Meeting of the Federal Open Market Committee
March 23, 1993

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, March 23, 1993, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Broaddus, Jordan, Forrestal, and Parry, Alternate Members of the Federal Open Market Committee

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

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

Messrs. R. Davis, Lang, Lindsey, Rolnick, Rosenblum, Scheld, Siegman, Simpson, and Slifman, Associate Economists

Mr. McDonough, Manager of the System Open Market Account

Ms. Greene, Deputy Manager for Foreign Operations

Ms. Lovett, Deputy Manager for Domestic Operations

Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Winn,[1] Assistant to the Board, Office of Board Members, Board of Governors
Mr. Madigan, Assistant Director, Division of Monetary Affairs, Board of Governors
Mr. Hooper, Assistant Director, Division of International Finance, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, T. Davis, Dewald, Goodfriend, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Kansas City, St. Louis, Richmond, and Atlanta, respectively

Ms. Browne, and Mr. Sniderman, Vice Presidents, Federal Reserve Banks of Boston and Cleveland, respectively

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

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1/ Attended portion of meeting relating to discussion of merging minutes of action and policy record into one document.

Transcript of Federal Open Market Committee Meeting of
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CHAIRMAN GREENSPAN. Good morning, everyone. The usual procedure, as you know, is to approve the minutes first. But prior to doing that I'd like to call on Governor Mullins.

MR. MULLINS. Thank you, Mr. Chairman. The topic is our subcommittee proposal for creating a new document called the "Minutes of the FOMC." The genesis of this proposal comes from the recent Senate Banking Committee hearing in which two senators, Senator Mack and Senator Riegle, stated that the Federal Reserve didn't even produce minutes for the FOMC. I think to some of us this episode made it abundantly clear that the public, including important public policy officials, has very little appreciation for the quantity and detail of the material that we already release. So, the subcommittee proposal would be to assemble in a convenient and easily accessible form, appropriately titled as minutes, all the information currently released on an FOMC meeting. As you know, we issue the policy record with a press release. But the Minutes of Actions, the other information currently produced, are simply placed in our FOIA office and are not accompanied by a press release; and they elicit very little public demand.

So, the specific proposal is to release a merged document consisting of the Minutes of Actions and the Policy Record along with an Executive Summary under the title "Minutes of the FOMC." The hope would be that this approach would underscore the quantity and detailed nature of the information we make available. The subcommittee feels that these materials do constitute and are appropriately described as minutes in the context of the use of that term by other organizations, both public and private. So, there would be no change in the timing of release or in the nature of the contents of the document under our proposal. Our suggestion is to initiate the proposal with the release this week of minutes for the February FOMC meeting. As mentioned in the document, the February meeting minutes will be somewhat longer due to the organizational votes, but we thought it would be appropriate to start with the new annual cycle. So, I would open for discussion the subcommittee's recommendation that we do this in the form described in our memo of March 17.

MR. FORRESTAL. David and Mr. Chairman, I have a comment and a few questions. The comment is perhaps minor in nature, but it seems to me that someone on the Hill might very well question the use of the term "Minutes of the FOMC" because what we're really doing is combining two documents. That may or may not be a problem, but I just throw that out for consideration and discussion. The question I have is whether you talked about the timing of the release in your group and whether you plan to accompany this with a press release or some explanation of what the change is.

MR. MULLINS. I guess the reason we used the word "minutes" is because we think these are minutes as they include the Minutes of Actions and the Policy Record. In terms of changes in timing, based upon the discussion the Committee had last time we did not propose any change in the timing. This [new procedure] may focus people's attention more on the timing. Norm, what are we proposing to do with respect to an explanation of what's going on?

MR. BERNARD. It would be just straightforward. There really would be no explanation. If someone inquired, presumably Mr. Coyne would provide the explanation that there's no new material, just a combination of these things. The minutes, including the attendance and the items having to do with approval of operations and so forth, would be published, as I understand it, in the Bulletin. And the policy record part of these minutes, at least, would be published in keeping with current practice in the Board's Annual Report. But the press release we have--it follows Governor Mullins' memo in the package--is simply patterned after the current press release. Instead of referring to the policy record, it refers to minutes.

CHAIRMAN GREENSPAN. I might say that what has happened here is that the arcane terminology of the Federal Reserve is being used against us.

The normal notion of what is in the minutes of corporations, as you well know, is three paragraphs. When it gets to the fourth paragraph everyone objects because it's getting too specific. And that's usually after a whole day's meeting! The impression I have of this issue is that by any stretch of the imagination these are minutes. What we used to term "minutes" is not the usual employment of the term in corporate America. What corporate America terms "minutes" is far closer to what Governor Mullins and his committee suggest we put out. We're merely taking an action to alter the language, which is creating a regrettable difficulty for us as I see it.

MR. FORRESTAL. I agree with that. I just wanted to make sure we focus on the fact that some of our critics might, and I use the word "might," allege that we've tried to get away with something here by just combining two documents and calling them minutes.

CHAIRMAN GREENSPAN. I have no doubt that there will be such comments.

MR. SYRON. I would think we'd have everything to gain and very little to lose by doing this. I can't think of what we'd have to lose. We do have to be careful that we don't--and no one has suggested that we do--advertise this as a dramatic, sweeping change.

CHAIRMAN GREENSPAN. No, we won't announce anything; we will just do it. And that doesn't have that kind of--

MR. PARRY. I think the change is a good one. I wonder about the executive summary. The draft that I read seemed good to me. I have no problems with it. But I can envision times when there would be an awful lot of disagreement about what should have priority, etc. Did you discuss whether or not this would be a very difficult process?

CHAIRMAN GREENSPAN. If I may just interject: I've been thinking about this overnight. I don't know of any minutes that have an executive summary, and I would question whether that is a desirable move if our basic purpose is merely to put out something that is more inclusive of the available information. The executive summary doesn't address that problem.

MR. ANGELL. Mr. Chairman, you're exactly right. The authority is Robert's Rules of Order, newly revised. Let me read [the description of] minutes: "The record of the proceedings of a deliberative assembly is usually called the minutes or sometimes, particularly in legislative bodies, the journal. In an ordinary society, unless the minutes are to be published, they should contain mainly a record of what was done at the meeting, not what was said by the members." So, Robert's Rules of Order clearly suggest that these are minutes and that we are doing them the way they suggest they should be done.

MR. MULLINS. Jerry.

VICE CHAIRMAN CORRIGAN. Dave, I think it's a good idea to do this. I have the same question about the executive summary. I think that could end up competing with the good and noble purpose.

MR. MULLINS. Tom.

MR. MELZER. I was just going to make a comment. This draft that you're seeing is the first draft that we've seen on the subcommittee too. In concept it sounded like it made some sense. When I looked at it and compared it against the policy record, it seemed to me almost impossible to do it without adding meaning. Now, I think it's a good summary for somebody who's not going to bother to read the policy record. But I think the people who will read these, the press and the Fed watchers, can read more meaning into it. For example--I don't want to beat this to death--where it talks about the Committee's commitment to maximum sustainable economic expansion the word "noninflationary" was added here and it wasn't in the policy record. Or where it talks about the uncertainty with respect to velocity, in the policy record that led us in effect to say that we were willing to miss the ranges; in the summary it says that it led us to conclude that we have to evaluate monetary developments in a broader context, which is said later in the policy record. I'm just saying that all the people who read this are going to add meaning that we may not have intended by how we say this, what we say, and what we don't say. So, I have some problems with trying, in effect, to restate the policy record.

MR. MULLINS. Mike.

MR. KELLEY. In defense of the summary notion, we're in a sound-bite situation here. People don't have long attention spans. They get impressions very quickly and those impressions are very hard to shake once they get them. I think the summary would provide for a much wider audience than the professional, careful reader, and that's an important audience. It would provide a quick, easy, access to [the essence of] 20 pages of the policy record that people are not going to read in many cases. A few will; fine, they should. But this will give access to the lazy, the overworked, the distracted, or the ignorant.

CHAIRMAN GREENSPAN. What's left!

MR. KELLEY. That I think is valuable. And it can be done in a way that presents the FOMC's story in a light that we approve of as opposed to relying on some reporter who may not understand what he's

reading and who plows through the policy record and picks out a phrase here and there that suits his purpose and presents the Committee in an erroneous light.

CHAIRMAN GREENSPAN. Given the full policy record, isn't he inclined to do that anyway?

MR. KELLEY. He may be, but if on the front of the release there is an executive summary, I think that will tend to be what gets picked up by a very large percentage of those who give it any attention at all. That's important and I think it's a positive.

MS. PHILLIPS. I'd like to support Governor Kelley on this. I thought the one-page summary was probably one of the more positive new things coming out of this. A lot of these news services will extract from the summary; and if we give them what we'd like them to extract, I think we have a better chance of there being a fairer reading of the minutes. So, I support Mike's contingent on this. And like it or not, we are in a sound-bite, concise summary kind of environment.

CHAIRMAN GREENSPAN. I think you're raising a separate issue, which ought to stand on its own merits, and that is whether we look good or bad. As I understand the proposal that Governor Mullins and his subcommittee are making, it is to consolidate already existing documents and in effect not to create anything new. It's the new that I think we want to avoid in this particular context. And as far as I'm concerned, the issue being raised should be on the table at some point and maybe we ought to discuss it; it really should be in the context of the subcommittee's work. But I personally don't feel comfortable with anything new in here. In fact, the message is precisely to make the point that there is nothing new, not that we're trying to improve this.

MR. MULLINS. Yes, and the Committee has steadfastly opposed newness in most proposals. It is true that this would represent a step forward in trying to communicate, and in its basic form our proposal is not supposed to be that. It's supposed to be a better organization of what we do now and a better labeling to make it more accessible to people. I think that's a useful distinction. Si.

MR. KEEHN. I think this is a constructive move. I can't see any down side. The up side does not seem to be considerable because I don't think it will diffuse the critics. I'd prefer to do it without the executive summary. I understand what Susan and Mike are saying, but I can't think of a time--again to use the private sector context--when I've seen private sector minutes with an executive summary. And I think the more we make it consistent with such minutes, the better off we are. So, I'd do it without the summary.

MR. MULLINS. Al.

MR. BROADDUS. I would recommend that we make some brief announcement about the change because inevitably there are going to be questions. Of course, we can answer them when we get them, but if we write the answer out to begin with, it might be clearer. I also had a question. Will the subcommittee continue to exist? Will some of the issues we discussed at the last meeting, such as the release date and

the possibility of doing something like the Memorandum of Discussion, still be on the table?

MR. MULLINS. It's my understanding that we still will meet and consider issues as they come up. It will be interesting to see what response, if any, there will be to this change. Perhaps it will sharpen the issue of release time. We will continue to test those issues. With respect to the explanation, I think it would be useful if we had Joe Coyne's description available to people so we all sing from the same hymn book on that.

CHAIRMAN GREENSPAN. Do I gather from the discussion that apart from the executive summary the recommendation being made by Governor Mullins' subcommittee is acceptable to the Committee? If I hear no objection, I will presume that that is in fact the case. On the issue of the executive summary, I think there's a technical problem at this stage. Tom Melzer raised perhaps only a few of the problems he would have raised if he had had a chance to look at the proposed summary in the normal course of events to make amendments, and I assume there are others here who would have the same problem. The notion of an executive summary has merit and it ought to be discussed, but I would like to recommend that we postpone it for now. In other words, I propose that we release what we already have put together and discussed without the executive summary and if it seems desirable to consider the latter, to do so at the next meeting or the one after. I personally have mixed feelings about it. I'm not saying that I wouldn't necessarily vote for it, but my initial reaction is to be a little cautious. In fact, I haven't given it terribly much thought so I don't want to say one way or the other how I may come out in the end. I'm not sure how mechanically we can effectively implement the executive summary even though we don't desire to do it this time; it just means we have to postpone the whole thing until the next meeting. Does anyone have any comments on that?

VICE CHAIRMAN CORRIGAN. I think the worst case with the executive summary is that we'd have to have a meeting between the meetings to agree on the language of the summary.

CHAIRMAN GREENSPAN. What it reminds me of more than anything is the communique of the G-7, which takes half of the meeting to argue out. If we're going to have an executive summary, it is a statement of policy of the FOMC. Everyone legitimately is going to want to get his views in on exactly how it is phrased, and I suspect that that may take a lot more time than anyone contemplates at this stage. I would recommend that we go ahead and vote on the new version of the "Minutes of the FOMC," excluding the executive summary at this time, and would ask whether there is any objection to that. Hearing none, would somebody like to move what we now will call the "Minutes of the FOMC Meeting"?

SPEAKER(?). So moved.

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. It has been seconded. Without objection it is approved. Let's move on to Bill McDonough on foreign currency operations. Bill.

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

CHAIRMAN GREENSPAN. Questions for Bill?

MR. LINDSEY. It wasn't just that the dollar didn't strengthen, the dollar weakened precipitously on the cut in German interest rates. I'm glad I wasn't in the classroom that day to try to explain it to my students. Do you have any other thoughts on why that happened?

MR. MCDONOUGH. Well, the particular market reaction last Thursday when the Germans lowered the discount rate was that the market had gotten itself hooked on the notion that the Germans would lower rates further, at least move lower on both the discount and the Lombard rates. So, the market disappointed itself. But then it corrected. So, we had that funny situation of a fair amount of volatility against a fairly stable 1.65 rate. But in answer to your direct question, I think it's just that the market anticipated more official action than took place.

CHAIRMAN GREENSPAN. Let's move on to the Domestic Desk.

MS. LOVETT. Thank you. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Joan?

MR. PARRY. I have a question about some of the reasons why long-term rates in particular responded so strongly in this period. There are a number of candidates for why that might have occurred. The one that you referred to was that it appears as though the markets buy the idea that there will be future deficit reduction, and I think studies of forward rates would suggest that. There are other possibilities as well. Most of the people who have looked at the Clinton program contend that it's going to produce weakness over the next several years, and that could be a factor. Thirdly, the interest rate developments--maybe not the declines that have occurred already in foreign markets but expectations of further declines there--could be a factor as well. Is there any discussion in the markets on the importance of these or is it just focusing on the one you mentioned, which is the increased chance of future reductions in the deficit?

MS. LOVETT. Well, I think it's what the future reductions in the deficit portend going forward rather than the reductions themselves. But, as you know, the general likelihood of an economy that performs reasonably well with low prices is probably more the key point than, say, overseas rate cuts would be in the markets going forward.

MR. PARRY. Or short-term weakness in the economy.

