Meeting of the Federal Open Market Committee Meeting
July 5-6, 1994

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., beginning on Tuesday, July 5, 1994, at 2:30 p.m. and continuing on Wednesday, July 6, 1994, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman
Mr. McDonough, Vice Chairman
Mr. Blinder
Mr. Broaddus
Mr. Forrestal
Mr. Jordan
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. Parry
Ms. Phillips

Messrs. Hoenig, Keehn, and Melzer, Alternate Members of the Federal Open Market Committee

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

Mr. Conrad and Ms. Minehan, First Vice Presidents, Federal Reserve Banks of Chicago and Boston respectively

Mr. Kohn, Secretary and Economist
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. Beebe, Goodfriend, Lindsey, Promisel, Siegman, Simpson, and Ms. Tschinkel, Associate Economists

Ms. Lovett, Manager for Domestic Operations, System Open Market Account
Mr. Fisher, Manager for Foreign Operations, System Open Market Account

Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors
Mr. Ettin, Deputy Director, Division of Research and Statistics, Board of Governors
Mr. Madigan, Associate Director, Division of Monetary Affairs, Board of Governors
Mr. Struckmeyer and Ms. Zickler, Assistant Directors, Division of Research and Statistics, Board of Governors
Ms. Edwards 1/ and Mr. Oliner 1/, Economists, Divisions of Monetary Affairs and Research and Statistics respectively, Board of Governors
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Mr. Bennett, Ms. Browne, Messrs. Davis, Dewald, Lang, Rolnick, Rosenblum, and Scheld, Senior Vice Presidents, Federal Reserve Banks of New York, Boston, Kansas City, St. Louis, Philadelphia, Minneapolis, Dallas, and Chicago respectively
Messrs. Guentner and Sniderman, Vice Presidents, Federal Reserve Banks of New York and Cleveland respectively

Transcript of Federal Open Market Committee Meeting of
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July 5, 1994--Afternoon Session

CHAIRMAN GREENSPAN. Before we get started on our formal proceedings, I have several announcements. First, we'd like to welcome the new Vice Chairman of the Federal Reserve Board to his first Federal Open Market Committee meeting.

MR. BLINDER. Thank you very much.

CHAIRMAN GREENSPAN. And my next news--the unwelcome news--is that Si Keehn is leaving and this is his final meeting. It says here that his first meeting was on July 6, 1981. Si, of course, will return for the retirement luncheon following the August 16 meeting. This is also First Vice President Bill Conrad's first meeting. Bill is an observer at this meeting, but he will represent the Chicago Bank at future meetings until a new president is selected. Finally, Karl Scheld will be attending his last meeting. He has been attending FOMC meetings regularly for nearly 25 years. I'd like to say a few remarks about Karl at the luncheon tomorrow.

Getting on to formal business, would somebody like to move approval of the minutes of the May 17 meeting?

VICE CHAIRMAN MCDONOUGH. So move.

CHAIRMAN GREENSPAN. Is there a second?

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. Without objection. I'd now like to turn to Peter Fisher for the report on foreign currency operations. Peter.

MR. FISHER. Thank you. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Peter? Ed.

MR. BOEHNE. How much discretion did you have here working with the Treasury in terms of the timing of the intervention?

MR. FISHER. Well, the events of the morning gave me precious little time. The final decision to intervene was not made until sometime between 9:15 and 9:30 a.m. There had been an uptick in the dollar shortly after 9:00 a.m. I must tell you I fear that was the result of some leakage out of European central banks. I was very nervous about trying to enter the market as the dollar was coming down and thus I was in rather a hurry to try to get into the market before it came off that brief high. So, when I did get approval from the Treasury to operate in that market, I jumped right in.

MR. BOEHNE. And the immediate response of market participants was to sell dollars?

MR. FISHER. No, I don't think that was the immediate response. The morning operation had a more beneficial effect. The dollar moved up--I don't remember the exact figures right now. It moved up appreciably over the course of an hour or so. It then began to come off when we pulled out of the market and in the afternoon when we tried to reinforce the dollar we really met a wall of dollar/marks.

MR. TRUMAN. President Boehne, just one comment on your first question from an historical perspective, which I think is the perspective you are coming from: The decision to intervene on that day was a joint decision, so in that sense Peter had no discretion. That is no different than it has been. But once the decision was taken, it was then largely in the Desk's hands as to how they would handle the intervention. That was in contrast to some instances of micro-management over the course of recent years. I think Peter had been given quite a large amount of resources for his potential use, and although he consulted about his change of tactics, the tactics were decided by the Desk rather than by the Treasury.

MR. BOEHNE. Thank you.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Reading the transcript from the last meeting--unfortunately these transcripts will come back to haunt us all--but I am going to haunt you for a moment, if I may. [Laughter] The reason given for the previous intervention in late April and early May was that it was to underline a change in policy. Was there any change in policy that this intervention underlined?

MR. FISHER. No, and I think that may have been one of its problems. I think when I spoke previously we were referring to both Treasury and Federal Reserve policy.

MR. LINDSEY. Right.

MR. FISHER. Looking back at last week, I think there was a change in Treasury policy. The clarity with which it was expressed evolved over the course of the week in which we operated and only became clear, I would say, toward the end of the day and subsequently. There was a change in the statements Treasury officials were making. They were now looking for the dollar to go higher rather than lower.

MR. LINDSEY. The market's reaction to that increased clarity, as I recall, was to send the dollar down.

MR. FISHER. I don't think the increased clarity was sending the dollar down. I really don't view it that way. Late Friday afternoon an unnamed Treasury official finally said they would rather have the dollar go up than down, not in so many words but that was the gist of it. I don't think that caused the dollar to go down rather than up. We did have a very regrettable series of headlines as a result of the President's interview on the radio. I think the overall remarks the President made were something any rational person could agree with. They map rather well with remarks I have made here to the effect that there are fundamental reasons for the mark and yen to be strong but that their appreciation is getting a little overdone, and we think it is prudent to intervene. This came out in a series of headlines. The first said "Clinton thinks exchange rates are puzzling." And subsequent headlines were "Clinton sees reasons for mark to rise versus dollar; Clinton sees reasons for yen to rise versus dollar." Our afternoon operations had to face these headlines literally head-on. That, I think, was an important cause of the dollar's weakening that afternoon.

MR. LINDSEY. Did the Treasury know about the President's forthcoming statements?

MR. FISHER. I was not aware of the President's interview prior to seeing it come across the wire.

MR. LINDSEY. Was the President aware that we were going to intervene?

MR. FISHER. I don't know that for a fact. I think he had been briefed on the Treasury's views on Thursday. But as I said, the final decision to intervene was made by Secretary Bentsen between 9:15 and 9:30 a.m. on Friday morning for their part.

MR. LINDSEY. I have a follow-up question. The transcript for the last meeting reads that I was asking you "How long do you expect the latest intervention to hold? I suppose the intervention last August bought us 9 or 10 months. I assume the second intervention"--which we had just had in late April and early May--"will buy us something less than 9 or 10 months." It bought us four weeks. "Do we have any ammunition left?" You said at the May meeting "I think the operation and the action of the Bundesbank last week and whatever the Committee does in the realm of the expected, if I can put it that way, will tend to stabilize the dollar/mark rate." Well, we didn't stabilize it. How much time has this intervention bought us? With the last, we went from nine to ten months down to four weeks. Will this intervention buy us four hours or four minutes? It bought us about twenty minutes, I think.

MR. FISHER. I think it has bought us more than twenty minutes. I wouldn't tell you it would buy us any great amount of time in terms of weeks or months. As I said, I do think the relative stability of dollar/yen in a trading level below 100 is very different from what all of us were expecting. The risk of a drop through the floor at that point, I think, was very real; dollar/yen sentiment was extraordinarily negative and there was very little indication that there would be buyers there. Although there is a risk of a big drop now, I can't, of course, prove that to you scientifically. But I don't think it buys us more than a few weeks--I'll be honest with you, I don't like to admit to that--unless there is some other change in market dynamics. I think the market views itself as being a little oversold now. The reaction of the dollar/mark last week was frequently to tick up as nervous people covered shorts. That was not the case--we had not gotten that far--after the April-May operation.

MR. LINDSEY. Given the interest rate differential--this is the last question, I promise--what is your expectation of the yen or DM exchange rate or both a year from now?

MR. FISHER. You're trying to make me enjoy the transcripts even less! [Laughter] I don't have any forecast that far out myself.

MR. LINDSEY. Higher or lower, how does that sound?

MR. FISHER. I haven't a clue.

MR. TRUMAN. Governor Lindsey, just on your first question, it is correct to say that one of the purposes of the May 4 operation was to send a message. That doesn't necessarily mean that the purpose of every intervention should be to correct a policy misperception.

MR. LINDSEY. Well, Ted, I don't want to dig it out of the transcript, but I can swear that Chairman Greenspan, who I guess is authoritative in these matters, said that if one were to list the reasons for intervening, underlining policy was about the only reason. I will find the quote for you. It may be in one of our Board meeting minutes, but if I am substantively wrong, Mr. Chairman, please correct me.

CHAIRMAN GREENSPAN. I am not quite certain what you've accused me of. [Laughter]

MR. LINDSEY. I was accusing you of being quite correct actually in making the very wise statement that, if one looks to reasons for intervening, the most legitimate reason one can think of is to underline a change in policy.

CHAIRMAN GREENSPAN. There actually is another that is important, and I think we have intervened for that reason on occasion. It is to break a psychology that is building up irrationally in the market. And if the intervention can accomplish that, maybe it can have a constructive effect. That's the only meaningful use of intervention in the context of unstable markets because the question essentially is whether the intervention will accomplish something. The only way it can do something is to catch the market short and break the back of a cumulative psychological downtrend. We have accomplished that on occasion when we tried it and sometimes it has failed.

MR. LINDSEY. And would you view our last attempt as success or failure?

CHAIRMAN GREENSPAN. I would say that for the last attempt we did not have the benefit of a net short position in the market. We knew that at the time, but we were at a point where there were no easy solutions.

MR. LINDSEY. So, the intervention last time didn't meet your second criterion?

CHAIRMAN GREENSPAN. I would think not, but I was one of those who supported it, so I can tell you that I had my fingers crossed; I was hoping.

MR. LINDSEY. Okay.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. You implied in your comments that you thought there was a significant risk that if we had not intervened, the bottom would have dropped out of the dollar/yen relationship. Was there anything going on in the market that morning that indicated a disorderly market?

MR. FISHER. Well, disorderly is different in one context from the risk of dropping through a trap door.

MR. LAWARE. I understand that. But an estimate of risk is absent or is just speculation in a disorderly market or at the beginning of a disorderly market.

MR. FISHER. Well, on Thursday afternoon and Friday morning of that week I was looking at an options position, which I included in my written material but did not include in the charts circulated today. I am referring to risk reversals which are two equally "out of the money" options--one dollar put and one dollar call. The pricing is expressed as the difference between the implied volatility of the two positions. Now, when the put is over the call in "vols." we express it as a minus number; when the call is bid over the put, we express it as a plus number. From my entire observation of this pricing, we have always talked about a range between -1 and +1. Thursday afternoon and then Friday morning, the dollar put was offered at 2 "vols." over the call. People who had never discussed options prices with me were calling me up on the phone to make sure I was aware of this pricing development that suggested that the market was about to step back and would not want to touch dollar/yen as the rate dropped down. So, that's as precise an indicator as I had; it is not the only one that I rely on in assessing market sentiment, which obviously was extraordinarily bearish.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. I had a comment rather than a question if that is in order, Mr. Chairman. I just have to say that this intervention, particularly its outcome or lack of outcome, really bothered me a lot. I think just about everybody saw it as a generally unsuccessful operation--maybe not everybody but most people. It got a lot of attention even in the Richmond papers. The headline on the front page the next day was about the failure of this operation. What concerns me is that our involvement in such a conspicuously unsuccessful operation is bound to raise questions in the public's mind about our general effectiveness as an institution, about our ability to do what we set out to do. In that sense, it could tend over time to undermine or at least weaken the credibility of our longer-term monetary policy objectives. As I see it--I think most people would agree on this--the basic problem with sterilized intervention operations like this one is that the short-term objectives of a particular operation may be perceived as inconsistent with, or at least not fully consistent with, the broader objectives of monetary policy at a point in time. I think this shows pretty conclusively that sterilized intervention operations only have lasting effects if the markets believe they are going to be backed up strongly by basic monetary policy actions. Clearly, on June 24 that expectation or that conviction was not there. Given this experience and others like it in the past, Mr. Chairman, I would respectfully recommend that to the best of our ability we avoid getting involved in these operations unless there is pretty general agreement within this Committee in a particular instance that we will back up the intervention with whatever monetary policy actions are necessary. To get that kind of agreement in any particular case would imply that at that time we would be giving short-term exchange rate objectives a dominant role or at least a lot of weight in monetary policy. With that in mind I think that we probably would not want to undertake these kinds of operations very often, which would be a good thing from my standpoint. I think the longer-term cost of operations like the one on June 24 is significant.

CHAIRMAN GREENSPAN. You know, it depends really on whether we expect markets to be wholly efficient and not run periodically into some significant abnormalities that an intervention could rebalance. This is the key question. You are telling me that we should not respond to this market at all; it's the Treasury which has to be convinced of that, which they were not. If we are put in a position where we opt out of coordinating with the Treasury, I think that would do the financial system more damage. In all of these actions it has been we who have fended off recommended interventions which we thought were superfluous and potentially counterproductive. We have only gone forward when we thought there was at least a reasonable shot. Our choice is not, in my judgment, to withdraw from these discussions because the damage it could do to the financial system if we are perceived to be at loggerheads with the Treasury in this sort of arrangement, I think, would be very substantial. If you are asking me whether I personally disagree with the underlying philosophy that you were outlining, the answer is, no, I do not; I do agree. The question is what do we do about it. What we are trying to do is to make the financial system, in the context of the structure in which we have to operate, as sensible as we can make it or less nonsensible, if I can put it in double negatives.

MR. BROADDUS. Well, I certainly respect your view, Mr. Chairman. I just hope that what I perceive as a significant cost of an outcome like this one gets factored into the equation.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. Could I just go back to the discussion we were having a few moments ago about the more generic exchange rate policy? This may be a rookie question, but I am highly uninformed. I thought the generic policy was that we did not intervene very much but that we did intervene to correct "disorderly markets." This might be translated as saying we sometimes try to prick speculative bubbles; different people would translate it different ways. That is to say, it is not that we intervene only when there is a change in policy to be signaled. This basically has been the policy of the United States Treasury for a long time, and I would have thought we viewed the last operation as a continuation of that long-term policy. There was a change in rhetoric, I would admit--

MR. LINDSEY. As the Chairman said, there were no shorts in the market; we weren't pricking anything speculative.

MR. BLINDER. You could argue that implicit in what you just said is an argument that the operation was doomed to fail. I don't think that was quite so obvious before the fact. But it seems to me the effort was predicated on the belief that there was a downward speculative bubble and that it was at least possible to prick it or to prevent it from getting worse. Peter suggested, contrary to the evaluation that it was a failure, which I tend to share myself, that you could look at it as a success in that the floor has not dropped out of the yen. But the main point I wanted to make was not about the specifics of the tactics but that I didn't really see that the long-term generic exchange rate policy of the United States government was as you described it.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. I'd like to make some comments in two areas: One is on the operation itself because, like the Chairman, I was involved in the decision to do it. The previous Friday at about midday, as Peter mentioned in his prepared statement, there had been a very significant weakening of the dollar on no volume. We had what is technically the worst of all worlds: a price correction with no position correction. So we had all the people who didn't feel good about the dollar sitting there with exactly or essentially the same positions that they had at the start of the day. On the particular Friday morning when we intervened, the market had very much the same feel about it. The question, which always plagues one after an intervention as it should whether it is successful or not, is what would have happened if we had not intervened. The answer is we don't know. But the likelihood of the dollar having been considerably weaker is significant in my view. I would agree with Peter's comment that the ability of the dollar to stay in the 98ish area against the yen since that time had a relationship, perhaps the main beneficial one, with the intervention itself. Secondly, I think we should realize that the dollar's weakness is essentially against the yen. The dollar/deutschemark is about in the middle of a range within which it has been floating for some considerable number of months. So, having made the policy statement to accompany the intervention, I think people are now correctly thinking that the main thing going on in the exchange market is that we have a very strong Japanese yen and that's a very big problem for the macro economy in Japan.

On the policy issue, I very strongly support the Chairman's view that it would be unwise, I think in the extreme, for the Federal Reserve to distance itself from active involvement in the decisionmaking in this area. First, as a purely technical matter, the world does not know until the next quarterly publication of our exchange market activity by Peter as the Manager for Foreign Operations whether the intervention by the U.S. monetary authorities has involved both the Treasury and the Fed or just one or just the other. So, in order to establish that we were not involved in the operation, since the Federal Reserve Bank of New York carries out intervention operations as the fiscal agent of the Treasury, we would have to make a public statement that we did not sympathize with an action by our own government. That is something which I do not think any of us would wish to do, at least I certainly would not. The ability of those of us involved in these discussions to have a very positive influence on the Treasury is considerable. They pay attention to us. I think they believe that both our knowledge of economics and of markets is considerable; we hope that belief is well-founded but the important thing is that that is what they appear to think. Therefore, we do have a considerable amount of influence on what happens. The Chairman and I have both stated that we supported the operation on that day. It does not appear to have been a success, but again we do not have a clue as to what would have happened had we not intervened.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I can agree with everything the Vice Chairman and the Chairman just said and still feel uncomfortable with this particular operation. Let me first ask Peter a follow-up question to the response he gave to Governor Lindsey about the 100 level on the yen and a floor and so on. Now, the rate is something under 99 and the market is still functioning. Is there another number that's magic?

MR. FISHER. I don't think there is one that has anything approaching the magic quality or aura of the 100 level. I think that the market looks to 95.50--actually 95--as a sort of floor; this is the view of the chartists of the world. That level would represent the bottom of the dollar/yen rate going back to the early 1960s, taking the troughs over that period; people with their rulers can draw a line to there. That level has some significance for the market, but nothing approaching the significance of 100.

MR. JORDAN. Part of the reason I asked the question was that one of the things that troubles me is taking action because of a psychological barrier. The market participants now say, well okay, that level is not going to come back again, so as far as magic numbers--

CHAIRMAN GREENSPAN. Jerry, could I just say--I think the Treasury was acutely aware that what they did not want to do was to protect the 100 level. In fact, they have often made statements to the effect that if we could close our eyes and all of a sudden readjust the number to under 100 they would feel a lot more comfortable than trying to defend that number.

MR. JORDAN. But Peter argued it wasn't our view or even the Treasury's. Rather this was in the minds of the participants in the market.

CHAIRMAN GREENSPAN. That's right.

MR. JORDAN. That was creating this situation that forced our hand. And if it was, we might call it irrational.

MR. TRUMAN. Well, the dollar had traded below 100 earlier in the week and that was indeed one of the reasons why we didn't operate then and why we felt somewhat more comfortable--though I think it's fair to say not greatly so--about operating at that point, having approached the 100 level for the third or fourth time. First, the rate went through that level and then it came back. And so some of the psychological aspects of operating close to 100, but above it, were removed. That does not remove the point that Peter made about possible consequences of a large adjustment below that in the absence of any actions by the monetary authorities.

MR. FISHER. The dollar had traded briefly below 100 in rather discrete increments and we had all seen 99 on the screen several times; it did not stay there very long. So, it was a sort of episodic venturing below 100.

MR. JORDAN. Focusing on your reference to market participants, the magic number, and psychological aspects, I want to follow-up on something that Al Broaddus was referring to--the perception of success or failure. In a technical sense, it doesn't matter to me whether you sell $800 million of assets denominated in yen and deutschemarks and Joan Lovett rather mechanically buys assets denominated in U.S. dollars of the same amount in order to maintain the funds rate. So, what happens is that the Fed is just going to make the portfolio substitution. But people don't see Joan's actions; they see your actions. Suppose the perception is that our objective was to influence the rate--that we had a price objective and were trying to prevent the dollar from falling further or to cause it to rise, not trying to do something as Governor Blinder mentioned about disorderly markets. But the dollar now is not consistent with the objective. If we have a repetition of those, it makes the Federal Reserve look impotent because markets see what Peter does but they do not see what Joan does. And if we have several of those over a period, our image of being able to influence markets will be tarnished.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. This is a question for either Peter or Ted. The question is whether you are concerned about the extent to which our current account deficit has been financed recently through central bank intervention and, as a practical matter, how closely we can monitor that.

MR. TRUMAN. Well, I have some words in the Chart Show on this point. The extent to which our deficit has been financed recently by official sources is exaggerated because basically all that counts is the intervention by the major industrial countries. More than half of the financing last year, say, was by nonindustrial countries whose motives are the same as those of any other private sector investor; they don't have an exchange rate motive though they may be speculating on the exchange rate. It is not easy to track this accurately because, this is the second leading point, we don't really know why what gets recorded as official inflows are official inflows. For example, if a country moves its dollar holdings from the Euro-market to the New York market, it would show up as official financing of our current account deficit even though in some sense in a portfolio preference way and a currency dimension way, it would not be any change. So, it is very difficult to interpret all those numbers. We have lots of countries around the world that have different motivations for where they hold their assets and why they hold them there. That's about all I have to offer.

CHAIRMAN GREENSPAN. If one argues that the exchange rate is affected by the proportion of the current account deficit that is financed on official account, the implication is that sterilized intervention affects the exchange rate. I would argue strongly about that because a goodly part of our official support is coming from the Japanese; they are in the market every day, just picking up $100 million, $200 million, $500 million, and I think the evidence that they are affecting the exchange rate is very dubious. It's showing up in our accounts because, to the extent that they are picking up Treasury bills and the like directly, the issue that Ted is raising is not a problem. But to the extent that they are picking up dollars in the Euro-dollar market--I don't think there is much evidence that there are a lot of Euro-dollar holdings in Japanese reserve accounts--then it appears basically in the private account, not in the government account. So, my main concern about that argument is that it gives credence to sterilized intervention as an important tool in stabilizing the exchange rate. I don't think the evidence is there. Governor Lindsey has another question.

MR. LINDSEY. This is really for Don Kohn, but it is related to the foreign exchange operations and I wanted to pick up on a point that Bill McDonough mentioned. Suppose we had a change in price without any change in position. Let us just imagine something catastrophic--and for the recording of this meeting this is just hypothetical--suppose we had a drop to 85 in the yen, to pick a nice low round number, what would be the reaction?

