

Meeting of the Federal Open Market Committee  
June 30-July 1, 1992

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, June 30, 1992, at 2:30 p.m. and was continued on Wednesday, July 1, 1992, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman  
Mr. Corrigan, Vice Chairman  
Mr. Angell  
Mr. Hoenig  
Mr. Jordan  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. Melzer  
Mr. Mullins  
Ms. Phillips  
Mr. Syron

Messrs. Boehne, Keehn, McTeer, and Stern, Alternate Members of the Federal Open Market Committee

Messrs. Black, Forrestal, and Parry, Presidents of the Federal Reserve Banks of Richmond, Atlanta, and San Francisco, respectively

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

Messrs. J. Davis, R. Davis, T. Davis, Lindsey, Siegman, and Stockton, Associate Economists

Mr. McDonough, Manager for Foreign Operations, System Open Market Account

Mr. Slifman, Associate Director, Division of Research and Statistics, Board of Governors  
Mr. Hooper, Assistant Director, Division of International Finance, Board of Governors  
Mr. Rosine,<sup>1</sup> Senior Economist, Division of Research and Statistics, Board of Governors  
Mr. Clouse,<sup>1</sup> Economist, Division of Monetary Affairs, Board of Governors  
Ms. Low, Open Market Secretariat Assistant, Division of Monetary Affairs, Board of Governors

Messrs. Beebe, Broaddus, Lang, Ms. Lovett, Messrs. Rolnick, Rosenblum, Scheld, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Banks of San Francisco, Richmond, Philadelphia, New York, Minneapolis, Dallas, Chicago, and Atlanta, respectively

Mr. McNees, Vice President, Federal Reserve Bank of Boston  
Mr. Belongia, Assistant Vice President, Federal Reserve Bank of St. Louis

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

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1. Attended portion of meeting relating to the Committee's discussion of the economic outlook and its longer-run objectives for monetary and debt aggregates.

Transcript of Federal Open Market Committee Meeting of  
June 30-July 1, 1992

June 30--Afternoon Session

CHAIRMAN GREENSPAN. Let's start with foreign currency operations. Mr. McDonough.

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

CHAIRMAN GREENSPAN. Any questions for Mr. McDonough?

MR. LINDSEY. I'm always struck by the purchasing power parity basis. Further weakness in the dollar just doesn't seem justified. Has that theory of exchange rates been routed or are we neglecting it? Why isn't that showing through in the markets?

MR. MCDONOUGH. I think it's not routed completely, but it's certainly less important now because of essentially speculative capital flows based on interest rate differentials and views of stock markets. As I mentioned, I think what is hurting the dollar at the present time is the interest rate differential, which is clearly against us, and a view that Wall Street may not be as attractive [as previously]. People are reading about the flows into equity mutual funds slowing down and so on. The capital flow, which was really the source of strength in the dollar, is slowing down; and that is giving us the weakness even though there's no question on a purchasing parity basis that the dollar is far, far weaker than it should be.

MR. TRUMAN. It may be, Governor Lindsey, that one of the reasons is that the conventional measures of purchasing power parity for the DM and the yen are so far from where [exchange] rates have been for so long--2.10 for DM, 190 for the yen--that they've lost their credibility as a benchmark even for such considerations. Still, we can imagine [tolerating]--if you want to put it that way--exchange rates at that level, and the associated current account deficits that go along with that. Now, that's one man's reaction to your question. I have been struck by the work that McKinnon has done at Stanford on this. Two or more years ago there was some suggestion that we could get back [to PPP] and, therefore, there was a lot of attention given to that issue. But with the dollar essentially [disconnected from any anchor] on a purchasing power parity [basis] for such a long period of time, it has lost its [relevance] and we should not use the word "anchor."

MR. MELZER. Bill, you mentioned the market's expectations with respect to what might come out in Munich in terms of multilateral intervention. Is there validity to that? Is that an expectation that has some substance behind it?

MR. MCDONOUGH. From what we hear, the Europeans don't have any interest in any multilateral foreign exchange activity. And I haven't heard anything from the Treasury as to their planning to [undertake such operations]. But the market is quite convinced that there is going to be at least a U.S./Japanese accord, which the Europeans will probably bless but not participate in.

MR. TRUMAN. The Europeans are somewhat divided. The French I think will go along with anything, but the rest of the Europeans will not. My sense from my own conversations with Treasury staff, unless their views have changed in the last several days, is that they are not thinking of a deal, but one can never be quite sure when one is dealing with the United States Treasury.

MR. MCTEER. Under the circumstances in Japan, I'm not sure I understand why they would want a stronger yen. I know it would damp inflationary pressures but it would also work against the real sector.

MR. McDONOUGH. I believe there are two factions, but they wind up in the same place coming from different directions. The Ministry of Finance thinks that it will be very convenient for them politically in the bilateral relationship with the United States to have a stronger yen. The Bank of Japan seems to have a very firm view that a stronger yen encourages capital flows into the stock market, and they would very much like a stronger stock market because of, among other things, the positive effect it would have on the tier-two capital ratios of the Japanese banks.

MR. MCTEER. I always thought that a strong currency didn't encourage inflows but that the prospects of a stronger currency later did.

MR. McDONOUGH. I think what you say is accurate, but what I've described is the position of the Bank of Japan, I'm quite convinced. They need not necessarily be right.

CHAIRMAN GREENSPAN. That's not contradictory. If you are the Bank of Japan and the yen is strong, the presumption is that the probability of [the yen] getting stronger is higher than the probability of it getting weaker. So, it's essentially the same issue; at least that's what they're saying.

VICE CHAIRMAN CORRIGAN. Well, it's especially true in stock markets. I was speaking to [unintelligible], which is what they're hoping for.

MR. JORDAN. That logic has a chicken and egg problem if the idea is that you want a stronger currency to help asset prices, but what is going on in that market [relates to] this purchasing power parity in tradable goods, neglecting asset prices. The dominant factor is what is going on in that system--weakness in real estate and equity and other asset prices--and the idea that they can do something with the exchange rate to turn around asset prices doesn't wash.

CHAIRMAN GREENSPAN. Further questions? If not, let's go to the report from the Domestic Desk. Joan Lovett.

MS. LOVETT. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Ms. Lovett?

MR. JORDAN. I was monitoring the "Call" this period and was struck by a couple of things. There were at least two occasions when the projection was for a need to add reserves but the funds rate was

trading down toward 3-5/8 percent. So, even though the projection would have called for adding reserves, at least tentatively the program was to drain reserves in order to avoid giving a false message to the markets as to our intentions. And then there seemed to be some gaming going on in the Street by some banks that were bidding up the funds rate just at the "Call" time. Whatever it was they were looking at, they were thinking "Uh oh!" and trying to keep us from doing what we otherwise would have done.

MS. LOVETT. Even though they didn't want to have to do that!

MR. JORDAN. What is your reaction to that kind of heuristic action-reaction? We would have wound up doing something in reserve supplying operations that really wasn't consistent with what we wanted to do because of this perception. And then they would have a perception on the other side regarding what we might do and try to game it in order to prevent us from doing it.

MS. LOVETT. It's one of the foibles of having a federal funds rate objective that gets narrower and narrower. That did happen on a couple of occasions and we didn't want to have to drain the reserves if we could avoid it. So, the fact that the perception out there was that at certain rate levels and at certain times we didn't have a tolerance [for actions] that would cause people to bid the rate up is part of what one has to call the "market dynamics."

MR. JORDAN. You could now be in [a similar] position in the opposite direction. With the funds rate at 3-7/8 percent if you saw a need to drain, [you would] feel compelled to add reserves--to do something that is not really consistent with supplying reserves--in order to avoid giving a wrong signal.

MS. LOVETT. Well, we have a little more flexibility on one side of the rate depending on the state of market expectations. There isn't anyone out there who expects that the Committee is going to be firming policy, so there's more tolerance for a funds rate that deviates to the high side of the expected level than there would be for a funds rate that deviates to the low side. So, actually, we have throughout this period felt somewhat more comfortable with having our operations be a little loose on the up side--that is, letting funds trade at higher levels without necessarily going in and offsetting it. Whereas on the low side we wouldn't feel as comfortable because if there were any direction to policy in this period, that's the way the market thinking has been.

MR. JORDAN. That asymmetry, though, is due to market perceptions that we are conditioned by real magnitudes; they think we're responding to things we can't control anyway. But the follow-up question is this: Over this last week the market tried to [interpret] that failure to cut the funds rate, in a reserve supplying sense, as a relative tightening of policy. From the Desk perspective, would you view it as tighter?

MS. LOVETT. The market has built in a good amount of the 25 basis points.

MR. JORDAN. So, maintaining the funds rate is more restrictive than lowering the funds rate given where the Street [thinking] is?

MS. LOVETT. In fed funds terms, the market--

MR. JORDAN. Well, [I mean] in terms of reserves. We have to supply less or drain more in order to maintain the same funds rate, given where the yield curve is.

MS. LOVETT. No, I don't think so.

MR. KOHN. I'm not sure about that because the amount of reserves is very small. I agree with Joan's earlier implicit assessment that if the Committee does not ease at this meeting, particularly if the employment data were on the soft side, short-term rates would back up a little. The market has built in a Fed reaction to the incoming data. I think that's equivalent to what you're saying.

MR. JORDAN. Not quite because I don't really interpret tightening in terms of where the funds rate is. I really don't care [about that].

MS. LOVETT. But the market does.

MR. JORDAN. I do care about reserve operations. If the yield curve is under downward pressure, wouldn't you drain more reserves or supply fewer reserves than you would have otherwise in order to support the same funds rate [objective]? In this recent period when the funds rate was trending down you were saying you saw a need to ease but you actually were going to have to drain reserves to maintain the same funds rate.

MS. LOVETT. We may have to drain.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. We have seen some improvement at the long end, with rates coming down. I was going to ask you--this may be unfair--to look at what has occurred since the last meeting, not on a day-to-day basis but rather on a week-to-week basis. We now have a long bond rate just a tad above 7-3/4 percent. How much of that is consistent with the fairly steady pattern we're seeing of, if not softness, a lack of firmness in the real sector and then a building in of further ease in the market? Again, it comes down to the question of expectations. What I'm asking, and I'll try to be more direct about it, is: Do you view the improvement that we've seen in the long end fitting in with the market's expectation of what we might do?

MS. LOVETT. You're right that there has been a better tone underlying the long end of the market. And the barrier, which seemed to be 8 percent for the longest period of time, now seems to be 7-3/4 percent. The long rate doesn't seem to be able to get through that barrier; it has been at about the 7.80 percent level, which is where it was at the time of the last meeting also. So, there hasn't been too much net change over the full intermeeting period, even with the decline--

MR. SYRON. I thought it went up after the [ previous directive] came out indicating symmetric language and then--

MS. LOVETT. Yes, and then it came back down.

MR. SYRON. It came back down as the data weakened. It depends on where--

MS. LOVETT. It's hard to say. The fact that the recovery doesn't look robust certainly has been a factor in any improvement in the long end of the market. But in discussing what the long end will do [in response to] Fed policy, it usually turns on whether or not the long rate is going to back up, not so much whether there's a chance for sustained improvement. Most people in the market don't [consider it likely] that there is room for a sustained improvement in the long end for quite a while. There's at least a sense that people have to wait to see whether or not this improvement in prices is sustained, and there's a lot of skepticism about that. Some people don't think the progress has been all that it should have been. And then we have these deficits. The market also frequently makes reference to the global demands for capital. Finally, our own statements may not be adequate, and there are all these political uncertainties. So, people don't seem to have a lot of high hopes for the long end of the market doing a lot better. It's really a question of [rates] moving back up if the Fed were to ease.

MR. SYRON. I don't know what caused [a move of] 10 basis points one way or the other but it was interesting to me that on reports of symmetric [language in the directive] the market backed up.

MS. LOVETT. Right.

MR. SYRON. And then they saw, if not a softening, a lack of firmness in the economy--not an enormous amount but a measurable amount.

MS. LOVETT. Right, and I do think the fact that the recovery doesn't look like it's rolling ahead has been a help for the long end.

CHAIRMAN GREENSPAN. Any further questions? If not, would somebody like to move the ratification of the transactions since the last meeting?

VICE CHAIRMAN CORRIGAN. Move it.

CHAIRMAN GREENSPAN. Without objection. We now move to the Chart Show: Messrs. Prell, Stockton, and Truman.

MR. PRELL. Thank you, Mr. Chairman. We'll be referring to the set of charts that you all have before you labeled "Material for Staff Presentation to the Federal Open Market Committee."

MESSRS. PRELL, STOCKTON, and TRUMAN. [Statements--see Appendix.]

CHAIRMAN GREENSPAN. Thank you very much, gentlemen. Questions from any of the Committee members? Vice Chairman Corrigan.

VICE CHAIRMAN CORRIGAN. What is the potential growth rate implied in Chart 17?

MR. STOCKTON. Basically 2 percent throughout the forecast horizon and 2.1 percent as time goes on. Obviously, beyond the next three years what potential output will be is certainly open to much wider question. But the evidence in the last few years at least makes us reasonably comfortable with something in the 2 percent range.

CHAIRMAN GREENSPAN. What is your labor force participation rate projection?

MR. STOCKTON. It would go up a few tenths over the period.

MR. PRELL. This potential output assumption is basically what we communicated in that report on potential output, with the adjustment that was needed because of the change in the 1987 base year for the output measures.

VICE CHAIRMAN CORRIGAN. So, essentially, what is built in here is a modest further increase in the labor force participation rate. Even allowing for that and taking the potential growth rate at 2 percent, what I find really surprising--bordering I guess on unbelievable--is that if you look at case 2 versus case 3, the cumulative difference in the real GDP growth rate is always 0.6 of a percent over the whole period. And the absolute difference, of course, in the unemployment rate at the end of the period is only 0.5 percent. That strikes me a little as magic.

MR. STOCKTON. Well, part of the problem is that in the price stability case there is a timing difficulty. It has to do with the lag [in] Okun's law relationship that relates real GDP to unemployment. In the stable inflation case, you can see we're easing up growth a lot at the very end of the simulation in order to try to limit the potential overshooting. In effect, if you carry out the price stability simulation a little further, the unemployment rate is going to be down to about the natural rate within a year from the end of that simulation. So, that limits the discrepancy around 1997. The simulations use the identical Okun's law relationship so that there isn't any structural difference in those two simulations. But there is in the quarterly model, with relatively long lags elsewhere for the unemployment [rate].

CHAIRMAN GREENSPAN. Further questions?