MS. LOVETT. Yes.

CHAIRMAN GREENSPAN. How does the market respond to the notion that if a weakness is propelling the decline in long-term rates, why when the economy was a lot weaker than it is now weren't long-term rates lower?

MS. LOVETT. I guess it [depends on] the point from which they're all starting. Some of the people in the market are looking at the near-term weakness as being somewhat mitigated by the drop in interest rates that has occurred already. So, if expectations before all this [centered on] worry that the economy's recovery was going to produce growth rates in the 4 percent plus range early on, which reflected some of the estimates toward the end of last year, those estimates are being scaled down to something that's--

CHAIRMAN GREENSPAN. The reason I raised the issue is that when you're looking at a 10-year or 30-year bond you're looking at basically either inflation expectations or real rates. And to the extent that over that time horizon expectations of a weaker economic [performance] would have impacts on those [rates], then you can't really argue that the passage of a year or two can affect that. That means that since a year ago the longer-term outlook was far weaker than it is today, one would expect that long-term rates would be lower than they are today if that were a substantial explanation.

MR. PARRY. If the prospect of short-term weakness were a substantial explanation?

CHAIRMAN GREENSPAN. Yes. In other words, to the extent that short- or intermediate-term weakness is driving the long-term rates lower, the question is: Why didn't recent periods in which the economy was perceived to be much weaker not change the rate? I'm not talking about the rate of change in long-term rates; I'm talking about the level, which is what is crucial to this discussion.

MS. LOVETT. I do get some sense that there is or has been--and maybe it's taking a long time--some underlying shift in expectations about future price performance than had been the case before. I think that has been ratcheting down.

CHAIRMAN GREENSPAN. Prices?

MS. LOVETT. Yes.

CHAIRMAN GREENSPAN. My own explanation is, however one looks at this, that this is a decline in inflation expectations. And I could argue that we had a weak economy, say, a year or so ago without the expectation of significant change in long-term inflation. That's what strikes me as the only credible explanation, whether you attribute it to the budget deficit or policy or any variety of other [factors]. That's what makes sense.

MR. PARRY. I think 1-year forward rates are a quirk because if you looked at 1-year forward rates 3 years out last year, they were coming down. At the same time the [1-year forward] rates at 10- and 30-year [horizons] were basically flat. So that would be in accord with the idea that it is reflecting more short-term weakness. What has happened in the last several months is that we've seen a reduction in those 1-year forward rates at all the maturities, which would be more consistent with a change in views about inflation.

MS. LOVETT. One thing that has been interesting on a day-to-day basis in the market is that there has been [less] day-to-day volatility by a fair amount. And sometimes people are at a loss to

explain the movements in prices on any given day to the next. Many of the dealers in the market are not expecting to see this kind of movement take place and are constantly expecting to see it give back its ground. That's why I mentioned the climate being a little skittish. Not everyone was a believer in the full degree of the rally.

MR. D. LINDSEY. I'm going to argue in my presentation, though, that there is a feedback effect from the lower interest rates, particularly in real terms--that the future strength of the economy and the fiscal reductions in the out years did in the markets' mind shift back aggregate demand for constant real rates such that the ensuing real rate declines helped to mitigate those fears, giving investors a sense that the economy could continue growing at more or less a moderate pace. I also think, going back several years, that clearly the decline in inflation expectations has played a role as well.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Joan, how sensitive is the market? You said the market is skittish; how vulnerable is it to a reversal of this recent rally? In other words, if we get another strong employment report, let's say, and maybe another month of unfavorable inflation data, do you think the market is going to react strongly to that or is there enough in the deficit reduction program to prevent that?

MS. LOVETT. Oddly enough, at this juncture I think the information that the market expects on the real side is favorable inflation on prices. People generally have tended to feel that while the reports for January and February were sobering, they were really not indicative of the trend in prices. They believe that there is slack, particularly on the labor side, that is going to keep inflation reasonably well contained, even if it's not on a downward trend, and that the employment report perhaps overstated things. They think the recovery is here and will continue, but the sense of where it's vulnerable is in [the process of] going through the Congressional passage of the budget. [There are concerns] that some compromises are going to be made to get the package through and that some of these compromises are going to mean the death knell for the intent of the package, if you will, and that we're going to end up with perhaps half a loaf.

MR. MCDONOUGH. Mr. Chairman, if I could add something to that. I think one of the things that would give the market a fair amount of insulation from a really nasty kickback is that the investment banking firms--the Street--have for all practical purposes missed this rally completely. They have been outsmarting themselves consistently by saying: "Well it can't be true; inflationary expectations cannot be being adjusted downward." And, therefore, every time they've had a temptation to short the market they've fallen right into the trap. The net result is that they're still not long. They still are pretty much either flat or fooling around with a short position. And, therefore, the securities are being held by safer hands, those less likely just to throw them out if they see a bad number. So, from a technical point of view, the markets are in pretty good shape to get some unpleasant news and absorb it very well, which has been the case for about three weeks now.

MR. LINDSEY. Are those stronger hands bond funds?

MR. MCDONOUGH. Bond funds, pension funds, and investors in general. That's because one of the things that has been happening as rates have been coming down is that investors are worried about yield; they're pushing their duration out in order to get the yield. That's one of the factors behind the strength as you go out the yield curve. I don't think it explains the strength of the long bond, but it does explain a fair amount of the strength in the 5- to 10-year area; people are moving out the curve to get the yield.

MR. MULLINS. The thing that seems inconsistent with future economic weakness explaining the long bond performance is the stock market and the quality spreads as well. We have seen tightening of quality spreads both within investment grade and also among the below investment grade issues, and that's quite inconsistent with the notion of impending recession and doom.

CHAIRMAN GREENSPAN. Any further questions? If not, would somebody like to ratify the actions of the Desk? I assume there have been some!

MS. LOVETT. That's how we got the 3.02 percent fed funds rate!

CHAIRMAN GREENSPAN. Would someone like to move it?

SPEAKER(?). Move it.

CHAIRMAN GREENSPAN. Is there a second?

VICE CHAIRMAN CORRIGAN. Second.

CHAIRMAN GREENSPAN. Without objection. Mr. Prell.

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

CHAIRMAN GREENSPAN. Questions?

MR. SYRON. Mike, people have been talking for a long time, particularly at the retail level and some at the wholesale level, about the fact that they felt very squeezed on margins. That sort of talk has been consistently heard. What do we know? Do we know much at all about what is actually happening to margins?

MR. PRELL. Well, not in specific detail. But I think we have seen some improvement overall in margins over the past year or so. There are still some sectors, though, where it has been very difficult--in some of the materials areas particularly, where prices have been soft and there has been a lot of discounting. Now, we've seen circumstances where there has been some pressure put on capacity. Firms are looking for price increases and in some instances getting them; steel is a clear example. The steel industry has had extra help from our trade policies, but their bookings have been very strong and have stretched out some months. They've had some price increases already that have stuck and they are looking for more. And there are a few other places. But it does seem to be only here and there that

we're really seeing much happening among materials prices. Lumber is another obvious example. Again, there are special supply stories. More broadly, though, there is still considerable slack. And we see some industries, chemicals and so on, that are still pretty hard pressed in terms of widening margins.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. A few questions, Mike. For some time now you've had a more optimistic outlook for the bond market than the Blue Chip forecasters or some other private sector analysts, and that was hinged on a better inflation outlook. The idea is that as they come to realize our inflation outlook is right, then the bond market will adjust. The Blue Chip pattern has been that from this point forward interest rates and inflation will rise; that has been [their view] over the last year. And here we are today with bond yields lower than even your optimistic forecast and you have them going down somewhat further. Yet, as recently as the January Greenbook we were looking at a CPI for the first quarter of about 2-1/2 percent; and now it's closer to 4 percent. So, the actual numbers have gone in one direction vis-a-vis your earlier forecast versus the Blue Chip, yet the bond market has gone the other way or even faster than you hoped and ahead of the Blue Chip. How do you reconcile those?

MR. PRELL. You've asked a complicated question. I might observe that there were times when our interest rate forecast was even lower for this period into 1993 than it was, say, at the time of the last meeting. We got worn down a bit by the fact that the markets weren't responding to all that good news the way we thought they should be, so we tempered our [rate] decline somewhat. I guess our notion involves two things. One is the view that inflation would remain lower than the market was anticipating. And that seems to have been the theme recently. As was noted earlier, the market seems to have sloughed off the recent bad news on the price measures and still sustains this view that inflation, at least for some period of time, will be lower than the market seemed to have been worrying about earlier. The other element in our thinking was that simply holding down short-term rates as we've assumed--it's not a prediction but simply a conditioned assumption in our forecast--would tend to pull down the long-term rates. One explanation of the dynamics of the recent market movements that wasn't given a few minutes ago--well, I think there was some hint of it--is this: People are simply growing impatient with the low yields they're getting; they're reaching for current income, and this gives us an inexorable pull on the long-term rates. It took a bit of a psychological breakthrough, I think, to get us into the current zone. Over recent years something in the low 7 percent area had been a floor to rates. People had not adjusted their thinking to bonds possibly being a good buy at 7 percent or less, but we seem to have broken through that [barrier] recently. And what we're anticipating going forward is that inflation still will be on the low side of expectations, that people will become more hopeful that the economy is not going to bound back up to high inflation rates, and that this persistence of low short-term rates will continue to push [investors] out on the yield curve. We have only a mild further decline in long rates, though. Our models, which I noted before seem to have performed quite well over time, now are again fairly well aligned with where bond rates are and would suggest that

we could still get a very large decline as people respond adaptively to the kind of news that we think there is going to be.

MR. JORDAN. I'm left a little uncomfortable with part of your explanation about expectations of short rates as they relate to long rates. Earlier this year, and beginning last year, some academics testifying in Congress argued that the reason intermediate and long rates are as high as they are was the fear that the Fed was going to raise the funds rate. They said all we had to do was take the pledge that we wouldn't raise short rates and bond yields would fall.

MR. PRELL. Well, there may be some element of truth to that. In fact, one story that we've heard is that the change in the perception about the likelihood of the Fed tightening over the next year has provided the bond markets with some encouragement.

MR. JORDAN. That's starkly in contrast to the view that longer-term expectations about debt monetization and inflation--

MR. PRELL. Indeed. I think the other story about the fear of Fed tightening was consistent with the view that as soon as the cycle begins to show some substantial growth in the economy, we're going to have inflation picking up and the Fed will then respond to that. So, these things do fit together. But there are many strains that aren't entirely consistent.

MR. JORDAN. But if they do fit together, then having 4.8 percent [GDP growth] in the fourth quarter and the CPI numbers we have in the first quarter gives you a problem because it says we're getting that real strong growth and now we're getting the CPI popping up. This worst fear is confirmed and yet the bond market has rallied further.

MR. PRELL. Indeed.

MR. JORDAN. The other question that I still struggle with is how monetary policy, what this Committee does, feeds into the outlook over the next couple of years. The funds rate is currently at 3 percent. You talk about it staying more or less at that level through the forecast horizon. You have nominal GDP [growth] slowing to about a 5 percent rate for most of that period while the Blue Chip forecast apparently has nominal GDP rising in a 6 to 6-1/2 percent range out through as far as they go, about 4 or 5 quarters, and short-term rates rising 70 basis points. So, they have higher short rates, higher real growth, and higher inflation. What do you say about the Greenbook forecast versus the Blue Chip forecast given those policy assumptions?

MR. PRELL. Well, the difference in forecasted real growth is not a vast one between the two. The rise in nominal short rates in the Blue Chip is offset to a significant degree by the acceleration of prices in assessing what their real short-term rate path is. So, their real short rate path may not be vastly different from what we have in the forecast. The differences may be less than meets the eye in terms of an underlying sense of what the determination of aggregate demand will be in this period--real activity.

MR. JORDAN. How confident are you that a 3 percent funds rate for the next 6 to 8 quarters produces 5 percent nominal GDP?

MR. PRELL. What we've noted before and we've hinted at recently is that we're not at all sure, given the kind of disinflation movement we anticipate, that this level of the funds rate is really sustainable all the way through 1994. This level implies a relatively low real rate, perhaps one that is not sustainable; and we think it's more likely that we'll see the rate higher rather than lower in 1994 and that there may be a need for some tightening as we look out beyond 1994. The other side of this is, of course, that there is going to be a clearer negative fiscal impetus as we move into 1995 and some of the pent-up demands will have been satisfied and so on. It may be a little early to get particularly far out on a limb in predicting where interest rates will have to go, but our notion is that the movement is likely to be upward by 1995 and that perhaps there will be a need to move before then.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. I assume that the forecast of the rate of inflation is basically from a Phillips curve framework. One question I have is this: To the extent that there's a real output surprise--that is, a growth in real output that exceeds expectations--is there any attempt to incorporate the possibility that this could change expectations about inflation independently of traditional [unintelligible]?

MR. PRELL. Well, I think you're saying if things turn out stronger than--

MR. PARRY. As they did in the last six months.

MR. PRELL. Right. I think what we saw for a while in the latter half of last year was stronger growth and very strong productivity and not much sign of any real deterioration in the price trends. But we've gotten a bit of a pop in early 1993. What we see at this point is some evidence that inflation expectations really are currently higher than what we anticipated the outcome would be. In a sense we may have to fight against _that_ to push the inflation rate lower. But if things turn out stronger, I think it will create not only a lower unemployment rate--less slack in that kind of Phillips curve argument for higher inflation--but it may also create a psychological environment in which pricing behavior becomes a bit more aggressive. This is in a sense the speed effect that we've talked about, simply that the rapid growth may create some additional pressure. That may be what we've seen in the deterioration recently. We really did have a pickup and that may have given us a little of that. Unemployment was coming down relatively rapidly.

CHAIRMAN GREENSPAN. Further questions for Mike? If not, who would like to start the Committee's discussion? Ed.

MR. BOEHNE. Modest growth in the District continues. While there is a lot of caution and we still lag the nation, there are signs of a somewhat better underlying tone. Commercial and industrial loan demand is rising modestly, and I'm hearing more reports from bankers that small and mid-size businesses are using their credit lines more

than in recent months. They tend to want to go ahead and get the projects under way whereas several months ago that was not the case. Manufacturing, which had slowed earlier in the [quarter], may have picked up some later, judging from rail shipments and other anecdotal information. Some executives in sheet steel think they should be able to make more price hikes stick given the strength in their order books. And that's the first indication of that sort of thing I've heard in a long time. Hiring is still sluggish, particularly in New Jersey, but one does hear more reports of firms adding workers. They're adding them even if they're adding them cautiously. In real estate, residential sales were up before the snow storm, as was the demand for industrial space. The office market continues to be quite weak and likely will be for a long time. I hear very little talk these days that the expansion will grind to a halt; and that's a different tone than was there several months ago. But there still is a lot of caution about just how fast the expansion will proceed.