MR. KOHN. Joan can comment on this as well, but I think the experience of the last month or so is that the bond markets would tend to react negatively. That is, they would be concerned about one of two things: One, that the decline in the dollar/yen relationship was itself indicative of inflation expectations, and that might end up affecting the bond markets. Or, two, that in fact a very rapidly sinking dollar, given where the economy is and the strength of aggregate demand, would have inflationary implications via direct price and indirect aggregate demand channels. So, I think at least over the recent period, the decline in the dollar has had an adverse effect on bond markets. We have had periods in which the dollar has fallen and there has been no effect on bond markets, but that has occurred in the context of much more slack in the economy.

CHAIRMAN GREENSPAN. There is also the implication that the dollar will continue to decline. If we get a sharp reduction and everyone thinks it is overdone, the bond market will rally.

MR. LINDSEY. That would be my reaction, and that shows why I am not on Wall Street, Mr. Chairman.

CHAIRMAN GREENSPAN. I think that has happened.

MR. LINDSEY. I would think we'd have a big rally in the bond market if the dollar/yen rate suddenly went to 85.

MS. LOVETT. How the bond market is going to respond will depend on the circumstances that caused such an abrupt change and what that does to the expectations and how long it persists.

MR. FISHER. I think you would have to have a sense of how confident the market was that it would stay at 85 or whether the next stop was 75. Now, if you were confident that it was stopping there, I would agree with your hypothesis for a rally in the bond market; that would be a plausible reaction. But if the market did not have confidence it was going to stop at 85, I don't think we would get much of a rally in the bond market.

MR. KOHN. But that's a problem in itself.

MR. LINDSEY. But if we have any confidence that markets can be stabilizing factors--I picked 85 because I was trying to take a worst case scenario of the dollar/yen fall and I thought 85 was so low that the rate would not get there--wouldn't we view a fall to such a level as the foundation for a rally in the bond market? I would think the answer is yes. So, I would say that if the markets want to overstep themselves and they are going to overstep themselves irrationally, why not let them?

MR. FISHER. I haven't said anything about irrationality. I'd like the meeting tape to be very clear on that because I don't think people betting millions and billions of dollars are doing anything irrational. They are trying to serve their interests as they see them in the short run. That's very important to me. That's the question, though. I look at asset prices and I see that as prices go up, demand goes up in the short run and as prices go down, demand goes down in the short run. And whether the markets are stabilizing or not depends on where the short run ends and the long run begins.

MR. LINDSEY. Thank you.

CHAIRMAN GREENSPAN. Would somebody like to move to ratify the transactions in the foreign exchange markets?

SPEAKER(?). Thank you!

SPEAKER(?). So move.

CHAIRMAN GREENSPAN. Is there a second?

MS. MINEHAN. Second.

CHAIRMAN GREENSPAN. All in favor say "aye."

SEVERAL. Aye.

CHAIRMAN GREENSPAN. Opposed?

MR. LINDSEY. No.

CHAIRMAN GREENSPAN. One opposed.

[Secretary's note: Mr. Jordan also voted "no" and so informed the Chairman immediately after the end of the afternoon session. His voice vote was not heard by the Chairman or members of the Secretariat.]

CHAIRMAN GREENSPAN. Shall we now move to Joan Lovett who, I hope, will be treated with slightly more upbeat questions! [Laughter]

MS. LOVETT. I feel I am starting on an uneventful note here, and I am. I was going to comment that reserve management was relatively uneventful over the intermeeting period. [Laughter] And I was going to go on to say that that occurred notwithstanding the huge flows in reserve markets. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Joan? If not, would somebody--Governor Blinder.

MR. BLINDER. Since there weren't any questions about the immediate strategy, could I ask a longer-run question about the maturity structure strategy?

MS. LOVETT. Of the System's portfolio?

MR. BLINDER. Yes. As I look at the report, since the last meeting I see that the System added about $5 billion in bills. And when I look at the notes and bonds, it's a sort of swap. That's the outcome for the whole six-week period as was described in the table in your report. Should I read anything into that? Or could you just talk for my benefit, as a newcomer, about the maturity structure of the System's portfolio and the Committee's policy regarding it?

MS. LOVETT. Let me start out by saying that when we make additions to the portfolio on a permanent basis, we usually do so when we see a protracted need to supply reserves. If we really don't see that, if it looks as if there are going to be short-term swings, we will address most of that reserve need with repurchase agreements and the like. I don't know what page of the report you have in front of you, but during the intermeeting--

MR. BLINDER. I was looking at Roman numeral IV of your report.

MS. LOVETT. The New York Desk report?

MR. BLINDER. Yes.

MS. LOVETT. Okay. On an outright basis, the portfolio went up by $4-1/4 billion during the period. That increase reflected $3-3/4 billion of bill purchases in the market and securities purchased directly from foreign accounts that were essentially all bills. The data you see in the middle of that table partly reflect the exchange that took place at the end of last week when the refunding settled, so it's a wash; it doesn't count as an increase. It's just an exchange of notes and bonds that matured in May, not new purchases. Most of the increase in the portfolio over the intermeeting period came in Treasury bills, virtually all of it. For the year to date our holdings are up $16 billion and that has been, in some sense, almost evenly distributed between coupons and bills. We have been looking to keep the average maturity of the portfolio pretty close to the level where it was last year. We are not aiming to shorten it or to lengthen it very much. There was a view in earlier years that the portfolio should be somewhat shorter, but we reached a conclusion about a year or so ago that the amount of liquidity in the portfolio is probably appropriate for current circumstances. Basically, we try to keep it pretty much at about the 38-month average reached last year. The reason for doing the acquisitions in the bill market during this particular six-week intermeeting period was that we already had made some additions on the coupon side earlier.

CHAIRMAN GREENSPAN. Would somebody like to move to ratify the transactions of the Domestic Desk?

SPEAKER(?). So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Let us now move on to the Chart Show with Messrs. Prell and Truman.

MR. PRELL. Thank you, Mr. Chairman. I'll give you all a second to locate the Chart package that was distributed to you. [Statement--see Appendix.]

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

CHAIRMAN GREENSPAN. Revisions of individual member forecasts may be submitted to you, Mike, through when?

MR. PRELL. We have tentatively indicated that next Monday, July 11, might give us ample time for completing the report and reassessing the members' forecasts.

CHAIRMAN GREENSPAN. Questions for Messrs. Prell or Truman?

MS. PHILLIPS. I have one. I'm not sure this is quite the right place. In the Greenbook, there was a discussion or intimation that we are starting to see more inflows into bond funds and stock funds. Could you comment a little more on that? Maybe that should be addressed to you, Don, I don't know.

MR. KOHN. We had outflows from bond funds mostly in March. That situation stabilized and subsequently we had some small net inflows. Inflows to the stock mutual funds actually were quite strong. However, the data received as the Bluebook was going to press or perhaps shortly thereafter showed that in the most recent week both stock and bond funds were weaker. There were outflows in all of those accounts. But our assessment is that the initial shock of the upward movement in long-term rates and the downward movement of the stock market had their major effects--driving people out of those funds who were surprised--in the ensuing four to six weeks. Looking forward, we would expect continued flows to those funds, but at much lower levels than in 1992 and 1993 on the presumption that people have learned their lesson; they now are recognizing those are riskier assets than perhaps they thought before.

MS. PHILLIPS. What about money market mutual funds?

MR. KOHN. Initially, they had very large inflows in the period in which the bond funds had the outflows. But since then, they have cooled down quite substantially; their pluses match bond fund minuses reasonably well.

MS. PHILLIPS. Thank you.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. A question for Mike and one for Ted: Mike, regarding the growth of potential output, when you look at labor force growth, is there no longer a decline in hours worked?

MR. PRELL. Do you mean in the longer-term trend in the workweek?

MR. PARRY. Yes.

MR. PRELL. It's not apparently obvious in the very recent data, but our presumption is that eventually we will see that occur. In the forecast, we have the workweek shortening in the near term from its very high recent level and not changing a great deal thereafter through the forecast period. Our assumption is that perhaps there has been some interruption of the prior trend as companies may tend, particularly with fringe benefit costs being as considerable as they are and with the possibility of incurring costs to fire someone and so on, to keep the workweek a bit longer than we certainly were anticipating at the beginning of this year.

MR. PARRY. So, it's not a major factor in the calculation of potential output growth?

MR. PRELL. It's a small factor. There are a number of small factors we have taken account of in getting from the nonfarm business sector to GDP.

MR. PARRY. Ted, this isn't directly affecting the United States all that much, but I refer to your table on Chart 7 with regard to China. One of the issues, of course, for those who follow China is whether or not they are going to be successful in dealing with their economic overheating problem. I am trying to figure out from your forecast whether they in fact will succeed in controlling it. It looks to me as though they have not had great success thus far.

MR. TRUMAN. I think that's right. It's not clear how much they need to do in order to have great success. They have taken some of the bloom off but not a lot. Their expansion is running close to double-digit rates.

MR. PARRY. It would be interesting, maybe not so much for this Committee, to look at the implications.

MR. TRUMAN. I think that's one of the factors--a good point. If China were more successful, or if the cost of that success were 5 percent growth rather than 10 percent growth, the implications for Japan and the other Asian countries might not be entirely negative. There would be a risk. Definitely the Japanese will tell you, as I think I have commented in other briefings, that they consider slower growth in China to be one of the uncertainties and risks in their forecasts. So bad news for China is good news for Japan.

MR. PARRY. Right. Thank you.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I have a couple of questions for Mike. In your initial oral presentation, you remarked on the role of long-term interest rates at current levels in maintaining growth of real economic activity in line with the economy's potential. You might recall that we had a discussion at the May meeting about the linkages in the model of short rates to long rates to residential and nonresidential investment, measures of aggregate demand, inflation and inflation expectations. In this month's Greenbook, on page I-2 of part I relating to key assumptions, that same idea is back again. I want to see if I understand what this says. The sentence I want to focus on says that "maintenance of adequate overall financial restraint," and I take that to mean long-term interest rates, "thus seems likely to require at least some further tightening of money market conditions." That says that the fed funds rate is the target and long-term bond yields are the indicator of the thrust of policy actions. Am I correct in interpreting this to mean that if we were to maintain the current funds rate, long-term bond yields would fall, possibly significantly?

MR. PRELL. The reference to financial restraint was intended to have a broader meaning, encompassing all interest rates and also the nonrate terms of lending. As I noted in my presentation, we think that one ingredient in the current situation is a pretty substantial shift in credit availability from banks and, to some extent, other intermediaries. That, in effect, has provided perhaps over the past year some significant incremental stimulus. I wouldn't want to try to quantify it, but it has been in an expansive direction. To your specific point, there are several things one needs to consider in thinking about the long-term path. One that I referred to specifically in my remarks was the notion that there is a considerable liquidity premium, probably larger recently than it was earlier, in the term structure and that, under calmer conditions in the markets, one might expect that to diminish somewhat. It's that in particular that I was referring to as a rationale for thinking that some rise in short-term rates would be necessary. Now, getting to the broader cyclical dynamics of this, if the Fed did not tighten as assumed here under the conditions that we have perceived to be prevailing in the economy, at least two things I can think of might happen. One is that so-called credibility might be diminished if there is a broadening perception that we are behind the curve at some point and that we are not exerting anti-inflationary restraint. The inflation premium in rates might rise. The other possibility is that it comes about more automatically in that we are too stimulative, aggregate demand is stronger, pressures arise ultimately in the economy which tend to push up rates, and if we didn't tighten at that phase, then we would be getting this inflation premium generated in the rates. It's a complex issue.

MR. JORDAN. Well, I guess I am more puzzled than before!

MR. PRELL. That might qualify me for elevation to a higher level position! [Laughter]

MR. JORDAN. But a liquidity premium can come out from either end of the yield curve, and you're trying to stay away from saying that if we don't raise the funds rate, long-term rates will fall or that the yield curve flattened from the long end because of the short rate. But at the May meeting, there was a lot of discussion about a 4-1/4 versus 4-1/2 percent funds rate, policy neutrality and all of this, and some uncertainty about that. Now, we have a much stronger statement in both the Greenbook and Bluebook that policy neutrality is 5-1/4 percent. What changed between May and now that it went from some uncertainty as to whether it is 4-1/4 or 4-1/2, and now it is 5-1/4 percent?

MR. PRELL. Well, there is no greater certainty attached to the relationships in this forecast as we perceive them than there was in the prior forecast. The major changes were a result, I think, of changes primarily in so-called exogenous factors. We have a higher oil price; we have a lower dollar, with the likelihood of there being some greater pressure coming through import price channels and so on. We also have a somewhat lower unemployment rate with all the adjustments we care to make that suggest that the economy is at a somewhat higher level of resource utilization and has more of a tendency to pass these kinds of shocks through to the general inflation rate. We also had a stronger sense about this liquidity premium effect after we saw what happened when we announced our policy decision in May and the bond market rallied. We took that as confirming what we had thought was going on. All of these things led us to raise the short-term rate assumption, I'd say moderately, certainly relative to what seems to be built in in terms of market expectations, at least after 1994. We have rates peaking out at the end of this year, leveling out, whereas the market seems to anticipate further tightening. Our judgment is that this will be enough to bring about the moderation in aggregate demand that we forecast.

CHAIRMAN GREENSPAN. Cathy Minehan, weren't you appointed acting president recently?

MS. MINEHAN. No.

CHAIRMAN GREENSPAN. When did I dream that?

MS. MINEHAN. I think that was a reading by some newspapers of the wording in the Federal Reserve Act--in the absence of the president, the first vice president is the acting chief executive officer.

CHAIRMAN GREENSPAN. I call on First Vice President Minehan.

MS. MINEHAN. My question is very much the same, and I know there's a risk in comparing a range of forecasts arrived at in very different ways with a particular or specific forecast. But just comparing the central tendency to the staff's projections next year, the staff seems to be on the low side vis-a-vis real GDP and on the high side vis-a-vis unemployment. That leads me to the question of what happened and what do we get by not tightening the full 100 basis points that you talk about in your Greenbook. Does that simply work on the inflation side or does it work elsewhere?

MR. PRELL. There are two questions that you've raised. You're certainly correct that there's a symmetry here. We have a slower growth rate in 1995 than the central tendency, and we have a higher unemployment rate. I might note that we're sort of at the low end of the overall range for growth, and at the high end of the overall range for unemployment. So there's certainly a consistency here. We come out with an inflation rate well within the range. I didn't think there was a great deal here fundamentally to make a point about--

MS. MINEHAN. It's sort of a lead-in to what do we get if we don't tighten?

MR. PRELL. If you don't tighten, the effects are likely to be very modest on inflation even through 1995. A difference of 100 basis points would have a fractional effect on the level of real GDP over that forecast period and a very small, almost imperceptible, effect on inflation unless we get out of this some distinctly different kind of path for long rates than we have talked about. That could throw in some additional variation in the outcome. But basically, the 100 basis point increase in the funds rate would have a rather moderate effect on inflation.

MR. TRUMAN. I think it depends, as I indicated in my comments, on what you assume about the dollar, the reaction of other rates, and what else is going on at the same time. If the 100 basis points were to cause a several percent lower dollar, then because of the direct price effects you would get the price effects much sooner. And, of course, you'd have much stronger economic activity. On the other hand, the dollar could--for lack of a better word--"levitate."

MR. PRELL. I think the prospect would be an only slightly perceptible upward tilt to the inflation rate rather than this flat path that we have, if you simply isolated in the standard way that 100 basis point difference in the funds rate. But we also have been sensitive to these expectational considerations.

MR. KOHN. The other point I would make, President Minehan, is that the Bluebook had tighter alternatives, a no change alternative, and no easier alternative.

MS. MINEHAN. Right.

MR. KOHN. We ran simulations with the funds rate flat, and as Mike said, we didn't get much effect on inflation by the end of 1995, but the unemployment rate was significantly lower. Given our assumption about where the NAIRU was, we started getting an uptick in inflation by 1995 and more noticeably in 1996 and 1997. We assumed that the Committee had a strong presumption against that increase in inflation occurring, so we didn't include this alternative. Obviously, aggregate demand is also a consideration; if aggregate demand is weaker than in the staff forecast, the funds rate can stay the same. Actually, that simulation indicates lower inflation. But given the staff's aggregate demand projection and its assessment of potential, we had some significant effects in 1996 and 1997.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I have two questions. I had one when I put my hand up, and now I have two. The first was for Ted about the forecast for central Europe. As you well know, there was a notable feature of the OECD forecast that went out yesterday--the question of to what extent was Germany especially, and Europe generally, relying on selling to the United States to get the growth that the OECD forecast. I can't remember if yours is higher or lower because one is Q4-to-Q4 and the other is year-over-year, but this forecast has a weaker U.S. economy than the OECD forecast and it also has a lower dollar. Could you say something about to what extent the growth in Germany and central Europe is export-led in the staff's forecast?

MR. TRUMAN. Well, two points: The answer is that it is export-led in the sense that our assumption about Germany is that net exports will be a positive factor in their growth. I think we have a little less growth overall, and a little less growth in net exports for Germany than the OECD. I know that we do for the OECD countries other than Germany. So that's the answer for the second half of that question. We are a little less optimistic than they are in that regard. They are all in the same ballpark, but they show a little more growth this year and a little more next year. And that's somewhat consistent with the fact that we have somewhat lower U.S. growth so there is less impetus coming from outside than in their forecast.

MR. BLINDER. Secondly, I'd just like to pick up on the question that Cathy Minehan was addressing to Mike Prell. Quantifying the difference between 100 basis points on the funds rate between now and December, and say 0 or 25 or 50 basis points or something--say 0--would I be wrong to think that the effect on the 1995 fourth-to-fourth quarter growth rate would be in the range of 1/2 percentage point?

MR. PRELL. I think our model, which is reasonably interest sensitive, and with the normal rather sluggish adjustment of long rates, which would be questionable, would show less than that over the course of 1995. But your order of magnitude would not be far off.

MR. BLINDER. Thank you.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mike, I may have misunderstood you, but when Jerry Jordan asked you why there was this 100 basis point shift in your assumption, you said that exogenous factors had changed including, for example, the price of oil. Now, this could just be another experiment. If a Mideast war broke out tomorrow and the price of oil went up $20 a barrel, would you recommend that we raise interest rates?

MR. PRELL. It would depend on your objectives, short run and longer run. I think there would be a significant inflation jolt in the short run. Your policy dilemma would be to prevent that from tending to flow through into an ongoing inflation process where it had its initial price level impact but then perhaps got built into wage increases and broader inflationary expectations. You would need to raise the unemployment rate substantially above the prior level that you thought acceptable in order to get you back on what you thought was an appropriate inflation path. I think we would lay out the options in that way. I think we'd have a hard time deciding exactly what forecast design to present to you. We would probably work toward a compromise scenario that you could then assess to decide whether you wanted to be tighter or easier.

MR. LINDSEY. Nominal GDP is unchanged in the forecast--essentially unchanged. In order to get that result--to have virtually the same nominal GDP as we had before--you are telling us we have to raise interest rates 100 basis points, and that's because of exogenous factors?

MR. PRELL. The nominal GDP forecast is .3 of a percent higher in 1994 and .2 percent higher in 1995.

MR. LINDSEY. I was looking at Chart 16 in the Chart Show.

MR. PRELL. So, you are going back to the January forecast?

MR. LINDSEY. I see; the previous estimate is the January forecast?

MR. PRELL. Yes, I am sorry; we tried to make this comparable.

MR. LINDSEY. But going back to these exogenous factors--

MR. PRELL. Right. The change in our assumption from the last Greenbook is 3/4 percentage point. I regard all of this almost on the order of hair splitting given the uncertainties, but certainly we wrestled with it and it gives some meaningful indication of where we think things need to go.

MR. LINDSEY. But it would be your view or the model's view that an exogenous shock, such as leaving monetary conditions unchanged, would raise nominal GDP?

MR. PRELL. Yes.

MR. LINDSEY. If the price of oil went up, you'd have a higher nominal GDP level?

MR. PRELL. If policy accommodated it. Certainly, if you held the funds rate, which is in an extremely accommodative posture in the face of that kind of shock, you would have astronomical GDP growth. But let me note, for example, that there was a footnote in the Greenbook reporting on a partial simulation of an exchange rate shock. I think it was about three times what we have in terms of the forecast change, but that's a reference point for you. I think you would see it is in general terms consistent with the kind of adjustment that we have incorporated in this forecast.

MR. LINDSEY. Thank you.

MR. PRELL. I would also note that in the last Greenbook, and in my presentation, we emphasized that we thought the risks were that it was going to take higher rates than our assumption rather than lower rates. So in a sense, mentally, the adjustment isn't even quite the 3/4 percent that we made.

MR. TRUMAN. To come back to Governor Blinder's question about the forecast for Germany, I just now recall that our outlook for year-over-year growth in Germany is almost exactly the same for 1995 as the OECD's, though in general we tend to be a smidgen weaker. However, OECD put their outlook together before they had the first-quarter numbers. My guess is they would probably have a stronger outlook, everything else being equal, just the way one averages. Now, that may be made up from the fact that they do have a bit stronger growth next year, so they average out. But it's about the same for Germany.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. I need to ask Don and Mike for a clarification. When you were answering questions earlier about the fact that you assumed a higher short-term rate, Don, you said that in terms of aggregate demand you had different alternatives including maintaining the same rate or changing the rate. What were some of the factors that went into the picture? As you have it here, the staff forecast must presume a fairly strong growth rate without this increase in short-term rates. What were the factors in terms of your aggregate demand forecast that you considered in making this assumption of a higher rate?

MR. PRELL. Are you talking about the alternative simulation in the Bluebook or simply why we raised the assumption in the Greenbook forecast?

MR. HOENIG. Why you raised the assumption.

MR. PRELL. Well, as I said, I think the major consideration was how we could in essence cap the inflation rate close to where it has been in the face of these shocks. Implicitly, also, I think we probably have incorporated a sense of a little stronger underlying aggregate demand. We're not talking about a vast difference, but the real GDP path in this forecast is little changed from that in the last forecast.

MR. HOENIG. And that's taking into account in your model the effects of the moves to this point?

MR. PRELL. That's right.

MR. HOENIG. And so you still see continued stronger growth?

MR. PRELL. Basically what we have here with the dollar depreciation and the stronger growth abroad is more impetus coming through the external sector, which we have essentially offset through higher interest rate effects on domestic demand. That's the simple version of the story here.

MR. HOENIG. Thank you.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. I have a question for Mike as well. In preparing for this meeting, we had the research staff at New York play the game of what would be the result of various tightenings. In the model that we used, which is partially in our heads, we got about the same result from a 50 basis point tightening that you get from the 100 basis point tightening, and a fair bit more, i.e., a much weaker economy from 100 basis points. Do I assume correctly that the policy point is not so much that policy will have to be firmed by 100 basis points, but that policy will definitely have to be, to pick an adverb, substantially firmed in order to avoid the inflationary result that you are convinced the Committee would not wish to see?