MR. PARRY. You talked a bit about the effect on inflationary expectations of our goals with regard to inflation. I wondered if you had done some work or had a judgment about what some of the possible advantages might be of our being more explicit about our goals and how that might affect inflationary expectations and therefore the actual tradeoff between growth and inflation that results from pursuing those objectives.

MR. STOCKTON. I certainly don't have any particularly wisdom to add on that point. We did a similar exercise a couple of years ago for the Committee and we talked a great deal about the role that credibility might play. I guess one could look at this current episode and, given the output losses we have already incurred to

achieve the disinflation that we have, feel that it's difficult to see in that any credibility effects so far. The costs seem pretty much [as expected]. If there were a dramatic break in the regime--in the way in which monetary policy was made--one certainly couldn't rule it out. And one cannot rule out the fact that credibility even in financial markets and among wage and price setters may not come as smoothly as the models suggest. It could very well be that at some point in the next year and a half or two years there will be a significant break in inflation expectations. But I suspect that the effects on output costs and disinflation will have more to do with your actions rather than your pronouncements.

CHAIRMAN GREENSPAN. We in the past have had various studies suggesting that there was an inverse correlation between the degree of price stability and productivity. I assume that that's not embodied in here; that [takes] a much longer time. So, to that extent one might presume that there is some underestimation of the real gross domestic product here at the lower price expectations levels.

MR. STOCKTON. That's correct, Mr. Chairman. We've made no adjustments here in terms of our expectations for future potential output or the effect of price stability itself. Our research suggests that to the extent that correlation is there, it occurs at very long time intervals, probably perceptibly beyond the time interval that we're considering here.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. What would be the impact of following case 2 versus case 3 on the saving rate and thereby the investment rate over that period?

MR. STOCKTON. Well, the feedback from that to actual potential output would probably be very minimal within the time frame that we have here. It's certainly the case that in the price stability example the short-run effects of pursuing that policy, which would require higher real interest rates for a period of time in order to bring inflation down, would be adverse for capital equipment investment. But over the longer term in none of these cases is the sort of natural rate of interest being influenced by the course of monetary policy within this time frame. Our estimates suggest that because there is an interaction in the long run between inflation through the tax system that is adverse [to] investment, the benefits to potential output growth over the long run would be positive from pursuing case 2 versus case 3. In the short run, though--for the time period that we're considering here--it's not clear that we see that. It would be more [true] of a 10-year horizon.

MR. ANGELL. So, the argument for case 2 really is that the benefits would appear in the period from 1996 to maybe 2006, which I think everyone would admit is a very long time.

MR. PRELL. When you do a present value calculation, [given] the distortions with a non-indexed tax system, the payoff doesn't look bad for the short-term sacrifice. But it is a substantial sacrifice in the short run.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I'm a little puzzled by the projected effect of food and energy prices. We've been seeing a lot in the press just recently and also in the Beigebook about crop problems this year and cutbacks in beef and pork, and yet you forecast very modest increases in food prices in the CPI this year and even next year. And on the energy side we see increased imports and you seem to dismiss the effect of that by not believing that OPEC and Saudi Arabia are going to stick to a more restricted production capacity. Is that because you see it being fully offset by Iraq returning to the market?

MR. TRUMAN. On the OPEC side, there is a considerable debate in the market as to exactly what Saudi Arabia's position is. There was a runup when the market thought [the Saudis] were shifting their position, and then it backed down somewhat when uncertainty was introduced. We have predicated our forecast on the assumption that they haven't shifted their position on market share. That is because they have been increasing their productive capacity and it would seem to be a waste of money to increase productive capacity if they weren't going to use it. And we have Iraq coming in three months later than we had before, so that's a negative factor. This forecast of a drop in oil prices from the current spot rate is essentially the same as in the futures market. It is a bit more optimistic but the optimism is on the order of 50 or 75 cents a barrel. So, for better or worse, it's essentially consistent with the market forecast, which for obvious reasons is taking the same view, and that leads us to [a forecast of] a little more of a drop-back.

MR. STOCKTON. On the agricultural side, it's obviously too early to tell yet how this year's crop production will turn out. Indeed, there has been a great deal of volatility in the markets in the past month and a half. As you know, it looked as if the weather would be dry and then in the last few weeks the rains have come and the situation has looked considerably better. We're not expecting to see any serious disruptions in terms of crop production this year. But inventories are lean and if I had to say which side the risks might be on I'd say that if we did see a shortfall, there could be a potential price spike. We're expecting meat production to pick back up this year and we think that is going to keep the lid on meat prices as well. Basically, on the food price side, a really encouraging development was the significant break we saw last year. [Previously, food price increases] had been running in a reasonably high 5 to 5-1/2 percent range. And a big chunk of that [break] is attributable to the nonvolatile components. It just looks as if underlying food price inflation and probably wage developments as well have settled down considerably.

MR. LAWARE. Thank you.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Back to Chart 17: I want to ask a question on potential, just in terms of gross orders of magnitude. If we were to follow case 2 right now, say, and [the economy] were running below capacity in the interim, the question I have--and I think I know the answer--is about the relative magnitude of the investment that is given up because of running below potential for a while and how that influences potential in the out years even beyond [your forecast horizon]. It's probably not great. There were other questions about

how these various approaches could affect potential. I was wondering to what extent the foregone production and the share of production that would go into investment have been incorporated and what the magnitude of that would be.

MR. STOCKTON. In terms of the price stability scenario and the interest rate assumptions that go along with that, we would look for the level of business fixed investment through the end of '96, let's say, to be roughly 5 percent lower than in case 1, the disinflation case, which is more of a middle ground type case. But I don't think even in the longer term that that is a transitory reduction in investment; we don't really see that having significant negative effects for the overall rate of capital accumulation further down the road. If anything, we think at some point that would turn around and, because the tax distortions would be less, that we'd actually see better and more productive investment further out.

MR. SYRON. Thank you.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. On Chart 10, the household spending chart, what kind of job growth lies behind the personal income and consumption dynamics that you've laid out?

MR. PRELL. Dave showed you some numbers for the household employment increase. Basically, we have payroll employment gains creeping up toward a level of 150,000 per month by the end of the year, which is really a very modest increase relative to the trend, say, in the last decade. And that's reflected in the very slow progress that we see in the reduction of the unemployment rate.

MR. BOEHNE. What do we have for the year to date roughly?

MR. PRELL. Well, we've had only a very small increase in total payroll employment. I'm not sure what it is. We're approaching 1 million on the household series, I think.

SPEAKER(?). Payroll [employment growth] has been more like 300,000 so far, hasn't it?

MR. PRELL. Payroll has gone up only about 300,000 from December to May.

MR. BOEHNE. So, even though it's modest growth, we still have to have a notable increase in the rate of job growth?

MR. PRELL. Well, a little better than we have been doing. The last couple of months have been in the ballpark. We would expect to get some acceleration, but it's quite modest overall.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. On Charts 5 and 6, just to make sure I heard what you said, is the projected improvement in our export figures due more to the devaluation of the dollar than to the economic activity in this country?

MR. TRUMAN. No, most of it is due to economic activity. The dollar, although it has moved around and is at the low end of where it has been, doesn't stay there. It may be wrong in the forecast per se because it has been up and down for the past year. What I meant to say was that, in comparing the two halves of 1993, the relative [widening] of the gaps between the red and the blacks bars is a function of the lower level of the dollar as a secondary effect that plays out.

MR. HOENIG. Okay, thanks.

MR. PARRY. Related to that, do you have more conventional assumptions about income elasticities of demand for imports?

MR. TRUMAN. It's on the order of 1-1/2 percent, though we have this level because we're picking up additional factors on capacity utilization [unintelligible] and that pushes up the [unintelligible] end of the income elasticity on the import side.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. Back to that comment about inflation: I'm very sympathetic to the latter part of your presentation and your responses to questions. I think this issue of the transition costs and how they are related to the credibility of our commitment to price stability deserves a lot of attention. That's a very difficult issue but a very important one, and I think we need to keep reemphasizing it. But I found Chart 14 very disturbing. Whatever the model or theory we have [to explain] those kinds of relationships [as they may relate to] progress toward actively reducing inflation, it gives rise to the perception on the part of the public at large and political people that credibility of that the commitment is tied to our ability to withstand political pressures, in other words the willingness to [unintelligible]. Credibility of the price stability commitment is tied to tolerance of slack, a gap of actual output below potential, or an unemployment rate above the natural rate. So then it becomes a contest of political wills, which I don't think any of us believes is embodied in what we're doing. To tie together the progress toward reducing inflation to any kind of real magnitude [in] explaining what monetary policy has done or is doing shifts the nature of the discussion, I think.

MR. PRELL. Of course, this isn't a public discussion.

MR. JORDAN. I understand.

MR. PRELL. I would emphasize that basically we are looking from various points of view here at the debate that one might have about the progress we'll make. This relationship has proven to be quite robust in the short run, though as Dave Stockton emphasized this is not a fully specified model. We are not taking account of expectations effects, which are obviously very important in shifting the short-run Phillips curve around. But there is information in this that suggests that to a first approximation slack is what gives us the disinflation force. And I think we need to confront that internally in our policy decisions in terms of what tradeoffs are acceptable in the short run, recognizing as Dave emphasized that over the long run

the actions might build credibility and lower those costs and make those short-run tradeoffs increasingly advantageous.

MR. JORDAN. But even that response--saying that slack gives [impetus to disinflation]--may be based on a model that says the appearance of slack is information that people use in forming their expectations. I don't know how people form their expectations. Some people will cite budget deficits; some people will cite the past; some will cite politics. But by saying that it has to do with slack or unemployment being above what is perceived to be an acceptable rate may be simply something that helps people form their judgments about future inflation. But that again ties it back to a tolerance on the part of this group to that slack or unemployment--and I find that very troubling--rather than the more straightforward way of saying that what we're talking about when we talk about inflation is the purchasing power of money over time. And, therefore, one would talk about it in terms of money growth.

MR. SYRON. I thought this was just looking at the stylized facts. Have we had any period in modern history in which there was substantial progress in the fight against inflation without slack?

MR. PRELL. Well, one can look at dramatic regime changes--major currency changes and so on--to see whether there were tradeoffs in those instances and try to find information there. I'm not sure the results are uniformly favorable. I appreciate your point, President Jordan, but from our perspective there has to be some mechanism that gets you from money to prices. And that mechanism historically seems to involve some constraint on aggregate demand expansion, some weakening of demand for resources, some slack that evolves, and then there is the wage and price response. One finds only limited evidence--Dave has worked on this in the past--of a more direct effect which may be consistent with a view that all wage and price setters out there are watching the money stock trends and adjusting their expectations accordingly. But that isn't obvious; the statistical evidence is limited to support that kind of direct channel. But if one could declare with absolute credibility that inflation will end next week, then it would be costly for people to behave in any other way. So the question does arise: What could one do if one of those [unintelligible] was raised here to enhance the credibility of that commitment. Of course, once you fail, then you've lost that--

MR. JORDAN. Well, I don't disagree with the dynamics that you're describing, given the institutional context and the rest. I'm just hesitant to explain to anyone that I think inflation will come down because of the high unemployment rate.

MR. PRELL. Well, we're always very attentive to that political problem in writing public statements. But some sense of that, I think, is abroad and it doesn't come as a very great shock to people that that is the mechanism that many people have in mind.

CHAIRMAN GREENSPAN. Any further questions? If not, would somebody like to start the discussion? Bob.

MR. PARRY. Mr. Chairman, uncertainty about the direction of the Twelfth District economy has increased since the last meeting. It

has become clear that many of the District's states that previously had posted solid employment gains have weakened in 1992. The District as a whole has posted employment gains of only 0.1 percent between December 1991 and May of this year. All states except Oregon and Utah have registered either little increase or actual declines in employment since December. Since the beginning of the year California's employment has stopped declining. However, employment is 1.5 percent below the level of a year ago and downside risks clearly remain. Northern California is following the national pattern, but southern California is exhibiting further weakness. Manufacturing continues to report job losses, and more declines in aerospace are expected in the Los Angeles area. Moreover, addressing the state budget deficit is likely to weaken the state's economy further. Current estimates suggest that the state has close to an \$8.1 billion deficit. Cuts of that magnitude would reduce next year's nominal state and local spending below that of the fiscal year just ending. Failure to accomplish cuts by tomorrow will force the state to issue scrip. Negotiations have been deadlocked, particularly on cuts in education spending, which also is likely to see nominal spending below the current level.

Finally, the agricultural sector is facing hard times. Drought conditions prevail in Idaho, Utah, and eastern Oregon, leading to low yields and some acreage reductions as well as herd reductions in the cattle industry. While drought conditions are not as severe this year in California, prices for many commodities, including vegetables, cotton, and citrus, are down sharply from a year ago, leading to low profitability and some losses.

Turning to the national economy, I believe that a moderate expansion will continue throughout the remainder of this year and in 1993. Although consumption data for May were disappointing and I'd say somewhat worrisome, they were not too surprising in view of the very rapid growth in consumer spending that we saw in the first quarter. Overall, I wouldn't be surprised to see somewhat faster growth this year than is projected in the Greenbook, but the difference certainly is well within the normal range of error. I also would agree with the Greenbook that underlying inflation is on a very gradual downward trend. However, it is surprising that we have not seen a more rapid decline in inflation, given the slow growth over the past three years. And I believe it is possible that the Greenbook may be a little on the pessimistic side. Perhaps a more explicit statement of our inflation goal and our plans to achieve it might dispel questions about our resolve and lead to improvement in inflation expectations. Thank you.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Thank you, Mr. Chairman. Starting first with a comment on the staff forecast: Our forecast is very similar to the staff's in terms of the numbers; the pattern, though, is somewhat different. Our GDP forecast for '93 is lower than the staff's and in fact is lower than our forecast for this year. The differences seem to be in the auto and housing sectors. Our forecast for sales of cars and light trucks in the second half of next year is lower than the staff forecast by about 500,000 units at an annual rate. Our outlook for long-term interest rates also is not quite as optimistic as the staff's and, as a result of that, our housing starts for next year

also are lower than theirs. These two differences, of course, lead to secondary differences at least in terms of growth. Our inflation forecast is very similar to the staff's; we're a little lower this year and about the same for next year. While the differences between the forecasts aren't that great, assuming that this year and next year work out about in line with either of these forecasts, in my view the bigger question is whether there is enough momentum in the underlying economy to be sustainable. After three years of comparatively weak growth, the likelihood of a fourth year of weak growth this year and perhaps a repeat next year for a fifth year of the same, [the question is]: Is this the best we can do and will this growth be strong enough to improve significantly the employment problem as well as the utilization of our industrial capacity? I have growing feelings that it will not--that this is not a satisfactory forecast--and that in our policy discussion we will need to take steps to try to develop some stronger growth.

