suggesting some caution by private lenders. Looking forward, we see a gradual strengthening of private debt flows next year. However, money and depository credit remain quite subdued and the expansion of private debt is slower than that of income as balance sheets continue to be rebuilt.

A sense that this expansion of money and the greenbook outlook for spending behind it were not adequate might argue for consideration of some easing of policy. This option might be particularly attractive if there were perceived to be some chance that the forces of disinflation around the world were sufficiently strong that price stability might be reached in the next few years with excess capacity remaining, risking actual deflation. If underlying demands are seen as weak, the possibility of fiscal stimulus need not deter easing at this time, especially if that stimulus were seen as possibly muted by financial market reactions or significantly delayed. The easing would tend to offset the effect of the recent backup in longer-term interest rates and the dollar.

Alternative B might be chosen if the greenbook outlook were considered probable and acceptable. The strength of recent data and possibility that pleasant surprises could continue, along with the likelihood of fiscal stimulus to take effect fairly promptly next year, might also reinforce the case for keeping policy on hold. However, should the Committee view the risks and costs of unexpected shortfalls in activity to be weighted to the downside, it may still wish to keep its directive biased toward ease under alternative B.

November 17, 1992

Detailed Minutes
Donald L. Kohn

Committee members have received several letters from Chairman Gonzalez concerning detailed reporting of FOMC discussions. One to Reserve Bank presidents asked about their willingness to have their comments and votes recorded in minutes, which would then be released "promptly." The other, to Chairman Greenspan, requested the Board's views on videotaping FOMC meetings for release 60 days later.

As background for this discussion, Committee members also received a memo from Norm Bernard giving some of the history on this topic. Before April 1976, proceedings at each meeting were detailed in a "memorandum of discussion." This document recorded what each participant said essentially in the order it was said. It was not a word-for-word transcript; each intervention was edited by the FOMC secretariat for wording and organization, while adhering to the substance of the argument made by each participant. The document was then reviewed by meeting participants. It was released after five years, with deletions of sensitive international matters.

The FOMC voted to discontinue the memorandum of discussion in 1976. One reason given was an imbalance between costs and benefits: in fact there were very few requests for it, and it consumed considerable staff and principal time to prepare. It seems clear, however, that the precipitating factor was a recent U.S. District Court decision under the Freedom of Information Act. The Committee saw a risk that, under that Act, a considerable portion of the memorandum might have to be made public with a very short lag. As a substitute, the Committee expanded its policy record to include a fuller report on the

discussions at the meeting, and moved up release of the policy record to immediately following the next FOMC meeting.

The matter bubbled around in Congress until 1984, though it has been quiet since then--itself perhaps an indicator of a lack of widespread interest. Through the earlier period, the Board generally did not object to a law requiring detailed minutes, provided several safeguards were in place; the whole document had to be protected from FOIA requests for a minimum period--from 3 to 5 years; and after this interval sensitive international information could still be deleted for an extended period.

The advantages of producing some kind of detailed record of Committee meetings would seem to be two-fold. First, it would be available to economists and historians for study and analysis; informed analysis of how policy is made should enhance public understanding and possibly result in worthwhile suggestions for improving monetary policy. Second, it gives a sense of greater openness to Federal Reserve deliberations, perhaps reducing suspicions about what goes on behind closed doors. The disadvantage is potential adverse feedback on the policy process itself. Concerns about market reactions, about revealing confidential sources or information on specific firms, or about public reactions to arguments or proposals could inhibit the free flow of ideas and discussion needed to reach the best possible decisions. The longer the lag in releasing the detail of discussions, for example, taking it out of the immediate cyclical context, presumably the less the inhibiting effect, but whether it could be completely eliminated is an open question.

If the Committee decided that a more extensive record of discussion and decisions should be released, it would need to determine the lag and the format. With regard to the latter, there are

several possibilities. First is the videotape suggested by Chairman Gonzalez or simply an audio tape--presumably edited to delete certain sensitive material, and perhaps also accompanied by a transcript for use by scholars. Second would be a transcript alone. This could be literal, or it could be in the style of a Congressional hearing, in which each person was allowed to edit his or her own remarks--but only lightly and without changing meaning. Editing, including suggested deletions, could be reviewed by the Secretariat. Third would be a revival of the memorandum of discussion, prepared by the FOMC secretariat and reviewed by participants.

Fourth would be an expansion of the policy record. One way of addressing Chairman Gonzalez' concern about taking responsibility for positions and votes would be to have more attribution in the policy record. As you know, dissenters now submit statements giving the reasons for their dissents; the majority is presumably covered by the record itself. But those in the majority could also have the right--or even the obligation--to file statements about their policy position. As is now true for dissenters, those statements would have to be drawn from their comments at the meeting. A second possibility for the policy record would be to attribute the views described in the policy discussion to the specific members giving those views. For example instead of the policy record saying "several members noted they could live with an asymmetrical directive but preferred a symmetrical one because..." it could say "Messrs. X,Y, and Z noted ...". This practice could be followed both for the majority and the minority, possibly eliminating dissenting statements.

Finally, Mr. Chairman, the Committee needs to determine how it wants to respond to Chairman Gonzalez--through one letter written

by you on behalf of the Committee, or with the individual members responding in addition to the letter you promised.