Turning to the nation, the national profile as laid out in the Greenbook looks about right to me. I continue to think that job growth is the key indicator as far as the durability of the expansion goes. Job growth I think is both an indicator of business confidence and it's a necessary ingredient in building consumer confidence. So while in theory we can have an expansion without job growth, I think in reality it's a critical ingredient. The recent price numbers strike me more as an aberration than as signalling a new round of inflationary pressures. I think the lack of robustness in the U.S. economy plus really quite favorable unit labor costs and weaknesses in a number of other industrial countries argue for a continuation of subdued rather than increasing inflationary pressures.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, the recovery in the Sixth District continues to be moderate and I would say that it's probably maturing. The District is exceeding the national pace of activity. For example, we see employment growth at about 2-1/2 percent in 1993; that's about twice the pace that we had last year, although it's well below the rates of growth we had in the 1980s. Retail sales have been fairly strong in the District so far this year, even after we factor out the impacts of Hurricane Andrew. There is increased consumer spending for a wide [range] of goods, although auto sales have been somewhat mixed in the last two or three months. Single-family housing did well in the opening months of 1993 but again we expect weaker gains compared to 1992. Nonresidential construction is <u>slowly</u> turning around, and I think that's in contrast to other parts of the country. That is due to industrial and retail development primarily. As I've said before in other reports, we have certain advantages in manufacturing and other areas but those are beginning to narrow as the year goes along. We're seeing this, for example, in slower apparel production. It's also showing up in our manufacturing survey for February: The percentage of firms that month seeing increases in activity declined a little, although the percent experiencing decreases also fell. The 6-month outlook, while still positive, is not quite as bright as a month earlier. A major concern in the District now is the effect of military base closings. The region has suffered relatively less than others as a result of declines in defense expenditures, but we have a higher proportion of military employment than the rest of the nation. On the wage and price side,

pressures remain generally quiescent throughout the region. Labor supplies are still plentiful. Factory activity is rising but firms are reporting little change in current or future employment levels; there's just no talk about adding additional employees at this point. No significant price pressures for raw materials or finished goods are evident with the exception of construction materials. And the spike in lumber prices has [spurred] production and inventory speculation that don't appear to be sustainable. I continue to hear from bankers that they are looking for good borrowers--the emphasis being on "good" or credit-worthy people--and the evidence is that loan demand is up slightly. So, the outlook for the region, Mr. Chairman, is relatively good.

Looking at the nation, we have changed our forecast very, very little since the last FOMC meeting. We think also that the profile in the Greenbook is reasonable, although we would have somewhat more growth and somewhat more inflation, but the differences are marginal. Having said that, I think perhaps with the relatively good news we're experiencing that it might be appropriate and prudent at this time to express some concerns for the longer term. One that is on my list at least is the deterioration in the outlook for the industrialized nations. Those forecasts have been constantly pushed down. While there is some expectation, as Mike indicated, that this may turn around in 1993, I think the jury is still out on that with all the political and economic uncertainties overseas, particularly in Japan and western Europe. The lack of progress in the GATT negotiations and in the reconciliation of differences in the NAFTA agreement are also causes for concern, especially because a worsening trade situation will undoubtedly give rise to more protectionist sentiment at home, which could have an effect on our recovery. And last but not least, it seems to me that the turmoil in Russia and some other foreign activities that are going on are also threats to our economy. So, while I think things are good, it would be wise for us to keep our eye on some of these developments, particularly on the external side.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, in the District the level of economic activity has shown clear signs of improvement since the last meeting. At the February meeting we talked a bit about the impact of trade restraints on the steel business. And in terms of pricing and production levels, I think that along with the basic increase in domestic demand is having an effect, as Mike has suggested. Bookings during the last two months have been running at an annual rate of 110 million tons; that's clearly an unsustainably high level. Delivery lead times are lengthening to the third quarter for at least one manufacturer, and one large steel purchaser has been put on allocation by two of its main suppliers. The mills are currently operating at a stated rate of capacity of 83 to 85 percent, but there is a view in the industry that the [stated] capacity is too high, and at least in our District we think the mills are really operating at a level of about 90 percent of capacity. Steel prices were raised, as you know, by $20 a ton in January; another $20 a ton increase will go in effect in April, and they have announced another $20 a ton increase to be effective in early July. If all of these stick, it would raise the price about 10 percent from the low point in this most recent cycle. But in a longer-term perspective the industry will only have regained

about one-half of the decline from the last peak in prices, which occurred in '88 and '89. And that 1988-89 level was still well under the levels that prevailed in '78 and '79 in nominal terms but, of course, further under in real terms.

In other District activities, the second-quarter domestic production schedules in the auto industry have been set at about 12 percent over the second quarter of last year. That production level is somewhat higher than the current dealer order rate. Therefore, if the retail sales don't pick up fairly soon, there is some downward risk in the second-quarter production schedules. The manufacturers I talk with have reduced their '93 sales outlook. Their forecasts are down just a little to 14 million units. But even that level implies very strong third and fourth quarters. The truck business is also improving. I've commented in the past on the heavy truck business, the class 8 units, and at this point both the order and production levels for those trucks are expected to be about 17 percent over last year. But this time there's also what I think is a fairly significant change in the medium truck category, the class 6 and 7 units. The current forecast suggests that these medium truck sales, which are regarded as being quite sensitive to economic changes, will be about 13 percent higher this year. Agricultural equipment is doing better. Sales there are improving at the retail level, and production schedules have been increased by 5 percent for one manufacturer. There is a somewhat larger increase in terms of production for industrial equipment.

The only sour note I heard, and it really wasn't all that sour, related to retail sales. The District's sales held up quite well coming into the new year, but we hit something of an air pocket in February. It's unclear whether that reflects uncertainty following the President's State of the Union message or is attributable to bad weather. I must say that I think it's probably more the latter than the former.

With regard to employment, we have some mixed developments. Most of the people I talk with, particularly those in heavy industry, continue to say that despite the higher levels of production they are simply going to produce more with fewer people and that the staff reduction programs that they have in place will continue. Yet we do think that the underlying employment data may suggest a somewhat brighter picture. We've been doing considerable work on some of the statistics related to our District employment levels and we think they may be re-benchmarked and that the net effect a re-benchmarking of the state data will raise the employment level as of the end of last year by some 128,000 jobs. And if that develops, it could well be that we've had a greater growth of employment in the District than we had thought. If this is false, though, it may be that this higher level of employment will be consistent with the improvement that we're seeing in terms of economic activity.

With regard to the national economy, when we did our forecast for the February meeting we were somewhat under the central tendency of the FOMC members. Given developments since then, if we were redoing our forecast, I think we'd raise it a bit and we'd be very much in line now with the staff forecast. And despite the recent PPI and CPI reports, which we don't think represent a fundamental change in the inflationary picture, our outlook for inflation has not

changed; we'd leave our fourth-quarter forecast at 2.8 percent. Thank you.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, widely varied economic conditions continue in the Twelfth District. Job growth in the District states over the year ending in January ranged from among the strongest in the nation--about 3-1/2 to 4-1/2 percent in states such as Idaho, Utah, and Nevada--to among the weakest, which was a negative 1.4 percent in California, second only to Connecticut. The recent benchmarking of employment data increased our measure of 1992 job growth in Arizona, Idaho, and Washington. However, California data were revised only for 1992, with revisions for prior years expected in June. This creates considerable uncertainty about California economic statistics in recent years. We understand that the data for prior years are likely to be revised down significantly to correct for an overcount that occurred prior to January 1991. The revision likely will reduce our estimate of job losses in California during the recent business cycle. The official figure now, with this break in the series, is about an 800,000 loss since the peak of employment. That will probably be cut to somewhere closer to 500,000.

The cutbacks in defense spending and aerospace continue to receive an awful lot of attention in the District. In California proposed military base closings threaten a net loss of 32,000 military jobs. Civilian job losses on those bases probably will be greater than 32,000; in addition there is some multiplier associated with it. Most of these losses as it turns out will be in the San Francisco Bay area and not in southern California. I also heard that the morning papers suggest that [McClellan] Air Force Base, which is a big one, and the Monterey Presidio, which is not so big, both were taken off the list by Defense Secretary Aspin about a week ago. They are now thought to be somewhat more iffy but they could be closed as well. In Washington, Boeing has confirmed that it intends to eliminate 15,000 jobs in the state during 1993 and an additional 4,000 jobs in 1994. This would bring the total reduction of employment to about 25 percent from its 1989 peak, so that is a significant development for that area of the District. Although the company remains bullish regarding long-term demands for aircraft, recent airline weakness and cancellations of orders further threaten the company's short-run outlook. I'm sure you all saw that there was a big cancellation or at least a postponement by United at the same time they decided to continue to take delivery of the Airbus.

Turning to the national economy, it seems to us that recent data continue to suggest that the economy is in a sustained, though moderate, expansion. Assuming no change in monetary policy, our forecast of growth over the next two years is almost the same as the Greenbook, with the main impetus to growth coming from the interest-rate-sensitive sectors of the economy. We do project somewhat stronger growth in investment and a little less consumption than the Greenbook. Obviously, the effects of the Clinton economic program are uncertain; however, the program effect to us at least appears to be a slight positive for real GDP growth in '93 and a small negative in '94. In any case, the effects of the program are likely to be less than that of traditional forecast errors. Despite the recent spurt in consumer prices, the outlook for inflation in our view is reasonably

favorable with real GDP remaining below potential. And with relatively moderate growth rates, we expect the downward trend in inflation to continue even with the passage of the BTU tax. Specifically, in our forecast inflation in the CPI is expected to drop from 3 percent in 1992 to about 2-1/2 percent by the end of 1994, which isn't all that different from the Greenbook. Thank you.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Well, economic conditions in our District have continued to improve in recent weeks, continuing the trend we had seen earlier in the year. Most of our contacts are at least reasonably optimistic about the outlook for their respective local economies and industries going forward despite the potential contractionary impact of at least some of the elements of the Clinton economic package. The most recent information we have comes from our various board meetings; both our Charlotte and Baltimore boards met last week. The comments at both of those meetings were generally upbeat, especially those of the Baltimore directors. That was encouraging because that area has been the part of the District that has experienced the weakest recovery to date. The Richmond board met about 10 days ago, at the end of the previous week. The comments at that meeting were less optimistic than either those of the branch directors or their own comments at their previous meeting. In particular they seemed to sense some reduction in both business and consumer confidence over the last several weeks. But generally they're still reasonably optimistic, and I think the picture in our District is quite strong.

With regard to the national economy, the Greenbook projection is certainly reasonable. It is close to other projections we've seen and close to many of our projections. But my instinct, and my staff shares this view, is that the risk of error in these forecasts is still generally on the up side and that we'll get at least somewhat greater growth in real GDP if not in the current quarter at least over the balance of the year. Recent increases in unfilled factory orders and lengthening delivery times are one reason for thinking this. I believe we may have a greater rate of inventory accumulation and perhaps [more] growth in employment than the staff is projecting. But from my standpoint the main reason for this view is the broad-based and rising confidence about both the near-term and the longer-term outlook for the national economy on the part of a vast majority of our business contacts. People are concerned about the tax increases in the Clinton program. They are critical of them, to put it gently. But they don't seem to think that the program is going to derail the recovery or even slow it appreciably going forward. This optimism pretty clearly is related to the good performance we've had with respect to long-term interest rates recently, which has enabled many of these businesses to significantly improve their balance sheets, finance some new projects at lower rates, and reduce debt service--not to mention what lower mortgage rates have done to the household sector.

With this in mind we certainly think that one of the Committee's principal objectives in the near-term future if not <u>the</u> principal objective ought to be to do all we can to foster a continuation of these favorable longer-term interest rate tendencies. Because of the recent upturn in inflation statistics, the upward revisions in inflation projections in the Greenbook bother me. I

recognize that the signs are still pretty [limited] and that the revisions are still pretty slight at this point. But both the reports and the revisions suggest to me that the risk of an uptick in inflation at some point in the projection period is now somewhat higher than it was earlier. I don't think that's inconsistent with your comments, Mike. And I simply hope that the Committee will be ready to take whatever actions are necessary earlier rather than later if we need to take such actions to arrest these developments.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. The Eleventh District economy continues to be among the stronger in the country in terms of employment growth. We estimate that total employment was up a little less than 2 percent last year. There was an article on revised employment numbers by city in Friday's local paper; it listed the ten top cities for employment growth in the nation. The Eleventh District had three cities on that list; the Sixth District had four out of the ten. But while the numbers continue to come in reasonably strong, the mood seems to have shifted a bit negatively since the Clinton program came out, from optimism to uncertainty. And that does have real impact in some sectors. For example, in Houston they have a number of things to worry about: the BTU tax, NASA and the space station, and health care. In particular, the Houston Medical Center had been the source of a lot of construction and planned construction; we hear that a lot of it is being put on hold until they determine what is going to happen with health care. There are scattered reports that some businesses are finally beginning to have to hire some people. They have been resisting mightily because our workweek in manufacturing in Texas has been over 43 hours recently, which I believe is over an hour longer than the national average. So, that's beginning to give and we do believe we're going to be getting some employment growth [in manufacturing] now. I haven't talked to a lot of people about it but, given the optimism over NAFTA that has been prevalent in our District for some time now, it seems to me that all this negative press we've been getting--the NAFTA bashing and the signs of disarray in the Administration's trade policy--can only suppress activity. And that's a source of great concern for the nation. I wish there were some way we could weigh in with a little economic education promoting both NAFTA and GATT.

Just an observation: I believe that the Fed and the Fed's ability to conduct policy in the near future have benefited from some luck recently. In particular, I think we've been lucky to have had this clear demonstration that the bond markets are responding to expectations. First, we had the rise in the bond market based on the prospects for the lower deficit and/or lower inflation. And then we had a decline in the bond market when the price indexes looked a bit unfavorable. I think the world knew that Fed policy was not involved --it was steady-as-you-go--and that longer-term interest rates were responding to these things. We've been telling people that, but this was a clearer demonstration of it than people have had in a long time. I think that will serve us well and give us a little more flexibility in the future.