In terms of the region, while many of the major sectors of the District's economy have shown some improvement, here again the durability as well as the strength are open to question. The major area of improvement has been in the auto manufacturing sector. The second-quarter production schedules were somewhat over those of last year. Third-quarter schedules have been set preliminarily at levels about 17 percent higher than last year. But those schedules are based on the expectation that retail sales will increase from current levels; and if they don't, then we would expect the production schedules to be reduced. In turn, the suppliers to the auto industry have seen some pickup in orders. In the steel business, for example, they expect to ship some 21 million tons in the third quarter, up from 20 million tons in the second quarter. For the full year they are forecasting shipments of 82 million tons; that's not a bad year. And the improvement in the steel business is not just on the auto side; for example, shipments to appliance manufacturers are also a bit higher.

Other parts of the District have been a bit mixed. Housing activity was higher in May than in April, though April was quite weak, and transaction volume has been pretty good. However, retail sales, which increased in May, seem to be down in June; at least the reports are that sales were a little on the soft side. Weather may have been a factor; it has been exceptionally cold in our part of the Midwest and people just are not buying the things that they normally do at this time of the year.

In the agricultural sector, we may be in for a difficult summer. We had an exceptionally wet spring, which resulted in a difficult planting season. That was followed by an exceptionally dry spell and has affected much of the corn and soybean crops of the District. And most recently we had frost conditions in Michigan and Wisconsin, which have had an effect on the fruit crop. Despite that, it's still early enough that if we get a reasonable break on the weather from this point on we should get pretty good crop yields. But given this uncertainty in the farm area, sales of agricultural equipment have been very weak--surprisingly weak--and indeed were described as terrible by one CEO. As an example, combine sales in May were some 80 percent under the volume sold last May. Therefore, production schedules, which had already been reduced, are now in the process of being cut further.

On the employment front, District employment has increased by about 100,000 since the low point in August of 1991, but despite that increase we still have recovered only about 25 percent of the losses that we sustained during the recession. Many manufacturers are continuing to implement staff reduction plans, and I just don't sense any fundamental improvement in the underlying employment conditions. Inflation continues to look constructive. Intensive competitive conditions seem to be an absolute lid on significant price increases. The people I talk to say the pricing environment for all products is really very tough. One major manufacturer, admittedly [with] an enormous amount of clout, is achieving a reduction of almost 1 percent in the cost of outside purchases this year. And I must say that in talking to people I just don't have any sense that inflation is a part of their current thinking. Net, while I think the District has shown improvement since the last meeting, the strength of the underlying momentum and the vulnerability of this level of activity are the major questions. Thank you.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Thank you, Mr. Chairman. Let me start with the District activity. As in the nation as a whole, the pace of improvement in the Sixth District that became evident in the first quarter has tapered off. The District's economy is relatively dependent on housing activity in the nation as a whole, so the downturn in housing activity--or moderation perhaps in the pace of home sales and building at the national level--has been very quickly felt in the District. Our most recent survey of manufacturing plants also reflected this; our respondents' outlooks were a bit less optimistic than the month before. At the same time it was still a relatively positive report. In general, a fairly broad-based but moderate expansion seems to be taking hold in most areas of the District with the exception of oil-dependent Louisiana and South Florida. The situation in South Florida is linked to declines in interest rates, as you would expect with the heavy retirement population there. As for other areas, consumer spending appears to be moving ahead, with nondurables, particularly apparel, continuing to sell quite well. Auto dealers are also showing some improvement.

While the business contacts I have met with recently appear confident that growth will be sustained, they're very clearly disappointed with the pace of expansion and are looking for greater growth. At the same time, their comments don't indicate that a lack of liquidity or financing is a problem anymore. If anything, they're reporting improved cash flows from lower interest rates, and several have noted that banks have become increasingly aggressive in efforts to make loans. Only a few of the people that I've talked to believe that a further easing of policy would provide much help or would generate the enthusiasm about the outlook that seems to be missing. Rather they think it's going to take a long time to work off the imbalances that developed during the 1980s. As others have said, in the Sixth District we're not hearing any reports of price increases at all. So, while there has been some [moderation] in activity in the District, I think it is still relatively good albeit quite modest.

Now, with respect to the national outlook, we have some minor differences with the Greenbook in the various components of GDP but our forecast is basically the same. We still have a substantial

difference in the forecast of inflation, which we see as being basically unchanged through 1993. I guess I'm a little less confident than I was at the last meeting that the recovery has really taken hold, although I still think we're in a sustainable recovery. It may be that this is the best we can do for the time being. It seems to me that we need to keep in mind that monetary policy can't raise the economy's potential, at least in the short run. So, in general, while I think we're moving ahead with some falling back perhaps in the rate of growth, we need to measure our policy response very carefully.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. The big economic news in the Fifth District, as I suspect many of you know, is that it may soon be possible to buy a BMW that has a honk with a southern accent! BMW people have just announced that they are going to build a huge new factory in northwest South Carolina that will create jobs for about 4,000 people. I wish that had been announced before our last directors' meeting when you had an exchange with our protectionist-minded Mr. Chairman, who has been mourning the loss of those high paying jobs and their replacement by this sort of thing. But there is an unfortunate side of this in that South Carolina paid about \$150 million in subsidies in order to get that factory. So, this is not a purely economic decision but it does augur well for that particular part of the country at the expense of some other part. Now, beyond that, not much really has changed in the region. Gradual recovery seems to be continuing and business people are generally optimistic about the near-term outlook pretty much across the spectrum of sectors and industries. The tone of the anecdotal information, though, at our last joint meeting of our three boards was a little less positive than it had been at the meetings immediately before that. Against this background, we think the optimism about the future could fade pretty fast unless actual business activity does accelerate at least a little in the fairly near-term future.

At the national level, our projections are very close to those of the staff. We expect slightly more real growth and slightly less inflation, but the differences are not really significant. The question of where the risk lies seems to me to depend largely on how much weight one wants to give to the persistent weakness in M2 as an indicator of what lies ahead. We're still inclined to discount most of the recent weakness that we've seen because we feel most of it comes from the portfolio adjustments that are reflecting the structural changes in banking and financial markets with which all of us are very familiar. But the longer this weakness persists, the more uneasy it makes us. Our uneasiness was heightened by the excellent analysis in the second part of the Feinman/Porter memorandum which suggested that M2 is by no means dead. So, on balance, we think the risk of error is now moderately on the down side rather than the other way around, given this renewed contraction in M2 that apparently has been taking place in June.

Despite whatever questions there may be regarding the real side of the projections, we are very comfortable with the staff's projection that inflation will come down. This is also our projection and in fact we expect somewhat more decline than the staff does both this year and next. And we think there's a good possibility that a

growing acceptance of this belief on the part of the public would work to bolster real economic activity.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. The District economy continues to expand slowly with New Jersey the weakest of the three states. Manufacturing has been the relative bright spot, although by no means robust. Retailing has been flat to up slightly, reflecting in part the weather but also just the general weakness in the economy. The sense I have in the housing area is that it has been slowing, but in the commercial real estate area there are people close to that market who feel that it has reached bottom. Some of the deals are now attractive enough that some properties may begin to move, although there's no real hard evidence of that; that's just a sense. The major weakness in the District has been in the job market. We've had a weak labor market now for many months. There is some hint of improvement perhaps in the manufacturing area, but overall there continue to be losses in jobs in the District. At banks, consumer lending is up some but business lending is still soft and I don't hear any of the talk about bankers being aggressive, at least from the point of view of the business community. All in all, I think the District continues to expand but probably more slowly than the nation as a whole.

What strikes me about the national economy is that almost wherever one looks the various sectors are either weak to begin with or, after some improvement for several months, are in the process of slowing. That again puts the spotlight on sustainability. What we're counting on for the Greenbook forecast is that out of this slow and slowing situation we're going to get enough job growth and generate enough income that it will feed enough consumption to keep a modest expansion going during the second half of this year and then next year. I have more doubts about this sustainability than I did several weeks ago. If growth in the early part of this recovery had been at 5 or 6 percent or 4 to 5 percent or even 3-1/2 to 4 percent, I think this slowing in momentum that we're experiencing would be welcomed. But the strongest quarter we've had is under 3 percent; and this is supposed to be the fastest part of the recovery, so there's not a lot of downside margin. If there were brighter prospects from exports or something stronger outside the immediate job/income/consumption dynamics, I'd feel more confident about achieving this [projected] growth rate of 2-1/2 percent or so. But there just isn't much margin and we appear to be going into a period of some slowing. So, I think the downside risk is greater than it was a few weeks ago. And while monetary policy should never depend on one particular indicator, it seems to me that the key area we need to look at with regard to the sustainability and dynamics [of this recovery] is job growth. If we don't get even the modest kind of job growth that underlies this Greenbook forecast, the expansion is going to break down. If we see some signs of this job growth [expectation] not being met, then I think this expansion has some real problems and we will have to take a serious look at what our options are in the monetary policy process.

I think we can largely discount what is happening to M2, but what bothers me is that M2 was growing slowly and now has turned negative and it's in the context of total credit being very weak. If the weakness in bank credit were being offset by credit from other financial intermediaries, it would be easier just to forget the whole

thing. But that's not happening. So, there are a lot of good reasons for discounting M2 but, putting it all together, one just has to have a nagging feeling that there is something here that is reflecting the underlying demand in the economy.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. Our District continues to grow very sluggishly in my opinion. We have seen some job growth in construction, particularly residential construction, over the last year. This is primarily in our northern area, in Omaha and in the Denver, Colorado area. Beyond that, agriculture is at best steady; we've seen some production loss in wheat because of the weather but that is being helped a little by some firmer prices. So, we don't expect a drop there but we're not seeing [that sector provide] any strength to the economy, as it has in the past. Our manufacturing sector was very sluggish through the first quarter; while we have seen some improvement there anecdotally, it really has been very modest at best. Others have talked about the auto industry; we've not seen any pickup in jobs in plants in our area, at least to this point. Our energy sector is, as it has been, very, very poor for a lot of different reasons, so it's not generating a lot of activity in our region of the country. So, we expect continued growth but at a rate less than we're seeing for the nation as a whole.

As far as the national economy goes, we also are very close to the Greenbook projection, which we would note was adjusted down in the period going forward; that's consistent with our view. We see the economy growing very sluggishly and we're sensitive to that. That is consistent with the type of credit activity we're seeing on loans and what is being reported to us. So, we think there is a downside risk to the economic recovery right now and, although we see improvement in the inflation rate, we think that downside risk is something to be alert to as we go forward with the policy discussion.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, the economy of the Eleventh District, which did better than the U.S. average during the recession and the first phase of the recovery, seems to have fallen back to the average of the U.S. recovery. Previous sources of strength have dissipated somewhat; activity is essentially flat now with employment growth barely perceptible and certainly too slow to cut into the unemployment rate, which is about at the national average. There's just no sense of momentum in the District as far as I can tell.

At the national level, we have no quarrel with the Greenbook although we believe that the risks are greater on the down side. It appears that the strongest quarter of 1992 may already be behind us. The headwinds include: declining defense spending, which will be going on for a long time; the overhang of real estate, which will be with us a long, long time; the need and desire to reduce debt at all levels in the economy; the fact that there is no room for fiscal stimulus; and now the recently diminished export prospects. All of these headwinds seem too strong for the stimulus of lower short-term interest rates. It may even seem surprising that we have the strength of the recovery that we do have in view of all these longer-term trends. Our own staff's optimism about the sustainability of this

second phase of the recovery seems to have waned somewhat lately. We're concerned about the slow growth of M2. While we have been discounting the measured M2 somewhat because of the special factors that we all know about, we're still concerned because even after taking those into account there appears to be some slowing in M2. The problem with all this is that I'm not sure there's anything we can do about it. It seems to me that further easing moves at this point are just as likely to raise long-term interest rates as to lower them. But I believe we ought to consider [a move] carefully. And if we think a further slight easing of monetary policy might result in a cut in the prime rate, even if it did not result in a lower 30-year bond rate, since the prime rate-based lending is so important to the small businesses and the entrepreneurs who are so essential for job creation at this point, we might want to consider it on that basis.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. In terms of the economic projections, we're an outlier at the high end in both years on real GDP and the CPI. I don't put a lot of credence in these projections in general in terms of how helpful they really are in the policymaking process. But even if we were where the staff is, with a somewhat more modest projected recovery, I would actually be somewhat encouraged by that. I think the monetary policies that we have pursued really have been quite different than those pursued in and around other postwar recessions. And I think the fact that we're coming out of this recession with a much more modest growth rate gives us the chance to make some sustainable progress on the price front. I would say in general that the pattern in the past was that monetary policy was much too stimulative in and immediately following recessions; and that has been associated with much higher rates of real growth than we're seeing now. But that creates relatively soon, in a matter of several years, a fairly tricky [choice to] reverse course to keep things expanding. So, I'm actually not discouraged by what we're seeing here. In terms of what our fundamental job is, that may set up a unique opportunity for us. The other thing, which is not something that I've heard around this table but when I read it in the papers I cringe, is this thought that the low measured inflation we're seeing right now somehow gives us room to do things. It may in a sense if we could perform this high wire act and figure out when to reverse [course] again. But I really think the effect of our actions on inflation ought to be based on what we see happening two or three years down the road and not on the concept that low measured inflation right now gives us perceived room in somebody's mind to do something.

As far as what we're seeing in the Eighth District, it's the same pattern that I've been reporting. We continue to have job growth that's considerably in excess of what we're seeing nationally. And the pattern is still the same: We're seeing very modest declines on the manufacturing side that are made up by fairly significant growth on the non-manufacturing side, generally across the board except in mining. There is particular strength in construction; residential construction contracts remain very strong. We're seeing some slowing on the commercial side, which had also been very strong. The anecdotal information that I'm hearing is consistent with continuing improvement. I'm not picking up any ebullience but I haven't picked up some of the negative vibrations that I've heard others report here. In terms of the anecdotal information, I see a pattern, for what it's

worth, of an expansion that's continuing to take hold, with confidence among consumers and business people that is increasing and no warning signs on that front.

MR. BLACK. Tom, when you said you were an outlier on inflation did you mean on the low side?