MR. PRELL. You've served up such a softball here, I hate to reject it at all, but I am not sure whether in the greater cyclical scheme of things, I'd call 50 basis points or even a 100 basis points substantial. Now, we're not talking about throwing the economy into recession, but looking back over time, I think, we have seen that it has frequently taken very large movements in short-term rates to achieve a major change in the direction of aggregate demand. The other point I'd make is that, yes, the signal we hoped to convey was some degree of conviction. I wouldn't say definitely we're going to need to tighten, but we have some conviction that a significant movement in that direction was probably going to be needed to achieve the kind of outcome that we're talking about. I must say I am a little surprised and quite interested in the results that you described from your staff's work because the numbers that we have been citing come from a model that tends to be one of the most highly interest-sensitive that we can find. And so to get the result that you characterize is a bit surprising to me. There may be a lot of other add factors and so on that are going on in this exercise.

CHAIRMAN GREENSPAN. Who would like to start our Committee discussion? President Keehn.

MR. KEEHN. Thank you, Mr. Chairman. Our 1994 forecast is so close to that of the staff that it's hardly worth mentioning the difference here. In some respects, we get there in a different way. Nonetheless, the 1994 results are the same. For 1995, though, there is a greater discrepancy. Our outlook is somewhat stronger for GDP and just a bit lower for inflation. Therefore, we have not built into our forecast the policy tightening that we have just been talking about. I think fundamentally these differences perhaps reflect our view that potential growth is a little higher than the Board staff's.

With regard to the District, overall conditions are largely unchanged from the past meeting or two. The Midwest economy is continuing to operate at what I think is a comparatively strong pace. The auto business continues to be good, and I think the recent reductions in sales in April and May had more to do with capacity constraints than any significant change in consumer attitudes. The auto industry sales expectations for the third quarter are comparatively strong, with domestic production schedules set at some 18 percent over last year. Since retail inventories are very low, I think at this point the downside risk in this production schedule is very limited. Of course, all the industries that are serving the auto sector such as steel continue to experience very strong operations. What's true for the auto sector, I think, is true for manufacturing in general; there are not many soft spots in our District in that sector. The forecasts of sales for heavy trucks have not increased since the last meeting. At this point, the manufacturers are dealing with capacity constraints, and lead times for delivery of the large, heavy trucks have been stretched out. The delivery times for heavy trucks in general have stretched out even more out--to July 1995. In the home appliance business in April shipments were at record levels; and sales of agricultural equipment, another part of our economy that's important, are likewise at high levels.

Despite the strong results in the manufacturing sector, I think there are some signs of moderation and slower growth in other parts of the District economy. who runs the trucking company reports that there has been a downward shift in the rate of increase in shipments. But this downward shift is from the very, very high levels the trucking industry has been experiencing. He says it is particularly apparent in shipments to retailers in general and for paper products. Also, the retailers I talked to are seeing signs of moderation. In looking back over the last few months, there seems to have been some kind of a shift. People I talk to are not sure whether it is because of the higher interest rates or the result of high income tax payments. Nonetheless, I think there clearly has been some moderation in the retail sector from the high levels earlier in the year.

On the price front, I do sense some pressures, though nothing dramatic. But after a protracted period when manufacturers were able to push their suppliers to reduce prices, they are, as one company put it, approaching payback time, and we hear of more price increases. There are also some upward pressures on wages. The trucker that I just mentioned has reported an extreme shortage of truck drivers. To deal with that, has granted an 8 percent increase in wages. Another manufacturer I talked to who has a multiplicity of contracts they are renewing says the terms are a little higher, at least, than in the past. With tight labor conditions, we have to worry that at some point these are going to be translate into higher labor costs. So our outlook for inflation, while still positive--indeed it is a little lower than the staff forecast--suggests that there are some worrisome signs out there that we need to keep our eye on.

Finally, in the ag sector, growing conditions for the grain crops continue to be favorable. Planted acreage in the District this year is 3 percent higher than last year. As of the end of June, the corn crop was described as excellent. That obviously is a very significant improvement over what we were experiencing last year. There is, of course, a long, long time from now to harvest, and we're at a critical point in the growing cycle. But with a reasonable break in the weather the crop production should be pretty good. And grain prices, which certainly have been terribly weak over the last several weeks, are likely to be restrained and ought not to be a significant cause of inflation.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, the economy in the Twelfth District is continuing the trends noted in the last few meetings with weakness persisting in California and Hawaii and strength elsewhere. The situation in California has changed very little. Employment growth has been weak through May, rising at an average annual rate of about 0.4 percent since employment hit its trough in December. Most forecasters expect this very weak recovery to continue, with service employment gains slightly outpacing losses in the manufacturing area through the remainder of 1994.

Turning to the rest of the District, conditions range from good to very good. Washington and Alaska have reported employment gains of 1.6 and 2.4 percent respectively over the last year. Moreover, Boeing's announced layoffs are nearing completion, which will help the Seattle economy since a major negative for a long period will no longer be present. However, Alaska is facing an uncertain future largely because of a long-term decline in oil production. The rest of the District is very strong. Nevada, Utah, and Idaho are the three fastest growing states in the nation in terms of employment. Arizona and Oregon also report rapid employment growth. Construction remains at a high level in these states, although activity has leveled off a bit in both Idaho and Nevada.

Turning to the national economy, my outlook differs somewhat from that of the Greenbook in a couple of respects. First, I would not be surprised to see the economy slow somewhat more in the latter half of this year than shown in the Greenbook forecast as a result of the tightening moves that have been made so far. I would then expect a little more strength than the Greenbook implies for 1995, although the outcome clearly depends on future policy actions. Second, I have been impressed pleasantly by recent inflation results and certainly impressed by recent data on employee compensation costs. Even after considering the lower dollar and higher oil prices, I think it's possible that CPI inflation will come in at or even a little below 3 percent for the next year and a half. I do, however, think that most if not all of the slack in the economy probably has been used up and that the longer-term inflation outlook is a significant concern. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. The Philadelphia District economy is growing at a moderate pace, although still less than the nation as a whole. The expansion is generally broad-based, geographically and across sectors. Some slowing, however, is occurring in the pace of growth. Consumer spending is still leading the way, particularly in areas of home furnishings and autos. Retailers remain guardedly optimistic about the outlook, but a number have trimmed their projections for the rest of the year. Much the same can be said for manufacturing. Orders and shipments are positive, but a number of manufacturers see less growth during the second half. Realtors generally report that home sales remain good, especially for low- and mid-priced homes. Some builders, however, report slowing in the pace of new construction. Concern about rising mortgage rates has damped their enthusiasm somewhat. Commercial real estate markets remain soft; the prospects are better in suburban areas for next year and beyond. In Philadelphia, there is still a markdown of some less than top-grade space.

Sentiment in the District overall is positive, but a little less so than when we met six weeks ago. Most business people believe the pace of growth will be positive, but slower during the months ahead. It's the "but slower" part that makes them a bit uneasy. How much slower and the impact on the bottom line make them just a touch nervous. Consumer sentiment is positive as the job market improves. With few exceptions, however, wage pressures are well contained in the District. High visibility layoffs still cast a cautioning note on people's feelings, though, about the job market.

Price pressures appear to be contained. There is more talk of rising input prices, but most people still feel it's quite difficult to pass on those increases, although I am certain businesses would if they could.

Turning to the national economy, there is clear evidence from the consumer sector, labor markets, and the industrial sector that points toward a slowing from the rapid pace earlier in the year. The Greenbook forecasts are reasonable estimates in my judgment of how things will turn out. Nonetheless, we should be naturally skeptical of any forecast. We are in a transition from a higher growth rate to a lower growth rate. And we have to monitor incoming data closely as a reality check on the magnitude of this adjustment. We could easily underestimate or overestimate the extent and smoothness of the adjustment for a whole range of reasons. Likewise, we are in an especially sensitive period on the inflation front. We have come too far in the disinflationary process to reverse course at this point. At the same time, we do need a lengthy period of sustainable growth. These objectives are compatible, but the margin of error for policy is sufficiently narrow as to require a close reality check on incoming information about capacity constraints and demand pressures.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, growth in the Atlanta District continues to be quite positive, although we are seeing some moderation, and I think our growth rate is now moving closer to that in the nation as a whole. The exception to this is the State of Georgia where strong in-migration and the beginning of preparations for the Olympics are having a very noticeable spurring effect on the expansion.

We are seeing some price pressures, but they are concentrated primarily in the construction area, although manufacturers are also experiencing pressures in the cost of commodity inputs and they expect these to continue. But they tell us at the same time that they are not able to pass these price pressures through to the final consumer. We are seeing some wage pressures also in the construction area, and that pressure comes from the shortage of skilled workers in that industry.

Retailers in the District were disappointed by their performance in May, and they experienced some undesirable buildup in inventories. Activity apparently picked up in June, but they are indicating downward revisions to expectations of sales in the future. Trucking firms are also reporting that shipments to retailers have slowed by more than they had expected. Automobile sales are a little difficult to interpret. They have remained fairly slow during the second quarter, but low inventories of popular models seem to be cited as the reason for this slowness. But unlike the expectations of retailers generally, car and truck dealers expect 1994 to be better than 1993. Tourism and business travel are mixed around the District. We don't yet have the results of our manufacturing survey for June. We did see a pickup in production in May, and the share of firms expecting increases over the next six months also rose. In the area of capital spending, I think it's interesting to note that a number of industries in the District have recently announced plans to expand or to upgrade their facilities. In the energy area, the rig count in Louisiana declined a bit in May, but it's still well above the level that we saw a year ago. Spot and futures prices for natural gas remain above the level needed to encourage additional activity.

In the housing sector, rising mortgage rates are having an impact on the residential market. Demand for new homes is described as strong, but here again the pace is moderating and permits have tapered off from the very high levels that we had earlier in the year. Multifamily building, as Mike reported for the nation and it's also reported in the Greenbook, is strong in many areas of the District and this is expected to continue. Commercial real estate markets are beginning to improve; slow and steady gains are expected in the future in this area as well. Financing is not particularly easy to obtain in this area, but it is more available than it has been in the last few years. With respect to overall loan demand, it's about flat in the District. Of course, as in most parts of the country, residential mortgage refinancings have pretty much dried up.

The general sentiment, I think, among people in the District is very positive in the context of the good growth that we are experiencing. There is very little apprehension about inflation, notwithstanding the price pressures in construction and the wage pressures. But interestingly, I have had no complaints from business people about our policy actions over the last four months.

Looking at the national economy, our forecast follows a pattern that's similar to the one in the Greenbook. On balance, I think we see somewhat stronger growth, although we have a smaller rise in the federal funds rate than is assumed in the Greenbook. Our outlook for inflation is a little less sanguine than the Greenbook's. We see some deterioration in inflation toward the end of the forecast horizon, but it gets a little better as we look further out into 1996. The principal uncertainty that I have is the outlook for consumer spending. Are we going to see it sustained? It seems to me that the consumer is building up a good deal of debt, and there is a question of how long people can continue to spend, given this deterioration in their balance sheets. I think we have an interesting period ahead of us, Mr. Chairman, and I see the risks as evenly balanced between the up side and the down side, although I think the inflation outlook is not terribly good as I look further out over the forecast horizon.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. The Tenth District continues to grow at a very good pace. Some early signs of price pressures have emerged and we have reports of high prices and short supplies of some construction materials and scattered reports of labor shortages in the District. Also, we continue to hear of some increases in land prices; right now our land prices seem to be rising year-over-year at about twice the CPI rate of inflation. At least to date, we do not see any upward pressure on consumer prices in the region. Construction activity and especially residential construction are vigorous. Manufacturing continues to rebound and we see growth shifting from nondurables to durables manufacturing with emphasis on autos and airplanes. Higher oil prices have boosted drilling activity only a little in the District. District crops are generally in good shape. Of course, we have seen a sharp drop in cattle prices, and that has triggered some significant losses to some of our producers in the cattle industry.

Looking ahead, we think the District economy should remain strong on the whole. A rise in construction activity is anticipated, although residential construction is expected to level off during the remainder of the year. We also think a strong national economy should maintain a rebound in manufacturing. The outlook for firmer oil prices still points to only modest gains for the energy industry in the District. As one of our directors pointed out, that industry is affected by so many different factors that they are very cautious in terms of going ahead with energy exploration. Losses in the cattle industry, we think, will drag down our farm incomes this year despite the good outlook for crops.

On the national outlook, incorporating the latest first-quarter revisions, we expect that real GDP will be just slightly over 3 percent for 1994, assuming an unchanged monetary policy. Economic growth is projected to slow in the second half of the year as past increases in interest rates begin to affect, or continue to affect, interest-sensitive spending. Nevertheless, we think growth should remain slightly above potential in the second half, and as a result we expect overall CPI inflation to rise to around 3 percent on the year for 1994 and to continue at that rate in 1995. Thank you.

MR. PRELL. Mr. Chairman, may I just follow-up on something I said to Governor Lindsey earlier, which may not have been the perfectly good answer, as President Hoenig's remark about oil prices and production reminds me. Obviously, with the higher oil price, we could get some stimulus to domestic production that could be positive. The other side is that to the extent that we are importing all of this oil, we have the so-called tax plus the shift in income, even to domestic owners of oil, from consumers which leaves a damping effect. How we come out on nominal GDP, I think, is a very tricky empirical issue here. But our simulations would still suggest that, if you wanted to avoid the blip in inflation, you would have to add restraint even beyond what you would get just automatically from this oil tax as it were, in order to have enough slack to even out all of that impulse on the price side.

MR. LINDSEY. The inflation blip but not the nominal GDP blip?

MR. PRELL. On nominal GDP, it could be a wash and certainly we have simulations that could produce that result.

CHAIRMAN GREENSPAN. First Vice President Minehan.

MS. MINEHAN. Mr. Chairman, New England continues to recover, with employment about 1/3 the way back to pre-recession levels. Nonfarm payroll jobs have expanded over a year ago in all six New England states, with the regional total growing only slightly below the rate for the nation as a whole. May unemployment rates in all six states were below year-earlier levels, disregarding the measurement change. Jobless rates in four of the six states were below the national rate. Among the six, Massachusetts and New Hampshire were better, and Connecticut is bumping along the bottom in employment growth over the year. Business sentiment is generally positive, according to several local indices as well as anecdotal reports. The region's job growth is concentrated in services. Employment in manufacturing has leveled out in recent months, following almost a decade of shrinkage. Producers of automotive parts, computer components, residential construction materials, industrial machinery, and replacement parts report strong sales. The price picture is reasonably favorable. Manufacturers continue to say they are unable to raise prices except in the area of consumer nondurables. While some of their own costs of materials are rising, businesses have been able to reduce other costs by pruning workforces or introducing other efficiencies.

With respect to the national outlook, our current view is generally consistent with the Greenbook's for 1994. We were glad to see the staff's reassessment of the NAIRU, since it brings them much closer to our own assessment. However, we continue to be a little more optimistic about potential GDP. In 1995, we see growth rates a little stronger with the same levels of inflation and slightly lower levels of unemployment. All of this, of course, depends on the definition of the appropriate monetary policy, and ours is slightly less restrictive than the Greenbook's.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. With respect to our projections for 1994, we have somewhat higher rates of nominal GDP growth and inflation than the central tendency, but for 1995 we have significant further acceleration in inflation--considerably more than other members' forecasts that I have seen. Basically, I would attribute that to our view of the lagged effects of an increasingly accommodative monetary policy, roughly in the period 1991 to 1993. That degree of accommodation has been manifested in a number of ways. One way I would cite is--I have mentioned this before--that base money over that period was up approximately $100 billion, and that in turn provided the basis for growth in the stock of M1 by more than 1/3 over that period of time. I thought it was quite interesting in Joan's report that she indicated that, even though we perceive that we have tightened, we have purchased $16 billion of securities this year, so in 1994 we are essentially on the same $100 billion per 3-year pace of additions to base money.

With respect to national economic conditions, conceptually I think what has been going on is that we have seen the more rapid growth in nominal GDP reflected in strong growth in output and employment rather than rising prices and wages. Even though there has been some slowing in output and employment, in my view the economy is still growing at an unsustainably high rate. In that regard I would cite just two examples. Industrial production, which has slowed down, has still been growing at a 3.9 percent annual rate since February, and payroll employment has been growing at about a 3.4 percent annual rate over the same period. I find that information particularly troubling against the backdrop of capacity utilization at a relatively high level of 83-1/2 percent, which is up 3 percentage points in the last year. The civilian unemployment rate is down 1-1/2 percentage points over the same period to a relatively low 6 percent. I might also note that the level of unfilled orders as indicated in Part II of the Greenbook has risen quite substantially over the last year. So my view would be that our focus should be on the prospect of rising inflation at this juncture, not on growth which is slowing from unsustainably high levels.

With respect to the District, economic activity in the Eighth District also has expanded rapidly in recent months. We have had many firms report expansions, additions to payroll, and increases to sales. Major auto producers in the District plan to boost production significantly in the third quarter, in line with announcements for national production increases. Loan demand continues to grow rapidly, and favorable crop conditions are reported. We hear more frequent reports of difficulties in finding labor. Two of the examples that I have heard in the District would be skilled construction workers, which Bob Forrestal also mentioned, and truck drivers, which has been mentioned by someone else. There are also reports of growing delays in deliveries of materials. District civilian employment growth has outpaced that of the nation in recent months. As a result, our measure of the District's unemployment rate, which we base on a proxy of four principal states in our region, has fallen to 4.8 percent in April from an earlier high of 6.9 percent in October 1991. This is the lowest level registered in almost 20 years. The District's real estate sector remains very strong, with robust home sales. The inventory of houses for sale is unusually low in many areas, and this is adding to price pressures.

Finally, let me make a couple of comments about inflation. I was certainly more comfortable last year when the broad measures of prices were showing annual rates of increase of 1 to 2 percent. But even then, as I think I expressed at the time, I was worried about the stance of policy and its likely implications for future inflation. In the meantime, most inflation measures, as we all know, have accelerated, including broad inflation measures. Just to cite an example, since September the CPI has risen at a 2.7 percent annual rate, up from the 1.8 percent registered from April to September 1993, and similar patterns obtain for other broad measures of prices. In addition, some narrower price measures are moving up even more sharply. For example, in the latest four months, both the PCE deflator and the capital equipment component of producer prices were up at about 3.8 percent annual rates. This information, taken together with recent data on sensitive industrial materials prices and oil prices, makes me very uneasy about the possible path of future inflation. I think the risks are very clearly in that direction.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. I want to add my own two cents worth to the Lindsey question about the spike in oil prices and to what extent it should lead to an increase in the fed funds rate. To me that points out the need for a good reliable monetary aggregate. Then we could say we would not change it; we would stick with it and let the market answer that question.

On the national economy, our expectations are very consistent with the staff's forecast both for 1994 and for 1995.

In the Dallas District, we have seen some slowing in the pace of economic growth over the past two months compared to the two months before that. Much of the slowing was concentrated in the interest-sensitive sectors such as construction and construction-related manufacturing. Interestingly, many of the same sectors were suffering from capacity constraints, so monetary policy does seem to be exerting some impact where that impact is most needed. Sentiment has shifted slightly from accelerating economic activity to continued moderate growth. In our recent surveys, fewer firms than previously are reporting a pickup in price and wage pressures and an increasing number of firms are reporting that they do not expect prices to increase in the short run. Competition remains pretty fierce, particularly at the retail level. Capacity constraints are limiting output gains in brick, cement, glass, and structural steel in spite of efforts to boost capacity over the past year. Semiconductor and computer equipment manufacturers are building large, new factories in Texas, but they still have growing backlogs. A truck manufacturer outside Dallas reported that he was operating at full capacity and expecting to continue doing so for at least another year given his orders flow. These industries experiencing capacity limitations represent about 23 percent of our District's manufacturing output but only about 4 percent of total output.

On the trade with Mexico and NAFTA, the situation is a little confusing. If you visit our border cities, you get the impression that the favorable impact NAFTA previously had on retail sales in those cities is somewhat weaker. But what they can see involving trade between the two countries is much more positive. The anecdotal evidence suggests that the backup in truck traffic is longer going south than it is going north, but that doesn't accord with the figures, which I believe show that imports have gone up 20 percent in the first quarter compared to a year ago, while exports have gone up only about 13 percent.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mr. Chairman, for some time I have been talking about strength in our District. Perhaps I am too sensitive to reports I hear of economic strength, but the recent reports we have gotten from our business contacts and the surveys we conduct suggest to me that, overall, the District economy is still strong. A couple of examples: shipments of manufactured goods and new orders at factories are still rising; tourism, especially at the Carolina coastal resorts--places like Myrtle Beach--is exceptionally robust; we have reports of record bookings at a lot of these places. With respect to commercial construction, both retail and office vacancy rates have been declining, and as a result we are seeing for the first time in some time some speculative commercial construction. We also have seen some scattered reports of labor shortages in parts of the District--not a whole lot, but a few. We do see some signs of moderation in our District, as has been reported for other Districts. Car sales seem to be slower and residential construction activity may have moderated a little recently. In explaining that slowing, our contacts cite demand factors and to some extent higher interest rates and higher income taxes. But they also cite supply factors as has been the case in some other reports--low car dealer inventories and shortages of skilled housing subcontractors, something mentioned by a couple of people. Men are working seven days a week in places like Raleigh-Durham, and they are getting a $1,000 bonus if they move to new jobs.

With respect to the national economy, our projections are very close to the Greenbook for both 1994 and 1995. Like the staff's, they are predicated on the assumption that this Committee will take additional near-term policy actions necessary to contain inflation. Even with that assumption, our view is that the risks in the projection are on the up side--pretty clearly so from our standpoint for the remainder of 1994. My view would be, and I think my staff's view would be, that policy was pretty accommodative and stimulative at least through the first quarter of this year. We think that will tend to bolster aggregate demand, at least through the end of 1994. It would not surprise me at all if we got a nominal GDP growth rate for the second half of the year that is a good deal higher than the 5 percent annual rate projected in the Greenbook.

In any case, what is key in my mind is not so much the exactness of our projections quarter-by-quarter for the next several quarters but rather the accuracy of our assumption that we will take necessary action to keep the inflation rate from trending upward in 1995 and thereafter. The unemployment rate has already fallen to the bottom of the range of current estimates of the natural rate, which is a situation that concerns me. I have a lot of sympathy with Tom Melzer's comments on this. I am certainly concerned about the possibility that inflation pressures will now begin to intensify. We are hearing more comments, more concern about price pressures, especially supply prices in our District. And as far as I am concerned, these pressure showed up pretty dramatically in the latest purchasing managers' report. That report showed the percentage of respondents reporting higher prices as 48 percent, which was about double what it was three months ago.

CHAIRMAN GREENSPAN. Wasn't it higher because of the oil price increase?