Anticipating our policy discussion, I can't resist commenting on Paul Samuelson's statement in the academic report. This is not a direct quote but about what he said was that no change in monetary

policy is currently required. Given the source of that, I think we might as well just stop the meeting and move on!

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, our District recovery continues on track for the most part. Tourism trade is still good in the region. Oil and gas activity, though, is still subdued after the year-end peak and that does not look to be building up. Construction activity in the District remains strong; there has been some weather-related slowdown, but that [strength] will reemerge. In the agricultural area, there is a degree of greater uncertainty, although aggregate income should remain good for our region. But the facts [about] the grain loan repayment and what the Russians can afford after the more recent crisis have put a real pale on things and I think that has been partly responsible for the lower prices. Secondly, in the cattle industry there have been some very significant weather-related losses in the area. That has driven up prices to their historic highs but on balance it probably has hurt that industry, and that may have some degree of impact. Nevertheless, overall our District will continue to grow at a moderate pace, still better than the nation as a whole.

On the national economy, in terms of the GDP growth we see things about in line with the Greenbook. We are a little less optimistic on consumption and a little more optimistic on residential investment. Overall, we don't really differ too much with the Greenbook. On the inflation front, our view is that inflation has come up a little but that doesn't really portend problems going forward, although I think it also says that our gains on inflation may have run out. So we're in this steady state and we'll have to make some decisions along those lines in the near future. Thank you.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. In terms of the District, things aren't very much different overall but there have been changes in the mix. I would note that several people have talked about this change in bench-marking of the state employment figures and that same pattern holds in our District as well; it seems to be true in most parts of the country. I don't know that anyone is going to feel that they were less ill during the recovery, but that's certainly what the data would suggest to some extent. Retail sales in the District continue to show improvement; that began in the Christmas season and there is some continuation more recently. There has been a fair bit of improvement in consumer durables--autos particularly, though, were affected by the weather. They are changing, as you might expect, the composition of auto sales. Four-wheel drive vehicles are very big and little convertibles are very small. Actually, this is exacerbating the trend toward the increasing competitiveness of U.S. vehicles. It's really quite striking when you talk to people who carry Japanese, European, and American cars. They really see the beginning of a dramatic change under way here. In the manufacturing sector, I'm quite struck by a differential pattern depending to some extent on the size of the manufacturer. The larger manufacturers such as United Technology, GE, Raytheon, Polaroid--not all defense businesses--really seem significantly more pessimistic in their outlook and are still planning to continue restructuring as they go forward, whereas the smaller manufacturers of instruments and

pollution equipment and a variety of other [products] feel a bit more upbeat. Everyone seems a lot more concerned about the outlook overseas, particularly in Europe. We happen to have a lot of trade with Europe and there is almost no one with any real anticipation of significant employment increases. The real estate sector has shown some improvement. In Boston on the commercial side, rents have stabilized and actually have picked up a little. That's very uneven across the District; parts of Connecticut are still doing quite poorly. There is a substantial amount of homebuilding activity going on, with house prices rising. They're rising very much town-by-town depending on the availability of lots to build on and that kind of thing, consistent with other considerations. Banks are seeing some loan demand now, slightly more than offsetting the runoff. There's a real mind set--a bit too much I'd say--in some banks in terms of their view toward the future and wanting to get going on acquisitions and things like that. The nonbank financial sector--and we talked a fair bit to people in the mutual fund business--continues, as reflected in the data, to see very, very strong inflows. There is a lot of nervousness among the managers in that area because of the inevitable reach for yields and some concerns about credit quality spreads and about the market getting ahead of itself. One last comment on the state and local fiscal side: There will be a lot of pressure on localities because of having overspent their budgets due to weather-related [expenses] from the snow and [ice].

As far as the nation goes, we agree with the Greenbook. It seems to us that economic growth is ebbing and flowing around 3 percent. Right now, for a short time, it may be ebbing a little more than flowing. But it's always difficult to forecast and it seems to me that it's even more difficult in the current situation given all of the structural changes that we have going on. I have been struck in my conversations with people--again many of these people are in the financial sector--by how much more optimistic they are than perhaps a year ago on the inflation front longer term, but not in the short run. And a fair amount of that has to do with a kind of enhanced confidence in the Fed over time. It seems to me that there's not very much we can do in the immediate situation to enhance that confidence. That may be something that happens as the economy strengthens, which is really when people are going to look to see what we do. [Unintelligible] undoubtedly what we say and other things that we can do to diminish the confidence in the short run.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. Well, economic activity in the District continues on the more or less steady upward course it has been on for quite some time. At a recent meeting somebody used the phrase "silently successful" to characterize the District and I think that's a pretty good phrase. There doesn't seem to be any change in inflationary pressures so far as I can detect, but there are a couple of areas of spot labor shortages. I referred to this a little the last time; I've picked up a few more indications of it. It doesn't seem to be very pervasive at the moment but the fact that it exists at all has surprised me. There has been almost no discussion of the Clinton program that I've detected, certainly in its broadest terms. What people are mostly concerned about, as you might expect, is what it implies for either the military bases in the District or for the agricultural programs. I get the sense that whether they like

the program or not, they're willing to accept it as long as they believe it's affecting the country more or less across the board. What they're worried about are the differential impacts that might affect the region.

With regard to the national economic outlook, I have no problems with the Greenbook forecast both for growth and for inflation. What does concern me are some of the same issues that Bob Forrestal alluded to. I don't know, obviously, where the Administration is really going to come out with regard to trade policy or health care or industrial policy as it pertains to the airlines or technology or whatever. But it seems to me that those things all work in the direction of resource misallocation. While I don't know that they are going to be very significant quantitatively, they certainly cut in the wrong direction both in terms of growth and in terms of inflation, assuming that the Administration doesn't just go ahead and support NAFTA or GATT. And I'm worried that there are some things going on there that may not help the economy in the long run. Having said that, there's a question about why interest rates have finally come down. I think, as several people have commented, that it is due to more favorable expectations about future inflation; it's really a consequence of the conduct and prospects for both monetary and fiscal policy, given the way those things have evolved over the last 6 to 12 months. And I do think the credibility of monetary policy has probably improved a bit. I doubt that we could demonstrate that in any convincing way; that's just my sense of things. And I think that has been a principal factor in the decline in rates.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Thank you, Mr. Chairman. As for the District, conditions are very similar by sector and industry to what Si Keehn reported for the Seventh District. I won't repeat those kinds of observations except to add a couple of observations. One is on steel. While the orders are good and the production level is very high, and while there is a comfort level over the recent price increases and hopes for more, there is no confidence after midyear. There is a real concern that they've borrowed on subsequent activity. What they can see and what they can report are coincident or lagging indicators; there's nothing to suggest what [demand] might be out in the future. And that's similar for nonferrous metals; there's a lot of caution. They say the current situation is very good but that they don't know about the future. Motor vehicles are strong in a general way but in a specific way it's the Big Three that are doing quite well in the District, recalling workers and adding new labor. The transplants, the import manufacturers, are not doing well; their inventories are extremely high. The overall inventories look pretty good but that's because they're low for the Big Three. Their sales are good both for trucks and cars, but sales at the transplant firms are much, much softer. As for heavy trucks, they came into the year with a very good backlog but they say the rate of new orders has dropped off sharply recently. They're working off what they carried before. A bicycle manufacturer, a very major manufacturer, says they came through the fourth quarter quite strong; December was excellent and they came into January feeling good, but the orders just collapsed. As far as employment goes, state revisions are going to be different for us. We were reporting a decline in the state of Ohio for the 1991-92 period

and that's going to be changed to a plus 1/2 percent. So, we never did have a decline in the recession period.

In our meetings with small business groups, the capital goods producers are all reporting quite strong markets, especially those that sell labor-saving equipment. They say their backlog is good, both domestic and foreign. The services firms are in reasonably good shape, especially those in civil engineering and software supply; and the communications-related firms are in quite good shape. Most, though, when they say they have to hire put it in that sense of "have to." There is a great reluctance to add workers, especially low skilled. And they say they'll do everything they can to maintain their higher-priced labor and get rid of their low-cost labor. It's the entry level positions they want to automate out of existence. Now, there is a sophistication about what their true total cost is and what government policies are doing to their cost that's partly coming through. A concern frequently noted by the homebuilders recently is lumber prices and what they are doing to costs; the increases are extremely large and there is no reason to expect prices to go back down.

On the national scene, there's certainly a mood of caution in the District. One major firm whose business is national--repair, maintenance, and renovation of aircraft, rolling stock, buses, and rail cars and so on--said that they had a very good backlog through the fourth quarter and coming into the year and then in February the phones stopped ringing. They feel it is because of concerns about national economic policy. They're hoping that turns out to be wrong or that it goes away. But they say there's just nothing new going on; they're working on what they have and they're extremely cautious. I subscribe more to the view about the 50 mile an hour head winds, which were holding us back before, rather than the view of at least some academics that it was restrictive monetary policy somehow measured that was holding us back. In my view what we've seen in recent months --through the fall and into the beginning of this year--is the dissipation of those head winds. And we shouldn't misinterpret that as sustained momentum if it is a one-time release from negative forces. I have no confidence that current monetary policy is geared right for that environment--that a 3 percent nominal fed funds rate will promote the kind of environment for growth that's in the Greenbook. And I worry that the head winds that were coming from all the restructuring--all those things that we talked about--are now being replaced by a fiscal head wind that is decidedly negative. I see no way to interpret fiscal policy other than as a negative shock to the economy.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. In my view the economy is doing fine. The way I view the capital market environment is that the performance of the long bond market suggests that participants are not looking for unsustainable robust growth and accelerating inflation. As I look at the stock market it suggests to me that stock market participants are not expecting recession. Again, the quality spreads would also raise questions there. All this adds up to moderate growth in my view. The reduction in long rates should sustain housing and business fixed investment. We're starting to break through; there's some progress on employment in many parts of the country. There is still plenty of

uncertainty with respect to the fiscal policy package and even more uncertainty about the health care package. And, of course, there are nagging concerns about protectionism, Russia, and our trading partners. I see many of these uncertainties posing risks down the road in '94 and '95. In '93 it looks to me as if the benign capital market environment we have should provide enough momentum. We have the lowest interest rates in several decades and the stock averages are within whispering distance of their all-time highs despite the hits taken by drug companies and biotech companies and multinationals. So, I view all of this as pretty consistent with moderate growth.

With respect to inflation, we've made quite a bit of progress over the last couple of years and the underlying fundamentals suggest the likelihood of continued progress in gradually reducing inflation. There is ample slack in the economy both on the labor side and in terms of capacity utilization. Competitive conditions still seem tight. We've seen no sign of an unsustainable surge in activity or in supplier delivery times, or other sorts of measures. We have very subdued money and credit growth still. Even M1 has decelerated, so there seems to be little monetary thrust to inflation. So, I think we would all agree that the underlying fundamentals appear to be in place to sustain a continued gradual trend toward disinflation. The only thing that doesn't agree is measured inflation itself, which seems to show signs of rising from the grave, apparently oblivious to the fact that the Greenbook has pronounced it dead! It's not just the two consecutive core CPI numbers we've had. But in three out of the past five months core CPI has been 1/2 percent and over the past six months core CPI has been 4 percent. We've had 4 percent inflation over the past six months versus 3.3 percent in the 12 months ended in December. It's still early but, based upon these data, it's hard to convince oneself that we're safely gliding on the Greenbook path toward continued gradual disinflation. It may be hard to reject the hypothesis that instead we're on the Blue Chip highway of a gradual return to 4 percent inflation. Core PPI in the last two months was 4.1 percent and in the last three months 3.6 percent. The purchasing managers' inflation diffusion index, which had been below 50 for many months, jumped above 50 last month. Expectations survey data remain high. It is true that the implied forward rates have come down on the 10-year bond, but so have foreign rates. And the implied forward rates remain 200 to 300 basis points above those in Germany and Japan, and commodity prices are twitching. The CRB is up; lumber prices are up. Presumably this is due to the housing recovery, the spotted owl, and perhaps the paperwork requirements of FIDCIA! I'll leave more detailed analysis to my colleagues. I think there's some reason to be troubled by these trends. All of this could be an anomalous blip which will soon succumb to the disinflation forces described in the Greenbook. Indeed, we've had a couple of these episodes before, most notably in the early parts of '91 and '92, which were swamped by the trend and soon forgotten. What's different this time? It's already a bit longer-lived, six months at 4 percent. It's not just a first-quarter phenomenon. In the third quarter of '92 core CPI was 3.8 percent, which followed two quarters of 2.5 and 2.8 percent. So, this may be a little more; it has some commodity price increases attending it and a growing economy now. Still, I must admit that the notion of a reemergence of inflationary pressures is not confirmed by many other indicators such as precious metals; gold and other metals appear dead in the water. The ECI appears well behaved and wage increases are unlikely to swamp productivity gains, so that should assure that unit

labor costs [will remain] in line. And I can't detect inflation fears in the long bond market. Of course, I don't think the long bond market foresaw the disinflation. So it seems to me, given the relatively high implied forward rates, that the long bond market 5 to 10 years out may have been looking at 4 to 5 percent inflation during this entire period.

I do think at some stage that we may have to decide how seriously we want to take this index, the CPI--whether we want to take it very seriously or mechanically in a price level targeting sense. The Greenbook says not to worry: Core CPI after all the hand wringing will come in at 3.1 percent in '93 and 2.7 percent in '94. And the market appears not to take the CPI seriously. We know the index is not perfect; we've seen it made much like sausages and laws, which causes us to lose some respect for it. Still, there is some bottom line credibility to measured inflation. It's difficult to rebut with economic arguments saying it shouldn't be that high but it has been. And there is some risk in putting our faith too long in economic fundamentals. Before the next FOMC meeting we will receive two CPI numbers. If those are poor, we will be facing a 6- to 8-month trend, an embedded trend, of core CPI in the range of 4-1/2 percent to perhaps close to 5 percent. And I think that will raise significant concern that after all the progress of the past two years we may be back to where we started. A more mechanical perspective that we might think about is: If the near-term inflation outlook is really 4 percent or higher, as it has been over the past six months or so, then a 3 percent federal funds rate looks a bit low in terms of real rates. It's hard to reconcile this with the negative M2 growth so far this year, but I think we should think about it. If the Greenbook is right and we're really looking at 3 percent inflation, that's roughly a zero real rate; but if inflation is really 4 percent, as it appears to have been, then perhaps that's a significantly negative real rate.