MR. MELZER. No, on the high side.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. I personally agree in almost every detail with the outlook presented in the Greenbook. The possible exception is the unemployment rate, which I think might be a little slower to come [down] than is indicated in that forecast. I must admit I'm a little surprised at some of the comments I've heard around the table. It seems to me that we're getting pretty much what we expected for the first half of the year or maybe doing even a little better. If I look back at the Humphrey-Hawkins numbers that we put together in February or just think about the Greenbook forecast over time, it seems to me that the numbers have come in pretty much as expected. I don't see any really negative surprises in what has unfolded. We were expecting a modest recovery and what we're getting is along those lines. For what it's worth, we run an exercise in updating our forecast with the latest evidence on the national economy that has become available since the last meeting, and we did it again this time, of course. Our model, by the way, is purely statistical; there are no judgmental factors in it at all. The evidence that has become available has looked rather mixed, but when we put it in the model we got pretty much the same forecast that we had before the latest data became available. So, I take it from at least that one indicator that what we're getting is pretty consistent with what we thought we would get as we go along here.

I might add, John, in regard to the question you raised about food inflation: Talking to people in a couple of big companies in the food wholesale and retailing business in Minneapolis recently, they said they think we're overestimating food inflation at the consumer and wholesale levels. We're going to be meeting with them further to try to understand what the difference is, but their view is that it has been pretty tough to raise prices in that business as well. We will see if we can find out a little more about that.

I would think that the risks, at least in terms of real growth, may be on the up side as much as on the down side at this juncture. I say that on the basis of the anecdotes that have come my way recently in the District. The obvious caveat, of course, is that the District is pretty thinly populated and may not have a big impact on national performance. Just to give you a formula for this: Tourism was at a record last year but all the tourist spots are way ahead of last year so far this year.

VICE CHAIRMAN CORRIGAN. It has been discovered by Canada!

MR. STERN. I don't know; maybe we ought to secede and join Canada!

MR. BLACK. You have an awfully big sample in relation to your universe! Let's look at it that way.

MR. STERN. Highway construction has been strong; I take it that is tied to the highway program that was put in place at the federal level, but we're getting a number of reports along those lines. Residential construction has been strong; auto dealers seem encouraged; and retail sales in general have been pretty positive. It's not that everything is positive. The military bases, especially the air bases in the District, are adversely affected by what is going on there. And there is some expectation that the [influx of] Canadian shoppers, who have been streaming across the border for quite some time now, may slow. In the past that kind of information would have led to some sense of despair; but this time people seem to be shrugging it off as something they can deal with.

As for M2, I think I'll await Don's wisdom on that subject before I comment.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. In the First District we have not had a great change since the last time we met. But I would have to say now that it's on the soft side of "mixed." The reason for that characterization is that there is a lot of variance within the District. The only place we're seeing any significant bounce-back is inside [Interstate] 495 in the greater Boston area, where the economy does show some signs of strength with vacancy rates stabilizing, commercial rents stabilizing, and residential prices actually firming. But all of this is because M2 is behaving the way it has! That's an exaggeration, but we're seeing enormous flows into mutual funds. I meet with people from the mutual funds fairly frequently and they actually are at the point where they are concerned now and are sending warnings, if I can characterize it that way, to people who are investing in junk bond funds. They have had just enormous flows--

CHAIRMAN GREENSPAN. You're saying that M2 has an inverse correlation with the [inflows to mutual funds]?

MR. SYRON. That's right, because of the importance of the management of funds and institutions [whose assets] don't count in M2 and their being a big part of the greater Boston economy.

MR. LAWARE. Boston strives to be different!

SPEAKER(?). As the non-M2 economy!

MR. SYRON. That's right, the non-M2 economy. See, that's why we've always been heretical! But there really is a concern about a potential break [soon] in the equity market and also further out in the junk markets. There's a lot of worry about how sophisticated many people are who are reaching for yield coming into this market. On a more serious note, once you get outside the greater Boston area, the periphery--my notes here say "the periphery"--is poor. And that, of course, is tied in large measure to what is happening in the manufacturing sector. We're not benefiting for reasons that don't have anything to do with the national economy and the improvement with

computers. It has to do with the problems in the high-tech industry generally in New England, though we are suffering from the pull-down in defense. I think we're just in a long and inevitable period of readjustment here that's going to be painful. Looking sector by sector: Retailers, excluding autos, report a somewhat weaker situation; housing is slightly weaker compared to the last time except at the low end of the market; and manufacturers, particularly of non-computer high-tech products, have seen some fall-off in their foreign sales but some slight improvement domestically. As for capital spending plans, the only reason anyone we talk to is investing is not to increase capacity but because they have the notion that they have to do it to remain competitive in a tougher world. The price situation is very similar to what we have heard elsewhere, with lots of pressures on margins and prices looking quite good. Bank lending is still quite slow and, given the amount of capital that has been raised by many institutions, I think it's less because of supply constraints and more generally because of the [slow]down in demand. [Unintelligible] anecdote, we find that these things always seem to take a year and a half: This week the Rhode Island crisis was resolved a year and a half after it started--at some substantial cost to the state, as is always the case.

As far as the national economy goes, we're in general agreement with the Greenbook. However--and this isn't a comment on the Greenbook so much--in going through the exercise myself for a Humphrey-Hawkins forecast this time I noted that at least in my own forecast, and I think this has been true generally, the central tendency for the last four years has been for serial optimism in our forecasts for economic growth and, with the exception of one year, serial pessimism on inflation. I'm not saying that that's going to continue going forward, but I think it is instructive that we have generally been too optimistic on the economy and too pessimistic about the price side. In my own view I'm nervous about a lack of firming or cumulative [improvement] in the economy and how this will fold together. We're not seeing a firming, and a great deal of new softness is emerging. On that score, the numbers that we've been getting on unfilled orders now for three quarters of the year become a concern. One starts to ask: What is the dynamic for this to come together? We keep talking about confidence, but unless we see some improvement in income, we have to start to wonder how sales are going to keep going. And as for the improvement we've seen in income so far, even with the most recent figures income is not growing as much as retail sales and an awful lot of that income is in transfer payments. If we look at what has come from employment in the profit sector, we don't see anything there that is consistent with an improvement in confidence. All things put together, we would expect a somewhat higher unemployment rate than the staff, but marginally so, based on about the same outlook for GDP. We think the staff forecast is pretty evenly weighted; however, I'm concerned that the cost of a mistake is not evenly weighted but [is greater] on the down side. My view may be formed too much on the basis of conversations with people who are worried about continuing financial fragility and what will happen if there's too much disappointment in the marketplace.

I'll make one final comment on this: As far as the Ms go, despite the inverse beneficial impact in Boston, we've always been rather skeptical of the Ms. But I do think they say something. Just looking back over the last decade, unless we get a break back up in M2

we will be further outside the M2 and M3 target ranges than we've been in the last ten years in an environment in which we would have to say that, at least thus far, we've been disappointed with the economic performance we've seen. I think that puts us in a potentially difficult position in explaining our actions as we go forward.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. It seems to me that we ought to assume that the economy is really moving along at about a 2 percent growth path in the first half. I tend to discount somewhat that little higher number for the first quarter, and I wouldn't consider moving back to 2 percent in the second quarter and maybe only a little higher than that in the third quarter as being out of line. It seems to me that it's very difficult to derail and change the direction of an economy. We have a huge transfer payments support network in this economy, and I just don't see what it is that's going to turn all this around. We're seeing a lot of the same things we've been seeing for some time but I don't see new sources of weakness out there at this time. Whereas my forecasts for real GDP and the CPI are identical to the staff's for 1992, I have some concern about the particular mix that the staff uses to get there. And it seems to me there's a vulnerability. I think this adjustment period we've been in is really an adjustment period in regard to the personal saving rate in our economy. I expect the personal saving rate to be inching up whereas the staff has it pretty flat. I also see the trade deficit moving south again as a vulnerability for the foreign exchange value of the dollar. And with the dollar as weak as it is, any move at this point that would be associated with a lower fed funds rate could quite easily be interpreted as Federal Reserve acquiescence to a depreciating or devalued dollar. And I'm not sure how world capital markets would react to such an event. There's a real potential for upset in that regard. Corporate profits and cash flows look pretty good, so the saving rate in the business sector may be much better than in the government sector, which doesn't look like it's going to respond very rapidly and yet does, I think, provide a considerable amount of restraint.

So, it seems to me that we're in a circumstance in which our being seen as focusing on price level stability has more payoff than any other action in terms of having faster growth. I just do not see how an alteration of the present fed funds rate is going to contribute to an improved outlook, and I think it could very well contribute to instability rather than stability.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. First, I have some comments from a District perspective. Traveling around the Fourth District and getting acquainted with bankers and business people all over the area, I'm most often meeting people for the first time. It's been very helpful, very instructive. In manufacturing, which is very important in the District, the general sense is that things are improving modestly. The headlines will be something like "British Petroleum lays off 300." That's front page news. But Ford Motor Company recalling 800 or planning to add another 800 doesn't make the news; or Goodyear, Reliance Electric, or Piedmont Corporation adding workers, if it shows up at all, is back on the third or fourth page or buried well inside

the paper. When I talk to business people about their own views they tend to convey a sense of "well, we're doing a little better but we're worried about the national economy." And they're worried about the national economy either because of the budget deficit or because of national politics and concern about what kind of leadership we have, believing that the long-run outlook for the economy depends very much on political leadership rather than institutional factors. But they do not reconcile in a way that's clear to me what they are seeing or feeling as they personalize their own businesses with what they think about the economy at large. The retailers comment about how slow sales have been and usually attribute that to weather, which carries with it, of course, the expectation that sales are going to pick up with better weather. So they could easily be disappointed if better weather comes and they don't see sales and order books picking up.

When I quiz people about their inflation outlook, consistently manufacturers and retailers say that it's not a question of inflation, it's a question of deflation. They ask: How do we manage stable prices or a decline in prices? But they think that the national inflation rate is going to be 4 or 5 percent. Very rarely do I find somebody who is talking about something less than 4 percent over a 5- to 10-year horizon, even though in their own businesses they don't expect to be able to increase prices. So there is a disparity [between] what they face or feel they are contending with and this national [view]. When I ask why they don't believe us about going to price stability and what that world would be like in terms of interest rates and other things, they often cite the budget deficit or national politics or [what they see as] the outlook for easy money-- that sort of thing. There is no real substance to why they feel that way.

A few other comments on sectoral developments: We see strong increases in bookings at hotels throughout the District; the convention business in the Fourth District is really doing quite well, maybe in part because it didn't have a boom so it didn't have a bust and kind of moved right through this. When I try to elicit sympathy for how tough things are in southern California where I'm from, I get no sympathy at all. They think it's well deserved! [Laughter] There have been reports of a pickup in residential activity throughout the District; we're seeing some new home starts pretty well throughout the whole area. One banker reported commercial lending up 12 percent year-over-year; he happens to be in an area where Ford Motor Company is recalling workers and adding workers. That's balanced off against bankers in the more agricultural areas expressing concern about a third year of drought; [they say] they're going to be getting a lot of keys if we do have a third year of drought. But they have carried [the farmers] this long; they need rain and there's nothing they can do about that.

When I talk to bankers about interest rates and inflation, consistently without exception they talk about higher interest rates and higher inflation. I asked them why we don't see more growth in time certificates of deposits. They say it's because their customers are waiting for higher rates and don't want to get locked in. Why are they waiting for higher rates? [They reply that] when we get the higher inflation, we're going to get higher interest rates. And I asked them why they don't tell their customers that that is not going to happen. They say because it is going to happen; we are going to get higher interest rates because we'll get higher inflation as soon

as we get [more economic] growth. I've asked them to consider a world in which we have roughly stable inflation and what that means and what they're going to pay on their checkable deposits and their regular savings--what it was like, say, in the early 1960s. And they simply say they don't believe it [will happen]; they're not willing to lower checkable rates or regular savings rates and make their customers, especially their older generation customers, unhappy because they will just have to raise them again as soon as growth picks up or as soon as inflation picks up.

Turning to the national economy, I don't disagree significantly with the Greenbook. I guess I would be a little more optimistic on real growth--on the higher end of the [Committee members'] range--but not any different at all, really, on the inflation outlook for the near term. The comment that Mike made about capital goods was consistent with what I heard throughout the District; I heard the same kind of phrase about the pickup in capital goods being far from spectacular. Most of our capital goods suppliers say they are getting more orders; the transplant plants especially are picking up business from the foreign producers and taking back domestic markets. But they all would characterize it as "not spectacular growth."

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Well, I don't have much to say this time so I'll probably talk longer than usual! For me there is an issue of risk which has intensified since the last meeting. There's no question about the point that Gary Stern raised: When you look at our forecasts, they look better than last time or roughly in line. For the first quarter we expected growth to be around zero and it was 2.7 percent; at least, I think it's settled on 2.7 percent now. The concern is about the pattern, obviously--the pattern of a surge early in the year followed by deterioration on the spending side--and that raises questions about sustainability. Housing has clearly lost momentum and there's also concern about retail sales. Auto sales have held up, but I wonder if that's not due to the age of the fleet and some replacement demand or quality effects of American autos. Export growth also has slowed and we do have industrial production coming in [slightly higher] now. As Ed Boehne pointed out, the key is whether that feeds in through job growth to stabilize the situation. We're now projecting a couple of quarters of growth of around 2 percent. There's some question in my mind of a stalling here. Given the spending outlook, I think the chances are perhaps 1 in 3 that we'll have a couple of quarters of growth below 2 percent and that indeed the unemployment rate, instead of stalling, might well move up toward 8 percent with a couple of quarters below 2 percent. I think there are risks here.

There are risks to the institution. I wonder how good a job we've done in selling our goal of price stability, and I wonder how widely shared it is within the body politic and the American public. And I would just as soon not test that too strongly in the current environment. I think there are risks also of instability and damage to our long-term objective. If we don't make a move and indeed we do get some bad news, I think we'll feel compelled to take more aggressive actions down the road. The hallmark of the success of the price stability program has been gradualism, and there might be

concern about instability. On the other side, I see the upside risk as 4 percent growth; and with this degree of slack in the economy, I don't think the consequences for inflation are all that troubling. I do think there are businesses out there that would be relieved of the vise of several years of really tough demand considerations and who might try to increase prices. So, I wouldn't entirely discount some inflation consequences. It does seem to me, though, that compared to last time the downside risks have increased.