MR. BROADDUS. That could be. In any case, it was a significant jump, and I think that's something we need to keep in mind.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. The District economy remains in very good shape, and most of the indicators suggest that that may continue for some time, perhaps for an extended period of time. Employment gains have remained sizable; job availability is good. There are some shortages of labor--in construction trades clearly--as has been mentioned. Despite this healthy economy having been in place for quite some time, there really are no widespread signs of building wage and price pressures. Interestingly enough, the one place one can find wage pressures without looking too hard is in the entry-level jobs. Firms have said they have had to raise starting wages in order to attract and retain people; otherwise, they move on pretty quickly as soon as there is an opening at the next wage level across the street. Much of the agricultural sector of the District is in good shape, although the livestock and dairy industries are having a very difficult year because prices have declined. We recently had a meeting of our Advisory Council on Small Business, Agriculture, and Labor. The members were generally upbeat along the lines I have been describing, although they did suggest that there was a note of caution in the air as a consequence of the increase in interest rates. But it didn't seem to have translated into any changes in plans or intentions or in what they were seeing in their businesses as yet.

With regard to the national economy, my own view is that we might get a little more real growth and a little more inflation than is depicted in the Greenbook, but I don't view those differences as significant. If I take a step back, my sense of things is--and maybe I am a little too sanguine or am overly influenced by what has been happening in the District for a long time--that we are on a path that we may well stay on for some period of time, that is, moderate growth and moderate inflation. I personally have been surprised, given the performance of the economy over the last couple of years and given the diminution of unemployed workers and of unused capacity in manufacturing and elsewhere, that we have not seen more wage and price pressures. I have asked myself about that development or lack of that development as it were, and I have tentatively concluded that perhaps the economy is a little less inflation prone than I thought earlier. In any event, my sense is that we may remain on the path we are on for some time.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, the economy in the New York District continued to advance at a moderate pace in late spring. Unemployment rates fell and payroll employment rose. State tax collections for retail sales, personal income, and corporate franchises have risen moderately so far this year, suggesting growth in the underlying streams of personal income, corporate income, and retail sales. Vacancy rates for commercial office space continue to decline in most metropolitan areas, while permits for residential construction of new, single-family homes have snapped back from the weather-reduced lows of the first quarter. For New York City, however, several recent economic indicators, including establishment employment, city government payrolls, and initial claims for unemployment insurance suggest that an economic pause may be developing. The financial sector, needless to say, is not having quite the happy experience that it had in the first half of 1993. On an overall basis, the District economy maintains a reasonable pace, although we still compare rather poorly with most areas of the country.

Our forecast on the national level is that, even given an unchanged monetary policy, real GDP growth will gradually taper off from the roughly 3-1/4 percent rate in the first half of this year to around 3 percent in the second half and about 2-1/2 percent in 1995. We think that slowing growth is likely the lagged result of the run-up in long-term interest rates. The forecast is a bit softer on growth than the one we prepared for the last meeting and it reflects the 50 basis point increase in the funds rate at that time and a slightly higher path of long-term interest rates than we had anticipated. We think this increase in long-term interest rates will particularly affect housing and related elements of consumer spending, such as furniture and appliances. Indeed, available evidence suggests that single-family housing starts may have begun to slow, although how convincing those data are remains to be seen. We think that higher rates should also affect motor vehicle sales and perhaps slow down capital spending. That forecast would put us rather along the lines that Gary Stern suggests. Our problem is that we think the risks to our forecast are asymmetric. There is not much risk of the economy being less strong, but there is a major risk that we are underestimating the upward momentum in both real output and inflation. The housing market could recover later this year when households adjust to higher interest rates, while export demand could pick up strongly with a decline in the dollar and overseas recoveries. Therefore, we think it is very important at the present time to watch very carefully the real economic data coming through to see whether the rather benign path that is possible is in fact taking place or whether the stronger growth, which we think is the likely alternative, would indicate that rather strong policy moves will be required.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I can comment on a number of things in the District that might add to what has been said so far. Generally, people feel that the District economy is stronger than before and better than some people were projecting earlier. I have no conviction at all as to whether this is even a coincident indicator, let alone a leading indicator. A regular recently completed quarterly survey of almost 500 businesses in the District indicated that 42 percent of the companies expect to hire full-time permanent workers this year versus 33 percent when that survey was previously taken; 43 percent now said they are going to increase capital outlays; 37 percent said that earlier.

Energy used by the industrial sector is said to be booming by one of our companies, up very sharply in the first half. Some segments like cement are up 35 percent, while nonresidential construction is flat. Overall, residential activity is up in the District, and we continue to hear anecdotal comments about shortages of skilled workers and certain kinds of supplies. My contacts tell me that lumber prices appeared to have stabilized, but copper is so volatile that builders can't get firm bids on electrical work for future projects. Various aspects of communications are quite strong. Firms in the Pittsburgh, Cincinnati, and Lexington areas claim to be operating at capacity levels and increasing employment. One director referred to explosive growth in the high-tech area. Throughout the District, though, medical care is down, and that's a big segment of the Pittsburgh area economy; it's large but relatively not as large in Cincinnati, Columbus, and Cleveland. Our contacts in medical care all say that they are shrinking their payrolls. That was really the only sector that was cited as being weak. Interestingly, contacts in eastern and central Kentucky say that conditions are the best in over a decade, and they're talking about planning to do away with coal dependency and produce other things, especially wood products given the problems in the Northwest, and interestingly poultry. Western Ohio and Indiana have done so well on poultry that Kentucky people have decided to enter into the glut of chickens, eggs, and turkeys.

We visited a Toyota plant outside Lexington, in the Georgetown area. They are going to add a new model to their production line. They employ 5,200 workers now and are going to add another 800 by year-end. They say their biggest problem is that the workers have to commute 1-1/2 to 2 hours to the plant because there simply is no housing and no schooling in and around the Lexington area close to where they work. Also in the Lexington area, people say that apparel is booming, that it's easy to raise prices, and that several thousand workers have been recalled.

There were a lot of reports of price increases in the District. I don't have any sense that they have anything to do with inflation, but still people talk about prices going up. The coating business people said that their backlog is at an all-time high and getting even longer. They have seven-day, 24-hour operations for the first time ever, and they put through chemical price increases on intermediate products of up to 9 percent on July 1. The strike at Allegheny Ludlum that I reported on before has ended. They settled on a package of four years with a total increase increase in compensation of 11 percent plus profit sharing. The manager said he is running his operations quickly back almost to capacity. Demand for his products, both domestic and foreign, is very strong. He said exports of specialty steel to China, India, and Poland are growing very rapidly. He was looking for price increases of anywhere from 5 to 9 percent for the balance of this year. He complains about the rules that give the government veto power over his business. Plastics also are reported to be the strongest in six to seven years, with record orders especially for equipment for plastic manufacturing. That applies mostly to plastics used for medical supplies and appliances. They also are talking about their ability to raise prices later on. I got contrasting reports from auto parts suppliers. One supplier, representing a huge company that operates worldwide, was berating me because he said that I didn't understand that it was global capacity that was preventing increases in the prices of their products. Another almost as large company said it was very easy to raise prices sharply because of the level of the dollar and the related fact that domestic auto companies and transplants were regaining domestic market share. He was talking about his need to pass through higher input prices--chemicals, metals, etc. He thought he could do it; other contacts thought he couldn't.

On the national outlook and the Greenbook, I had a lot of problems with the inflation projection--I guess this spills over into the Bluebook discussion for tomorrow--that the 3 or 3.1 percent inflation rate in the staff forecast continues into the next millennium because it seems to me that the basic model is consistent with a constant rate of inflation. That sort of analysis says that whatever the rate of inflation is at the time the economy hits the NAIRU, that is then the inflation rate we live with forever unless we are willing to cause unemployment by raising interest rates. To me the projected inflation numbers that we are looking at--whether or not they reflect reliable model results--should be unacceptable to this Committee if we are going to maintain the wording in the directive that our objective is to move toward price stability. When I submitted my projections for 1994 and 1995, I took literally the instruction that they should be based on what would be an appropriate monetary policy. It seems to me that an appropriate monetary policy objective should be one that leads to a lower rate of inflation. And so that's what I submitted.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, this economy sounds as good as it gets. But before we all start feeling too good, I thought I would report on something that I have not mentioned for a little over a year--it won't make us feel good--and that's health care. There are four Congressional committees considering the health care bill, and I thought I would share with you some of the economics that are implicit in that legislation. It looks like the direction in which it is moving has some kind of subsidy for moderate income families. If we think about it, that's a very natural path that we should applaud. The catch is that when the subsidy is phased down as family income rises, it is no different than imposing a tax, at least in terms of the side effects. The numbers involved are impressive. The CBO has scored the Clinton plan for a family as worth \$7,000. So, say we phase down the \$7,000 subsidy over a range of \$20,000 or something like that; that is a 35 percent marginal tax rate. The chances are that something that generous will not pass. So, I scaled back the Clinton plan by about 30 percent to a 1994 cost of \$4,800. For a family, these numbers are very much in line with what Senator Cooper has proposed and what Senator Moynihan got through his Committee. For a family of three, the health care bill would add 27 percent to the marginal tax rate. So on top of a 15 percent federal income tax, 7.65 percent social security and FICA taxes, state and local income taxes, plus the phaseout of the earned income tax credit, a single mother supporting two kids would be in a 75.7 percent marginal tax rate bracket for income from about $14,000 to about $34,000. I know our staff's model doesn't take marginal tax rates into account directly, even 75 percent ones, but that would seem to have some serious effects, especially to me. For larger families, the phasedown range is wider and the effects are more modest. Assuming the earned income tax credit is already phased out, families of four earning between $20,000 and $50,000 would have marginal tax rates of around 49 percent. So we are now in the situation of having the great bulk of moderate-income America facing marginal tax rates of between 50 and 75 percent. And that's with a moderate health care bill! We speculated earlier about possible supply shocks that might come from the Middle East but the actual shock might come from Capitol Hill. Things are as sweet as they get, but we always manage to shoot ourselves in the foot somehow. Thank you.

CHAIRMAN GREENSPAN. Governor Laware.

MR. LAWARE. It may be a habit, but as has been usual in recent months, I am going to play the role of Cassandra and I would encourage you to worry with me about the economic environment. I am convinced that the moderation in housing, autos, and retail sales is not as much a function of higher interest rates as it is a function of anxieties endemic in the public. This would seem to be borne out by recent marginal changes in consumer attitudes. When members of Congress cannot make up their minds about health care and how it will be paid for and by whom, the public becomes confused and uncertain. Add to that the continued reengineering of corporate America and it is easy to understand why people worry about the security of their employment. That all adds up to a reluctance on the part of both consumers and the corporate sector to take on long-term commitments. Certainly, the pattern of business investment spending in recent months is for replacement, not expansion, of capacity. While many of the market measures of capacity utilization and unemployment levels are at the threshold of exerting upward pressure on inflation, it seems to me that the tea leaves are still very hard to read. This might be an appropriate time to take a breather until it is clear what the direction and magnitude of economic activity turn out to be. You're welcome. [Laughter]

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I have been comfortable with all of the policy moves we have made this year. The primary reason is that it certainly has seemed to me that we needed to remove the stimulus from policy that was there for a long time and was no longer appropriate. But I have had questions throughout the spring as to what the real economy might require after we eliminated that stimulus. The questions were primarily in two related areas. It's clear that we are approaching full utilization of resources in the economy, but it has been unclear to me just how close we really are. More important than that, as we move into that zone, what sort of momentum will the economy have that might push us into an overheating-type situation? Related to that, over the time horizons that the FOMC can usually and reliably work with, how likely are we to set off some type of inflationary episode? In support of that line of questioning, I have been reciting a litany of factors and I am not going to repeat those, but it does seem to me that the recent information, on balance, has been stronger than I would have expected. The first quarter of 1994 has proven to be stronger than it first looked to us and the second quarter looks stronger than I expected earlier. We have talked about the decline in the dollar and the foreign economies beginning to strengthen. The hours numbers recently have been remarkably strong, and employment looks as if it might be as well. I am not prepared to say that all my questions have gone away, but it does seem to me that so far events seem to be more on the side of strength in the economy. Momentum is certainly greater so far than I would have anticipated. We have been getting reports today from around the Districts that some slowing is beginning to become evident; we will see how much of that takes hold and how quickly. But from where we apparently have been recently and appear to be today, if that momentum is clearly still in effect very much longer, I am going to have to move in the direction of thinking that we may need to do considerably more in the area of policy changes.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Thank you, Mr. Chairman. While the expansion appears to be continuing, the question is at what pace, and we all seem to be struggling with this question as to whether we are below, at, or above capacity. On the supply side, how much slack is left in the labor and product markets? Even if we had good historical measurements of aggregate capacity and slack, I wonder to what extent we could use these to estimate the future. In the area of labor markets, I felt more uncertainty around the table than usual. The staff estimate for the current quarter is 6.3 percent unemployment when the current rate is at 6 percent, and Mike Prell suggested that we were uncomfortably close to being analytically blind at this point. I thought he gave a pretty good description of some of the concerns with the labor market information. A number of folks are re-estimating the NAIRU, and the announced values that they're coming up with vary all over the lot. I think we are experiencing significantly different labor conditions in different parts of the country. At least for me, that's one of the explanations as to why there is so much uncertainty. This raises questions about labor mobility between regions or perhaps labor mobility just with respect to certain professions. We are hearing certainly of spot labor shortages, and a couple areas were mentioned. I do think that this re-engineering that we have talked about over the last several months may be changing the equation and causing a bit more churning. And just because somebody has a job, they may well be looking for a better job. So I think that that is fogging the numbers somewhat.

On the price side, the most consistent story, it seems to me, is that while there are pressures in the basic commodities, competition is constraining final goods prices. But even this story may not hold up for too long if capacity utilization continues to be strained. For me, it's very hard to ignore the sustained price increases in 1994 for many of the basic commodities. Certainly, there are ways to deal with price increases in commodities that continue for a short period of time. If these increases are sustained for a longer period of time, that's going to be more of a problem. On the demand side, we have heard and are seeing evidence of some slowing in spending, but the question again is whether we will overshoot, achieve, or undershoot that elusive soft landing.

I haven't heard quite as much discussion of the financial markets today; maybe everybody was exhausted after the exchange rate discussion. I think that the markets have survived significant turmoil beginning with the Fed tightening in February. After that tightening, markets have been hit with international uncertainties, foreign exchange crises, and domestic political crises. But overall, the market performance, I think, has been quite good. We have had no major U.S. casualties; money has moved; we do not have gridlock. The market capacity improvements and the safety nets that have been put into place in the last couple of years seem to have worked. Bank internal risk management models appear to have worked. The contraction of exposure has been fairly orderly as we have gone through significant market moves. Bank credit has expanded. I think we have weathered that road quite well. I didn't want a fair amount of this turmoil to go unnoticed just because we are not seeing headlines about problems in financial markets and institutions. The markets seem to be a bit more settled. I question the strength of inflows to mutual funds, but at least we are not seeing massive outflows from some of these markets. The stock market is certainly down for the year but it has moved sideways for the last three months. We may still have some volatility concerns about the bond market, although this is less likely to cause political concerns because the bond markets affect individuals less directly.

In sum, this is what Ed Boehne called a transition period and whenever we are at a change in a business cycle, we are likely to get a fair amount of conflicting data and mixed views. And since we seem to have more than the usual amount of conflicting data and opinions, I am going to assume that we have found the turning point. At best, we have the soft landing and maybe this is as good as it gets as Larry Lindsey mentioned. The key at this point is not to make a mistake and end up with too much inflation or in a recession. I do think that the tough part is going to be to hold on to the gains that we have made against inflation and, in fact, to make some progress toward achieving price stability. Unfortunately, I think that the going will get tougher, with more tightening from this point on. We may well be going onto slick pavement as we travel forward.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. Thank you, Mr. Chairman. As all of you know, I wasn't here when this tightening started, and I was trying to imagine, if I had been here on February 4th, what I would have wished for July. I think I would have wished for almost exactly what we have gotten in terms of the real and nominal economy. I wouldn't have wished the dollar down, obviously, and I think I would have expected and certainly wished that the run-up in long rates was less than it has been. But in terms of the evolution of real spending and the signs of inflation, I think what we have today is very, very close to what I would have wished for back in February--which is to say better than anyone reasonably should have hoped for, because wishes don't usually come true. I judge the risks now to be pretty balanced under current policy, as Bob Forrestal said; and I would add something to that: "and they are small." It's very hard for me to put much probability on a scenario that has a very large overshoot capacity. And it's very hard for me to put much weight on a scenario of the economy's growth rate--never mind a recession--going down to growth of 1 percent or 1-1/2 percent in 1995; that seems quite unlikely. So the risks are balanced, I think, and small. It looks to me like a three bears economy: not too hot, not too cold, it's just about right. It seems that the Committee was very, very lucky--[laughter]--skillfully lucky! Let me say for the record that you can do the right thing and be unlucky and come out in terrible shape.

CHAIRMAN GREENSPAN. You can do the right thing and turn out right.

MR. BLINDER. And you can do the right thing and turn out right, which is the way it looks for now. The staff's forecast looks about correct to me, given the further tightening of monetary policy that's assumed in that forecast. I call attention to something that I felt very much and that Mike Prell pointed to himself, that the 3-1/2 percent growth rate for the quarter just ended was predicated on some good numbers coming in that we haven't seen yet. Mike characterized it as a stretch, and it looks like a stretch to me; we might get it, but it does look like a stretch. The staff's 2.2 percent real growth forecast for 1995 is weaker than the Committee consensus; but I think, given the additional 100 basis point fed funds rate increase presumed in that forecast, it's not unreasonable. I would point out that, given the lags in monetary policy, we should expect that tightening to carry over into 1996, and that would say to me--the forecast horizon ends at the fourth quarter of 1995--that we may see a slower growth rate than 2.2 percent, perhaps a slower growth rate than 2 percent, in 1996 under the assumed policy of another 100 basis point increase in short rates with some sympathetic movement in long rates, not with a zero change in long rates. I want to talk some more about this when we talk about policy tomorrow. To me, 2 percent growth starting in late 1995 and into 1996 looks a bit on the low side, if you believe that we are fairly balanced right now, and I'll come back to that.

I wanted to raise one more question. Susan and a number of others talked a lot about capacity. Mike Prell was quite right, I think, to say the light's a little bit out on the extent of pressures on capacity right now. As I listened to the reports from the twelve Districts, which echo more or less the Beigebook, I thought there were fewer reports of tight labor markets than one would expect if we are sitting exactly at the natural rate right now. I think the anecdotes are consistent with the view that we have, not a lot, but a little bit further to go and, of course, we can never know that for sure. In the same vein, on capacity utilization: I think we want to remember that after an investment boom of the length and magnitude that we have had and are still having, it is very likely that there is more industrial capacity out there than we are actually picking up in the measurements. This just reinforces my view that the risks are two-sided. There is a risk of coming up short as well as the risk of going beyond. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. Thank you. We meet at the British Embassy at 7:30 p.m. for cocktails, and I assume dinner around 8:00 p.m. Transportation for the presidents will be at the Watergate from 7:10 to 7:15 p.m. and here for Board members also at 7:10 to 7:15 p.m.

[Meeting recessed]

July 6, 1994--Morning Session

CHAIRMAN GREENSPAN. I call on Mr. Kohn.

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

CHAIRMAN GREENSPAN. Don, let me sort of interpolate on what you ended up saying with respect to providing 1996 projections to Congress. I think our public policy posture always has to be in favor of either low or declining unemployment rates or low or declining inflation. The truth of the matter is that while monetary policy matters, it obviously can't encompass as much as the committees up on the Hill would like to require us to accomplish. I think we have to indicate that we will accommodate as strong a growth as comes out of a noninflationary environment. Indeed, we would foster such growth but argue strenuously that long-term stability and the sustainability of employment require that inflation be held in check. While we acknowledge the short-term Phillips curve, we can't acknowledge, because I think it doesn't exist, anything beyond the very short-term posture. Once we get into that, I think we are letting ourselves be led down a road of public policy perceptions that we can't meet and shouldn't meet. If Congress wants to impose certain requirements on us, that's their prerogative, but for us to get out there and make a projection, which we all do, we also have to recognize that projections are not goals. I will make a projection that I think the inflation rate will be "x" and I think "x" is unacceptable. That doesn't mean that I say "x" is unacceptable, therefore I will change it. A goal and a projection are two fundamentally different things. We don't make the distinction in our request for your projections. We merely ask what individual members are projecting. Some are thinking of them as goals and some are making them as forecasts. And that's fine; it's fine in the sense that it seems to be working. But once we get out beyond the intermediate period, I think we're in for some serious questions.

I might just say on the monetary growth ranges that I am inclined to do nothing on M2. The reason is that I think the 1 to 5 percent range is where we want to be when eventually we get velocity in M2 coming back, and I wouldn't want to touch it. But I am intrigued by the notion of taking the debt aggregate down as a symbol. The question is how relevant it is to the outlook. Indeed, I have a suspicion that it may be more relevant than the M2 numbers. What type of perception do you think that would create, if any, in the marketplace?

MR. KOHN. There might be a reaction that the Fed is paying a little more attention to debt, that is, you bothered to change the range instead of leaving it. But I think it would depend crucially on the rhetoric that was associated with the change. If it was explained that slower debt growth has been occurring over recent years and should continue to be associated with slower nominal GDP and damped inflation, I don't see us creating a new feeding frenzy around debt, if that's what you are concerned about. I think it is perfectly explainable. It is a very high range, especially compared to the M2 and M3 numbers.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Thank you, Mr. Chairman. Don, I was surprised by Chart 1, particularly in light of what the Chairman just said about our eclectic views of the Phillips curve, which is that one probably exists in the short run but not in the long run. That Chart 1, if I believed it--and I believe everything you tell me, Don--would convert me into being a wild dove because what we could do with easier money is to reduce the rate of unemployment permanently below what it would otherwise be without ever paying any cost for that. Now look at the bottom of the chart. It means, as I understand it, that simply by printing money we can increase the long-run aggregate amount of output in the economy.

MR. KOHN. I think the models embody a vertical long-run Phillips curve; it takes a while for it to come out here.

MR. LINDSEY. Into the next millennium!

MR. KOHN. Yes. If you had not noticed that the inflation rate is up at 4 percent and the only reason it's not continuing on the upward trajectory is that we bent the unemployment rate up and so you have--

CHAIRMAN GREENSPAN. But never backwards?

MR. KOHN. No.

CHAIRMAN GREENSPAN. Only the coefficient is unchanged even though it gets smaller. What Governor Lindsey's saying is arithmetically irrefutable.

MR. KOHN. In this time period, that's right. But if you stretched out--

CHAIRMAN GREENSPAN. Then the interesting question--I am sorry.

MR. LINDSEY. No, go ahead, please finish.