When I add this up I can't find a lot in the way of clear convincing evidence to be concerned about. We have as many well behaved inflation indicators as misbehaving indicators. Still, I'm slowly developing the uneasy feeling that if these trends are sustained for not too much longer, we're going to be forced to confront the difficult issue of whether we're satisfied with a return to 4 percent inflation--it may have arrived by the time we face this--and whether that 4 percent inflation is consistent with our objectives. Perhaps we're not there now but I'm increasingly concerned that the day is rapidly approaching when we will have to confront this issue. There is a risk of getting behind the recognition curve. I must admit that I don't relish confronting this issue in the current political environment. I'd hate to have a national referendum on the issue much less a local referendum on it, but I do have the sense that, obviously, in some fundamental sense this is the job for the central bank. And I'm getting increasingly uneasy that we may have to go to work soon.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I have several comments to make on the District economy. First of all, on the employment side we're seeing much stronger growth statistically. We look at this on a 3-month moving average basis, so it's more than just the most recent month. One of the two big shifts there is that we're seeing reasonably strong

manufacturing employment growth, which we hadn't seen up to this point. That had been slightly weak and we were offsetting that with nonmanufacturing employment. Nonmanufacturing employment is strong as well. So, at least for the most recent period we have a much stronger picture there. On the other hand, in terms of anecdotal information I've picked up the same things some others have mentioned. Since the announcement of the economic program, expectations have been dented a little. The uncertainty associated with that I think has undermined confidence a bit. In terms of credit demand, we are still not seeing a significant pickup at the larger banks but we are at smaller banks. We had a group of bankers in last week and [their reports were] a mixture; it was interesting to watch the bigger bankers listen to the little community oriented bankers who deal with small businesses talking about their increased credit demand. So, I think that's going on. One interesting comment that was made in that regard is that this demand is associated both with capital spending and in one case in particular with some inventory building. The banker associated it with concerns about building price pressures. It may be overstating to call it speculative inventory building, but I haven't heard comments like that for a long time.

The final comment I would make about the District economy relates to the issue of price pressures. I have heard a number of comments recently about building price pressures. Just three months ago if you even brought up the idea of inflation, people looked at you as if you'd lost your mind. It's very interesting how quickly this has shifted. Some of it is in the obvious areas. Scrap steel is up in the first two months of the year by close to 20 percent, I think, and we've all heard the stories about lumber costs. Also impacting residential building, at least in the St. Louis area, are finished lot costs. The inventories are being run down; they're not being replaced and there are probably only a handful. I heard one person mention that maybe three developers could get financing to develop lots in this environment. That's not a credit crunch comment totally. I just think the nature of that business has changed. Probably some people have been washed out of that business who maybe shouldn't have been in it for the long haul anyway. In any event, I'm hearing more comments about price pressures, not just in places where one would expect but more broadly--comments by people just hearing about this [from various contacts].

On the national front, I'd associate myself with what Al Broaddus said and what Dave Mullins just said in that I don't think this is the time to take action, but I think we are in a difficult position in a sense. We don't have monetary indicators that we have a lot of confidence in and we're in a very difficult political environment. But I think the day is probably fast approaching when these straws in the wind that we're seeing now may really take hold--and maybe it's more than straws in the wind--and we will have to move. I was struck by what Mike Prell said in his presentation--I think this is what you said, Mike--that it wouldn't take much of an overshoot in nominal GDP to see greater price pressures.

MR. PRELL. Real GDP.

MR. MELZER. Okay. In any case, we're going to have our work cut out for us in the not too distant future.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. I have very little to add in terms of anecdotal-type insights. I think the tone at the moment is better. Nowadays when one talks to business leaders and community leaders about a 3 percent economy they no longer look at you as though you're from Mars. But having said that, I don't find many, especially among the big firms--for the reasons that Dick Syron mentioned--talking about even 3 percent being a shoe-in. But at least there is a clear central tendency of popular opinion. It's hard, whether from an anecdotal base or empirical base, to disagree with the kind of outlook that Mike has in the Greenbook, and I would not. But I still have this nagging sense of unease that things are either going to be better or worse than that rather benign forecast, and I can't decide which way it's going to be. I do very much associate myself with the comments that Bob Forrestal and Gary Stern made about some of the intermediate- to longer-term problems or potential problems that are sitting out there. Indeed, some of those things could turn out to be more imminent rather than further down the road than we suspect right now. And I think one has to stay at least sensitive to those.

Like Dave Mullins, I cannot bring myself simply to dismiss these latest inflation numbers as nothing more than an aberration. Like Dave and others, if I look at the fundamentals it's very tempting to say it's just an aberration. But it's hard to dismiss. Now, one thing these numbers have done already is to make it a lot harder just to stand there and confidently say to somebody that, looking out over '93 or '94, the inflation rate is going to continue to edge down even as the economy does much better. You get the feeling that maybe your nose is growing as you say that. And that in its own small way is one of the reasons why I find it hard to dismiss those numbers out of hand. Partly for that reason but for some other reasons as well--and notwithstanding all that has been said including by my distinguished colleagues from Liberty Street--I think this long bond rally is vulnerable. I think we could see a turnaround in the long bond market. And I say that partly because of that nagging sense of uneasiness about inflation, but I want to go a bit further on that.

It's quite right, of course, to take the indisputable view that the long-bond rate has a real component and an inflation expectations component. That's the Bible. But I don't think it's quite right to argue that the dynamics of the marketplace as reflected in the prices of those bonds in periods of 3 or 4 or 5 or 6 months dissect quite that neatly and easily in terms of what's driving investors, especially when the so-called professional investors have missed the whole thing as Bill McDonough said. When you look at the behavior of the bond market over the last 5 or 6 months, I think you have to allow at least for a phenomenon that isn't quite as neat and precise economically and logically as we'd all wish it to be. For example, you could put this on one of three levels coming out of the period of the election. There's one very, very unsophisticated view of things that simply says people started to feel better; I don't quite know why, but they began to feel better. And there's a slightly more sophisticated version of that, which to me seems consistent with Gary Stern's comment, that says: "Well, at least fiscal policy is getting into the ball game here." It has been on the sidelines for 12 years and they don't quite know what it's going to do, but it's going to make things a little better no matter what. And then, of course,

there is the more sophisticated view that I think Al Broaddus brought up very early in the meeting and that is the net result of the Clinton package and all the rest leading to the view that there's distinctly less of a threat of forced monetization of debt over time and that is what's working its way back into inflationary expectations and fiscal policy being on the table and so forth. Now, having said that, I don't know where the truth lies. I don't think anybody knows where the truth lies. But if for any reason--and I'll get to the reasons in a minute--the public at large or the marketplace in particular conclude that something on the order of magnitude of the deficit reduction that is thought to be on the table cannot or will not be attained or that the whole program whether you like it or not is up for grabs, I think that bond market could turn around with a vengeance and in a hurry.

Unfortunately, my own comfort level with those prospects is not as strong as I'd like it to be. Just as an example, if everything went according to Hoyle in the context of the deficit reduction effort and economic assumptions were perfect and there were no technical mis-estimates, Medicare and Medicaid costs alone behaving over the next three years or four years like they behaved over the past two years could easily offset most or all of the deficit reduction part of the Clinton plan. So, I don't think that [deficit reduction] is a shoe-in by a long shot. Now, I'm not ready to throw in the towel either. I think this is the best chance that we've had in many, many years to get some of this stuff done. But if there is disappointment in how it begins to evolve in practice, there are going to be a lot of people scratching their heads asking: "Where did that wonderful rally in long bonds go?" I don't think it's secure by a long shot. So, again, I am essentially as comfortable as I can be with the kind of outlook shown in the Greenbook, but I must say that the multiple sources of my uneasiness about how things may in fact work out are no less today than they were two months ago.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I'd like to take a few minutes to review the economy's performance in the monetary environment that has prevailed six months before earlier troughs in economic activity. As you know, we've eased the fed funds rate from 990 down to 300 basis points. What struck me when I reviewed this was that we only had the fed funds rate down from 9.90 to 8 percent six months before the [latest] trough. So a fed funds rate of 8 percent six months before the trough seemed to be conducive to blunt the downward momentum that the economy had at that time. We know that we had some head winds that occurred around the trough and after the trough. And yet monetary policy seemed to be succeeding in overcoming the head winds and getting economic activity up to a somewhat lackluster 1-1/2 percent annual rate of growth in the second half of '91 through the first half of '92. Then, I think it's important to note that we lowered the fed funds rate. In some sense we were trying to buy insurance as you will recall. We kept saying that we must be sure that we don't [falter] because this recovery is pretty tentative and the outlook is pretty precarious. So, we continued to buy insurance. But at the time when the recovery was beginning to take off in the second half of 1992 with a 4.1 percent growth rate, the fed funds rate was 4 percent. Over the first three quarters of the recovery, the average rate of expansion was 1.2 percent; the real growth rate was then 2.2 percent in the

first two quarters of 1992 and up to 3.2 percent in all of 1992. And all this was occurring in an environment with a fed funds rate of no lower than 4 percent--that is, unless someone believes that monetary policy works faster than it seems to me that it works. Now, we know why we bought the insurance. And as we were buying the insurance of taking the fed funds rate lower we said that there seemed to be very low downside risks to taking the fed funds rate lower just to be sure. But there was all this talk about when the time comes, of course, we will pull that rate back up. The tough thing always is to know where we are on the monetary ease/monetary restraint path. It seems to me that monetary policy ordinarily needs to be in a slight restraint mode and ought to avoid having to be in a severe restraint mode. That is, we have made a mistake if we have to go to a severe restraint mode. Now, let's look at the indicators of monetary ease. It doesn't surprise you that I would use rising commodity prices. Let me give you some of the numbers. Our ex-food, ex-energy experimental index is up 20 percent year-over-year. It's up at an 87 percent annual rate for the first quarter. I put the numbers in my machine this morning to [include] yesterday's commodity prices so I'd have them almost into the first quarter and it was an 87 percent annual rate. Now, if lumber prices in this quarter are up at a 1000 percent annual rate, let's take lumber prices out and see what we have left. If you take lumber prices out then it's "only" a 33 percent annual inflation rate in the index and I would agree that lumber prices alone ought to be discounted as being a monetary phenomenon--

MR. MULLINS. You can take other things out, too.

MR. ANGELL. It's always so easy to take something out so one can say: "I don't need to be worried about this." Our total index is up 26 percent at an annual rate in the first quarter, given a very favorable energy price environment with energy weighted at something like 55 percent of the total. Then there are food prices, and I look at food prices because when we see these favorable unit labor cost factors there for us I think we have to know that that's really quite a positive. But we also have to know that when food commodity prices start moving upward as rapidly as they now are. And food commodities in our experimental index are now up in the first quarter at a 50 percent annual rate. Now, gold prices are no longer falling. In fact, gold prices are only 1.7 percent lower than they were one year ago. Gold prices have been on a downward trend for a long period of time as the world adapts to a different monetary policy environment. But gold has had a particular kind of technological evolution that is taking the United States from among the also-rans in gold production to the number two producer in the world with the new technology. That, of course, is unlike an equilibrium price for gold that would have occurred in an earlier period. That is, when we saw the price of gold get to $280 an ounce in the last decade, that was not in this environment with this new low-cost technique of producing gold. So, we're in an environment now in which U.S. gold production [incurs] variable costs somewhere between $220 and $250 an ounce. And naturally in this environment gold prices tend to move downward relative to other commodities. But gold prices have stopped that downward move. Now, I don't know that this 12 percent annual rate of increase in gold prices in the last six weeks is all that meaningful. Frankly, if it had not been for gold prices moving down, [I would have discussed this sooner.] That's kept me quiet on this subject for longer than I otherwise would have been.

As for the second indicator of monetary ease: It seems to me that we're at a somewhat tepid foreign exchange value of the dollar in the face of the relative strength of the U.S. economy versus economies abroad. With our economy so much stronger and the other economies so much weaker and interest rates abroad coming down and interest rates in the United States being fixed, I'm asking myself: Why isn't the dollar stronger? That seems to me an indicator that we may have more dollars out there than we realize. The third thing I would suggest--Governor Lindsey already mentioned this prior to the meeting--is that short-term real interest rates are approximately at zero, and that seems to be an indicator of monetary ease. The fourth thing we have is an unprecedented steepness of the yield curve, which indicates that short-term rates have been pegged below the Wicksellian natural rate of interest. I may sound very eclectic today but I guess that's how I am. I suppose another perspective on that would be that a 3 percent pegged fed funds rate when the economy was moving at 1-1/2 percent is different from a 3 percent pegged fed funds rate when the economy is expanding at a faster rate. Even I remember the IS-LM analysis! We have to have disappointing PPI and CPI numbers. It worries me a little to be trying to run monetary policy based upon the CPI and PPI because those are not forward-looking enough, and the dangers that Governor Mullins mentioned are certainly apparent. Now, in this environment I think we have to recognize that the favorable employment cost numbers continue to be extraordinary. Also, commodity prices and steel scrap prices are rising--and by the way, Mr. Chairman, steel scrap prices are up 89 percent at an annual rate in the first quarter, though annual rates, of course, tend to get exaggerated. But I think all of us know that if labor costs are being restrained and if prices are moving forward, indeed isn't that a wonderful opportunity in regard to profit expectations. So, that causes me to believe that the economy may be stronger; and I continue to stand with my forecast, which is 1 percentage point stronger than the Greenbook's. Now, if the Greenbook [forecast] keeps creeping up, at some point in time it may get closer to mine. But I haven't moved mine up any since my Humphrey-Hawkins [submission].

Now, let me also look very briefly at three historical periods of concern. My first concern is: Where are we? I feel that we are in a position that is very similar to where the William McChesney Martin Fed was in 1967. The inflation rate was still in the 1-1/2 to 2 percent range and yet I think they ignored what they needed to look at and instead set the stage for that decision that had to be made to scrap Bretton Woods, in a sense turning the Fed's money printing machine loose as it was in the 1960s. But, clearly, when Arthur Burns became Chairman, we already had launched into an era in which some very severe choices had to be made. I'm talking about over-restraint. Those severe choices, of course, were not made and the U.S. economy suffered gravely from that era at the last of the Martin period and the first of the Burns period.