It's less clear to me how we should respond. There's no question that the problems of the economy have not been caused by monetary policy, and it's not clear how much monetary policy can do to help at this stage. But we are facing weak money and I'm afraid increasing signs of weakness in the real economy. And as the central bank most people view us as responsible for money growth. M2 is certainly distorted; but, as has been pointed out, the debt aggregates are also weak and even M1 has started to decelerate. Even with the distorted M2, I can't help but suspect that the dramatic collapse we had a few months ago contained some information about what was happening to consumer demand. I guess we'll talk more about this tomorrow.

Of course, we could say that ease would have no effect; I think that's a tougher case to sell after the ease late last year and the surge in spending. Our staff would call that Grainger causation; others might call it coincidence. [Laughter] But I think the economy was poised for that response in the sense that [our easing actions] from October through December unleashed refinancings and put spendable cash in people's pockets and helped with that spending spree. Moreover, I think [further easing now] would result in a reduction in the prime rate and would increase cash flows. I doubt that it would unleash a wave of new borrowing. Governor LaWare's alma mater, Chemical Bank, reduced its prime a bit for a while and stood prepared to be trampled by credit-starved borrowers, and I think we can infer that it was lonely out there. I do think [an easing action] would help on the cash flow side. We could say there are inflation risks with easing. I think we're pretty much on record as saying that the pressures on inflation are easing, and I doubt that there's a strong case that we'd do much to reverse them; the fundamentals are well in place. But, again, it's not without cost. There is concern about the long rate. Consistently as information has come out which increases the probability of ease, that long rate has moved down and vice versa. That doesn't mean, though, that actual ease would not result in the long rate going up because then the critics actually would come out of the woodwork and start talking. But empirically I wonder about that argument. So, I guess I see zero M2 growth in the context of building evidence of decelerating spending and that makes me nervous. It's hard for me to believe that this economy is money starved. Nonetheless, the liquidity is really hanging it back. We've had some help already: some effective ease from a dollar that is down 8 percent from its peak in March; a long bond rate that is down 25 basis points since March; and a mortgage rate that is down 50 basis points since March. Moreover, late last summer I thought real short rates were a bit high. I think that's no longer the case. The [federal funds] rate has come down 200 basis points since last summer; market rates are low in real terms at about 0 to 1/2 percent. Bank rates still remain high in real terms, it seems to me, and a move may help there.

I'm also mindful of the need to save a little ammunition for adverse contingencies. In my view we have very little left in our arsenal with which to face an equity market packed with former bank CD investors who didn't like 3 percent returns; they'll be receiving their second-quarter mutual fund statements shortly showing a negative 3 percent return. We may have a better test of the wealth effects of market crashes out of this one. Indeed, I think the equity funds in the last couple of months have shown net outflows for the first time. It also may be wise to save a little fire power considering the prospect of a hung presidential election and three months of uncertainty on the impact on the stock market. And of course in that event the dollar may well fall out of bed, which may hurt our ability to respond. So, overall, the situation is pretty complex and I am concerned as every day passes that the chances increase that we're going to have to face another mini-dip. It seems to me the argument for considering a move is that it would do some substantive good, do relatively little harm, and would show responsiveness to economic risk. There are also arguments for holding tight and there are risks associated with that. To a certain extent a lot of [the problem] is illustrated by the colloquy that Jerry Jordan had with Mike Prell on this troubling sense in which price stability is linked, rightly or wrongly, to the tolerance for unemployment or bad economic circumstances. I think Mike is correct: This view is abroad in the land or at least in the local vicinity. [Laughter] And if we hold tight, I think we should feel pretty comfortable about weathering the adverse outcomes that could occur, which include a couple of quarters of growth below 2 percent and the possibility of a higher unemployment rate. I think we should go into that with our eyes open, willing to absorb these outcomes without having responded to developing signs of deceleration. We certainly can't do anything about the second quarter; we have little time left--six and one-half hours! [Laughter] We would I guess be expected to show responsiveness to the patterns of weakness that have been developing and we could take out a little insurance on the third quarter. We could wait and try to respond later. My view is that we're running out of time here and in this environment it only gets tougher to act. Maybe I'm too pessimistic; the odds are still favorable that we're going to scrape by this situation. But in golfing terms, I think it's a pretty tough lie; we're not in the sand trap and we're certainly not in the lake, but we may be in the rough looking at a possible "bogey" as they say.

CHAIRMAN GREENSPAN. That's not too bad.

SPEAKER(?). If it's a bogey, I'll settle for that any day.

SPEAKER(?). Or a double bogey.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, although I have read all the memos and listened to the various theories expounded, I don't claim to understand the refusal of M2 to respond to an established pattern of stimuli. It's as though Pavlov's dog had his saliva glands dry up! [Laughter]

CHAIRMAN GREENSPAN. That's a triple bogey!

MR. LAWARE. And no matter how loud and long Pavlov rang his bell the dog wouldn't drool. Something has to be different. I believe it is an unprecedented conjunction of discomfiture on the part of bankers, consumers, and businessmen. Businesses won't borrow for inventory because they lack rapidly growing sales; and they are reluctant to borrow at current rates for plant expansion or equipment replacement because they can't discern what the future holds. Besides, they're still paying off the economically unproductive debt they undertook in the '80s for buy-outs and takeovers. Consumers are intimidated by unemployment statistics--daily reports of corporate layoffs not only of white collar and blue collar workers but of top executives--and the still formidable task of paying off the debt that they incurred in the '80s. Bankers who have been badly savaged by examiners are just beginning to realize how much worse it's going to be under the wonderful FDIC Improvement Act. The very fact that they have not moved the prime as a pricing strategy to attract loans indicates a reluctance to lend at all, even to the best risks. And, of course, demand for credit is anemic. Add to all of that the prevailing public impression that the nation is adrift with no clear sense of direction and one can understand this discomfiture.

If these conclusions are accurate, then it is hard for me to see what effect we could expect to have from a further easing of policy. To the contrary, in my view there are some recognizable risks, including a further weakening of the dollar, higher long-term rates based on the conviction that further ease is inflationary, and finally the concern that we are pursuing a political course following public jawboning from the Administration. M2 has not responded to our previous moves and it is hard to reason that it will suddenly come back to heel. I think we need more time to see where [the economy is] headed before we make a policy move. And I don't see that the threat of immediate collapse is real enough to justify a tilt toward ease at this time. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. I thought that was an eagle, myself!  
Governor Kelley.

MR. KELLEY. Mr. Chairman, my comments might follow pretty closely along the lines set by Governor Mullins and Governor LaWare.

CHAIRMAN GREENSPAN. Well, wait a second. If you can reconcile [those two sets of comments], that's a double eagle!

MR. KELLEY. Well, I think I came out understanding where Governor LaWare is but I'm not sure I came out understanding where Governor Mullins is, at least at this moment. At any rate, we've had our usual extensive and excellent economic analyses and it seems that we probably have a recovery pretty firmly in place. But it's a frail child and there's certainly some risk that it could falter. Policy setting would be a whole lot easier if things were either better or worse. If [the economy] were recovering smartly, we'd pretty well know what to do; or if it were faltering badly, we'd probably know what we should do. But we're in a broad gray zone here where we have a slow, tentative, stop-and-start situation that is hard to read. That leads me to ask myself three questions, which I can share with you. If that's where we are--in the slow, tentative gray zone--the first question is: What is appropriate for the central bank to try to do about it? Secondly, if we do wish to try to solidify [the

recovery] or accelerate it, what is the best way to do that? And thirdly, whatever policy we put in place, what are its likely long-term effects?

On the first question of what is appropriate, I think this Committee and the central bank have several responsibilities. The most basic one, a view I think we probably all share, is to foster and maintain the integrity of the financial system and its currency. Then, of course, if the nation ever got into a crisis--a world war or something like that--we would have to do whatever it was necessary to do, no matter what, under circumstances like that. I think we also have a responsibility to try to ensure that we don't strangle the economy for lack of money and achieve price level stability by rendering the economy comatose. We could probably do that, but that's obviously not desirable. So, if we do have a slow economy right now, I think we ought to ask ourselves if it is because we've followed an inappropriately tight money policy. And it seems to me that the answer to that is fairly clearly "no." There is plenty of liquidity in the system. We've all talked a lot about loan demand and so forth; it just seems pretty obvious to me that the sluggishness we're dealing with does not have its origin in overly tight monetary policy. So, we probably are meeting our responsibilities there, at least so far and in the short run. Beyond that, it gets pretty murky as to what is appropriate for the central bank to try to do. The conclusion that I come to on my first question is that we're not in a situation that forces the central bank to put at risk its basic responsibility to the financial system of maintaining its integrity. Surely, we want to do what is appropriate to help the economy in any way that we can. But I think it's important that we do that without unduly running a risk to our primary responsibility.

Turning to the second question: If we do decide that we want to try to do something to accelerate the expansion through monetary policy, what is the best way to do it? If we ease policy, we do that against the background of all this financial restructuring that is going on, which we all understand and have talked about a lot. I think it's critically important that it work its way through. If we do ease policy, clearly we would probably get a lower prime rate; but I'm not at all clear that that would help loan demand or make very much of a difference, given this other [situation]. Would it be a big boost to the monetary aggregates? I haven't seen any suggestion that that might happen. And it's very possible that it might be counterproductive in the sense that it could drive up long-term rates. If it did, it seems to me very likely that that would more than offset any beneficial effects we might get. So, the conclusion I come to on that question is that the chances are at least 50/50 that the best way to help this economy, if our number one wish is to help the economy, is to stand pat.

On the third question of what are the likely long-term effects of any policy either way: If we stand pat and don't change, I agree that it is certainly not riskless, as has been pointed out here. But I think the rewards that we could reap if we did stand pat and it worked out are very substantial indeed. If we ease now, I see several risks that could ensue from that. A couple of them have a pretty low probability; the third may have a little higher probability. The low but I think non-zero probability is that we could set up [conditions] for an inflationary surge down the road. If we were to ease and

should that cause a very severe deterioration in the value of the dollar and possibly unleash an incipient credit explosion, that could require a monetary policy response that would be destabilizing down the road. That could cause some fairly radical kinds of upset to the process over time. Maybe a little higher probability would be that we would succeed in what we wanted to do in accelerating the economy and in the process abort this restructuring process before it has a chance to work its way all the way through. That would be very unfortunate in the sense that it would almost surely set [the stage for] a renewed weakness in the economy very shortly and it could possibly get us into a new downturn prematurely. Perhaps a higher probability and a concern that I have would be in the area of Federal Reserve credibility. Our credibility may be on the line right here. We could do ourselves some serious long-term damage if we were to ease and if, however inaccurately, the market perceived that we were pandering to politics or that we were putting a premium on growth at any cost even if we had to accept a devaluation of the currency and the financial system to get it. That could be very unfortunate. I think we might be in a very important time right now in terms of testing our credibility. If it's very clear that the wheels are coming off the economy and that things are going south, then I think we probably would have to ease and the markets would understand that and would not fault us for it long term. But if an easing is seen as some kind of panic or a response to political pressure or what people would perceive as mistaken priorities, then I think our credibility would have had it for a long time. And that would make our job down the road much, much tougher. If we're able to stand our ground here and the economy struggles on through, which seems to me to be the most likely possibility, that could be a very, very major boost to our credibility and pay us huge dividends over time. So, on balance, Mr. Chairman, I come down for now, subject to how events unfold, saying that standing pat is our best bet to help the economy short term and long term.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Let me just start with the national outlook in terms of the forecast. The forecast that the gentlemen and ladies in New York put together this time is virtually identical to Mike's forecast, not just in terms of the totals but even the components. As a matter of fact, you could put a postage stamp on the two of them and cover them both in all the details. From my point of view, given all the structural problems that people have been talking about, if the results over the next six quarters through the end of 1993 were in line with those forecasts, I'd be a very happy fellow. I would also point out that in Mike's forecast the cumulative growth rate in real GNP for the years 1992 and 1993 combined is to the decimal point equal to the 2-year growth rate in the price stability scenario in Chart 17. So, there's no conflict whatsoever [between] the forecast, if you want to believe that chart to that level of detail, and this notion of price stability.

But the question, of course, is: How does one feel about achieving that result? I have to say that I share the views that have been expressed by a number of members in that I am uneasy about achieving that result. The point has been made at least by a number of people that the problem is this sustainability question and the lack of any clear momentum in the economy; there's a sense [that the

recovery] just doesn't want to take hold. The anecdotal comments that I get from businesses, small and large, are virtually without exception consistent with that concern about sustainability, momentum, etc.; it's a lot like Ed Boehne's characterization of the situation. Now, the one thing that we do hear anecdotally that is different, even from small businesses, is that the banks are out beating the bushes looking for business. And this is the first time we've heard that on any kind of systematic basis. But even where they're looking for business, it isn't there. However, they do tell us now of calling officers back on the road and of banks running seminars in various parts of the state, and that's a change, clearly.

In terms of where we go from here, Ed Boehne put his finger on it as far as I'm concerned: The crucial variable in terms of hitting something close to that forecast is the employment/income side of the equation in a context where, Wayne, we at least don't have the saving rate going down. At the beginning of the year one could roughly visualize income streams compatible with that forecast with rather modest growth in employment--65,000 to 75,000 a month--throughout the year. But we've lost ground relative to that. To be sure, some of it has been made up in income terms by [increased] hours, but the fact of the matter is that employment in Q1 was lower than in Q4 of last year and, if I have this roughly right--again using Mike's forecast--Q2 payroll employment in the forecast is something like 400,000 higher than Q1. Obviously, it's going to take a pretty healthy increase [in June] to get anything like that. The question really in some ways does come down to: Will the employment growth and income growth be there that can produce enough by way of spending, given the structural problems, to get an outcome that roughly resembles the forecast?

On M2, I've never worried too much about it, but I think we can explain a lot of that [weakness]. But, again, the point has been made by a couple of people that it's not just M2. If we look at the broadest measures of credit, we still find this systematic weakness. We can explain a lot of that away, too, by the debt restructuring and the necessary consequences of all the problems in the 1980s. But if that continuing pattern of very sluggish growth in any M out to M27 continues in a context in which the economy begins to fall short of the forecast, it's going to be pretty hard for anybody to dance to that tune.

Again, I don't think the question in any sense is: Should we be trying to accelerate the economy relative to something like the [staff's] forecast? As I said, I'd be as happy as a clam if we got a result that was even roughly like that forecast. But I come back to Si Keehn's comment a long time ago--3-1/2 hours ago or something like that: What if it turns out that instead of looking at a 2-1/2 percent economy we find ourselves looking at a 1-1/2 percent economy? And in terms of this argument about Fed credibility, which I think cuts both ways, if it turns out that we have a 1-1/2 percent economy and that's what we're responding to, then there's going to be a big problem in terms of Fed credibility on the other side.