CHAIRMAN GREENSPAN. It strikes me that if we're postulating that there is no evidence of long-term Phillips curve tradeoffs, but that there is one in the short run, it therefore follows that somewhere between the short run and the longer run, it is backward sloping.

MR. LINDSEY. Right.

MR. KOHN. If the unemployment rate had not come back up toward the natural rate, inflation would have continued to accelerate on a straight upward line. If you believe that there are some costs to inflation, those are not embodied here; that is, the uncertainties and costs of higher inflation rates are not in here. I think it is very strongly the Committee's view that they are not indifferent to creating a 4 percent inflation rate versus a 3 percent inflation rate.

MR. LINDSEY. What does this cost? I assume the civilian unemployment rate is not a bad proxy for real GDP, so we never pay a real output cost. The only time the unemployment rate even starts to go up under this chart is when we eventually raise the fed funds rate.

MR. KOHN. But if you didn't do that, the inflation rate would continue to accelerate forever.

MR. LINDSEY. But if I were going to vote just on this chart or if Mr. Gonzalez or any member of Congress asked me to vote on this chart for a term that exceeds a senator's term, we now can vote to have an interval, which is really what we want to look at on the CPI, that would--let us see it looks like, I am just going to ballpark it and say 3/4 percent for 6 years. So 4 million extra job years can be bought by this Committee by voting for the easier money path at virtually no inflation cost.

MR. KOHN. You have a percentage point of inflation cost. There is, as you say, an interval if you go from 3 percent inflation forever to 4 percent inflation--without taking account of the feedbacks on economic growth but just in Phillips curve terms--in which you will realize some extra output in the meantime because you can drive the unemployment rate below the natural rate for a short time before bringing it back up to the natural rate. But you will end up with 4 percent inflation, not 3 percent inflation.

MR. LINDSEY. And when will we ever pay the price?

MR. KOHN. When you tried to bring inflation back from 4 percent if there were a cost associated with 4 percent rather than 3 percent in terms of the efficiency with which the economy operates.

MR. LINDSEY. But there's no cost in terms of output?

MR. KOHN. Unless there is a feedback from the 4 percent to 3 percent on productivity and on efficiency.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I just want to make a comment, but first a technical question. Do these results come out of the MPS econometric model?

MR. KOHN. The baseline is judgmental; the deviations from the baseline come out of the MPS model.

MR. BLINDER. That thing will cycle as you let it run; so that's one part of the answer. I am a little surprised that it actually hasn't crossed zero by 1999, but it's going to cross zero and actually get, I think, to fairly exciting numbers on the other side before it cycles back down again. But the main point is that this really shouldn't be a surprise. Larry, you just described what happened in 1988-89. We had an interval of extra jobs as we overshot the natural rate; the inflation rate rose by almost exactly 1 percentage point. Then this Committee reacted to that, and we had a recession, and that's where you pay the cost. You're looking at a picture of 1988-89 here, basically.

MR. LINDSEY. If you extended that to 2006 or 2008 or something like that, you do believe I think that we would actually be starting--

MR. BLINDER. I think this would probably cross in the year 2000, if you just let the MPS model run.

CHAIRMAN GREENSPAN. Yes, but the fact that the base case is a judgmental model tells you something about the add factors that we have to deal with in this broad MPS model. If we allow the MPS model to run with no add-factor changes, the results we'd get--I will stipulate without knowing it and Mike can take a shot at me if he wants to--would be garbage. It would be unacceptable. If the un-add-factored model engenders results that do not seem to capture what is going on in the real world, why do we assume that a simulation coming from that model, which is supposed to capture what's going on in the real world, captures the actual scenario? I think we have this problem that is always involved in any of these simulations. I think Don is merely doing what we want in putting something together to get us focused. But what may be wrong with all this is that instead of putting down a literal timeframe, I think we should put down T, T+1, T+2, because I am not sure we know what the timeframe of this whole process is, and I am sure we don't know what the reduced form of this whole system is because it doesn't fit the real world in a way that makes any of us comfortable at this stage. If it did, we wouldn't be using so much judgmental evaluation in working off the MPS model to get a set of relationships, which I think is the right way to forecast. That model forces you to make certain key judgments for consistency. But it doesn't force you when certain elements within the system are very difficult to measure and are really highly important to the end result. We can argue this as much as we want, but the truth of the matter is that we would have to fall back on our own judgments of the impact of this sort of thing because we are pressing the limits of our technical capabilities to get anything more than illustrative types of scenarios, which is what Don has been trying to do.

MR. KOHN. I was going to suggest not only removing the dates from the horizontal line but also removing the scale from the vertical line. [Laughter] I agree with what you said, Mr. Chairman; it is supposed to illustrate tendencies.

MR. PRELL. I have no quarrel with anything you said, Mr. Chairman. Indeed, it's a point that I have made many times, and I have convinced myself that I should be very leery about presenting these kinds of simulations. If I don't buy the model in the baseline forecast, why should I buy the differentials literally? Now they are probably the best we can do systematically at this point because it's very hard to juggle all of these variables in a judgmental fashion and come up with a whole array of alternative simulations. And we are trying to improve the model so we can have greater confidence. I think the key question the Committee has to ask is whether it believes the baseline. For example, those who feel that the NAIRU is much lower or that the true unemployment rate is lower relative to the NAIRU would have a different baseline path so that the most stimulative policy wouldn't necessarily yield higher inflation than we forecast. It might be comparable to what we forecast. Still, the point, I think, is that you only get a short-run benefit, and not a long-run benefit, if you feel that over time higher inflation has a negative implication for economic efficiency and productivity in the economy. That, I think, is the key judgment you folks have to make.

CHAIRMAN GREENSPAN. I just want to make one response to Governor Blinder. It is true that when the inflation rate went to 4 percent, we responded. But if we believed the MPS model with its linearities and the very long-term implications for tradeoffs, we basically would have said, well, 4 percent is acceptable. That's because I found, looking at the MPS model in 1989 that simulating 4 percent or the type of inflation rates that existed using nominal add factors, the case that could be made for the type of policy we initiated to tighten up was very weak. The model that we were effectively using as a policy instrument did not coincide with this. I think one of the things we are learning is that we are forced to fit linear models to structures that don't stay stable long enough to get a fix. I think intuitively, if I want to use that word, we try to adjust to that. I am sure because we were here, at least I was in 1988-1989. It's not as though we have an irrational sense that 4 percent inflation is sinful or that it is inappropriate for society for a whole series of non-economic points of view. The reason we moved as we did was because we thought inflation was truly undermining the fundamental growth and stability of the economic system. You could not have inferred that then, I would wager, by running projections off the MPS model. In fact, I remember them. I looked at some of the ones in which we tolerated just mildly higher inflation, and I had the same impression as Larry did. You know, why not, if you believe it. The question is do we? I don't want to speak for the Committee, but listening to the way this thing evolved over the years, I would say that there's very great skepticism with respect to this type of linearity. My own guess is that the MPS model isn't simple. It's complex, very sophisticated--the best econometric model I have ever seen. But the world is far more complex than that, and I think we have a tough task in trying to figure our how to play against that world, which always does things we insist it shouldn't be doing.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I just want to comment on what we have been discussing. I think one of the problems with an exercise using this approach is that there are no explicit costs associated with inflation. That was implicit in Governor Lindsey's comments. But if we continue to look at it this way, we are always going to say, at least at first glance, why not avoid a tighter policy or why not indeed go to an easier policy. One of the things we have to try to find is a way of considering explicitly the costs of inflation in all this. My impression is that there are some models around that do that. But until we do that, it seems to me that these exercises are really of very limited value, because it always looks as if the best thing to do is either nothing or ease.

CHAIRMAN GREENSPAN. That basically is built into any Keynesian structure that does not have a feedback mechanism that overwhelms the Phillips curve and turns it around. None of the models of which I am aware, including the one in which you draw a vertical Phillips curve in the long run, which is correct for the long run, answers the question whether or not the path going there is quite different. I don't think we have adequate data to capture that. That's why we have trouble with this sort of stuff. We have to ask ourselves whether we should forget monetary policy and focus on the budget deficit. I would venture to say, because I had some tests run on this, that if you just allow the budget deficit to expand by 20 percent a year indefinitely, it's remarkable how long it takes for something wrong to happen. President Broaddus.

MR. BROADDUS. Mike, along the same lines, as I remember, a couple of years ago you were experimenting with a model that had a forward-looking expectations formulation mechanism in it. As I recall, you actually ran some simulations on that model at one point and included those in the Bluebook or at least a description in the Bluebook that give very different pictures with respect to alternative policy postures. Have you dropped that or are you still doing that?

MR. TRUMAN. They weren't used in the Bluebook; they were based on the experimental model. This was done in the International Finance Division. We did it for the special presentation that was made for the FOMC on costs of inflation. But I think the characteristics of those models were not different fundamentally--at least what I took away from those models--from what the Chairman just described in terms of these models. It's a question of what you put in. You do not get a better tradeoff unless you impose on the model, which we did at that time, that you have a credibility gain. Rational expectations models don't give you that unless you build in that view. But that's ex cathedra--not something that you can derive from statistical estimations.

MR. PRELL. Mr. Chairman, I think it's important to mention that if people anticipated this higher rate of inflation, we might not get this short-run output gain.

MR. BROADDUS. To be explicit, under the tighter alternative on Chart 1, I think something like that model would show that the cost --in terms of unemployment--of moving toward price stability in this timeframe would be lower. I am not suggesting that you substitute that kind of model for this model. I am only suggesting that it was helpful for me to have that as another benchmark to establish a range of possible outcomes.

MR. TRUMAN. As Mike explained, there are two projects under way this year in which the staff is trying to produce a richer set of models for you to draw on, which will probably confuse matters further. But our objective is to try to improve these models and to be able to capture, if I can put it that way, a richer mix of the expectations process in the presentations we put forward to you. You may end up having so many branches on the tree that you get lost in the forest from it.

CHAIRMAN GREENSPAN. Ted, it strikes me that what you are basically saying is that we are missing a few variables in the system, such as a statistic for inflation expectations as a key operative variable. If you want to look at the feedback effect, one would presume that the actual mechanism through which it would work basically would be through something that is measurable, which we can't very well observe at the moment. If you look back through the '60s and the '70s and the '80s, the crucial missing variable in the models was a number for inflation expectations. If one could have forecast that with any degree of accuracy, a lot of what evolved over the period would have been readily captured in the models.

MR. PRELL. At least that expectations might be shaped by something other than the experience of the past several years--

CHAIRMAN GREENSPAN. Yes. I am not saying what that is a function of. We know it's a very difficult issue, but that is the key variable. It's important, but just because we can't make a judgment as to what these driving forces are in an econometric sense doesn't mean that it's not real. President Boehne.

MR. BOEHNE. I just wanted to make an additional point in this discussion about whether one believes the model or not. If you believe that you can go from 3 percent to 4 percent inflation and permanently buy some increases in output and jobs, when you get to 4 percent you will also find the model will show that you can go from 4 to 5 percent and also buy some more output. The same applies from 5 to 6 percent. So you tend to get on that kind of slope, and it's much easier to draw the line at lower rates of inflation than it is at intermediate or higher rates. I think we have 20 years of experience which indicate the validity of that.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. I'd like to take President Boehne's point and just reduce it to a single question. If we ran the model out, do we believe that if we applied some social rate of discount, the losses in output later on would be more than, less than, or equal to the gains in output in the short run?

MR. KOHN. The model itself doesn't have, I don't believe, losses in output from higher inflation rates.

MR. LINDSEY. Ever?

MR. KOHN. I don't believe so.

MR. PRELL. Well, it might, though, in tax terms. The fact is that our tax system isn't fully indexed; the effective corporate tax rate rises as inflation goes up, and that would raise the cost of capital, reduce investment, and lower productivity over the very long run. That, I think, is probably embodied in our current model. And it's one of the things one would point to in estimating the losses over the long run with higher inflation. There are other possibilities in terms of inefficiencies in the price mechanism's operation and so on that are not captured.

MR. LINDSEY. But if I heard you right, we never have a net loss in output resulting from a choice to go for inflation?

MR. PRELL. It does not take, in terms of a normal simple cost of capital calculation, a very big inflation differential to get you a net loss in the present value in the long run.

CHAIRMAN GREENSPAN. The argument as to why we get a net loss is "the Federal Reserve will react--do something." But the question is, we are the Federal Reserve and why should we react if that's true?

MR. LINDSEY. If we don't believe that the present value of output in this economy will be lower by letting inflation alone, then we should let inflation go up. It's as simple as that. Is there anyone around the table who thinks that by printing money, the present value of output of this economy will go up? If there is, I will join them in voting to cut the discount rate to zero.

CHAIRMAN GREENSPAN. Oh, no, you don't mean that statement as you said it!

MR. LINDSEY. Why not?

MR. BLINDER. Because the Federal Reserve Act directs us to maintain stable prices. We are created to do that.

MR. LINDSEY. If we can prove--

CHAIRMAN GREENSPAN. What you said was: If anyone around here believes that, I will vote to lower the discount rate.

MR. LINDSEY. Yes. I was surprised that Alan bought that.

CHAIRMAN GREENSPAN. If anyone convinces you--

MR. LINDSEY. That's true. Do we believe that printing money will increase the present value of output?

MR. BLINDER. Yes, I think we would. I believe that printing money will give the economy a temporary high that will not last and therefore in the integral sense that you said, yes, you get a larger integral of output over an historical period, _if_ you never decided to end it--if you never said, when you got to 10 percent inflation, whoops, that wasn't very good, and you went back to lower inflation.

CHAIRMAN GREENSPAN. Yes, but why would you conclude that at that point when, because as Ed Boehne says, 11 percent is still better?

MR. BLINDER. If 11 percent is better than 10 percent, if there's no cost to inflation--I am a little bit surprised at the tenor of this conversation around here! [Laughter] There is some academic content that is--

CHAIRMAN GREENSPAN. In all seriousness, the question really gets to the models. Why would you believe that there is a cost of increased inflation from the models?

MR. KOHN. Isn't there a lot of cross-country and cross-time evidence that once you get past very low rates of inflation, there are costs in terms of growth and efficiency at higher levels of inflation? Higher levels of inflation tend to be more variable; you get a lot more uncertainty; people have to interact with the tax system and other things that aren't indexed to inflation rates. So, there are substantial costs. Now if the System had confidence--

CHAIRMAN GREENSPAN. I am guilty of this whole operation and the clock is running, and I request your forgiveness for opening this issue up. But sometimes we have to have a little fun, I guess. Bob Parry, do you have a question?

MR. PARRY. Yes, I have a somewhat different question. I want to ask about an earlier comment that you made that you had a preference for not changing the ranges except for perhaps the debt range in 1995. I think we're all well aware of the problems in terms of the significance of the growth in the aggregates. But as I read the Bluebook, I certainly associated alternative I with the baseline forecast, which I feel is an unacceptable outcome as one goes out to the next millennium. Would you talk very briefly about whether you think, if we were to leave the targets alone, that we would be constraining ourselves to follow the baseline? Or would you say that those targets are sufficiently broad and the uncertainties sufficiently great that we could still be confident that we could follow a path where inflation would get no higher and would begin to come down?

CHAIRMAN GREENSPAN. I think with respect to M2 and M3 that the deviations from different versions of P* are such that we have correctly abandoned those aggregates, but hopefully they will come back and be useful. If they come back and are useful, we would assume M2 would go back to a zero trend in velocity, which essentially would suggest that the 1 to 5 percent that we have in here is where we want to be ultimately. It took us a long time to bring the ranges down to what we perceived to be a noninflationary base if there is stable M2 velocity. My view, and I suspect yours and others, has been essentially to leave that alone and just wait for M2 to come back in the range rather than to try to adjust the range continuously to these variations. We can just sit and wait for M2 to come back to us, as distinct from trying to chase it.

The question that I am raising, however, is that I am not sure that the debt aggregate is all that irrelevant at this stage. I've raised the issue before. I can't prove it and I don't know if we can prove it after the fact. But I would say that there have been many, many episodes in American history where, if we had had the data then, they would have shown an unemployment rate under the NAIRU and capacity slack very rigidly constrained and yet we had very modest price changes. The reason basically, of course, is that we had a structure in which credit expansion was restrained--institutions did not allow it--and we had the convention of a balanced budget. Under those conditions, one can argue that it was the lack of credit that created the stability of prices. There is the alternative inflation expectations view in terms of the gold standard theoretically, which might be the ultimate explanation. But what I am saying is that it's worthy of at least thinking about one important element here. That is, how much credit is actually made available out there because the credit aggregates may be working. That hypothesis raises all sorts of problems including how derivatives affect all of this. But I am unsure of the credit aggregates question. I don't feel strongly about bringing its range down, but if we were to do something, that's what I think we could do.

MR. PARRY. Just a follow-up question: It seems to me that in your testimony you could make the point that you just made about M2 and M3, saying that, if velocity returns to normal, those ranges would be consistent with our long-term objectives with regard to inflation. You could then make a similar argument with regard to debt, indicating that the change in the range was being made to make it consistent with our long-term objectives for inflation. I would certainly find that preferable to saying the range is being changed for technical reasons because we expect debt growth to come in lower. I think there is a critical difference in the two interpretations.

CHAIRMAN GREENSPAN. I agree with that. Tom Hoenig.

MR. HOENIG. Mr. Chairman, thank you. I have two comments. First, on the debt aggregate, I tend to agree with your suggestion for bringing that range down. As Bob Parry was saying, a lower debt range would make it more consistent with the monetary figures. If that could be done, as Don described, without raising other issues or having other things read into it--

CHAIRMAN GREENSPAN. Do we want to leave the so-called sleeping dog alone?

MR. HOENIG. That is the other option, yes. The second thing I want to comment on, though, is your reference to the 1996 projections. I very much agree with you there. It is, I think, unwise for us to be presenting specific projections into 1996 because they are often looked at as goals and also lead to the presumption that we know more than what we are really able to predict into 1996. If we do it, we would be well served in the long run to do so as Don suggested, by your making general statements about the 1996 outlook and not committing us to specific numbers.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. I have just two comments. The first is on whether we should change the debt range. I have a very strong feeling that that is a good thing to do but that the likelihood is that it would take on a life far greater than it has any reason to have. You will recall, Mr. Chairman, that when you presented your Humphrey-Hawkins testimony, it included the concept of the real fed funds rate as one of a variety of things we look at. The press reacted to it as if it were the new "North Star" for our policy, which you never intended it to be.

CHAIRMAN GREENSPAN. That's a good point.

VICE CHAIRMAN MCDONOUGH. I think a change in the debt range would almost certainly have the same fate. Secondly, just briefly on my pet theory on the problems of inflation, we tend to think--and we should because our job is economic policy and the economic results--in terms of the economic effects of inflation. But inflation also has socio-political effects. There is a traditional economic view that an increase in inflation transfers wealth from lenders to borrowers; I think that is probably valid. But there is a whole segment of our society, most of whom live in inner cities, who don't borrow for all practical purposes. I think any increase in inflation makes their lot worse, and since their lot is already very seriously bad, it risks sufficient social imbalance that society would have to react with a very heavy allocation of resources to solve that problem. That can lead to very serious economic difficulties, which we ought to think about when we decide how we feel about the overall effects of inflation. That is very, very hard to put into an economic model. But I think that if some day we come back to a general discussion of how we really feel about inflation, we ought to try to crank that reality, if others agree that it is one, into our considerations.

CHAIRMAN GREENSPAN. I must say that the objection you made with respect to the debt range goes to the point, and I think you are probably right. President Jordan.

MR. JORDAN. I was going to ask whether this is the time to talk about the 1995 and 1996 projections, or will you have a separate go-around about that later?

CHAIRMAN GREENSPAN. Let us just hold up on that. Unfortunately, our discussion has gone astray, but let us see if we can get questions out of the way, then hopefully go back formally to the agenda. President Keehn.

MR. KEEHN. Mr. Chairman, I agree with your comments with regard to M2 and M3. The point on the debt aggregate that Bill raised made the comment that I was going to make, but I really wonder what the correlation has been over a period of time between the debt aggregate and output, prices, and the like. Has there been a reasonable correlation?

MR. KOHN. It was very, very good until we started to target it! [Laughter] The nominal GDP/debt ratio fluctuated around a fairly constant level until the early '80s, and then there was the explosion of debt in the '80s. In the last few years, debt has come back much more into line with nominal GDP, and our projection, as Mike showed in a chart yesterday, is that it will remain in line. There is no guarantee, obviously; it's hard to see the natural force that is necessarily keeping debt in line. But it did fluctuate closely with nominal GDP for many, many years, before the leveraging phenomenon of the '80s.

MR. KEEHN. Hearing that, it seems to me that Bill's comment is particularly appropriate. By focusing any attention on this, we are creating something that could be very awkward in the long run.

CHAIRMAN GREENSPAN. I am becoming convinced. Governor Blinder.

MR. BLINDER. Let me address the two questions that you raised, Mr. Chairman. On moving the range for the debt aggregate, I don't feel very strongly about that. I feel mildly receptive toward the "let sleeping dogs lie" philosophy. But it's not something I feel strongly about; one can make a case the other way.

I want to raise the possibility of being a bit more forthcoming about the 1996 projections than seems to be the consensus, at least based on what we have heard around the table so far. One of the things the Federal Reserve gets accused of by those who are looking to accuse it of things is being overly mysterious and secretive. Some things have to be secret, of course. But the kinds of numbers we were just speaking about for 1996 projections are very much in line with the consensus; they would put us right where the Administration is, right where the CBO is, right where the central tendency of private-sector forecasters is. I very much agree that we should qualify it, fudge it, make sure that these are viewed as projections, not goals. I couldn't agree with that more. But with broadening them into ranges, with the kind of prose that goes around it, I think our interests might be well served by saying a little more about where we think the economy is going in the slightly longer run. The second reason is, as we know and as we always stress, that monetary policy needs to be focused on a longer horizon than six quarters. I think any one of us around the table would say we couldn't make monetary policy if we closed our eyes to what was going to happen in quarters 7, 8, 9, and 10. All of us have some ideas about what's going to happen in those quarters, which are quite important to what we want to do about monetary policy today--probably a lot more important than what we think is going to happen in the next two quarters in fact. So, both in terms of clarifying our own thoughts for the broader public that is watching us closely and in terms of meeting a little bit--this is a very small step--the request for more openness, I think there is at least something to be said for going public, so to speak, with these projections.

CHAIRMAN GREENSPAN. Let me ask you this. These numbers, if we could make sure they are conceived of as forecasts, are benign, but releasing them would set a precedent, which would then have to be continued in the future. There are going to be occasions when I would suspect the judgment of this Committee as economic forecasters, as professionals, would be to forecast a rising unemployment rate or some other unwelcome development, and I wonder how we would handle that at that point. You can argue that it's a forecast, but then the response will be that the Federal Reserve should prevent it from happening.