I'd also like to look at a more favorable example from history, the Volcker Fed in 1984. Now, I think that anyone knew [the Fed had] to do what was done in 1981 and 1982, but to do what was done in 1984 was really unprecedented because the Volcker Fed at that point of time--and some of you were here--in a sense began to tighten up before they looked at the CPI and PPI numbers. They didn't wait until they had bad PPI and CPI numbers. I think Paul Volcker was always a closet commodity price watcher! [Laughter] And clearly he took the

steps that needed to be taken in a preemptive way. And what that did was to lock in the progress on inflation. It meant that the double-digit inflation came down to 4 percent and they locked it in. It also meant that we introduced a period of rolling recession adjustment sector by sector rather than having the whole economy synchronized, and that prolonged the economic expansion.

The last period in history I want to look at is one in which I participated--early 1987. I knew in January and February that I should be voting "no" to accepting a status quo monetary policy. I knew we had over-extended ourselves in regard to lowering the fed funds rate in 1986 and we did not correct it. But somehow or other in the mood of the time I went along. Now, I think we're at a very dangerous crossroads. We are pegging the short-term fed funds rate, and pegging the fed funds rate is a very dangerous exercise. We have to recognize that the fed funds rate may not stay in neutral very long, pegged as it is. I agree at least with Jerry [Jordan] that we shouldn't peg the fed funds rate, whether or not we agree on the direction it ought to go. Now, it seems to me that we ought to enter a period here in which we let ourselves in for a little trial and error, [moving] the fed funds rate in response to the outlook for economic activity. At this stage I don't believe that it is necessary to accelerate [our move to] the natural rate for fed funds--that has to be higher than the 3-1/2 to 4-1/2 percent range. I just say that now is the time to say that monetary policy is working and we need to [begin to adjust] it before the time comes to do something drastic because doing something drastic is always very disruptive to the U.S. economy.

So, I think we're in a dangerous period. I don't know that inflation is going to rise to 4 percent; I think not. I don't think we have 4 percent inflation on the horizon. What I do think is that our progress to get inflation down low enough so that it [isn't a factor affecting] any business decision is now in jeopardy. And I think we have to bring restraint on board which gives us a chance to realize a continued diminution of the rate of inflation because 3 percent is really a very, very bad inflation rate. The newspapers say inflation is gone; they mean 3 percent. Three percent is terrible, and we have to keep on our course. If we don't keep on the course to get it to 2-1/2 and then to 2 percent, I'm quite certain we'll lose it on the other side.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. That's a hard act to follow!

CHAIRMAN GREENSPAN. I measured the decibel level and Wayne is about 3 or 4 percent higher than his normal!

MR. LAWARE. Well, Mr. Chairman, to some extent I share the concerns that Governor Mullins and Governor Angell have expressed that we run the risk of hanging in here too long with this lower rate structure. On the other hand, forecasting in this environment is like trying to solve an equation with 23 unknowns. It seems almost impossible to assess accurately the full impact of President Clinton's economic and health care programs. But on the face of it, higher taxes and simultaneous cutting back in government spending have to be considered to be contractive. And while the full effects of the

program won't be felt for some time and the financial markets have reacted favorably in the belief that it represents a credible attack on the deficit, we still have not seen what the full impact on employment will be of defense cutbacks and other spending cutbacks, including something that hasn't been mentioned here today and that's the armed forces personnel reductions, which are clearly going to contribute to unemployment. What worries me is the potential impact of these impending developments on consumer and business confidence. Now, we may be seeing a signal, a first signal of that, in the recent declines in the Michigan survey particularly as to consumers' expectations for the future. If in fact consumer spending contracts sharply and business investment retreats from present announced plans and if we get a dramatic enough slowing in the economy, there is the specter of a retreat from fiscal discipline toward outright stimulus that I think is almost inherent in this government, and a probable inflationary result. The realities of the situation I suppose will become clear later in the year; and certainly in my opinion a policy shift at this moment is not necessary. But I think we ought to stay on red alert.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Thank you, Mr. Chairman. First of all I'd like to thank David Mullins for his good balanced commentary on the inflationary outlook a few minutes ago and I certainly share [his views]. I must say that if we are looking at the re-emergence of some inflationary pressures, what scares me most about that is that we could wind up looking at it in a stagflation-type context. How did we get there? Well, I'm very encouraged by the comments that I hear from around the country that the uptrend continues and seems to be gathering strength. That's certainly good news and I share the feeling that I hear around the table that we're in less and less danger of having this economy swoon out on us. On the other hand, I don't see the economy as being very likely to run away on the up side to say the least. If the Clinton program goes through, we're going to be looking at some level of fiscal drag beginning to set in during '94 and [continuing] thereafter. The old constraints that we've been living with for a long time have not been excised yet. The 50 mile per hour head wind may have slowed down some to 25 or 30, but we certainly haven't gone into a calm. We have a lot more defense restructuring to go through. At least on the consumer side, if not on the corporate side, we have more debt restructuring to do in my opinion. The outlook for net exports certainly doesn't begin to improve over the forecast period and may be deteriorating further. The economy was carried by the consumer in '92 and I worry that the consumer doesn't really have that much reserve buying power building up yet. Consumer debt is off a little in terms of the service-to-income ratio, but that's mostly due to lower interest rates not to lower absolute levels of debt. As we know, the latter were at an all-time high recently and I guess they're still [close to] an all-time high even though they're off their peaks. But none of that leads me to believe that we can have much confidence that consumer spending is going to continue to carry us the way it has so far, particularly if, for whatever reason--inflation fears or whatever--interest rates begin to rise again. That could have an effect on the consumer and just about everything else, and we could possibly be a part of causing that to occur. Then, of course, there is [the question of] what the broader monetary aggregates may mean, and I certainly don't know what

that may be. Nevertheless, they have been extremely weak and continue to be so; and as we speak they seem to be weaker than ever. Taken all-in-all, I think the Greenbook's path is the best one; I hope we get it; it's the most likely one. But if we are looking at the possibility of a re-emergence of inflation here, and we could be, then I really fear that stagflation may be the context within which it could occur. And that, it seems to me, would [cause us to face] some very, very special and very painful kinds of considerations.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Well, with a few uncertainties or exceptions, the economy appears to be showing signs of being in the upswing portion of a more traditional business cycle, although certainly not of the same strength that we saw in the fourth quarter of '92. We are seeing consumer purchasing continue; it's not surging, but it's at least continuing at a reputable pace. Employment is showing some signs of strength. We're seeing pretty strong corporate cash flows. Long-term interest rates, as we've discussed this morning, have finally come down, and the financial sector appears well positioned to continue to provide capital to a budding recovery. Prices are firming in some areas and certainly that has negative connotations, but it's also a sign of a strengthening economy. Now, given those traditional signs of an improving economy, I think there are some forces that are likely to continue to restrain [it and preclude] a more robust recovery; we're certainly seeing that in the monetary aggregates. The corporate and household restructuring is continuing and this is both balance sheet repairing but also on the operating side. I don't think we're seeing any diminution in the operating restructuring that began last year. We still have ahead the defense restructuring and the effects of that on employment.

On inflation I had written down some nascent signs of inflation reoccurring, although after listening to Governor Angell maybe I should just say plain old signs, not nascent signs. I would have pointed certainly to some of the anecdotal evidence that has been reported--lumber prices and so on. We could probably find some story for every one of these things, but we can't keep throwing out pieces of the indexes. At some point, it all starts to add up. As for the international situation, [problems] seem to range from a very weak G-7 to a potential crisis in Russia. So, certainly that could have an effect on this economy. On the fiscal side, we really don't yet know what the full impacts of the fiscal package are going to be. And we have the health package yet to come. We all have great hopes that we're going to see the deficit reduced, but I think there's considerable skepticism as to how much deficit reduction in fact is going to occur as we move forward with this package. The taxes and redistribution effects may well be more contractive than some of us would like to see. In sum, I think we really can't be complacent about this recovery. Maybe a year ago we would have been glad to see a 3 percent type of recovery. But any one of these downside risks could certainly upset a very fragile consumer confidence situation and send the bond market into orbit again.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I think the comments to this point really reflect the divisions that we're seeing. It's almost a

dissonance. So, I ask myself: What's wrong with this picture? We have a soggy economy and rising CPI numbers. We have a Greenbook that says one thing and Blue Chip forecasts that say another. We have commodity prices pointing toward a boom and a dollar which is weaker than it should be given the current economic situation. On the other hand, we have a bond market rally and [weakness in] M2. What I have to conclude from that is that we're probably looking at the wrong things. What I'm struck by as I go around the country--and this is how I tend to piece it together--are the regional [variations] in the current economic situation. What does that signal to me? It might mean that we could have a version of stagflation, but more likely--well, let me sum it up this way. The statistic called the unemployment rate outside of California--not to pick on a particular state but it's a good state to pick on when it's down--is 6.7 percent. That's a lot closer to NAIRU than our 7 percent sounds. And I suppose if we could pick out other states such as Connecticut, it would help us get the number down closer to NAIRU. In other words, in many markets of the country we are closer to what we call full employment than we seem to be when we look at a 7 percent unemployment rate [for the nation]. That might be why we're starting to see the CPI pick up a little. My mind was changed last week when I was in the Third District, which I never think of as a particularly booming district. But a number of comments were made to me. One was by I've already told this to my colleagues [on the Board]--a man I've never viewed as an inflation hawk. I was sitting next to him at lunch and asked him what his forecast was. And he thought that we easily would have 4 percent inflation this year. He's worried about labor market [pressures] picking up. Then I spoke to the dean of the school; he is a macroeconomist who has to negotiate. His theory goes something like this--again we're looking for what's wrong with this picture: That we have a change in attitude. [Unintelligible] workers have been rehired; the airlines have been told that they're going to receive loan guarantees; we saw what I thought was a humorous spectacle of going to the Administration and urging them not to impose import quotas. In other words, the tough guys are out and the easy guys are in and now's our chance to grab something. I don't know how much [credence] to put in that, but it does signal to me that when there is the capacity for people to ask for a greater wage settlement than they otherwise would or [for firms] to raise prices, the kind of hesitancy that we may have seen in the '80s is no longer there.

My objective function is to maximize long-term growth. It seems to me that we might be nearing a point, and it might be today, where if a stitch in time saves 9, maybe 25 stitches today will save us 200 down the road. If that's the case, I would much rather see us signal that we are concerned about these inflation numbers than take another chance and find that maybe in 6 months time we do not have a 3 percent fed funds rate but a 5 or 6 percent rate. That's [unintelligible] from Larry Lindsey anyway!

MR. KELLEY. It surely is.

CHAIRMAN GREENSPAN. I think we have cold coffee!

[Coffee break]

CHAIRMAN GREENSPAN. Mr. Dave Lindsey.

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

CHAIRMAN GREENSPAN. Thank you, Dave. Let me start off by making a few purely self evident observations. One, at a 3 percent funds rate and effectively zero or slightly negative real rates, there is no way that we can stay at this level for any extended period of time without courting the types of problems that emerged in the late 1960s and the late 1970s. For us to fail to be fully cognizant of the mistakes that were made in the past would be extraordinarily unfortunate for the economy, the country, and a lot of its institutions. And when we do move, it's unlikely that everybody will cheer, needless to say; they never do. Indeed, if we waited until the cheering was there, we wouldn't be doing the job that we have to do and are called upon to do.

In my judgment this is not the time to be immediately concerned about this problem. I do not disagree that the measured price indexes are showing some firming. I think, as Governor Mullins said, that the CPI is an interesting construct. If we take it apart in very considerable detail and realize how it is put together, our general confidence in its ability to measure prices does not get enhanced. It's like sausage meat. Nonetheless, it's measuring real things. A problem that I have with looking at the data at this stage is the issue that a number of you raised earlier--namely, that the cost structure is not going anywhere. The underlying materials costs are. There is a significant firming trend in a large series of materials prices and I think that's going to continue. I don't think we have seen the full effect of endeavors to increase profit margins from the price side in a number of manufacturing products, including chemicals, paper, and [others]. And I must say that I'd be most surprised if we did not see a firming in the general price level. The increases in steel prices very obviously are being significantly assisted by trade policy, which is as [dangerous] a process as one can get into; fortunately it [does not extend to] too many other places but it is a very dangerous type of policy, which I think we are all deeply aware of.

I think everything we can see is exceptionally well behaved in the crucial area of labor costs, which on a consolidated basis obviously comprise the great chunk of our underlying cost structure. There is no ambiguity here; wage rates are clearly under control. And we are not yet seeing, despite our saying that we might, any signs of a significant pickup in contract wage pressures on the union side, which incidentally is now a very small part of the economy--and it's an even smaller part if you take out the government workers that have unions. The major area of wages in our system is basically outside the union area; and compensation, which is far more important these days than the underlying wages, is [not] under very significant pressures. One of the reasons we have seen such a huge increase in temporary versus non-temporary employment over the last several years is that the underlying cost structure is enforcing pressures to restructure, [inducing firms] to go to temporary workers to try to alleviate all sorts of costs. And basically that is succeeding. That is, unit labor costs clearly are under very significant restraint. Productivity is picking up in a fairly substantial way, and I suspect it is basically real. Having said that, however, it is a mistake to try to look at the price indexes or the cost indexes themselves as an

indication of anything other than what history has been. I don't know of any really significant inflationary pickup that has been foreseen very far in advance. I might also add that I've never seen deflation foreseen very far in advance either. The forecasting capability in this area, especially through econometric models, is very dubious.

The one major factor that gives me great concern about moving too fast in the area of restraint is that we have at this stage a still severely impaired financial system. The ordinary structure of moves that the Fed takes is usually to restrain credit growth. And the purpose of restraining credit growth is because we perceive very extraordinarily expanded credit as feeding the underlying inflationary fires. In fact, while we all talk in one form or another about NAIRUs and slack and the like, as far as monetary policy is concerned we are looking at or should be looking at the financial system because it is our job to restrain the expansion of credit before it becomes an inflationary force in the economic system. At this particular stage, there is absolutely no evidence that we have anything other than an extraordinarily restrained credit and financial system. Leave M2 aside; M2 is a different problem. We are not getting an aggregate level of finance that is anywhere near being consistent with very strong nominal GDP growth. What we find is that we are getting a significant profit margin opening up which is financing a good deal of the activity. [Businesses] are financing essentially from cash flow, not from credit. So, the way I look at this particular system is that I think at some point we are going to have to move; and I think we're going to have to move in a somewhat aggressive manner. It's just that I cannot get myself to believe that this is the particular point.