This is as difficult a policy setting as I can remember in a long, long time. I think Mike Kelley had it right: It would be a heck of a lot easier if the economy were either a lot better or a lot worse. But I do think the crucial question is not whether to seek an

acceleration of the economy relative to the forecast but where one's comfort zone is as to whether we can either hit the forecast or come within striking distance of it. And I'd have to say that my degree of comfort in terms of our ability to hit the forecast has waned from where it was a couple of months ago. Thank you, Mr. Chairman.

MR. PRELL. Mr. Chairman, as a point of clarification, so that people know on Thursday [when the employment data are released] what the surprise is relative to our forecast, I think the Vice Chairman had the disadvantage of looking at some rounded quarterly average numbers. Actually, what we have for June is only an 80,000 increase in payroll employment.

VICE CHAIRMAN CORRIGAN. For June?

MR. PRELL. Right.

VICE CHAIRMAN CORRIGAN. I was talking about the quarterly average.

MR. PRELL. The quarterly average is 400,000 above the first-quarter average.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. What I'd like to do is to summarize briefly what I think I have learned since our last meeting in May. It is summed up well in the aggregate; that is, I think the staff have very well assimilated all the data that came out into their forecast. While quantitatively the forecast reflects some modest weakening, we still have a 2 percent quarter projected for the second quarter and some minor downward revisions in the future. Those downward revisions anticipate that real GDP at the end of the second quarter next year will be about \$14-1/2 billion lower than [projected previously]. And I think that's a fairly good summation of how much weakening we've seen. Although I call that a modest quantitative weakening, I'm somewhat concerned about the qualitative weakening that lies behind the numbers. Personal consumption expenditures will be about \$20 billion lower. Contrast that with a rise in inventories of \$12 billion. I think what we've seen is a more modest quantitative reduction that masks a substantial qualitative weakening in the economy. Much of the growth that is there is moving away from final demand and is moving toward business accumulation of inventories and faster business investment. That very well may come to pass, but we are gambling, I think, on a riskier scenario. Inventories and investment are necessarily riskier components of demand than is something like consumption. Quantitatively, that involves something like 170,000 fewer houses, 13 percent less, and payroll employment that's about 650,000 less or about 0.6 of a percent of the work force. So, that's the magnitude. And I think it sums up well the amount of weakening we've seen in the economy since the last forecast. I'd also point out that the anecdotal information we have gathered here today suggests that the quarter has ended on a weaker note than it began. We were all somewhat more sanguine about the economic forecast at the last meeting than we are now, and the anecdotal evidence from around the country suggests that in fact the economy is weakening in June relative to what it was earlier.

The second set of data that we've learned is that we've had two tests of market reaction to what I would call basically "monetary policy developments." The first came immediately after the last FOMC meeting on May 19 with the publication in The Wall Street Journal of the Wessel piece which described our reaction as having been one of going toward symmetry. At the close on May 21, the 1-year note was up 25 basis points, the 3-year note was up 30 basis points, the 10-year note was up 19 basis points, and the 30-year bond was up 9 basis points on the publication of the Wessel story. That is one test--and I admit no test is perfect--of how the market responded to our presumed decision to go with a symmetric directive rather than the asymmetric directive that preceded it. The other economic test came last Wednesday when the President had his interview with The New York Times and the paper published what is obviously rather public pressure on us to [ease]. The 1-year rate fell 11 basis points, the 3-year rate fell 11 basis points, the 10-year 5 basis points, and the 30-year 2 basis points. So, I think that gives us some idea of the likely market reaction to what we might do. Those are the two economic things I think we've learned.

The political lesson we've learned is one that I wish we hadn't learned. I was privileged to be able to meet with the Reserve Bank presidents up in Baltimore and I predicted that we were going to be coming under increasing political risk. I think the Chairman mentioned that earlier in his comments. Well, I think we saw the political risk in the President's comments. Frankly, I didn't like it much. So, this weekend I began contemplating how we might respond to that political risk. If this were Saturday, I might be quite tempted to want to stand strong in spite of what I think is evidence of weakening economic activity. Governor Kelley pointed out some key advantages to our standing [firm]. I couldn't imagine a better test for us to establish credibility. We have not only a Presidential statement but since the Beltway is within the Fifth District and I've worked there, I've studied the matter rather closely. This was a very unusual development for this Administration. They got everybody together to give background interviews. So, it was a pretty public act of pressure on us. We'd clearly establish credibility if we stood tall.

Second, there have been arguments around the table which may have merit--but on balance I think they're probably wrong, though I'm quite uncertain about my own views--that we might be at a juncture, an unusual juncture, where an increase in short rates may actually help M2 growth. The idea there is that we would stop the runoff into nonbank depositories. And as someone who is very concerned about M2, although I don't agree with that description of the sign of the elasticity, I'm willing to admit that I might be wrong. I couldn't imagine a better [time] to experiment than right now [and to be] wrong. And thirdly, standing tall might have another advantage. It's amazing when I go out [in public] that everyone thinks we know something that nobody else does. Given the amount of disagreement around this table, it's unclear that we know anything, but they all think we know something that nobody else does. And perhaps a sign of strength on our part might be a signal that in fact the economy is recovering; it may be a self-fulfilling prophecy that might get things going.

So, I think the political lesson is that we are at an unusual juncture. Were we to stand tall--perhaps we could even raise rates and, who knows, really show our independence--we might produce some very desirable results. We might have a tremendous bond market rally and that could get the economy going. I have to view that as a long shot, though. But it's a long shot with a high payoff. I haven't played golf in 15 years, so I'm not going to get into golf analogies but it would sound to me a bit like shooting a double eagle. Would that make sense? I'm a more conservative player and I think our real risks are very much along the lines of what President Corrigan said. And I think we have to get it right. We're not being asked to hit a home run or a hole-in-one, but we are being asked to get a par, not a bogey. On net I would have to go back to my economic training and to what I think were both market tests to our behavior and also the overall weakening that's epitomized in the change in the staff forecast. I would be inclined as a result of that to reject my instincts to act tough and do what the economy says to me, and that is I'd be inclined to ease.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Well, I think I'm batting clean-up again. I'm going to change the analogy a bit because I feel as if we're running both the top and the bottom of the ninth inning at one time and the bases are loaded on both sides. In any case, I certainly agree with the Greenbook forecast of a slow, modest, sluggish recovery. One of the things that seems to have changed since last time is the question of how long this period of sluggishness is likely to continue. The longer it goes on, the more I am starting to question whether or not we're going to start to lose consumers at some point and a slowdown will begin. [Various] drags on the economy have been identified--the [financial] restructuring and the operating restructuring; the defense restructuring is really only getting started at this point. We're starting to see a fall-off in demand. While the confidence indexes look better, as Mike indicated, they're still below their high points. I tend to wonder whether when people respond to the confidence surveyors they say one thing but when they respond to the political surveyors they say another thing, and thus we have a three-way race at this point. The international side has started to weaken and, of course, state and local government constraints may be starting to come in. I am encouraged about the progress on inflation. I tend to wonder whether the concentration on the CPI or even the core CPI is perhaps overstating the price pressures that people are really feeling given this inability to raise prices, the bargain or sales shopping, and so on that are going on. So, I'm a little more encouraged about price pressures than perhaps concentration on the CPI might indicate.

The study and analysis of the monetary aggregates that we all appear to have engaged in since the last time do help to explain, partially, what has been happening in the monetary aggregates. And that I think is helpful. I wonder whether the banks, instead of aggressively bidding for deposits, are now out making loans; I wonder if they're really out building their CRA files instead of spending time on loan development. In any case, we're not seeing the credit expansion. So, I think we understand a bit more about the monetary aggregates. Nevertheless, we're still seeing weakness in those aggregates. Again, if we concentrate only on looking at the Ms in the short run we may not know too much, but in the long run I do think

they tell us something. And we're having a [relatively] long period of weakness in those aggregates, so I think that is disturbing. I do agree with Presidents Boehne and Corrigan that the key is employment growth. And to the extent we have slow GDP growth--if it does drop down below 2 percent for an extended period of time--we're going to have some problems seeing sustained growth. So, while things haven't changed a lot substantively since the last time, it does seem to me that the length of time and the cumulating effect are heightening the downside risk.

CHAIRMAN GREENSPAN. Thank you very much. We've come to a break for the day; our next session commences at 9:00 a.m. tomorrow.

[Meeting recessed]

July 1, 1992--Morning Session

CHAIRMAN GREENSPAN. Shall we move on to the next item on the agenda which is the long-run ranges for monetary policy? I will call on Don Kohn to make his presentation.

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

CHAIRMAN GREENSPAN. Questions for Don?

MR. PARRY. The staff projections are certainly very important in terms of which of these alternatives should be selected. Typically in the past I think the way you have handled projections was that you took the difference between the actual and the forecast and had that difference decay over the forecast period as an error. Judging from the discussion, I take it you're assuming that the error persists at the same level. Or do you have a different rate of decay? How did you get such a low number?

MR. KOHN. Well, basically we assumed that the forces acting to raise velocity in the first half of the year would persist over the second half of the year. So, for example, relative to our standard money demand model, which has been missing for two years now, we assumed further shifts. Looking out to '93, and if we were to look out further than that, I think we might assume that the additional shifts would taper off; but we would not be tempted to assume that the level of velocity would tend to come back to what it was before. That is, if you interpret this as basically a shrinking of the depository system for one reason or another, as I think the memo to the Committee noted, some of that shrinkage might be a temporary reaction to the problems of the past. But I think a lot of it must be permanent. The safety nets are being priced differently and people view depositories differently. So one wouldn't expect the level of velocity to come back, say, to the old P\* [assumption] but--

MR. PARRY. So there's a different structure?

MR. KOHN. I think it is a different structure. Clearly, one could imagine without too much trouble that at some point in here growth rates will come back into alignment and that the growth of the monetary aggregates and the growth of nominal spending will move together again in a relatively predictable way. But I rather doubt that the level would adjust back, and there's a lot of uncertainty about growth rates in the interim.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Bob Parry's question raised something that has been on my mind for some time. I think there are two ways to look at these intermediate targets, or the long-term targets as we call them now. One is that they are in fact medium-term targets. The other extreme is to set these where we think the aggregates are going to be and not really think of them as targets. I think what Don has said is that the reason he has suggested lower [growth rates] is that he thinks they are reasonable targets because of the downward shift in the demand for money that we've seen, which makes [lower growth] perfectly justifiable. But I think it's a trap we can easily get

into: setting these where we think they're going to be rather than where we think they ought to be. I'm very much in favor of choosing targets and making the aggregates behave the way we think they ought to rather than just putting these out. I think the staff has done a very fine job in a very difficult environment in setting forth the numbers that we have here. And I think Don would agree with what I'm saying.

MR. KOHN. I would want to be clear though, President Black, that we have made our forecast based on the Greenbook projection for nominal income. So, if that projection is anything like what the Committee wants it to be, then we would say that the monetary growth you ought to want is something in the neighborhood of our projection, with this huge margin of uncertainty around all those things.

CHAIRMAN GREENSPAN. Any other questions?

MR. ANGELL. Don, when economic variables don't behave as our background and our history suggest they should behave, it seems to me that we may have a tendency to think too soon that there will be a return to the standard or what we would call "normal." Let me ask you what you think the risks are that this [unusual] behavior of M2 and its velocity has not yet peaked. What is the risk that M2 growth might be even lower and V2 might be even higher than you anticipate? The reason I'm asking is because a 1-1/2 to 5-1/2 percent range is pretty close [on the low side]. It doesn't do what Bob Black suggests, does it? That is, it doesn't really move the range down so that we center it on 2 percent. So, my question is: What is the probability that M2 growth might be substantially lower than 2 percent and V2 substantially higher?

MR. KOHN. Well, we've set our [M2] projection, we hope, with the risk balanced on both sides. Now, as Bob Parry remarked, we did lower it quite a bit this time relative to where we were last time; in the February Bluebook I think we had 3-1/2 percent [M2 growth], or roughly the same as nominal GDP. So, we've gone from 3-1/2 to 2 percent in stages. Quite frankly, my thinking was influenced a lot by the expectation of a bounceback by May and June; we didn't get it. In fact, we are getting quite a bit of weakness and that has caused me to reevaluate this relationship, assuming that the economy has expanded as we expected over those months. So, we made this downward revision. I think we have it centered more or less in this wide sort of very flat probability fan there. I couldn't say that there's no probability that we would have higher velocity: of course, we could have larger velocity increases. At the same time, one issue here is how the Committee wants to treat the possibility of even lower M2 growth, i.e., how worried it should get about M2 or even M1 and whether to put a little weight on that. While I would put the probabilities of a greater velocity increase as obviously not zero, the Committee needs to consider how closely it wants to examine its federal funds rate target if money comes in weaker because it might be telling us something as well.

MR. ANGELL. No, I wasn't suggesting that you weren't balanced; I was just suggesting that if you were projecting 5 percent growth and we had a range of 1-1/2 to 5-1/2 percent, that a miss on one side would be a more serious--

MR. KOHN. Oh, I see. So, the fact that the range wasn't reduced even further to center it around 2 percent is what you're reacting to?

MR. ANGELL. Well, no. I would be historically at least close enough to Bob Black not to want to do that. But I think you've answered the question.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. My question was the question that Wayne Angell asked. It was concern about the fact that we don't know when the correlation of errors is going to break and in which direction, and you answered it absolutely as well as it can be answered.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I have two questions. One is particularly to help me understand some of the terminology. Would you say a little more about what you meant when you started off about using the aggregates as an information variable? Aggregates have been used as an indicator in two different senses: sometimes to underline the thrust of monetary policy actions influencing economic activity and sometimes as a more timely indicator of information about what is going on in economic activity compared to national income account information or other reports. Is there a tendency on the part of the staff at this point to go one way or the another as to how you use these as indicators?

MR. KOHN. No. As I tried to indicate here, I would say that I tend to use them a little both ways. In some sense, in terms of the current situation, we have other information coming in about hours worked and retail sales and this, that, and the other thing. So, the lead [time] of money [supply data] over that information, although it's subject to revision, isn't that great. It might give us a little sense that things were developing somewhat differently than expected but we have a lot of other information coming in. So, I give it some weight that way. But the other issue is whether there are some forward-looking properties to it; and I think in the past there have been, although they have been rather loose. I think money encapsulates both our actions and the demands coming from the market, and one can see influences on them before one sees the influences in the economy. So, in terms of this leading indicator property, I'd differentiate money from, say, the way we treated it from 1979 to 1982 when M1 was the direct target of the Committee and we moved the federal funds rate around very vigorously in a semi-automatic way in reaction to deviations in money growth from the path. Clearly, since the fall of 1982 it has been more of an information-indicator type variable.