MS. MINEHAN. Yes.

CHAIRMAN GREENSPAN. And we may not have the capability of doing so.

MR. BLINDER. I think that's a perfectly good question. I think it's likely--it wouldn't necessarily always happen--that in the event that we were forecasting a rise in unemployment over the coming two years, we would probably be easing monetary policy; possibly we wouldn't.

CHAIRMAN GREENSPAN. But maybe not.

MR. BLINDER. Yes, maybe not. I don't disagree with that.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. I'd just like to comment on a couple of these issues that we have been discussing. First of all with respect to the ranges, I agree with you entirely that we ought to leave M2 and M3 alone--I assume you included M3 with M2. I don't think, given the uncertainty surrounding those aggregates, that there's any purpose to be served by lowering the ranges at this point. I don't think there is a perception among the public or even people in Congress any longer that the ranges really reflect our expectations of what policy is going to be. With respect to debt, I don't feel very strongly about this, but if there is a reason to change the debt range, I don't know why we wouldn't do it. I am not persuaded by the argument that we will focus too much attention on it. After all, if we have ranges, presumably we have the flexibility to change them from time to time.

If there is good reason to do so, then I don't see why we shouldn't and let the markets make their own determination as to whether we are giving the debt aggregate undue attention. It's quite different with respect to the monetary aggregates because I don't think there is any good reason to change them. If we think it is desirable to change the debt range, then I think we probably should go ahead and do it.

With respect to Senator Riegle's request, I must say that I want to identify with the comments that have just been made by Governor Blinder. It does seem to me that there is a lot to be gained by being a little more forthcoming with our information. It clearly runs some risks; there's no question about that. But I think we basically have the same risks with forecasting 1995. We could be in a position, for example, in any given year of forecasting an unemployment rate that is going up. The Congress could focus on that, and that could give us some problems. Clearly, going out to 1996 presents more uncertainty, but I think the benefits of doing it are probably greater than the risks.

CHAIRMAN GREENSPAN. Incidentally, President Jordan, I hoped we would get back on the track, but I am afraid we are in the policy discussion; you're on.

MR. JORDAN. In principle, I would be in favor of publishing information on the inflation objectives out to 1998. But if a forecast of higher inflation is what we are going to produce, again, I am in favor of not even publishing 1995. I think it is a mistake for this Committee to put out numbers saying that we expect the inflation rate to go up in the context of what we think is an appropriate monetary policy--one that will result in higher inflation in 1995 than in 1994. The central tendency of our forecasts also has 1995 unemployment above where it is currently. So, we have both rising inflation and rising unemployment in 1995, let alone 1996. I don't think we ought to be putting out those kinds of numbers. I am pleased that our 1994 forecasts are below where the Committee collectively thought they were going to be in February on both inflation and unemployment. But from here on, we see things getting worse in both respects. I don't see why we would want to announce that.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Alan, I am assuming now that you want our views on what we would do with the ranges and these other issues; I am in that mode. I would reaffirm the existing ranges for 1994 and I would set the same ranges for 1995. I would be willing to adjust the debt aggregate. I think we could deal with any uncertainties that that might raise, but I don't feel strongly about it. My basic rationale would be the same one you expressed--the long-run benchmark concept with respect to M2 growth and normal velocity and the consistency of that range with long-term price stability.

Now, having said that, and this has come up in other discussions we have had, I don't think our target ranges communicate anything with respect to our long-run intentions. That is really the issue that Senator Riegle is raising. It has to do with the uncertainty about velocity and how we have been treating the aggregates, quite appropriately I think. My own view is that there is a good deal of uncertainty about those intentions and there would be two things I would cite. One was a survey, and I think it might have been discussed in a Board briefing, about long-run inflation expectations with respect to the G-7 countries. I was somewhat dismayed to see the United States ranked among the high inflation G-7 countries, along with Italy and the United Kingdom. The average inflation expectations for the United States in that survey were 3.6 percent over 10 years, with four other countries being considerably lower. So, that would be one piece of evidence in my mind about confusion with respect to what we all say about being committed to long-term price stability and yet having a survey--I don't know how reliable it was--that creates that sort of result.

The other uncertainty about our intentions is in a much more current context and relates to developments since our last meeting. I think our actions at the last meeting created quite favorable responses in financial markets, particularly in long-term fixed income markets. Those actions initially had considerable credibility. But if you look at what has been going on broadly since then, again it's quite disconcerting to me in terms of what people think about our intentions. In effect, we have had private-sector forecasters ratcheting up their inflation expectations for 1996. We have had additional anecdotal and other information with respect to rising prices and perhaps labor shortages here and there. Yet, what the FOMC said after its last action was that we had substantially removed the degree of monetary accommodation that had prevailed during 1993. What has emerged in the meantime is a perception that we breathed a big sigh of relief, having moved rates 125 basis points and maybe gotten at best to neutral, and we were going to rest on our oars while all these other developments were going on which would lead to higher inflation expectations and ultimately to higher inflation. In effect, we are viewed as having said, I think, that 3 percent or somewhat higher inflation is good enough as far as we are concerned.

Now, I understand that all hasn't been said and done by this Committee and over the longer run we will do the right thing. But there are significant costs, I think, to these sorts of perceptions, particularly in terms of longer-term rates. Recognizing that the aggregate ranges do not communicate anything about our intentions and that there is confusion in the marketplace and perhaps elsewhere with respect to what those intentions are, my own view would be that it's time for us to be much more explicit about what our long-run intentions are with respect to an inflation range and to indicate that as a practical matter it would probably take us a while to achieve that objective. If I did anything at all in response to Senator Riegle's request, it would be some sort of a nominal GDP target from which one could derive an implicit inflation target. I think if we respond at all, that is how we ought to be responding. If we don't make an explicit statement in this FOMC testimony with respect to our long-run expectations on inflation that goes beyond "we think price stability is good," and get more specific in terms of a target range, then at the very least I think we have to make it clear that we consider 3 percent inflation to be unacceptable and we are not willing to accept it. Obviously, we have to back that up with actions, but we are going to talk about that later. I really think there is a cost to how things have unfolded here.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. With regard to the ranges for the monetary aggregates, I certainly agree with those who suggest just leaving them as they are, including the debt variable. I don't see very much to be gained by fooling around with those right now for the reasons that have been cited.

With regard to the question about Senator Riegle's request, I would be inclined to provide the information on the notion that more information is better than less, and also I am not too troubled by the fact that somebody might look at those and think that they are goals. Obviously, we would want to emphasize that they are projections or forecasts and not goals, but some people could interpret them differently. Presumably if we weren't responding to a variable in that set that looked unfavorable to Congress, say, we would have good reason or reasons for why we weren't. We would explain in any event what policy was and why it was what it was. So, I am not too troubled by questions that might come up about whether the forecast was acceptable to us or why we were not responding to it.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, on the aggregates first, I am right where I seem to hear a lot of other people are. For 1994, I would not change them. I don't believe in changing targets or for that matter budgets in midstream unless there's some very, very compelling reason to do so, and I certainly don't see that here. In the same vein for 1995, I would think to signal a prospective change now would require that we have some very clear reason for doing so and a pretty firm intention that we will want to do so early next year, and I don't see that now. We may well change the ranges when we get there, but we will have six more months of experience and facts at the time and we will be at the start of the period that we are forecasting. I see no reason to call a shot this far ahead.

With regard to the release of a 1996 forecast, by a narrow margin I think it would be undesirable. Many of the reasons that have been cited here for doing so--primarily along the line of more openness--are quite significant and important, and I don't feel as negative about it as I did when I came in this morning. But I still think it is going to be very, very difficult to keep people from ascribing a goal to this forecast instead of just simply viewing it as a forecast and a very soft one at that. I am afraid that we would leave an implication that we will try or possibly can cause this forecast to materialize. Obviously, that would be over-promising what monetary policy can deliver. I also fear that the related thought process on the part of interested people would set up a whole new type of speculation for markets to play with, and they have enough already.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. Mr. Chairman, I would agree with your proposal not to change the M2 and M3 ranges. I don't feel strongly on the debt issue, but I guess, on balance, I would favor reducing it on the same sort of grounds that we had for setting the M2 target where it is now. Since debt tracks nominal GDP at least over the very long run, there is probably a case for trying to make that range fit our longer-run monetary growth objectives a little more closely. The current range has a midpoint of 6 percent, which is probably a bit high. So if we lowered it, it would become consistent with the rationale I hear you giving for the M2 range.

So far as 1996 is concerned, I have a good bit of sympathy with some of the things that Governor Blinder and Bob Forrestal said, but I am really in Tom Melzer's camp on that. My own preference would be to look at this as an opportunity to make our longer-term goals more explicit with respect to prices and tie ourselves down a bit.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I would leave unchanged the ranges for M2 and M3 for 1994 and 1995. Again, I think that any change would imply more than we know and exaggerate their importance. If the aggregates were performing properly, they would already be set appropriately for sustainable growth, so I don't see any case for moving them. With respect to debt, I can go along with a change in the range, although I don't feel strongly about it. Like Bob Forrestal, I think that if we believe there is a good reason for doing it, we ought to go ahead and change it, and 5 percent seems a better center point for the range.

With respect to 1996 forecasts, I agree that more disclosure is better. I also think that if we are going to disclose more, we ought to disclose more but better things, and I am not sure that the numbers for 1996 would necessarily provide better information. So, I'd prefer more of a description of direction or even goals. I know for myself that when I sit down to do those projections and I look 2-1/2 years out, I just don't think that the numbers for 1996 represent quality disclosure; it's quantity but not quality. So, I think we would do better with some description.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I would retain the M2 and M3 targets for 1994 and I would keep them the same for 1995. I think we ought to declare a victory on the ranges that we have for M2 and M3. We have them down now to where they are consistent with what we want to do longer term. I don't think we are skillful enough at forecasting to factor in the shifts in demand for either M2 or M3, and so I think we are essentially where we ought to be for those aggregates going forward. On debt, I came into the meeting without strong feelings. I still don't have strong feelings, although I think at the margin there is something to be said for lowering the range for 1995. I'd leave it alone for 1994, but I think a lower debt range would be more consistent with our ranges for M2 and M3 over time. I don't think it's equivalent to your reference to a "real" federal funds rate. That took a life of its own because people interpreted that as the justification for tightening. I doubt very much whether this Committee is going to tighten because we lower the debt range from 4-8 percent to 3-7 percent, so I just don't think it will come anywhere near taking on the same life. But I don't feel strongly. If there is a reason, and on balance I think there is some reason for doing it, I would change the range for 1995.

As for releasing the projections for 1996, it is awfully hard to recall an instance in this Committee when we had a request for more information and our initial reaction was to do it. We always have a long list of reasons; sometimes they are valid and I think sometimes it's just habit. We have the problem of goals versus projections; we have the bad news problem; we have the quality/quantity issue. If we go out 18 months or if we go out 30 months, I don't think that in substance it's much different. I think we elevate the importance of the 1996 projection more by not giving it than if we give it, so my inclination would be to give 1996. I would couch it in your usual articulate way and say essentially that it doesn't mean very much--you have a way of saying that very nicely. [Laughter]

CHAIRMAN GREENSPAN. Thank you, I think. [Laughter]

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. On the aggregates, I would leave the M2 and M3 targets at their current ranges for all the reasons that have been mentioned. I do have a preference for lowering the debt range in 1995, since I think there is a good reason in that we believe it is more consistent with the other ranges we have set. I also don't think it would result in an excessive focus by the markets if it's clearly understood why the change was made. On the Riegle request, I don't have strong views, but on balance I think that releasing our 1996 forecasts probably would not cause problems or create misinformation.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, I would prefer just to leave all three of these ranges the same rather than change them. I don't see any great advantage in lowering the debt range, and it may indeed create something that we would find awkward to deal with in the future if people attached more importance to it than we do. I don't see a significant probability that debt growth is going to be outside of the existing range for 1995, and so I think the better part of valor might be to leave the range where it is.

With regard to the Riegle request, I ask myself: In July 1992, what would I have forecast the economy to look like in July 1994? And I can't believe that there is any real accuracy in a forecast that far out. We run the danger of not being able to forecast accurately and then having to explain later on why we were so far off and why we didn't do anything about it. If, for example, the forecast says one thing and the conventional wisdom is that it ought to be something very different, then why are we not doing something to make the forecast different. The forecast is always going to be interpreted however someone wants to interpret it when they've got us on the carpet. If it was an attractive forecast, then it will be assumed to have been a goal, and if it is an unattractive forecast, it will be assumed to be an admission of failure. I just think we are asking for trouble if we get into something that dicey. I doubt very much that the models that we are playing with here would have accurately forecast in July of 1992 where we are today. So, I just think it's dangerous to get that kind of thing in numerical form in front of the public.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, I would leave M2 and M3 alone. I believe I would be inclined to reduce the debt aggregate, and just say the reason is to make it consistent with the other monetary aggregates and recent flows, not make a big deal out of it. I agree with those who say that it's not the same kind of concept as the real fed funds rate, and I doubt that it would be noticed or remarked upon. I would hope that the rhetoric that goes with the aggregates would not write them off as being moribund but help keep them alive for their return in the future because they are very handy to have. It's a lot easier to talk about monetary policy when we are trying to hold on to a previously determined target range than it is when we seem to be raising interest rates. I would hope you would discuss the flows between the depository institutions and the stock and bond funds and remind people why the aggregates have not done so well recently. I would prefer that you keep alive the concept of modifying M2 at least verbally with M2 adjusted for bond funds, stock funds and so forth, and maybe even go so far as to have an anticipated growth range for adjusted M2.

I don't know what I think about releasing the projections for 1996. It seems that there are no good options. We do need to be as forthcoming as we can. I basically agree with Jerry Jordan that if we are going to release them, we probably ought to redo them. They are going to be treated as our targets. We are going to be blamed if we are projecting bad things and not doing anything about it. So, at the very least, I think we ought to redo them if we release them.

CHAIRMAN GREENSPAN. First Vice President Minehan.

MS. MINEHAN. One of the problems of being on the end of this list of people being called is that all the other people say the good stuff! I am also in agreement with the discussion on the Ms; I would leave them the way they are. I agree with the comments, whoever made them, that it has taken us a long time to get the ranges down to a reasonable expression of long-run policy and I think they should stay where they are over a period of time. I am attracted to the idea of reducing the debt range marginally as suggested in alternative II.

On the issue of releasing our projections for 1996, I have some sympathy for what President Boehne said, being attracted to the idea that we don't know too much about developments 18 months in the future and therefore there may not be a much greater problem with releasing further out data that we don't know much about. But weighing everything in the balance, I think I am more attracted to the argument that if we release very explicit forecasts going out that far, we do set up expectations that may end up tying our hands rather than allowing us flexibility in the future. I would go for the middle alternative myself, not giving specific hard numbers but trying to explain the factors that we weigh in terms of looking at the longer run. I would be much in favor of a balanced discussion of inflation, unemployment--those sorts of things. Maybe it sounds like Mom and apple pie, but I don't know if we all share the same specific targets with regard to long-run rates of inflation and so forth. So I am a little concerned about putting out something that says that that is the goal of the Committee. I would be concerned about not coming out on a reasonably balanced side.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. On M2 and M3, don't bother changing them. Changing the debt aggregate range isn't going to make much difference, but I think we should probably lower it because I think it's a proxy for nominal GDP.

On forecasting, I think John LaWare had a very good point. I remember what happened to me when I was on the staff at the CEA in 1982. In December 1982, there was a deep recession and we had to make a forecast for five years out. Marty Feldstein, who had sort of a baseline, said let's guess 4 percent a year, starting in the second quarter of 1983. Here is the dart thrown at the dartboard. It turned out that the 1987 real GDP forecast was off in fact in 1987 by a total of $3 billion, which is as close to a bull's eye as I have ever seen anyone make. But in the meantime, first it was criticized as wildly optimistic, and then it was criticized as wildly pessimistic as the economy went above and below the forecast. So anyone has to be crazy to make that kind of forecast even if it turns out to be right! [Laughter] Nobody ever remembers you were right. At the very least, I think Jerry Jordan's point is correct, that this is going to be interpreted somehow as our wish list. For us to put out numbers that have unemployment and inflation rising has to invite an attack. It's worse than forecasting 4 percent growth for five years.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. In my earlier comments, I didn't remark on the forecast for 1996. I would be opposed to going forward that far unless we really have to. It seems to be awfully far out on the forecasting horizon, and I far prefer to state our expectations in terms of our long-run objectives.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. I am in favor of alternative I across the board for both 1994 and 1995. Perhaps, living in the city where financial journalists swarm, I am not at all convinced that, by leaving M2 and M3 alone and changing the debt ratio, we would not have much more discussion of the meaningfulness of that move than anybody in this Committee really thinks is meaningful.

As regards 1996, I find myself in the awkward position of being trapped in the middle of Alan Blinder's syllogism. I believe it is the major. I agree that we should be more open to disclosure, but my concern at the present time about forecasting 1996 is not unrelated to the fact that it is a year divisible by four, which may be the interest behind the request. If we ever forecast that far out, it would be better that we do it after considerably more discussion and thinking than is possible now. So as a tactical matter, I prefer that we not release a forecast for 1996. Perhaps as we meet in February or get prepared for February, we may want to think more fully about whether we wish to forecast out for a longer period. I suspect the answer to that would be "no," partly because of what Larry Lindsey just said. But it may very well be that we need to be somewhat more forthcoming about just what we mean by price stability. I don't have a conclusion for that, but I think it's probably a debate that we may wish to have.

CHAIRMAN GREENSPAN. Before we go further, Governor Kelley, I failed to put down your position on the debt issue.

MR. KELLEY. I would leave the debt range unchanged for now, Mr. Chairman, but I would like to see us do some work--perhaps the staff could give us a paper--on the implications of changing it to a lower level for consideration at our February meeting. I think that would be very helpful.

CHAIRMAN GREENSPAN. I am sorry, President Jordan, I didn't get answers to questions on the ranges and 1996. As I understood you on 1996, it's the goals issue. You prefer not to do that but you do think we ought to think more seriously about it. Have I got that correct?

MR. JORDAN. Yes. The numbers are as Don indicated.

CHAIRMAN GREENSPAN. You would vote no on the specific Riegle request?

MR. JORDAN. That is right.

CHAIRMAN GREENSPAN. And on the ranges?

MR. JORDAN. I wouldn't change them and I don't see what is wrong with letting the journalists write stories about debt. If they want to write the stories about the governors having green peas for lunch on Thursdays and that is the key to monetary policy, I don't see the harm in that. They have to fill up the space anyway. So I don't see a problem.

CHAIRMAN GREENSPAN. So you would be inclined to lower the debt range.

MR. JORDAN. I really don't care about the debt aggregate.

MR. KELLEY. Who released that information on the governors' lunches? [Laughter]

MR. KOHN. It was a week after the lunch!

MS. MINEHAN. Or was it the week before!

CHAIRMAN GREENSPAN. Before we get to any formal vote, let me just see what it is that we should be voting on. It's pretty clear that there is a consensus to leave the M2 and M3 ranges unchanged. The other two issues are really interesting. There seems to be a marginal inclination to go to a lower debt range--most of the voting members favor that. The Riegle request gets turned down, but there is a general view that as best we can we should be more forthcoming. There is a sense in which Humphrey-Hawkins essentially sets the monetary aggregates as a signal that could be objectively evaluated by the Congress with respect to what it is we are doing. As the meaning of the aggregates falls away, there is an obligation on our part to give the Congress some objective criteria. I happen to think that the one requested by Senator Riegel is potentially mischief-making, and I am not sure that it serves our purpose to do this in the way in which it is requested. What I do think we ought to be saying more about is what our goals are, what we are looking for, and what our outlook is for 1995 and 1996 in a qualitative sense. I mean to draw the distinction between goals and forecasts. I would judge that our forecasts as a group do not clash violently with those of either the Administration or the CBO, as Governor Blinder indicated. Perhaps noting that in the Humphrey-Hawkins text without putting numbers down per se would enable us to associate ourselves with the forecasts and still talk about broader questions such as where we think the goals of the Committee should be without putting the specific numbers down. I hesitate to think what would happen, as Cathy Minehan said, to the interpretation of those forecasts.

So, leaving aside the actual formulation of this, the consensus of the Committee seems to be that we leave M2 and M3 alone, that we marginally are in favor of bringing down the debt aggregate range and hopefully we will not get as a consequence a "real" interest rates type of discussion. I suspect that there probably is not much risk in bringing down the debt range; I don't think it's a big deal. Look, if credit really starts to move, that might be an important signal for us to respond to. So, I am not sure that it is wrong, in and of itself, but it is what I will put up; we have to have separate votes on 1994 and 1995.

MR. KOHN. Mr. Chairman, I heard a marginal preference among those talking about debt aggregates for lowering the range for next year but leaving it unchanged for this year.

SEVERAL. Yes.

CHAIRMAN GREENSPAN. Yes, I didn't hear any discussion about the debt aggregate for 1994.

MR. KOHN. Okay.

CHAIRMAN GREENSPAN. Let me first formally put on the table for a recorded vote that we leave the ranges for M2 and M3 unchanged. Why don't you read that part of the directive for 1994.

MR. BERNARD. I am reading from page 26 in the Bluebook, or if you are looking at the draft directive version, it is at the bottom of page 2, line 46. The first general sentence, of course, stays the same. "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. In furtherance of these objectives, the Committee reaffirmed at this meeting the ranges it had established in February for growth of M2 and M3 of 1 to 5 percent and 0 to 4 percent respectively, measured from the fourth quarter of 1993 to the fourth quarter of 1994. The Committee anticipated that developments contributing to unusual velocity increases could persist during the year and that money growth within these ranges would be consistent with its broad policy objectives."

CHAIRMAN GREENSPAN. That's it.

MR. BERNARD. We need the debt sentence.

CHAIRMAN GREENSPAN. We haven't got there yet. In other words, we can vote on this and then we can vote on 1995.

MR. KOHN. Well, he needs to read the debt sentence for 1994.

MR. PARRY. Yes, the next sentence--

CHAIRMAN GREENSPAN. Okay. Read that sentence.

MR. BERNARD. "The monitoring range for growth of total domestic nonfinancial debt was maintained at 4 to 8 percent for the year."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	Yes
President Broaddus	Yes
President Forrestal	Yes
President Jordan	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Parry	Yes
Governor Phillips	Yes

CHAIRMAN GREENSPAN. Okay, the next vote that we need is for 1995 with the same ranges for M2 and M3 but a lower range for the debt aggregate.