I'm worried that if we galvanize ourselves too soon and the economy slips back or sags or if we should get two straight months of very low inflation, we will dissipate the vigilance that I think is required here. I'm worried that in endeavoring to move too soon or getting ourselves psyched up to move too soon we will find ourselves in the same position, though in exactly the opposite direction, that we were in 6 or 8 months ago. And I remember sitting here and saying in effect that unless the economy picked up in two weeks we would have to move. I knew at that time that if there had been a vote on the table to lower the rate structure, it would have passed. I'm saying to you that we have to be very careful about reacting to short-term numbers. The problem that I have is that I cannot get myself to believe--and I'm more than willing to be convinced--that we can have the type of accelerating inflation problems we've been trying to constrain without first seeing some evidence in the credit markets. If we're going to restrain economic activity without constraining credit growth, I say to myself: Well, we could stop acceleration in inventories but we are not going to do it with 25 basis points; we can try 400 basis points and that may not be enough. We can constrain the growth in capital investment by getting a significant reversal in the bond market, and I agree fully with Jerry Corrigan's concern. Frankly, if I were in the private sector at this stage, I would be having fits on the bonds in my portfolio. This bond rate decline is running faster than I think it probably should, granted the particular evidence. Then there is the stock market, which is high at this particular stage. So, I must say that I've listened to this discussion--and I've been in the forecasting business since the late 1940s--and I will tell you this business cycle is different from anything any of us has seen. It has different dynamics; it has

different characteristics; and the one thing I cannot get myself to believe is that we are at the point where inflation has accelerated. I think we're going to get to that point; and if we stay at this funds rate indefinitely, we are inviting a major problem. It's just that I think the time is not this meeting. It may be the next meeting. David Mullins raises an interesting point that there are two CPIs to be released between this meeting and the next one.

I must say I almost prefer that we make our next move out of a symmetric directive rather than an asymmetric one because I'm not sure in this context that we're going to be dealing with evidence that's going to become very clear except very close [to the time for a decision]. My feeling is that when we have to move we may have to do so with very little advance notice because this is such a different type of phenomenon. Having said all of that, I would like to put on the table that we do nothing at this stage; that we stay symmetric but recognize that the risks are on the up side from a policy action standpoint. I don't want to put that in the directive because if we were to move at this stage to an asymmetric directive tilted toward tightening, we would set in motion some of the other forces that we don't need. My view is that when we have to move that we should move and not get terribly involved in how we say it or how it is structured in terms of asymmetric directives or the like. So, I would say that my preference at this stage is to stay where we are and be vigilant. But I do acknowledge most of the issues that have been raised by Wayne Angell, David Mullins, and a number of the others here: That there is a potential here of our being caught behind the curve and that if we get caught behind the curve, we are going to have to catch up very quickly. As everyone knows, when you have to catch up you have to go faster and harder than you ordinarily would, and that's what usually causes the next recession. If I believed that's where we were at this stage, I would be jumping up and down [in favor of moving]. But I must tell you that when I talk to people and look at the details of what is out there in the economy and the structure of the financial system, the presumption that we are at the cusp of significant inflationary pressures does not yet strike me as credible. The next meeting I may say to you that I've now seen enough to say that something has fundamentally changed. I cannot in all honesty say that that's what I see out there now. So, that's my impression at this stage.

MR. PARRY. I could support that recommendation both for staying with alternative B and for symmetry for the reasons that you suggested, including the fact that we really don't know at this time whether the signs of inflation that we have are of a temporary nature or are more likely to be sustained. I do have a comment and then a question. The comment is that even with symmetry, we certainly have the capability of taking action in the period between now and the next meeting. The asymmetry would be mainly a communicating device which, of course, is communicated the Friday after the next meeting. So, if we have some concerns about what we should be doing [in the period ahead], I'm not so sure that acceptance of symmetry limits our field of action. Therefore, I can very easily--

CHAIRMAN GREENSPAN. Let me put it this way. It involves an implicit premise that the wonderful security that we've kept here for the last number of months will continue.

MR. PARRY. Yes, but it seems to me that the symmetry does give flexibility. I have one question, though. For a long time we've talked about the advantages of being ahead of the curve and I think we complimented ourselves on doing that and talked about how that has served us very, very well. As I listen to this I get the impression that we may be rethinking that view and going in the other direction. I just wondered what you thought about that.

CHAIRMAN GREENSPAN. No, on the contrary, I think if anything we were very cautious on the down side in trying not to be ahead of the curve. On the up side we have to be. I think that's in the nature of a central bank because if we are too easy coming down, we set into motion a secular upward bias [in inflation]. There should be asymmetry in that respect; we should be ahead of the curve on the up side and behind the curve on the down side.

MR. PARRY. But not too far ahead of the curve.

CHAIRMAN GREENSPAN. Well, we can't be too far ahead of the curve because the markets don't give that much advance notice. Governor Lindsey.

MR. LINDSEY. A question, if I could. Mr. Chairman, if we got a .5 [increase] for the next CPI or, say, a couple of .4s for the next two CPI numbers released before the next meeting, would you consider that sufficient evidence?

CHAIRMAN GREENSPAN. I would say it's certainly significant evidence, but we'd have to make certain that--. Well, let me put it this way: The CPI strictly by itself and only by itself I'm uncomfortable with. If we don't get other evidence on the underlying cost structure of the economy or in the financial system that is confirmation, it's an interesting [question] of what is happening in those indexes. I don't know the answer to that; I don't think I have enough information in just the numbers you gave.

MR. LINDSEY. If I could just ask a follow-up to that. I share what you said about the CPI. I wonder what the bond markets' reaction would be to our not responding to, say, a .5 number or .4 or even .3.

CHAIRMAN GREENSPAN. Well, that is the consideration I think we'd have to be aware of. In other words, if we get evidence that is significant and of concern [to the markets], I would say that we'd have to move. If we were at a 5 or 6 percent funds rate, I'd say we probably could sit tight. But at this [funds rate] level I think the bias is [to move] since we know we can't stay here. I don't disagree with what Governor Angell had to say on the issue of [reducing inflation] from its current levels. But I'm hesitant at this stage to think in terms of hypothetical considerations. This is such a complex issue that we really want to know what else is going on at all times. But I do agree that if we are in a position where the markets think we should be moving against the CPI and we do not, we're in trouble. President Jordan.

MR. JORDAN. Thank you, Mr. Chairman. I'd intended to ask a question to Dave Lindsey but your analysis and the factors you cited just punctuate what is my concern about the decision that needs to be

made and the criteria at this meeting and other meetings back to last fall. Specifically, I want to refer to the table on page 8 of the Bluebook and the associated analysis and to put it into a broader [perspective]. I don't know whether this is a question for the staff to answer or for the whole Committee to address itself to. I remember seeing this kind of table 20 and 25 years ago and it hasn't changed a whole lot. What role it serves is not so clear to me. The various monetary and reserve aggregates that are shown in the little matrix have changed over time. It's still a puzzle to me how this serves to guide the Committee in formulating a directive on a meeting-to-meeting basis. In the discussion before our break and in your own commentary now, I thought it was very interesting, with all of the discussion about inflation concerns and all of the other things cited, that there was virtually no reference at all to M2 or any other monetary dimension to that problem. I take it that the purpose of this table or the commentary in Dave Lindsey's presentation or Don Kohn's presentation when he's in that seat, is to guide the Committee on a tradeoff of selecting higher or lower fed funds rates and what we are to expect associated with that. But nobody is talking about reserve and monetary aggregates. And there was your own response to Senator Sarbanes in the last question of the Humphrey-Hawkins hearings about having your staff work with his staff to move away from M2 in terms of Humphrey-Hawkins or at least to supplement that by looking at other things. And I don't know whether--

CHAIRMAN GREENSPAN. It was to supplement, not to move away.

MR. JORDAN. Supplement, right. I don't know what those other things are.

CHAIRMAN GREENSPAN. Nor do we at this point!

MR. JORDAN. Well, in the meetings during the fall I thought the discussion was clearly over real economic activity, output, nonfarm payroll employment, and jobless claims, with very little reference to where we were compared to money [objectives] as to whether we ought to lower the funds rate or not. And today it's a question of concerns over inflation with little reference to money and reserves as to whether we ought to raise the funds rate. So, does this serve any useful purpose at all or should we recast the input to the Committee that we get from staff in the Bluebook?

CHAIRMAN GREENSPAN. Is that a question!

MR. JORDAN. For Don Kohn maybe, but he's away.

MR. D. LINDSEY. Oh well, I'll fill in for Don. I do think the alternative sentence that we gave for the directive concedes that the meaning of that table for policy implementation is not what it used to be when M2 relative to the Committee's expectations truly was a factor in decisions to alter the degree of pressure on reserve positions or the federal funds rate. It was not the only consideration but it was an important one in a way that one can't say is still the case today. So in that sense I think your insight is a correct one. The next question you also asked is: Okay, what other intermediate target variable then do we use as a substitute for M2? If I knew of one, I'd supply it. But I'm not sure there is a unique alternative intermediate target that could play that role, at least

for a time. Down the road I think there's a chance that M2 or some other, possibly redefined, aggregate might show itself worthy of reasserting that kind of role. But I can't say that I can offer one today for you.

MR. MCTEER. May I ask a follow-up question to that? For some time now I have wondered if we pushed harder on the fed funds rate to reduce it whether that might just accelerate the disintermediation around the banking system and result in smaller values for the Ms rather than higher. But according to this, if we have a 3 percent fed funds rate, we will get a certain set of growth rates for the monetary aggregates; if we lower the fed funds rate 1/2 point we will get a faster rate of growth in the aggregates, and if we raise the fed funds rate by 1/2 point we will get a slower rate of growth in them. I question that, but my question is: Was this taken into account in the Feinman/Porter work, which I interpreted in part to cast doubt on this?

MR. D. LINDSEY. Well, let me take a minute to answer that question because it is complicated. First of all, the answer depends on the lag that you look at. Here we're simply going out four months to midyear. There I think the evidence is pretty clear that we've got the sign right. Around the ends of the two prior years the System eased and we got big increases in money growth in February of the succeeding years. Indeed, it was such a large effect that we're now saying we think X-11 distorted our seasonal factors. So, I think over the short run, given the lags and how quickly deposit rates adjust downward, there clearly is an effect from the narrowing of the opportunity costs and inflows particularly into liquid accounts. So in answer to that part of your question I would say I'm confident of the signs for these near-term effects. It gets tougher as you go out for a year. You'll recall in the February Bluebook that we put together simulations that did show that a decline in the federal funds rate would tend to increase the rate of M2 growth over a year's time. You, I recall, asked Don if he thought that was reasonable and his answer was--I'm paraphrasing it--that it's questionable in the sense that we had to make the intermediate-term rate adjust down faster in response to a funds rate [decline] than is standard in the quarterly model in order to get a result like that. If you allow the intermediate rate to come down with the speed that we did in that simulation then, yes, M2 will increase. We used the Feinman/Porter model for that simulation; that's the result we got. It is interesting, as Governor Angell pointed out at that meeting, that nominal GDP [growth] was more responsive to the decline in the funds rate than was M2. In other words velocity in that simulation tended to rise when we lowered the funds rate. Nevertheless, that simulation was based on the Feinman/Porter model with an extraneous assumption about how long rates react to movements in short rates. Finally, and I'll try to keep this very short, my own view is quite different from the Feinman/Porter model. My own view is that that model attributes too much to interest rate spreads and attributes, therefore, too little effect to reductions in short rates over time; it has a very small interest elasticity because there are certain variables that it doesn't embody at all. And it seems to me that those variables were at work over that period pushing M2 down at the same time our easing moves were tending to support M2. In my view, the model doesn't fully appreciate the support that we were giving to M2 through our easings because it isn't quite rich enough to capture the omitted variables.

So, my own personal answer to your question is: Yes, even over a year's time, there is an appreciable interest sensitivity to M2.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I think it's quite appropriate that several members have raised concerns about inflation in the future. After all, that is our responsibility. We need to be, in your terms, "vigilant." But I think we need to be vigilant on both sides of the equation. First of all, it seems to me that the evidence is far from persuasive that we are now in an inflationary cycle or even at the beginning of one. Secondly, it also seems to me that this expansion is really quite young; I don't know whether to describe it as being at a tender age or in its adolescence, but there is still a question as to its sustaining quality, although things are certainly looking better. So, having said that, it does seem to me that it is premature to make any move at this time. I think it would be a serious mistake for the Committee to take action at this time, so my preference is the same as yours--that is, to have alternative B with a symmetric directive. I would add that I would prefer the alternative paragraph for the directive to the one we've been using because of the uncertainties surrounding M2 and M3.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. I agree with Bob Forrestal. I think it's a good thing that people raised the concerns they have because I think maintaining our credibility is very important. I think 3 to 4 percent inflation is too high because it may creep up beyond that; the evidence in the past certainly is supportive of that. I strongly support [the view] that it is the wrong time to change for a variety of reasons, which I'd like to quickly mention. I look at the Bluebook--not just at page 8 and the questions that Jerry Jordan raised--but at table 2, which shows the credit flows over the last 6 months. And I have a hard time thinking that that has been very expansive in virtually any sector because I'm looking at bank credit but also at the debt measures. There just isn't a whole lot there. That, of course, is consistent with the weak Ms that we've seen. Also, we are in the early stages of a recovery and I think it's hard to say it has been overheated so far. There's a lot of uncertainty about these structural issues. None of us has any idea what this Russian business means, though I don't want to put too much weight on that. But beyond that, at least in my own mind, I have to think about how we affect prices and what determines inflation. And I don't think we can avoid [the conclusion] that the effects come through the real sector. There is no magic in this. I think, as Jerry and others have said before, on the way down we got prices down because the economy was quite soft; and I just don't see that we're in a position now--and of course this is what is reflected in labor markets--where there's the kind of impetus that's consistent with a longer-term rise in inflation. Having said that, I'll fully admit that that story is going to be way too old if the price numbers keep going up and we keep saying that it can't happen in the analytical framework we have. But I think it would be premature to move at this stage. I also would prefer the alternative language.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I agree with Bob Forrestal's desire for symmetric vigilance. Maybe another way of putting it is that we now have a policy equivalent of a kinked demand curve. We're not necessarily happy with the price that we have--that is, the fed funds rate--but there are great disadvantages in moving it in either direction. So, we're sort of stuck with it for a while. I was moved by the Mullins-Angell argument. I didn't expect us to be seriously considering tightening because of accelerating inflation, and that argument did make an impression on me. But for the time being I would prefer to follow Governor LaWare's admonition to remain on red alert in that regard. So, I support "B" symmetric with the alternative paragraph.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I think we have moderate, not robust, growth. We still have structural drags on the economy in the financial system; we have slack in labor markets and subdued labor costs; and we're facing a restrictive fiscal policy. While we need to be vigilant on inflation and avoid the mistakes of the past, we also need to look at the fundamentals when statistics are mixed. And I think the fundamentals still point toward an outlook of moderate growth and slowly declining unemployment and a still fairly persuasive case that inflationary pressures are likely to be held in check. When I add all these up, I come out with a constant monetary policy at this point, and I have a strong preference for keeping an even hand regarding what our next move might be.