CHAIRMAN GREENSPAN. Any further questions for Don? Let me raise an issue which is more than tactics. The issue is how to handle the problem that we have. I think the staff paper is extraordinarily good; I certainly agree with Jerry on that. It pulled together most of the crucial issues that have been discussed around this table for quite a while. I conclude from that paper as well as other observations that for the moment M2 is a proxy for the financing of a system that is clearly broken down. I don't deny that it probably

still has some shadow effect that we don't know the aggregate dimensions of, but the regressions that were employed to separate the different types of money are regressions of a model or series of models, all of which are unchanged over historic periods. Now, we do know that M2 has been falling off the charts in the last couple of years; indeed, a lot of things have. The question we have to ask ourselves [relates to] the underlying assumption we're making--namely, that the structure that we're endeavoring to measure econometrically is unchanged. If it is changed, then obviously one can't make any assumptions even about the nature of the adjusted effects of M2. This is an issue that I suspect we're going to be looking at for a number of months. With the degree of focus that we are giving to it, I would gather that we're going to learn more as we go on, as indeed I think the evaluation of the more complex opportunity cost functions has demonstrated. We will learn things if for no other reason than we will get more observations in this very crucial period, which will tell us about how nominal gross domestic product works its way through the intermediation process to M2-type components.

This puts us in a very peculiar position only because we have a Humphrey-Hawkins testimony in front of us. I would gather that if that were not the case, we would be somewhat more relaxed at this point about how we're going to handle this. So, unless somebody can find a better idea--and I must admit there are not great ones around--let me at least suggest as a fallback position that if we can't find anything better that essentially we communicate all of this discussion to the Congress. I suggest we say we are working on it and we will keep them informed in a written form or something of that nature. We will send them an interim report on our progress, which could be every quarter or what have you, and proceed not to change anything [at this meeting]. In other words, I'm suggesting that we not change the 1992 ranges and effectively pro forma allow the 1993 ranges to be the same as the 1992 ranges. I suggest that only because if we do anything other than that, we are presupposing that we have some knowledge about what is going on, which we don't have. So, we are caught in this dilemma where if we make any changes at all it would be on the basis of an insight we're professing to have, which at this moment I suggest we don't have. I don't feel comfortable with this as a conclusion; it means more work for Don. He doesn't even flinch; [maybe] he isn't listening! [Laughter] But unless somebody can think of a better tactical procedure with respect to how we handle this.... I'm not talking about the more important questions of what it does and how we interlace policy. The issue of how we relate policy to the monetary aggregates is something we're going to be struggling with on a very intense basis for the period ahead, Humphrey-Hawkins to the contrary notwithstanding. But I was raising this collateral, optical question and issue. If anyone would like to comment on that, please do.  
Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I think you have laid out a very good strategy for the approach to our Humphrey-Hawkins report. Based on the conversation and particularly President Parry's question, I would like to note that from an a priori view we may know something. There are really three possibilities that we're considering, which have to do with the money demand curve shifting because of loan repayments or runoffs of time deposits or what have you. The first possibility is that the shift in the demand curve is of a temporary nature and it will shift back. That means we believe small time

deposits, for example, may come back in vogue in the future or that bank margins somehow may [go] back down. If that's the case, then velocity will also bounce back and we are going to need a symmetric tolerance of M2 growth down the road. I think that gets to the heart of Jerry Jordan's question. The second possibility is that we have a permanent demand shift and we're going to see at some unknown point in the future a new equilibrium emerge between the banking sector and other financial intermediaries, with permanently higher bank margins. If that's the case, then velocity will not bounce back but it will stop growing and we'll establish a new velocity relationship but not one where we have this continual 3 percent growth in velocity. And in that case our M2 targets are going to have to be roughly what our nominal GNP targets are. The third possibility is what I would call a continual demand shift: that furthermore we're going to see loan repayments and runoffs of small time deposits. That would mean velocity will always be shifting. We'll have, say, 3 percent velocity shifts every year. In that case, we should permanently lower our money targets. Frankly, I find the continual demand shift model incredible. If nothing else, there are only so many time deposits to run off; there are only so many loans to be repaid. But I think [the shift] will actually stop before that. So, I think we're torn between the temporary demand shift and the permanent demand shift models. I believe that informs our discussion and if anything, Mr. Chairman, it reinforces the view that you have just expressed.

CHAIRMAN GREENSPAN. Thank you. President Syron.

MR. SYRON. Well, I agree quite strongly with where you come out, Mr. Chairman. While we may approach it differently tactically, we all agree that the idea of Fed credibility is very, very important, particularly I would say at a time when, as you mentioned earlier, there are so many shifting sands in other areas. But I think we reinforce that credibility when we don't know something by saying we don't know it rather than by pretending that we do. [That is] my greatest fear when we go up [on the Hill]. I think Larry has outlined three alternatives quite well. My own view is that the structural shifts are still going on and I agree with him in that I don't expect them to go on forever. But I would be very concerned about making a change that would be predicated on the notion that we have some idea, with a measurable degree of precision, of where we are in this whole process. I just don't think we are at that point. The more difficult problem, as you indicated, is the pedagogical one: the timing. And in that context I think we just ought to say that we don't have a precise answer regarding what is going on and we'll keep [Congress] informed. It's an excellent strategy.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I'm with you about 95 percent of the way, which is a lower percentage than it usually is.

CHAIRMAN GREENSPAN. I'll take it any time!

MR. BLACK. But in the absence of some multi-year policy strategy such as the "tunnel" strategy that Governor Lindsey and I so bravely proposed back in December, which we all did not have the wisdom to accept, I think we have to look upon these one-year targets that we set now as sort of a mid-term benchmark. We don't know what

the heck is going to happen, as you correctly said, so I think it's very wise to stick to the 2-1/2 to 6-1/2 percent [M2 target] for this year. The main reason I would suggest that is not that I think we're likely to be anywhere near the 6 percent, but that there is a possibility we might be there. And to have to change [the target] later on by raising it because we chose a range that was too low would reverse what we've been doing over a long period of time. There's a beautiful story in Appendix A of the Bluebook showing how, since about 1980, we've been lowering these targets steadily over time, and I think that conveys an important message. But if we were to choose the lower range and then for some reason or other M2 or the other aggregates were to strengthen and we had to raise the range, I think that would muddle the thinking of the whole financial market and it would be very bad. But by the same token, as we choose our target this time I think we ought to send an unambiguous message to the markets that we have not lost sight of our long-term objective of good economic growth with stable prices. And I would favor very strongly adopting for 1993 a range of, say, 2 to 6 percent [or] one of the recommended ranges--say, 1-1/2 to 5-1/2 percent. Governor Angell and I discussed that last night. A 2 to 6 percent range would be my preference because of the uncertainty, but 1-1/2 to 5-1/2 percent wouldn't bother me either unless we got to the point that it really wasn't enough and we had to raise that. So, I would really prefer the 2 to 6 percent because I think that gives us enough room on the downside to convince the market of what we really want to do and at the same time enough to provide adequate financing for whatever economic growth we can get.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. That sounded like 50 percent agreement to me, Bob!

MR. BLACK. It was higher than that!

MR. MELZER. Alan, I'm in agreement with what you recommend. The only other comment I would make is that in principle I'd align myself with what Jerry was suggesting and I think Bob was suggesting in terms of what these targets represent. If, let's say, we were experiencing some temporary demand shifts or whatever but we still felt confident about longer-term relationships between money and income, I would like to get to the point eventually where we set the targets to be consistent with what we think is an environment of price stability. In other words, we should gradually work them down to some level that we think is [unintelligible], explaining why we missed and not get into the mode that Bob suggested of possibly moving these targets up and down based on what could be short-term [developments]. That's a moot point in this context, I totally agree.

CHAIRMAN GREENSPAN. Implicit in my suggestion is that this item remains on the table until we get it resolved.

MR. MELZER. Oh, I understand that. I'm just expressing my view on that point, but I totally agree with where you are right now.

MR. BLACK. Just to reinforce that I was about 95 percent with you, I think your suggestion that you explain this in your Humphrey-Hawkins testimonies is absolutely vital.

CHAIRMAN GREENSPAN. Oh, indeed.

MR. BLACK. I strongly endorse that; I just forgot [to mention] it. But I'm 60/40 if--

CHAIRMAN GREENSPAN. So 50 and 60 adds up to 110!

MR. PARRY. He's 1000 percent behind you!

MR. SYRON. You have a narrower confidence; you're willing to support it with more precision than the precision we have in the Ms at this point in time.

MR. BLACK. Well, like Governor Lindsey, I think there's a limit to how far these things can go, but I don't know what it is. I think a lot of [the adjustment] probably is behind us because I don't know anybody who has thought about it at all who has not shifted money out of M2. I cited my mother-in-law who is 85 and has gone long-term. And the Chairman asked me if she was holding these for income. I said probably but she wasn't averse to taking a few capital gains if they came. There has to be an end to this, but I don't know when it will be. I think Don's group has done a very, very good job in addressing all the issues; it's one of the finest things they've done, yet I'm sure they feel somewhat dissatisfied with it because it's so complex. If this target-setting gets any more complicated than it is today, it is going to mitigate to some extent the disappointment I have in not being able to participate in the next target-setting session. I don't think I could find one any more challenging than what we have today.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I've agonized quite a bit over this issue of uncertainty about the velocities and control in hitting targets versus the information to the public at large--the need to announce the targets and how that is stated. I would not like to see targets announced in such a way that we are lowering the ranges and the headlines read "The Fed Tightens Policy" without [our action] being tied to some other things that would condition that perception. I go back to what Bob Parry said yesterday afternoon in the first go-around as he concluded his statement about the importance of making our longer-run intentions clear. With the uncertainty or the discomfort over what is going on in the legislative and executive branches of government and the current political situation, it is not the right message for this institution to say: "Well, if you thought that was bad enough, we've lost our compass as well and we also are not sure about the future and the outlook."

The monetary aggregates, especially M2 with its long historical record despite all our uncertainty about M2 as currently put together, are still the best guide that we have for communicating to people what the long-run outlook is. And we have to do what we can to say this will still serve for the foreseeable future. I was not a part of your deliberations not to lower the target range this year, so I'm not in a position of either saying "I told you so" or having to defend something now that was done without the considerable advantage of hindsight. I thought it was useful information to the public at large that the target ranges were gradually lowered year-by-year, with either the upper or lower bound or both being brought down. Had that

sequence been continued this year you would have [established a range of] 2 to 6 percent, which I think would have been very desirable, and we would be looking at 1-1/2 to 5-1/2 percent for next year and 1 to 5 percent for the year after that and would be serious about it. And that would help people in thinking about the long run. We've been in the situation very recently of being at the bottom end or even below the bottom end of the range, and people are wondering if we really are serious about the Ms. I thought the action in April couched in terms of M2 was a useful beginning toward saying we're really serious about it in a symmetrical way: if we're below the bottom end of the target range, we'll do something about it and try to get [money growth] up so that people understand that the opposite is also true. Therefore, if we were at the top or above the top end of the range, we'd also be serious about that, so people would know that we are committed to moving toward a growth rate of money that is consistent with price stability. So, I would like to see the range reset this year at 2 to 6 percent, where I think it should have been anyway. I'm in-between alternative I and alternative II. To go all the way to 1-1/2 percent now and leave it there for 1993 would lose some information that I think is important. But if we leave the bottom end of the range at 2-1/2 percent this year and have 2-1/2 to 6-1/2 percent again next year, then I think that we are bound to say "Here's what we're going to do to make very certain that [M2 growth] is at least within the range rather than at the bottom end," and couple that with [appropriate] short-run actions.

Just to cover what I would really like to see right now: [I'd favor] a very unusual event that should not necessarily be a precedent for the future. I'd announce the ranges well in advance of the hearings--[the Humphrey-Hawkins hearings] being the customary way to do it--coupled with a strong statement that we are serious about being within the range and are willing to engage in reserve supplying operations consistent with an expectation of lower interest rates [associated] with the lower monetary targets for '93. And especially important to me would be that this be done in a way that the Committee is viewed as being solidly behind both the short-run action and the long-run action. I'm very troubled by the perception of the press that changes in the funds rate up or down say something about our long-run commitment to growth versus inflation or the Phillips curve [tradeoff], or that sort of thing. So, [I'd suggest] an unusual press conference approach announcing the ranges and the interest rates expected to be associated with them. And I'd not do that on the day that the employment numbers come out so that we disassociate the action and the announcement of what we want from a measure like employment or unemployment.

CHAIRMAN GREENSPAN. Jerry, suppose we are in a process now of a major change in the role of intermediation in the financial system as a consequence of the decline in the franchise value of the intermediation process, significant increases in intermediation costs, statutory issues, and a major structural change involving one of the large elements in the intermediation process--the S&Ls. Suppose we in retrospect can look back on this period as one with a structural discontinuity that doesn't change the long-term interface between various monetary aggregates, inflation, growth, and the like. Suppose that our P\* model requires a level adjustment but then proceeds and works as well as before. It will turn out that we will be back to an appropriate process of where we should be and how we should be doing

that, but it will also turn out that this particular period will be a period of structural change that will create a deceptive [impression] with respect to how the aggregates are being employed either for monetary policy purposes or as indicators of what is going on in the financial structure of the system. And until we know that or until we have a sense of that, we would be taking a risk in doing what you're suggesting. I say that as one who philosophically agrees fully with the position you've just stated. I do think that we should be working our way down to a stable price environment and at that point then hold the money supply within a relatively stable, modest range--whatever we may decide that should be. But having said that, it would be an act of faith on my part to do what you're suggesting because it presupposes we know the answer to something I'm afraid we don't.