MR. BERNARD. All right. "For 1995, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1994 to the fourth quarter of 1995, of 1 to 5 percent for M2 and 0 to 4 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 3 to 7 percent for 1995. The behavior of the monetary aggregates will continue to be evaluated in the light of progress toward price level stability, movements in their velocities, and developments in the economy and financial markets."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	Yes
President Broaddus	Yes
President Forrestal	Yes
President Jordan	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Parry	Yes
Governor Phillips	Yes

CHAIRMAN GREENSPAN. I don't think--do we need a vote on that Riegle request?

MR. KOHN. I don't think so.

CHAIRMAN GREENSPAN. I think I got the consensus for trying to embody many of the notions that Jerry Jordan, Al Broaddus, and Tom Melzer proposed, namely that we provide a general qualitative view of our goals and their distinction from forecasts in reference to policy and try to put it all in a language form that says less than it sounds. [Laughter] This is what we mean by "Fedspeak." You know, the trouble with a lot of this is that language does matter, and I think we have to be very explicit in our terminology and clearly distinguish between goals and policy because that is what the critical question really is here. I hope, putting aside these facetious remarks, to be clearer on this issue than we have been in the past.

MR. JORDAN. In fact, could I say one thing? I'll speak for myself, but I think it does reflect the mood of the Committee and the actions we have been taking since February. With regard to 1996, had we not been moving this year so far in the way that we have to establish our current policy stance, by late this year and 1995 inflation would probably be worse and inflation psychology would have been escalating sharply, necessitating a policy response of such a magnitude that it would have depressed output and raised unemployment in 1996.

CHAIRMAN GREENSPAN. You mean in discussing the forecast for 1996?

MR. JORDAN. Right, and characterizing 1996. The uncertainty about 1996 is the effectiveness of our actions in 1994. If we are successful in what we are doing in 1994, then we are going to have higher output and lower unemployment in 1996. And that is the difficulty in giving them a forecast of what 1996 is going to do.

CHAIRMAN GREENSPAN. I think we have been saying something not dissimilar to that without mentioning the year. Coffee is available and we will reconvene in 15 minutes.

[Coffee break]

MR. KOHN. Mike and I were just discussing this morning's _Washington Post_ and how I should adjust my presentation. Have you seen this morning's _Washington Post_?

CHAIRMAN GREENSPAN. I haven't read it yet.

MR. KOHN. I'll let Mr. Prell tell you himself.

MR. PRELL. No. [Laughter]

SPEAKER(?). Don't keep us in the dark.

MR. PRELL. The _Post_ article carried an excerpt from the 1987 transcripts in which I said something to the effect that, given the lags of policy, we either should tighten or should ease, but I didn't know which. [Laughter]

MR. KOHN. This was cited as evidence of confusion and uncertainty in Federal Reserve thinking!

CHAIRMAN GREENSPAN. Another interpretation is that we are basically saying that the status quo is unacceptable. [Laughter]

MR. PRELL. I have been trying so hard all these years not to get quoted in the press!

CHAIRMAN GREENSPAN. Mr. Kohn.

MR. KOHN. Well, I am sure I won't relieve any of the current uncertainty here and probably will add to it. [Statement--See Appendix.]

CHAIRMAN GREENSPAN. Questions for Don? If not, why don't I start off. I think it's fairly apparent that if we move today, the general view is going to be that we moved in order to support the dollar. I don't deny that monetary policy has a significant effect on our exchange rate, but I think it's important for us to review just why it does and what it means to alter the exchange rate from what the markets themselves are engendering. Ultimately, when we are dealing with a world currency that is held virtually in all corners of the globe, the world portfolio adjustment process is very difficult to understand at times. But what is fairly apparent is that we are dealing with balance sheet shifts that essentially move toward expected higher risk-adjusted rates of return. In this regard, we are looking not only at interest rates but at stock prices or any type of instrument denominated in dollars that has a rate of return relative to similar types of investments in other currencies. We like to look at the issue of current account imbalances and a variety of other elements in the flow area, but fundamentally, the exchange rate involves a balance sheet adjustment process. When we are dealing with a reserve currency, the propensity to hold it in a balance sheet sense generally tends to override where the exchange rate ultimately comes out. If we think in terms of the aggregate amount of dollars growing not only because of current account deficits and increased claims but more importantly because of a general grossing up in the Euro-currency market, we begin to lose sight of the flow effects. Much is involved in the search for increased rates of return, but basically that is what dominates the system.

The reason this is important is that if we get short-term changes in expectations with respect to how the rate of return is going to be altered, we need a very large change in interest rates or rates of return to offset that. For example, an expectation of a 10 basis point capital gain in a week on an instrument translates to an annual rate of 5 percent, or more actually. We have learned in this process that it is very difficult to employ interest rates to forestall changes in expected rates of return on a currency. The result usually has been somewhat disastrous. We have to be careful to recognize that if we employ monetary policy to offset normal market forces, there have to be offsetting adjustments in the rest of the system. If we are looking for a classic case of what type of adjustments occur, remember what happened after World War I when the British endeavored to restore the parity of sterling at its pre-war rate with very extraordinary effects on the structure of their economy. In today's environment, that sort of rigid adjustment is very rarely seen, but I think the principle is fundamentally the same. Any attempt by us to use monetary policy to offset exchange rate effects has very considerable secondary, usually negative, effects on markets. Now, one may argue on the other side of that argument--and I think quite correctly--that to the extent we affect our exchange rate favorably and bring inflation and inflation expectations down as a consequence, there are positive forces basically driving the system.

That leads me to conclude that the fundamental exchange rate policy really ought to be that the best support of the dollar is to keep domestic inflation down. Exchange rate volatility creates problems, but they are different from those that exist in stock and bond markets where the net position is long of necessity. If massive uncertainty hits a market in which the net position is net long, then disengagement, which is what uncertainty produces, of necessity creates selling and lower prices. But currency markets are a zero-sum game. If you want to argue that an uncertainty premium induces disengagement of the dollar vis-a-vis the yen, then the question is what about the yen vis-a-vis the dollar. You cannot have massive uncertainty. Remember, uncertainty is not a statement that something is going to happen; it's a statement that one doesn't know what is going to happen and is therefore pulling back. If we consider the case in which two people have gross uncertainty about long-term U.S. Treasury instruments, they both sell and the market goes down. If we have one person massively uncertain about the dollar/yen, and the other massively uncertain about the yen/dollar, and they both sell, what happens? So, there is a limit to the cumulative process within an exchange market that is different from what exists in standard positions where there is a net long position in the system.

At this stage, I am inclined to be very careful about making a particular point of our moving in to support the dollar unless it becomes crucially necessary because of increasing financial instability and indeed an end-point game. We are nowhere near that, as best I can judge. The exchange markets were quite weak today; the stock market is up; the last time I looked the 30-year bond was down 10/32. This is not the type of environment in which more than the exchange rate is involved. This is, I should say, an exchange rate problem. It is a different type of animal than a broad inflationary concern about the currency in which bond markets plummet, stock markets plummet, the exchange rate plummets and the situation is unambiguous. At that point, the central bank has no choice but to move in and try to squeeze out the inflationary bias in the system. At that point, I grant you, it is very late in the game and there is a considerable question that the effort would succeed, but I would judge that we are not anywhere near that stage. In sum, I would argue strenuously that we should avoid being perceived as using monetary policy solely for the purpose of addressing the exchange rate. Essentially, we have to look at monetary policy in this context as an anti-inflation issue.

This leads to the question of domestic policy and the extent to which we address this. In a somewhat unusual sense, the outlook is really intriguing. It's clear that the rate of economic growth is coming down. The question is, from where? As a convention, we use gross domestic product as our broad measure of the economy, largely because the data there are seemingly more accurate. But gross domestic income is conceptually identical. Yet if we look at the gross domestic income in the fourth quarter of last year and the first quarter of this year, we see that it differed from gross domestic product. For example, as you may recall, GDP growth was at a 7.0

percent rate in the fourth quarter of last year. Gross domestic income growth, which is conceptually equivalent, was 7.8 percent. In the first quarter, GDP was 3.4 percent and GDI was 4.0 percent. It's pretty obvious, looking at the employment and hours data in the second quarter, that the growth in GDI is quite likely again to exceed the growth in GDP when we get final data for the second quarter. This raises interesting questions as to what the economy is doing. Where are we? Our alternative to looking at GDP and accepting the payroll hours data is that productivity is falling in a rising economy. I know of no conceptual framework, other than a bizarre scenario, which would say that that makes any sense. But the question is, do we trust the manhour figures and the work hour figures. What we have is an establishment survey increase of about--was it 200,000, Mike?

MR. PRELL. Exactly right. [Laughter]

CHAIRMAN GREENSPAN. On the basis of the overall data that we get from the unemployment insurance system with a significant lag, we essentially are picking up what the BLS calls the "bias adjustment" in the small business sector. It's probably fairly accurate going back in history. However, there is this plugged bias adjustment which BLS puts in that is not small; I gather that it has a 125,000 rate of change for the second quarter. That is a monthly number and it's a significant part of the 200,000 to 300,000 figures that were published monthly. If it's wrong by a significant amount, the hours figures that we are using as the denominator for the productivity figures are wrong. So, the first problem I have with all of this is trying to figure out where we are. And the conclusions are, as best I can judge: (1) the economy is still moving ahead at a fairly good pace; (2) whatever that pace, which is important, it's slowing. We are seeing very little cumulative deterioration in the system. We still have inventories in terms of days' supply at very low levels, especially when we strip the markup out of the trade inventories and deal only with factory-value inventories. This makes the inventory/ sales ratio a lot more like the manufacturing series. When we juxtapose that type of series with the evidence that we are beginning to get some delayed deliveries, we are getting at least the early makings of what one would expect to see if inventories were turning around.

But, as Governor Blinder indicated yesterday, considering how statistically close we are to all these various capacity levels, why aren't inventories rising more? Why aren't we seeing far more anecdotal evidence of skilled labor shortages? Why are we not seeing more evidence of price movements in final goods? Given this type of environment, if I were an anecdotal chronicler, I would be looking for examples like those. I am not saying there aren't any; there are lots of them. But the fact is, given where we are, the inventory situation and the behavior of prices suggest that there is far more fuzziness out there as to where the capacity constraints are. We are all arguing that we are getting close to them, but the way to measure when we are close is not by the NAIRU statistics or industry operating rates but by the presumed effects of that phenomenon. At this point, we are still looking for the effects. As Don Kohn said yesterday, the employment cost index, which will be out on the 26th of this month is going to be a very interesting statistic to see, because it will be a very important test of the underlying costs structure that is evolving. But having said all that, where we are at this stage is consistent with, as Mike Prell might say, either going back down or going up!

MS. MINEHAN. Or going sideways!

CHAIRMAN GREENSPAN. I don't think we know how far the unwinding of the growth rate will go, leaving aside where we are starting from, which I think may be higher than the GDP figures are indicating. As a consequence, I would be inclined at this stage to stay with "B," largely because, unless we tighten by 300 basis points, I think the effect on the exchange rate would not be all that visible. Doing 25 or 50 basis points, I fear, would be viewed as an endeavor to hit the exchange rate. Once we have done it, the markets would swallow it and say, okay, what more do we get? The more tools we use without success, the greater the danger of getting a destabilized system. I would not have any domestic concerns at this stage about moving the rate up today because I suspect we will want to move at a later time. But I am very uncomfortable about the inevitable analogy to the exchange rate, because the order of magnitude is all wrong if it were against the exchange rate.

So I would like to stay at "B" unchanged, but I'd like to be asymmetric. The reason for that is twofold. One, I am by no means convinced that this unwinding process will continue all the way down. I think there is a reasonably good expectation, as we have seen in many business cycles, that we will get unwinding pauses and the economy will start back up again. We are going to learn a lot about the most recent past in data to be reported over the next 10 to 15 days. However, I am not sure what if anything in those data would significantly change our minds. The only thing it would do is that it would distance us from the issue of the exchange rate if we were to move, and I think that has very considerable value.

I have a suspicion that if we were to do nothing until the August meeting, we might possibly want to do 50 basis points in August if the economy starts to pick up. I am biased toward the up side because of the way I read what is going on, but more importantly because of the so-called "loss function" that we have discussed on policy. If we were to move higher in the next few months and we were wrong because our tightening was more than the economy could take, I think we could adjust and move back down. There would be costs, but I think they would be containable and reversible. So if we make a mistake by being too tight, I don't think the cost is all that significant. If we fail to act when we should and inflationary pressures take off, I think the cost of restoring our position would be much higher and conceivably irreversible. Merely dealing with that loss function and knowing nothing about the outlook, I think we have to be biased toward restraint, not only with respect to the probability that whatever actions we take over the next six weeks are more likely to be up than down. But I do think we have to maintain the notion in the marketplace that we stand ready to move if necessary, but not knee jerk to every type or set of pressures that the markets can create for us. I think we have to move in a deliberate way. Whatever one may say about the economy, the model now I think enables us not to have to accelerate our tightening moves, at least as far as I can judge the forces at work here. I don't know what will evolve in the next four to six weeks, but I would feel more comfortable if the minutes that we release six weeks from today--hopefully they won't get released before that inadvertently--will show that we were in fact asymmetric. President McTeer.

MR. MCTEER. Mr. Chairman, I agree with your wait-and-see recommendation. When we do act again, I think we shouldn't consider a 1/4 point change; it ought to be 1/2 point, but I think 1/2 point right now would be premature. We did get a stronger first quarter than we expected, and it looks as if we are going to get a good number for the second quarter, even in GDP terms. But that is in the past. We have seen some signs of deceleration in the last couple of months, and we don't have any idea how far that is going to go. I think seeing some numbers would be helpful here. I agree with you that a tightening now would be interpreted as a move in support of the dollar. I would be against that for two reasons: One is that it gives the impression that we are placing the dollar above domestic considerations, and I don't think we should do that; I also agree with you that because of domestic considerations we wouldn't be able to tighten enough to do the dollar much good. So, I think a show of confidence in the dollar by not acting is probably more helpful. It's even possible that we could get the reverse of the market reaction that we got in February. In February, I believe that when we tightened 1/4 point, a lot of market participants said things must be worse than we thought if the Fed is concerned. I think it's conceivable that doing nothing today would lead to some market confidence that things may be calmer than the market might have suspected. I am not sure of that, but I think a steady-as-you-go policy today might be good for the markets. So, I would agree with "B." Normally, I prefer symmetric to asymmetric, but in this case having the minutes reflect asymmetric at this stage would be helpful. And I think I'd be inclined to use this as an opportunity not to make an announcement.

CHAIRMAN GREENSPAN. Would you view not making an announcement as consistent with saying "the meeting is over, we have nothing to say" or did you want to just let it ride?

MR. MCTEER. For this meeting if we have done nothing, I think I'd just go back to not issuing a press release.

CHAIRMAN GREENSPAN. Don, why don't you comment on what the other side of that argument is just to--

MR. KOHN. Mr. Chairman, I was hoping, as President McTeer was suggesting, that we would be in the position by now of having established a regular announcing time.

SPEAKER(?). 2:15.

MR. KOHN. And if an announcement is not made by that time, it would be clear that no action had been taken. I think I'd ask Joan Lovett and maybe Joe Coyne to comment. Both of them have some concerns that not announcing would leave people on edge and guessing that something was going on, with a result that could be a bit disruptive. Joan.

MS. LOVETT. Yes, I think there is something to be said for letting the market know that the meeting has concluded. In terms of what announcements the market is looking for out of this Committee when there is no action, I have to say they haven't got a clue. They know that decisions on how to handle these announcements have not been made and they know the Committee hasn't addressed the issue, so most of them think that the Committee wants to maintain as much flexibility as it can until it has made a decision on that. For now, I think some of them are hoping there will be at least an announcement that the meeting is over, so they can go about their business. If we said that we have nothing to announce, that would be helpful.

CHAIRMAN GREENSPAN. Yes, but that is not to prejudge what we are going to do in the future.

MS. LOVETT. It's to buy time until the Committee has had a longer discussion on this. That is what they are thinking.

MR. BOEHNE. Mr. Chairman, there was a subcommittee that looked at this some months ago. Others on that Committee might want to chime in, but as I recall there was a fairly strong consensus after a number of discussions that we ought to announce only when we change policy. However, I think today is a very awkward day, and whatever we do today, we have to set the stage for a less awkward future. And while I subscribe to the basic notion endorsed by the subcommittee that we ought to announce only changes, it might be well today to indicate what the Committee's policy is and to say the Committee's policy is to announce only policy changes and then to say the meeting is concluded and we will have no announcement. I think that gets us through the situation of today but sets the stage for the future. When the announcement time passes and there is no announcement, it means there is no change. So, we have addressed the awkwardness of today and what we want to prevail as we go down the road.

CHAIRMAN GREENSPAN. There is an issue here, and at some point--it will not be this meeting and I'll try to discuss why at lunch--we have to be able to lay out what our new disclosure policy is going to be. At that point we will make it very explicit. This discussion is presupposing the substance of that meeting; I didn't mean to get into that. We may end up deciding to do something. I merely wanted Don to raise the issue largely for those who are commenting on this because I didn't think that question was answered appropriately. Bob, are you through?

MR. MCTEER. Yes.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN MCDONOUGH. Mr. Chairman, I agree that we definitely should not make a policy move today, because I think there is no doubt whatsoever that the move would be associated with an effort to strengthen the dollar. For reasons you have cited, I believe the only way to help a reserve currency is to manage domestic monetary policy appropriately by stabilizing and, in the longer term, bringing down the inflation rate. I believe that any move that would make sense for domestic policy, be it 25 or 50 basis points, would be deemed to be an effort to strengthen the dollar, which would fail. Therefore, it could well put us into the kind of market instability that would require a sharp increase in interest rates, something that would be completely inappropriate for the domestic economy. As I stated yesterday, I believe that the economy could conceivably be moving to a path that will bring us sustainable growth and a decreasing, or at worst for the short-run a stable, inflation rate. However, I think that all the risks to that forecast are on the high side, that is, that the economy will in fact be stronger than that. Since we are quite close to capacity as is indicated by virtually all of the statements yesterday, a stronger economy would almost certainly bring increased inflationary pressures. Therefore, it seems to me that we should have a definite bias toward tightening, which says that we should have an asymmetric directive. I think it's entirely possible, as the incoming data give us a better feel for what's actually happening, that we would in fact wish to make a tightening move before the next meeting. That tightening move could well be as much as 50 basis points. Therefore, I am very much in favor of alternative B with an asymmetric directive.

CHAIRMAN GREENSPAN. Let me just say that I forgot to mention that I would very much like to call on the Committee in a conference call if events are such that some significant action is required. I would prefer that, implicit in the asymmetric directive, we left open the possibility of a conference call if numbers or events are moving in a way that is significantly different from what I have interpreted as the Committee's general view. President Jordan.

MR. JORDAN. Thank you. I agree we shouldn't act on the basis of strictly international considerations because ultimately the foreign international market's purchasing power for currencies is going to reflect what we are doing domestically. I don't have a sense that within the marketplace today the problems we are seeing in the international markets are the result of concerns about future domestic purchasing power. If I thought the source of the dollar's weakness was the U.S. inflation problem, then I would feel differently. I would not want international developments to be a constraint if I thought a policy move was the right thing to do for domestic reasons, but right now I don't see that domestic reasons call for a move. And I agree that if we needed to move in support of the dollar, it would have to be a very, very large move.

The story that Bill McDonough told last night at the UK embassy dinner about the deflation in Japan is correct, important, and needs to be developed more fully. It's partly the curse of double-entry bookkeeping. They have a huge current account surplus, yet they have a large number of banks and institutional investors trying to repatriate capital. This creates problems that have a price effect. That is not going to go away, and I don't know where it's going to settle down. It's going to keep coming back over and over again. We need to try to get people to understand that the politics of Japan as well as a lot of forces at work in that country are going to result in a turning inward and a need for domestic investment,

CHAIRMAN GREENSPAN. Can I just ask for a clarification?

MR. JORDAN. Yes.

CHAIRMAN GREENSPAN. Does that affect the rate of change in the exchange rate or does it bring it to a different level? In other words, if there is net repatriation of say $150 billion a year, is that consistent with a continuous erosion of the dollar vis-a-vis the yen, or does it merely specify a level that it adjusts to and stays at until that leads to portfolio balance?

MR. TRUMAN. The portfolio balance model will tell you that if you try to repatriate funds and your currency appreciates, that is the way you reduce the foreign share in your portfolio.

CHAIRMAN GREENSPAN. But does the currency's appreciation consistently go up instead of--

MR. TRUMAN. The theory does not give an answer; it could be either one. It's one person's decision; they all add to one so we ought to treat everybody as one person. They can't as a group reduce their foreign assets because of constraints on flows; they have to leave those assets abroad. They may add to them, but they have to have their assets abroad.

MR. JORDAN. I don't think you can answer in part because you need to know more fully what is happening on the trade side. Japan as we know is one of these economies where the net value added is all labor inputs because they import everything else. So their imports of raw materials, energy, and all of that give you the price effect of a lower dollar. I find that a very difficult story to unwind, but I don't think it's going to end soon. I don't know if the yen will go to 90 or 80, but I think we need to articulate the story that this is not a problem of the United States nor a concern about our inflation and our other economic problems as much as this is about Japan.

Regarding our policies, I expect to see some bad CPI numbers during the second half of this year. I have no reason to disagree with the Greenbook on that. We talked about this before: If the staff is right that the CPI less food and energy is going to come out around 3 percent or so this year as the Greenbook specifies, we are going to run into several months with the CPI getting up in the range of 3-1/2 to 4 percent annual rate. And that being the case, there probably will be adverse market reactions to the superficial reporting of those numbers. If we are going to act at some time in the second half of this year, I would much prefer to see our actions coincide with adverse price developments rather than strong real numbers, whether it's employment or output or industrial production or anything else. It would take a couple of months of bad CPI numbers to make a case for saying we need to act to show our resolve to bring the inflation trend back down again. That says to me that before the August meeting, we are unlikely to have conditions that I would think would trigger such a move. So, I would be inclined to stay where we are at the moment. I would not be inclined to go asymmetric. I wouldn't dissent against asymmetric, but I'd prefer to stay symmetric with the expectation that we will reassess the economy in August and see how the price numbers develop.

As for the announcement, I think Ed's point is right. Had we previously set forth what our policies were, we might get away with no announcement at all if we had said that that was what we were going to do. But under the circumstances, I think we have no choice but to put something out this afternoon.

CHAIRMAN GREENSPAN. First Vice President Minehan.

MS. MINEHAN. On the matter of policy, I have been impressed that things keep coming in a bit stronger than expected. I realize we are beginning to see indications of some slowing, probably as a result of the actions that were taken earlier this year. Even so, I think the risks for the rest of the year, given the depreciation of the dollar and the improvement on the external side, are more on the up side than on the down side. So the question is when do we purchase insurance, if you will, against inflation. I would be inclined to go with your recommendation of not making a move this time, but I would expect the need to purchase some amount of insurance in terms of increased pressure on fed funds rates in August. You noted the possibility of a telephone conference during the intermeeting period. Just being new to this whole business, if we go with asymmetric, what does that really mean? Does that mean any amount of movement between now and the next meeting? I know symmetric means 25 basis points.