CHAIRMAN GREENSPAN. Did you indicate a preference on the sentence?

MR. BOEHNE. The alternative is fine with me.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I support your proposal. My own view is that we're in a stage where we're looking at a moderate recovery. The issue is whether inflation will stay at the current level or begin to rise. We don't know at this point. And because we don't know, I don't think we should be acting as if we do. So, I would feel comfortable where we are and I strongly support symmetric language. I don't think we should be trying to tip our hand or anticipate at this stage. On the language, I prefer the alternative language at this time.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. "B" symmetric, alternative sentence.

CHAIRMAN GREENSPAN. A man of few words. President Keehn.

MR. KEEHN. Mr. Chairman, I would strongly support alternative B with symmetric language and the current language indicating specific growth expectations with regard to M2 and M3. We have been in an easing mode for quite some while now and a change in policy is going to be a very, very major change. Somehow the asymmetric language does imply a somewhat automatic shift. Well, perhaps not, but there is an implication of a somewhat automatic

shift. If we do make a change, and it's entirely possible that we might, I would far prefer to do that from a consensus in the group, perhaps in a telephone call between now and the next meeting. But for now I think maintaining our current stance is absolutely appropriate.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. I, too, would support alternative B, symmetric. Again, in the face of all these conflicting signals, I think we have to go back and look at the fundamentals. And the fundamentals, as best I can judge them, are still okay even though the risks have changed. Again, in the context of Governor Angell's earlier point, I don't remember '68 or '69, but I do remember '84 and '87. I might add '88; I think '88 was a watershed, too. In all three of those cases I was on the same side of the ledger, whatever that's worth, but in all three of those cases I had some conviction about the economy itself. I might feel differently six weeks from now but at least at this moment I still don't have that conviction about [where] the real economy [is going]. And it's for that reason that I prefer to stay where we are at least for a little while longer.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I, too, support alternative B, symmetric language, and the alternative description of the monetary aggregates. Like many others, after the discussion before the break I re-thought the price situation and went back to fundamentals a little, recognizing that we're probably not going to be very good at getting the timing precisely correct. Most of these factors have been mentioned and I won't belabor all of them. But it seems to me that [we are in] an environment where most of the other industrialized economies are either weak or contracting, where labor markets here are relatively soft, and where fiscal policy is probably going to give us at least some dose of restraint; that just doesn't strike me as an environment in which inflation is going to accelerate for any durable time. I think we can certainly wait until at least May before acting.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. "B" symmetric, alternative language, Mr. Chairman, for all the reasons that have been mentioned.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mr. Chairman, I certainly accept your proposal. Let me just say, though, that I think the next several months are going to be a really critical period for monetary policy as you suggested in your comments. It seems to me that what's happening is that we are now moving from a somewhat tentative recovery into a period of mature expansion; certainly the chances are that that is happening. And this has been the period in the business cycle in the past when inflation pressures often and quietly have begun to build, even though there was some slack in the economy. As Jerry and others have suggested, I think the markets are going to be watching us very closely in this period to see whether we act to resist those pressures, if in fact they do arise. More specifically, they're going to be watching to see how we react to the increased risks of inflation even before we see undeniable evidence of it. And in that context

Governor Angell's comments about the way we ran monetary policy back in 1984 and again in the 1987-88 period were right on the money. I don't want to overdramatize, but I don't think it's an exaggeration to suggest that the credibility we have fought so hard to establish--and I think we've done so successfully--over the last 10 years could well be on the line in the next several months. But again, as I said, I could certainly go with "B" and symmetric language. I agree with Bob Forrestal and you and others who expressed the need for some caution. But, frankly, if we get another month or two of crummy inflation data, I think we need to think about a change or at least a tilt toward tightening in the directive language.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. "B" symmetric. This certainly seems the time to keep our powder dry. I guess I have no objection to the alternative language; I'm not crazy about it.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. First, with respect to the rate adjustment, there's not only the question of tightening to restrain inflation; there's also the question of aligning the rate with what might be considered the observed rate of inflation, which has been 4 percent for the past 6 months, and 6 percent for the past 4 months. It seems to me that there is some possibility that we've eased in real rate terms as this inflation rate has gone up; so, that's something to think about. In general I am concerned that if we get a couple of bad [inflation] numbers, the market will respond. And the market will also start to wonder whether we're still on the job. I don't feel comfortable putting our faith in a quirky index with no persuasive economic logic as well as indicators on the other side. There is some risk in putting [our faith] in fundamentals in the sense that we may reassemble in May and look back, if we do have a couple of bad numbers, on almost three quarters of an imbedded trend in core CPI at 4-1/2 percent. But at this stage I would support the Chairman's judgment to ride this out a bit longer before responding and therefore hold off. I don't know that there's much advantage in trying to signal with an asymmetric directive; we might as well make a judgment as we go along here. So, I would support "B" symmetric and the alternative language.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I could accept your proposal, Alan. As I think about the symmetry issue, we might as well take the heat when we make a move, not through some words. We've been to that movie recently and it's probably not worth it. There are two things that influence my thinking right now. I'd probably be more concerned if we hadn't seen the slowdown in M1, reserves, the base, and so forth over the last couple of months. As you know, I don't think those are an appropriate target for policy, but I do think they have some value as an indicator of the thrust, and they have slowed down. The other thing is that we're looking at higher inflation numbers, although David makes the point very well that we're still probably not looking at enough numbers yet to be sure. It's dangerous to overreact to high frequency data. But I agree with what Al Broaddus said, that if we wait until

we're absolutely sure we're looking at inflation and expectations have become imbedded, it's very hard to catch up, as you said too.

CHAIRMAN GREENSPAN. Then we're several months late.

MR. MELZER. Yes.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I agree with everyone on the issue of symmetry. You've got that right. I hope I'm wrong on the other score. I hope that I'm worrying about something that doesn't need to be worried about. I guess I'm also engaging in a confessional; I'm sort of apologetic for my past criticisms of the Martin and Burns Fed because [the job] really is tough. It's very easy to sit there and look backward and say: Why did they do that? The signs are very clear when looking backward; they are not so clear when one is looking forward. I certainly recognize how tough this kind of call is. But a few of the things you've said convince me even more of my position. I hear the Committee being satisfied with 3 percent inflation. I hear the Committee targeting 3 percent inflation. I hear the Committee saying if the rate of inflation doesn't go up, we are all right. Now, stop and think about this a minute. What that means is that the Committee is confining the periods of diminishing inflation to periods of economic slowdown and recession, which is just the opposite of what our responsibility is, it seems to me. Our responsibility is to apply the pressure that brings the rate of inflation toward zero continuously and gradually and consistently. That's what our job is. And I hear you saying that if the rate of inflation doesn't go up--and maybe it won't--we're okay. I'm not more pessimistic on the rate of inflation going up than the rest of you. I'm just very pessimistic about inflation staying at 3 percent, and [I'm concerned that] if it stays at 3 percent, somewhere in this expansion it'll go higher. The minute it goes higher than 3 percent, then we're going to put the brakes on and we're back to a stop/go policy. It really is very painful for me to be a part of this kind of operation. So I thereby step aside from so many people I respect. And I am willing to say that I am only the fool who sees it correctly! [Laughter]

Choosing a fed funds rate is quite different from changing the fed funds rate by increments. If all of a sudden we dropped into the room and none of us had anything to do with where the fed funds rate is and we looked at the U.S. economy, at the world economy and at interest rates around the world, what rate would we choose for the fed funds rate? I wish, Jerry, that I could rely upon M2. I always wanted to rely upon the Ms. And I only left the Ms when the Ms left me! [Laughter] So, what we're doing here is that we're caught in an incremental creep. You see, in the Martin Fed it was those eighth of a point changes in the fed funds rate that they belabored over; in looking backward with hindsight we see that they were clearly out of the ball park in terms of what they should have been talking about. But we have the benefit of looking at that history and knowing that history.

As for the bond markets, what I hear you saying is just setting the bond markets up for a real spill. If we act now, some of the people in the bond markets will say: "What in the world are the people at the Fed doing?" But they'll think about it, and I don't

think that the bond markets will react by saying: "Well, my goodness look what's coming." Incremental creep, of course, gets the bond market participants to believe that the fed funds rate is not a random walk. Consequently, if we get behind and they make the first move, the bond market will say "Here they come" and then anticipate all the moves that are there because they will also see those price numbers that are going to cause us to act. I believe the fed funds rate ought to be set at such a rate that we would have just as strong a chance that the next move would be down as that the next move would be up. Otherwise, we're going to do the bond market in. But if we ask what should the fed funds rate be and say we should set it high enough that we would think the next move may be down because we really are in a fiscal mode change here--that I'm certainly very well aware of--it's possible that the fiscal drag in 1994 would be such that lower interest rates may very well be called for. But if we start off into this environment with the fed funds rate at 3 percent when we may need to be easing, I think we'll be lost.

Finally, I guess I have only pretended to be thinking the way many of you think because I really don't. I really do believe in price level targeting. I really do believe that our job is somehow or other to mimic that wonderful golden era, the gold standard, in which money is restrained in such a way that people have confidence in money and its purchasing power, and thereby I'd like to see credit growth right out of the roof in an environment in which people know that they can depend upon the Federal Reserve to maintain the purchasing power of the dollar. So, Mr. Chairman, as no surprise to you, I choose alternative C. And I really don't care what you people do with your alternative language.

CHAIRMAN GREENSPAN. Governor Lindsey.

VICE CHAIRMAN CORRIGAN. I'd say that was "C" symmetric!

MR. LINDSEY. Mr. Chairman, I listened to what you said, and unlike Governor Angell, I'm not the fool who sees it the way it is; I'm probably the fool who sees it wrong! You stated, and I agree, that we now have an unsustainably low federal funds rate. You also stated that at some point in the future we're going to have to move and move aggressively. You also pointed out that slowing down an overheating economy through monetary policy is expensive. You mentioned inventories; you mentioned that 400 basis points would slow down real investment, and I agree with you--

CHAIRMAN GREENSPAN. I was saying: What do you do in an environment in which the credit markets are dead and you decide you want to slow down the economy? The question is: Why do you do it? The other question is: How do you do it? And I say that under those conditions you need extraordinarily stringent tightening whereas if you're responding against a credit expansion you can do it by increments.

MR. LINDSEY. And we are not now talking about a rapid expansion of credit?

CHAIRMAN GREENSPAN. When was the last time you saw inflation without support from the credit market?

MR. MULLINS. The last six months.

MR. LINDSEY. I think you're right on all counts, Mr. Chairman, but if we have an unsustainably low [fed funds] rate, wouldn't it be better to have a mild move now? The mechanism by which I see that being translated into the real economy is that, frankly, I think we have overextended financial markets. I think you said so yourself; you said you would be quitting the bond market right now. And you said that the stock market is quite high. There's probably not a lot of real effect from 25 basis points on the fed funds rate. I do think, though, that it is a signal to those markets that perhaps we think they are overextended. And I would rather raise the fed funds rate 25 points now to put a little cold water on them than to be in a situation in a few months where we might have to raise it significantly more. Again, I am saying that with full respect for your judgment, which is far greater than mine. I'm lucky that I am just a governor and not chairman; that perhaps gives me more freedom of movement.

When it comes to other [developments that people] mentioned that are holding us back, fiscal policy and the international situation were mentioned. As for fiscal policy, this year the fiscal policy situation is not contractive. In fact, they've decided to postpone the tax increase in order to make it that way. The timing is probably smart from their perspective. With regard to international policy, the transmission mechanism from international weakness should be a strengthening dollar. That is what is going to restrain inflation in this country and it is not happening. And I am very concerned that it is not happening. When industrial production is rising 3 or 4 percent at an annual rate in this country and is falling at a 3 or 4 percent annual rate in every other country in the world, to have the dollar unchanged should be sending out alarm bells. So, I am not persuaded that those two factors, which should normally hold back inflation, are going to hold it back.

Finally, the real reason that decided me to jump off the deep end and join my colleague is the point he just made. When I joined the Fed I had to go through the cells in my brain and ruthlessly rip out all those I had learned in college that said inflation is really okay. And I prepared a speech in which I wrote down every reason why I thought price stability was crucial. Unfortunately, I have now given that speech so many times that I actually believe it. [Laughter] The point is that what we are really saying--every one of us around the table said it, perhaps by indirection--is that it's fine as long as inflation does not accelerate, meaning that 3 or 4 percent is fine. Well, that should not be acceptable to anyone here. Three percent inflation is not acceptable. In fact, it's in my speech; I have managed to convince myself that 3 percent inflation is not acceptable. Furthermore, if it goes back up to 4 percent, then we go back to the situation where we ask what was gained by the last 5 years of monetary tightness. And the answer is absolutely nothing. And our friends out there who were my former professors will say: "You see, we told you so. You can't hold inflation down; you can try for a little while at tremendous cost to the economy; but you can't hold it down permanently." So again, Mr. Chairman, I have tremendous respect for your point of view and I know I'm voting in a tiny minority but I have managed to convince myself that at this point long-term economic

growth without inflation can best be had with a small rise, maybe 1/8 point, in the fed funds rate.

CHAIRMAN GREENSPAN. You're taking alternative--

MR. LINDSEY. "C."

MR. MULLINS. Alternative language?

CHAIRMAN GREENSPAN. Alternative language?

MR. LINDSEY. Oh, I don't care. Yes, it looks fine.

CHAIRMAN GREENSPAN. Okay. Let's try "B" symmetric with the alternative language.

MR. BERNARD. "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions. In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, 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 a resumption of moderate growth in the broader monetary aggregates over the second quarter."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	No
President Boehne	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	No
President McTeer	Yes
Governor Mullins	Yes
Governor Phillips	Yes
President Stern	Yes

CHAIRMAN GREENSPAN. Okay. The next meeting is--

MR. BERNARD. May 18th.

CHAIRMAN GREENSPAN. May the 18th.

END OF MEETING