CHAIRMAN GREENSPAN. No.

MS. MINEHAN. It doesn't?

CHAIRMAN GREENSPAN. It doesn't mean that.

MS. MINEHAN. Okay.

CHAIRMAN GREENSPAN. We don't have a specific formulation. Asymmetry merely means a general sense of the Committee's disposition or the direction of our bias.

MS. MINEHAN. How long we should expect you to wait before making a change?

CHAIRMAN GREENSPAN. No, I have tried to articulate this and I have been much too specific, so I'll call on Don Kohn. [Laughter]

MR. KOHN. As I said in my briefing, the use of asymmetry in the past has been an expression of the Committee's disposition about how it would like to react to incoming data. If you think the risks are more on one side than on the other and if for example you would like to react to stronger data before you reacted to weaker data, asymmetry would send a signal to the Chairman that when the data come in a bit to the stronger side, or the data don't suggest a weakening that you would like, he should give serious consideration to a firming move, acting on behalf of the FOMC, or to having a conference call.

MS. MINEHAN. Fine--

MR. KOHN. It's sort of leaning to one side in reacting to incoming data.

CHAIRMAN GREENSPAN. Let me be very specific using Jerry Jordan's CPI as the model. Let us assume our normal expected CPI just for the sake of argument was .3 percent and we were asymmetric toward tightening. If the CPI came in at 0, we probably wouldn't move. If it came in at .6 percent, we would tighten.

MR. LINDSEY. Regardless of whether we were symmetric or asymmetric.

CHAIRMAN GREENSPAN. No, I'm just talking about asymmetric.

MS. MINEHAN. Does symmetric tie your hands?

CHAIRMAN GREENSPAN. Well, let me give another example: Say we expect a CPI of .2 percent, we are symmetric, and the CPI comes in at -.1 percent or alternatively at .5 percent. This is a strained example, but there is a different disposition depending on whether one takes a specific figure as being an aberration or a more fundamental change. In today's environment, if we saw strong data we would, at least in my judgment, be more inclined to take the strong data as representing generally what's going on because everything else looks that way. Whereas if I saw a specific number, let us assume home sales dropped 200,000 or something like that, I would say I don't believe it; that figure is wrong. It's that sort of thing.

VICE CHAIRMAN MCDONOUGH. Is that fully clear to you?

MS. MINEHAN. Yes, I am really clear on this. [Laughter] I am leaning toward the side of buying insurance on the up side, but I am a bit concerned about moving strongly one way or the other on any particular number. I think six-week intervals are enough time to look at things and see how they shape up. So, I guess I come out on the symmetric side. On the announcement side, I think we would be well off doing what President Boehne suggested.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, for all the reasons that you have suggested I support the recommendation for "B." Ordinarily, I prefer symmetric language, but in the current circumstances I think it's appropriate to indicate a bias on the up side, so asymmetric language is satisfactory to me. I think we have to make an announcement. I don't think we really have any choice on that. I think the precedent has been set now and it would be very difficult to avoid an announcement at this particular meeting. So I think something has to go out.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I agree with "B" for the reasons you indicated. However, I strongly, avidly am against asymmetry. My reasons are twofold. First of all, if we look at our four moves to date this year, the most efficient ones with regard to the move in the long rate relative to the move in the short rate were in May and in March, when we moved at a meeting. In fact, we had bond market rallies when we moved at a meeting. The next least efficient was in February, which was our first move, when we moved at a meeting. The most inefficient, the only one in which we actually had a bond market selloff, was in April on our surprise move--a surprise in the sense that it was not taken at an announced FOMC meeting. I don't think the market likes surprises; I think moving between meetings will buy us nothing; and it will cost us something on the long end of the market.

Second, the question comes up on what data we should move. I don't think we want to move on employment reports (a) for the reason Jerry Jordan mentioned and (b) for the reasons you gave. You commented on just how inefficient and unclear the employment report data are; they are lousy in this respect. We don't know how to interpret them and we should not move on their release. With regard to moving on a price number, I have to agree with Jerry Jordan's assessment that, even though I would tend to be very concerned, I would want to wait probably for two bad numbers before I drew any certain conclusions. For example, you stated in the past that the homeownership component could move suddenly and that would bias the number. I cannot imagine a single number that would cause me to want to move between meetings, given the inefficient results we have seen to date on our past four moves. The only reason given for doing it is--your phrase was--to maintain the notion in the marketplace. Well, in fact, the marketplace isn't going to know anything about it until after the next meeting was over. And given that, based on current expectations, we probably are going to move at the August meeting--and I agree with your analysis completely--I see absolutely nothing to be gained and quite a bit to be lost, by an intermeeting move.

CHAIRMAN GREENSPAN. Can I ask Don Kohn--I don't disagree with your evidence of the four moves--but what is the history of market responses to policy actions taken at or in-between meetings? Would you know offhand?

MR. KOHN. I don't know offhand.

CHAIRMAN GREENSPAN. My recollection is that the proposition you state generally is not necessarily true.

MR. LINDSEY. But has it--

CHAIRMAN GREENSPAN. It has been true this year, but that is four observations and you are enough of a statistician to know that you need five. [Laughter]

MR. KOHN. I think in the past, Mr. Chairman, a number of these intermeeting moves have been made after releases of data. The markets often tend to move ahead of us and then barely react when we move--say, when we were in the process of easing. But that evidence is not definitive, I would say.

CHAIRMAN GREENSPAN. President Broaddus.

MR. BROADDUS. This is a confusing period, Mr. Chairman. I thought you laid it out very well in your statement. And I guess I find it helpful in a situation like this to stand back sometimes from what's going on currently and refocus on our longer-term goals and objectives. We are on the record as aiming to gradually reduce the inflation rate and to try to minimize the cost of doing that by strengthening the credibility of that objective. We have made a lot of progress in reducing inflation in recent years, but it's pretty clear that that progress is at least slowing, maybe stalling, and that we are at some risk of losing ground. I would just briefly cite three things here.

First, the economy has grown at a much stronger pace over the last three quarters than we had anticipated earlier. As a result the unemployment rate is currently at the bottom of the range of estimates of the NAIRU, as we all know. Now, in that situation I am not at all sure that the actions we have taken to date are sufficient to get the sort of steady inflation picture and gradual deceleration in general economic activity that the Greenbook is projecting. So far we have raised the funds rate 1-1/4 points, and some outside commentators refer to that as a strong cumulative move. But I think the record shows that historically it's still pretty moderate. The second thing that worries me is that I think inflation expectations are stuck at too high a level and they may even be rising. The 30-year bond rate has risen two full percentage points from its low point back in October. Now, I know we don't fully understand what has caused this backup; probably real factors as well as inflationary factors are involved. But it's hard for me to believe that at least some of that is not signalling an increase in inflation expectations. And finally both the Greenbook and I think it's fair to say the great majority of private forecasters are telling us we need to raise short-term interest rates further just to maintain the current inflation picture.

In these circumstances, it seems reasonably clear to me that we need to make another fairly strong move toward restraint, and I guess I see no reason to wait. It seems to me sooner is better than later, and I think a good case can be made for increasing the funds rate 1/2 point this morning, quite apart from any particular focus on the dollar. My estimate would be that near-term expected inflation rates are somewhere between 3 and 3-1/2 percent. That would mean if we moved the nominal funds rate to 4-3/4 percent at this meeting, we would have moved the real funds rate from 0 to 1-1/2 percent currently. I don't think that presents an undue hazard to the economy at this juncture. On the contrary, it could save us a lot of grief later on. At a minimum, I think we should raise the rate 1/4 point today with the understanding that we would raise it promptly further if incoming information indicates a need to do that. I don't like 1/4 point increases generally, but I think that in the current situation such an increase would be better than none. I am still not sure I know what an asymmetric directive is, but I think I favor it in these circumstances.

As far as the announcement is concerned, I agree that we need to make some sort of announcement this morning. A little more generally, let me just say that on a couple of occasions this year in addition to saying what we have done, we have had some additional language in these announcements. Since those kinds of statements also can affect expectations and perceptions of policy and presumably longer-term interest rates as well, I think it would be good to do it a little more systematically if we are going to do that in the future. Perhaps we could have some alternative announcement language in the Bluebook ahead of meetings along the lines of the current inclusion of alternative directive language. But we can address that later.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, as I look at the domestic economy alone, I have a slightly different view than you do in the sense that, as I said yesterday, I think there is more symmetry there than asymmetry. That is to say, in my mind the risks are probably fairly evenly balanced. It's pretty clear from the evidence and from the discussion we have had around the table in the last day and a half that the expansion is moderating, and I think the big question is whether it is going to continue to moderate to a sustainable level, whether it is going to get down closer to potential. This is not to deny in any sense that there may not be some inflationary pressures that are building.

So, I think the best course for monetary policy at the moment is to pause and see what effect our actions totaling 125 basis points have had on the economy. I don't think waiting until August 16 presents any particular problem. To me it's very, very clear, as you have indicated, that any move today would be interpreted by the market as intended to support the dollar, and I think that would be a mistake for reasons that have been articulated by several people. It's also important to remember that the basic problem with the dollar is not widespread but really with the yen and to a lesser extent with the deutschemark. Therefore, the inflationary effects will be minimal, at least in the short term. I think there is one risk or one problem that may emerge from no action in that it may reinforce the impression held in some quarters that the United States really wants a lower dollar and we are following a policy of benign neglect. But I don't think there is a thing in the world we can do about that except perhaps urge the Treasury to keep saying things to the contrary.

That leaves me, Mr. Chairman, with a view that we should adopt alternative B. My preference would have been for symmetry because of my view of the economy. However, if we are going to err, I would prefer to err on the up side, and therefore I can support an asymmetric directive. I also think that we need to make an announcement today, but we face a dilemma in that we have not yet dealt with this policy announcement question. It would be very helpful to get that settled soon and inform the market.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I would support alternative B because I think the extent and duration of the moderating growth are uncertain at this point. I do think, though, that we may receive information in the next several weeks that will indicate more clearly whether this moderating is going to continue, or if we are going to follow a path that is more closely aligned with that of the Greenbook.

From my viewpoint if there ever was a good time for asymmetry, this is it. I also feel that having a conference call perhaps toward the end of the month is a good idea. It would give us an opportunity to review some of the statistics that are coming out, but in addition it would be an opportunity for you to share with us some of your own views about the testimony, which will have been completed as well.

CHAIRMAN GREENSPAN. I forgot about that; that is an important point. It might be useful, irrespective of what is going on, just to have a telephone conference after Humphrey-Hawkins.

MR. PARRY. Right. As far as an announcement is concerned, I think one is probably necessary following this meeting. It seems to me that to announce the fact that the meeting is over is subtle enough that I am sure markets could deal with that!

Finally, unless I am missing something, the discussion about waiting until a bad CPI number comes out is one I am very troubled by. It seems to me that we spent the last six months telling people that we can't wait for bad inflation news before we act, that it takes 12 to 18 months for policy to have an impact on inflation. The tactic of waiting until a bad number comes out, for whatever purpose, is just an incorrect approach. In fact, such a number probably would be one I would want to react to least. Thank you.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I have a lot of sympathy for the views Al Broaddus expressed earlier. In terms of reasons to act, the dollar is not a reason to act. I think there is information in the behavior of the dollar. I accept what Jerry and others have said about the dollar/yen, but I think there is a depreciation going on more broadly on a trade-weighted basis. Basically, markets are going to set those levels, and we certainly are not going to set them through intervention nor for that matter in the short run through policy actions. In the long run, as you said earlier, Mr. Chairman, our policy actions matter a lot. Secondly, I agree with what Bob Parry just said: Incoming data are not a reason to act now, particularly real data, but even price data. I think the reason to act is to keep inflation and inflation expectations from rising and ultimately to make further progress toward price stability than we have managed to accomplish so far. What I have been looking at for some time, and I mentioned this before, is that we have a very large monetary stimulus put in train over the last three years that we have to offset. Really, all we have done in our own words is to get back to a neutral policy. I continue to think that markets are sitting there looking at what we have said, looking at what we are doing, and saying that 3 percent or higher inflation is okay with the FOMC. From their point of view, if they think they have figured it out, it's okay with them too; they will just go with the flow. But I don't think in the long run it's okay for the country. So as far as I am concerned the sooner we change that perception the better off we will be.

Where I come out is that I would move at least as aggressively as we did last time. I'd move the funds rate up 50 basis points, and I would couple that with an increase in the discount rate of 50, maybe even 75, basis points. I would use the discount rate announcement to make it clear that we are acting because of concerns about domestic inflation and by implication not to defend the dollar. I might just say--now obviously I am interpreting events differently than others, so please take that into account--that from my perspective, not to do something that is fundamentally called for because of a concern about the perceptions about it is not a good reason not to do it. We ought to do what's right and we ought to explain why we did it.

To conclude, as I assess things and look at the risk-reward tradeoff, I think there is little risk of somehow derailing this expansion. There is a lot of momentum out there and I don't think 50 basis points is going to derail it. As I said before, the incoming month-to-month data on the real economy are not important to me at this juncture, although obviously they are over longer periods of time. I think if we did move, it might allow us to get ahead of this inflation process. Now, we could well have some development over the next week or two that even in the short run would make our job a great deal tougher than if we act right now, which I think is a risk associated with waiting.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I favor staying where we are today both for international as well as domestic reasons. I agree with your observations that we would have to have a very large bullet to be credible in terms of the dollar, and I don't think we ought to use that today; it's much wiser to keep our powder dry and wait for a more demanding day. Hopefully, that won't come, but I think that is what we ought to do. On the domestic economy, we are moving from a higher growth path to a lower growth path. And I think we need to have a better sense of the magnitude of that adjustment and where we are likely to end up before we make an additional move.

On the symmetry/asymmetry issue, the vaguer that concept the more comfortable I am with it. The more we try to define it and get specific the more uncomfortable I become. So, this notion of indicating a kind of disposition in a vague sense is fine. I think, however, that all too frequently in the past asymmetry has allowed us to key monetary policy on a particular statistic. We have had a run on employment numbers, for example, over various periods. The markets would anticipate that first Friday of the month, and they would move because they were trying to guess how we would move. That is not the kind of situation that we want to get ourselves into. I think we should react to a total evaluation of how we see the economy rather than a particular number on a particular day. So, as I hear definitions of symmetry and asymmetry that lead us more toward reacting to specific statistics, the less enthusiastic I am about it. However, if I were voting today, I could vote for either symmetry or asymmetry.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I came to the meeting in favor of alternative B with a bias toward tightening. I think you made a very strong case for that choice, and I certainly support that. Even so, I would slightly favor symmetric language, not because I think an asymmetric policy is an inappropriate stance--I think our next move is likely to be toward tightening--but because I just am not sure what asymmetric language really buys for us. On the other side of that coin, we have had some bad experiences, it seems to me, with asymmetric language. May of last year comes to mind in that context. So, as long as we have a good sense as to what we want to do with policy, I think that is all we really need to operate. Therefore, I prefer symmetric language, but I don't feel that strongly about it. In terms of the announcement, it is a bit of a dilemma, but the choice that Ed Boehne suggests seems to be a good way of dealing with that particular problem.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. I support your suggestion, Mr. Chairman, with "B" asymmetric. As far as an announcement goes, I like Ed Boehne's suggestion also. I would like to add that I don't think it's desirable that we tie ourselves into knots here trying to define asymmetry. It's not necessary for us to achieve precision there. To me, it's just a broad indication of a bias, or a leaning, or a concern, or whatever qualitative word you want to use, and that is quite adequate and quite useful to have available. I am comfortable to leave it at that.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. For the moment I am pretty comfortable with where we are as well as with the way I see things unfolding. So I would favor alternative B with a symmetric directive, which is my usual preference. Having said that, I do think we need to be careful here, though that is hardly new for monetary policy. There has been a lot of talk--Al Broaddus touched on this--to the effect that we have moved quite a bit and we have moved early and so on and so forth, but my reading of the historical record suggests that this is neither a large move nor a particularly early move. Now, other things are different, of course, that have to do with the economy--the stance of fiscal policy, and other things that we can enumerate. But I think we ought not to believe some of the rhetoric that is out there about the way policy has acted so far. We probably have not behaved as atypically as at least some commentators have suggested, and that suggests to me that over time we may well have considerably more to do.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Mr. Chairman, I would point out that even our more pessimistic projections suggest that the economy is continuing to build some inflationary pressures and that they will occur through the end of the year. And so I think there is a need to move. It's not a matter of whether but when. I agree with you in the sense that I think doing so now would get things confused as to why we are doing it in terms of the international market. The law of unintended consequences might take over and we could have some further problems from that. With that in mind I would be inclined to take the "B" alternative with asymmetry toward tightening, and would look for an opportunity to do more. I have no problem about doing so in the intermeeting period if we have the opportunity. As far as announcing, I'd say we are down that track, and we need to announce. I think the announcement should be very brief and it should say at most that no action was taken.

CHAIRMAN GREENSPAN. Governor Blinder.

MR. BLINDER. I think that alternative B, which is to do nothing right now, is the prudent course. When you are into the game of fine-tuning, which we are forced into once we get this close to capacity, there is always a danger of oversteering. I think we should be mindful of that. I see the risks, as I think Bob Forrestal and Ed Boehne said, as fairly balanced, and we need to know a little more about how much of a slower gear this economy is going into right now. Since the last FOMC meeting, interest rates are up a tad; money growth rates are down; reserves have now been falling for three months or so; and the economy is giving off a feeling of a slowdown. It's also the case that fiscal policy, which hasn't been mentioned, was moving into its maximum contractionary phase in the first half of 1994, and it too works with a lag, although not quite as long a lag as monetary policy.

Even though I think the risks are quite balanced now, I believe it would be useful to go asymmetric in order to cock the gun, so to speak. The asymmetry now says, I think, that we view it as extremely unlikely that we went too far in doing 125 basis points; that it's modestly likely that we have to go further; but combined with not doing anything now, that we are now in a waiting mode to get more information about the economy, because we are not quite sure. It leaves open the possibility that the 125 basis points were enough, but it expresses the view that there is some considerable likelihood that more will be necessary. I don't think--picking up on some of the other threads of conversation--that this decision should be triggered literally on any one number, be it CPI, employment, or anything.

The other thing I wanted to say is this: It was mentioned that the markets will not know tomorrow whether we went asymmetric or not, which is true. But we are in this game for a lot more than next week. Roughly 45 days from today the decision will be made public, and I think this asymmetric directive, if we adopt it, will feel right in terms of the broader strategy that was started in February. It will give the impression that the Fed had a general long-run strategy, was pursuing that long-run strategy, and was ready to act if necessary. Now, it might in fact be that we do act in August or at the following meeting, or it might be that we don't. But I think the asymmetric directive is the right message to give 45 days from now rather than now.

With regard to the announcement, I certainly strongly join what seems to be the consensus that we really have no choice but to make some kind of announcement. Here I agree, I think, more with Al Broaddus and Tom Melzer that saying something about what we are up to is, generally speaking, a good thing. Now, we probably don't want to try to draft something around the table, so if we want to make an extremely terse announcement now that says we didn't change the pressure on reserves or something like that, I wouldn't oppose that. But thinking a little longer run about operating procedures, I think the release of a few sentences pertaining to the policy decision would not be a bad thing after each FOMC meeting and probably would be a good thing.

CHAIRMAN GREENSPAN. Larry, what was your view on the announcement?

MR. LINDSEY. I think we have to make a terse announcement.

CHAIRMAN GREENSPAN. Okay. Governor Phillips.

MS. PHILLIPS. Well, based on what we know now, I think that we will have to tighten more at some point. I really don't see the case now for 1/4 point moves, so when we do move I think it should be 1/2 point. I don't think our moves should be prompted by foreign exchange situations, against the yen specifically. I can go along with a pause for now, which would be the "B" alternative. I am becoming increasingly skeptical of asymmetric directives, I guess partially because it seems the definition always changes as to what asymmetry is, depending on the circumstances. So, I worry a bit that we are injecting more uncertainty into the market by leaving open the possibility of moves. Having said that, I do think it's becoming increasingly clear that we will have to move on the tightening side. So, while I prefer symmetry, I probably would not vote against asymmetry. I think that a short announcement at this point would be appropriate. I would like to get to the final decision on what our policy is on announcements because I think it is probably appropriate that we adopt this approach of using a few sentences. But since we have not established a policy at this point, I'd go with a terse announcement just to get us past this period.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Alan, I forgot to comment on the announcement. I agree with announcing something. I guess I am wondering whether, if we just had Joe Coyne, as spokesperson for the Fed, contact the wire services and say that the meeting was concluded and that no actions were taken, that might give us a little more room in terms of setting a precedent. If you actually make an announcement--

CHAIRMAN GREENSPAN. I think that's basically what we will do.

SPEAKER(?). That is what we have been doing.

CHAIRMAN GREENSPAN. It would be Joe.

MR. MELZER. Well, no, it actually has been a statement by the Chairman in the earlier--

CHAIRMAN GREENSPAN. I think what I have suggested for today, although I have not been explicit, is that Joe would do it.

MR. MELZER. As spokesperson for the Fed or whatever.

CHAIRMAN GREENSPAN. In the past when we have had meetings he said the meeting was still going on or the meeting was about to be over, or something like that. He has done that in the past.

MR. MELZER. I just didn't think it would be a good idea to have a statement in your name on this.

CHAIRMAN GREENSPAN. Yes, I agree with that. There seems to be general unanimity on the announcement issue; we will work something out. There also was a fairly broad consensus for "B" and a modest majority for asymmetry. So, why don't we formulate that in the text.

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 would or slightly lesser reserve restraint might be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with modest growth in M2 and M3 over coming months."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman McDonough	Yes
Governor Blinder	Yes

President Broaddus	No
President Forrestal	Yes
President Jordan	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	No*
President Parry	Yes
Governor Phillips	Yes

CHAIRMAN GREENSPAN. The next meeting is on August 16 and lunch is now served.

END OF MEETING

*Secretary's note: At the end of this meeting, Mr. Lindsey indicated to Chairman Greenspan that his dissent on the operational paragraph was based on a possible misunderstanding of the implications of the bias in the directive. His dissent was from a directive that he perceived as calling for a more or less automatic tightening of policy during the intermeeting period. On the understanding that any tightening during the intermeeting period would depend on further indications of inflationary developments, Mr. Lindsey requested that his vote be recorded in the minutes as in favor of this policy action. Chairman Greenspan agreed that his request was appropriate.