MR. JORDAN. I appreciate that uncertainty. Presuming knowledge that we don't have is very troubling to me. I think that what you have described is the case. I agree that we're in some kind of transitional period to an environment that we will all easily recognize 10 years from now, looking back upon the period as maybe an early 1960s [type of] world in terms of inflation and interest rates and various relationships. It is also a risk to see things like total bank reserves down for the month of June and M1 or M2 or [some other] measure down. The whole array of [monetary measures] is contracting and we are not taking action to do something about it. I'm afraid that if we back away from the aggregates generally, especially M2 in the way it has guided this Committee in the past, that we will simply be looking through the aggregates to real economic activity. And--

CHAIRMAN GREENSPAN. Not necessarily. I think we'll be looking through the aggregates to the total financial system; what I think we actually will do is to try to use the aggregates as a proxy for a much broader view of a very complex financial system. What we should appropriately do is to try to look through [the monetary measures] into what in fact is going on in the financial system. If indeed there are other factors that are suggesting that movements in the aggregates in the most recent weeks are pointing to something, we should begin to see it in certain areas of the system other than nominal gross domestic product or any of the real variables. I don't think any of us would wish to argue that if we see financial constriction occurring in which the aggregates are merely indications of other developments, that action wouldn't be an appropriate thing to put on the table. Obviously, I think it would be. In fact we'll be discussing in our next segment whether or not that is indeed the case.

MR. JORDAN. I've taken some comfort previously from the fact that M2 was at the bottom of the range but M1 was off the top of the charts, the monetary base was growing very rapidly, and bank reserves were growing very rapidly. Given that, I concluded that probably the truth was someplace in between; M2 was probably understating stimulus and M1 and other [measures] were overstating it. Now, it's only one month of information, and I don't want to put too much [emphasis on] that, but I am uncomfortable with the idea that [all the monetary measures] seem to be contracting all at once.

CHAIRMAN GREENSPAN. Well, that's a most legitimate concern, and I don't think any of us would--

MR. BLACK. Mr. Chairman, I don't see a lot of difference in the approaches the two of you are suggesting except that I think Jerry would favor reducing the range next year because of the signal effect. Otherwise it seems to me you have said essentially the same things, as I've understood you. That's the point I was trying to make.

CHAIRMAN GREENSPAN. I think the difference basically is that I would prefer not to make a firm statement about 1993 until we know something beyond what we know at this particular moment. At the point when we can again say that we know something about the way M2 or whatever [measure] we're using at that time is responding, then we can tie that to our long-term goals in a manner which emphasizes what the very general policy of this Committee is.

MR. BLACK. I would much prefer that if we had the option. But if we should take a step toward [ease] either through adoption of a directive that is asymmetrical toward ease or through dropping the federal funds rate, I think we badly need something out there for the future that says we have not abandoned our long-term quest for price stability. And that's why I--

CHAIRMAN GREENSPAN. I would say, frankly, that it's essential that we do that in the Humphrey-Hawkins report, no matter what we do at this table. At this particular period in time to reemphasize our commitment to price stability over the longer run as a fundamental goal of the FOMC is fully appropriate independently of what our discussions [today] or otherwise are with respect to the issue of the ranges.

MR. BLACK. I was sure you would feel that way. I just feel that some tangible movement in cutting the aggregate ranges would be necessary and make that as believable as I would like it to be.

MR. JORDAN. That's why I was suggesting coupling them on just this one occasion. While they are independent in some respects, as I said, I wouldn't be happy to see a headline that says "Fed Tightens Policy" if we lower the ranges; but I also wouldn't be happy to see a headline saying "The Fed Caves In" if we cut the funds rate.

MR. BLACK. That's my problem.

MR. JORDAN. Putting the two together and announcing the range and an expectation of lower rates in order to achieve these [monetary growth objectives] is an important message about the future.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I very strongly support your recommendation. I think you put your finger on the issue correctly when you indicated that were it not for Humphrey-Hawkins we probably wouldn't even be having this discussion. As a matter of fact, I would like to see us spend a little time thinking about how we can get out of this Humphrey-Hawkins box entirely. But that's another issue and it's particularly unrealistic [to address it] at this time. Due to all the uncertainties surrounding the aggregates generally and particularly M2 at the moment, I think we'd be making a big mistake to pay too much attention to them and in effect to chase them by lowering the ranges either for '92 or '93. This is not to say that we should

ignore the aggregates; they do contain information that we have to look at, but certainly over a longer period of time. So, I think our best strategy at the moment with the Congress is to communicate fully. After all, that is what the Humphrey-Hawkins is all about--not so much the setting of the ranges but delineating to the Congress what our intentions are over the longer term both with respect to [economic] growth and prices. So, I think we can explain the shortfall in M2 adequately; and with so many uncertainties, to change the range for '93 now would be a mistake. And, of course, we have the opportunity since this is only a tentative setting of the ranges anyway to make a change in January or February. And by that time, hopefully we will have learned a little more about the behavior of the aggregates. So, I think your recommendation is right on target.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mr. Chairman, Bob Black got into part of my question but I want to follow it up. I just have two questions and then, depending on your answer, I'll respond. Our commitment to price level stability has in it, in a sense, the background that we thought we were going to be lowering these M2 targets until we got down to an M2 growth rate that was consistent with price stability. I believe many of us thought that it meant "never-never land"--that maybe at some point in time M2 growth rates of 1 to 4 percent or somewhere in that area would be consistent with price level stability if we didn't have something going on with regard to the aggregates. After the higher costs of intermediation have worked their way through--and I think Larry Lindsey is right that these [adjustments] can't go on forever, at least not in one direction--what in your mind would be an appropriate M2 target consistent with price level stability in that future out there?

CHAIRMAN GREENSPAN. Well, I don't want to say that I know for sure, but let's define a couple of issues. While Larry Lindsey is right that the adjustment can't go on forever, what he's really right about is that it can't go on at the rate of change that we now are looking at. It's really the second difference that he's raising from this perspective.

MR. ANGELL. Sure.

CHAIRMAN GREENSPAN. If we are using the franchise value of intermediaries--in other words, if in effect technology is gradually changing the fundamental purpose of commercial banking with its so-called credit knowledge capabilities so that securitization becomes increasingly the means of financing--one can envisage a very small intermediary sector. In principle one can visualize zero; there's no conceptual reason why a market economy as complex as ours cannot function with direct finance, provided of course that there is [unintelligible] part of securitization and other mechanisms for transactions balances and the like or a narrow banking system. So, I want to say that over the long run it matters what we are measuring. I can envisage the current definition of M2 actually being consistent with a trend in which unit M2, that is the ratio of M2 divided by potential real gross domestic product, falls relative to the level of prices, meaning it's a sort of P\* with a trend. Now, I don't know what that is at this particular moment. What I'm reasonably certain of is that to the extent there is a sign, if I may put it that way, it

is negative. That is another way of saying that income velocity is a long-term constant; that's the same thing as saying that the price level is proportional to unit money supply. Now, I'm saying that is the outside limit as far as I can judge of what is occurring and that the only thing that may happen is basically that we're getting to a long-term uptrend in velocity, which is the obverse of the decline of the intermediation process. I don't know what the number is; all I'm saying essentially is that in the context of a constant long-term velocity an appropriate guide to monetary policy may be somewhat less than a 1 to 4 percent range.

MR. ANGELL. The second question is: If you believe as you and Bob were indicating in your interchange that price level stability needs to be a significant part of the Humphrey-Hawkins report--and you know I agree with that--what alternate form of communication do you propose [to convey] that that's what we are out to do and the manner in which we want to do it? What would substitute for Jerry Jordan's 2 to 6 percent range that some of us voted for last year and pulling that down? I'm open to another program.

CHAIRMAN GREENSPAN. Let me say the only program that's involved here is a short delay until we get the issue resolved because I think at some point we have to revisit [the question of the ranges for] 1993. And I wouldn't necessarily wait until February if we've come to a conclusion before then.

MR. ANGELL. Well, you see my question stems from a view that there is something resembling a Wicksellian natural rate of interest prevailing in the critical 5-year, 7-year intermediate interest rate area, and we have tacked onto that Wicksellian natural rate an uncertainty premium in regard to inflation because the world doesn't know what we're doing. What I'm asking is: What do we say? How do we explain our action? What is the guidepost that causes the bond markets around the world to understand the nature of our commitment?

CHAIRMAN GREENSPAN. Are you talking about what we say in the Humphrey-Hawkins testimony?

MR. ANGELL. Yes.

CHAIRMAN GREENSPAN. I would say that we'd have to do it verbally and do it in a manner which specifies that we're working on this and that when we come to a conclusion we'll announce it.

MR. ANGELL. Well, I am so committed to such a proposal and I have such questions about M2, which we're working on, that I'm certainly willing to consider an alternative that has that kind of commitment to explain to the world exactly what it is that guides us. And it indicates in a sense the rigors of monetary policy. You know, gold standards aren't marvelous deals; the only thing gold standards do is that they ensure some kind of discipline that will remain there; if you stay with that game, you don't have the luxury of doing what's popular. What we have to do is to indicate some better system than that, which would give the world the confidence we need so that we can get economic growth restored.

CHAIRMAN GREENSPAN. If the judgment of this Committee is right--to the extent I can infer from the various statements different

people have made--I would contemplate, [indeed I think] it's quite conceivable, that we may end up in the latter part of 1993 and into 1994 with significant acceleration of economic activity in the context of a much lower inflation rate than we are looking at now. If that were the scenario and if we were at that point in a moderate financial posture as a central bank, I would say that the message would have been very well delivered and that we would have created a very high degree of central bank credibility. Now, the problem we have is the tremendous uncertainties about what is going on at this moment not only with respect to the economy but with respect to the money supply. It's very difficult to develop any firm footing because we have to be careful not to put our foot down solidly when we don't know whether what is underneath is firm. I think we have very little choice. If I personally thought that at this stage we had in the pipeline a level of inflationary liquidity in the system, I would say that we would be in a wholly different environment than what I think we're in. Then the issue you are raising would disturb me quite a great deal. But I don't think that is the case, which means that I don't think that our having difficulty with this issue is or should be more than a technical problem now rather than what it could be, which would be rather dangerous. As Jerry Jordan points out, if the view were that all of a sudden the Federal Reserve has lost its footings, then I think we'd be in real difficulty.

MR. ANGELL. Frankly, Mr. Chairman, I think that a statement in the Humphrey-Hawkins from you that indicates our commitment to this program and our expectations of some success--almost a Bundesbank-like commitment to price level stability--without any monetary aggregates in it, would work. But that's a pretty tough step for us to take.

CHAIRMAN GREENSPAN. Well, I think what we would do is to repeat basically what we have [said] before because we're testifying before Steve Neal.

MR. ANGELL. Yes, he's very friendly.

CHAIRMAN GREENSPAN. Yes, and what we are subscribing to is basically Steve Neal's proposition. We've already done that, and it is not--nor should it be perceived as--a shift in policy for this institution.

MR. ANGELL. Well, I can go with your recommendation with this interchange as background, and I thank you.

MR. MELZER. Alan, just to clarify: Your proposal for '93 would be just to stick with what we had in '92 and explain? It's not to say that we have nothing for '93.

CHAIRMAN GREENSPAN. No, I'm basically saying that what we are doing is putting in a marker temporarily.

MR. MELZER. Right. And that will be what we had in '92?

CHAIRMAN GREENSPAN. That is correct.

MR. MELZER. Okay. If we do that, I think a lot of the public is not going to look at the nuances, though some people will. But they would really notice if there were nothing there.

CHAIRMAN GREENSPAN. Yes, I think we have to put something in as a holding position.

MR. MELZER. I agree.

MR. BLACK. You said you didn't want to put your foot down firmly, Mr. Chairman; I think 2 to 6 percent would not be putting your foot down firmly like 1-1/2 to 5-1/2 percent would be.

CHAIRMAN GREENSPAN. A 2 to 6 percent range presupposes that we know something in order to move from one range to the other, and I feel uncomfortable about that.

MR. BLACK. I understand. You're in a very defensible position; you're a very persuasive person; you have higher credibility than anybody in the country. But if we don't lower that range, I think people are not going to believe everything you say. That is what I'm afraid of.

MR. ANGELL. In a sense that's the problem we had a year ago. When we talked about the range for '92 we said: "Well, let's just put the tentative marker down and leave it alone." Then when we got to February we said: "Well, we really don't want to change our tentative marker." So our tentative marker last year got to be a little more solid than some of us had hoped.

CHAIRMAN GREENSPAN. But then we believed that when we looked at M2 we were looking at something that--

MR. ANGELL. Well, I didn't think we were and I didn't think Don thought we were. I thought M2 was a problem a year ago. Opportunity costs and M2 velocity were running off the charts a year ago, so we knew we had a problem.

CHAIRMAN GREENSPAN. I knew we had a problem; it's not like the problem we have now, I tell you! President Parry.

MR. PARRY. Mr. Chairman, I certainly would support your recommendation for 1992, particularly with the explanation of the uncertainties. I really do think there is a far better alternative for 1993. It seems to me that if we were to reduce the range by 1/2 percentage point, there are some things we could say that would make a great deal of sense. First of all, we could indicate that the uncertainties are likely to persist, and I'm sure we feel that way. The staff projections would be more consistent with that range than the current range. And most importantly, it would be consistent with our view that over the long term we have this objective of price stability. I don't see anything to lose. That doesn't mean that we're changing it and the uncertainties have disappeared. What it means is that we believe that at some point in the reasonable future those uncertainties are likely to disappear. But there is no reason [not] to take small steps in that direction. As a matter of fact, I think there will be a large group in financial markets and other places who would misinterpret the meaning of our staying with the existing targets for two years. And I don't see what we give up at all by just reducing the range 1/2 percentage point. It's consistent with the long term; it's consistent with the projections; and it's

consistent with the idea that the uncertainties are temporary. I see no problem.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, I would support your suggestion. I have just a couple of comments to tack on. First of all, in terms of this discussion about credibility and price stability and so on, I'm a believer in what we do, not what we say. In trying to get a point of view across to the Congress and the public, it's obviously important, as a number of people suggested, that we reaffirm that. But it's also not a bad idea to look at the record. And the record of the past five or six years, including 1992, in terms of money growth is pretty darn good. Not only is it darn good in an arithmetic sense [unintelligible] in terms of achieving price stability, but the fact of the matter is that this Committee has shown a great deal of stick-to-it-ness over the past three years in a context in which the performance of the economy by most standards has been lousy. I think we have a darn good story to tell. So, I would tell both sides of the story: I would put some real emphasis not just on saying what we're thinking about for the future but what we have done. I think it's a very good story.

Now, the other comments I want to make are that I agree very much with this rather cute little idea of yours of keeping the Congress informed, but I wouldn't go too far in that direction or they'll have you up there every Thursday afternoon after the money supply statistics are released! So, I think we have to hang loose there a little.

The last point I want to make, and I think it's more important, is that clearly part of what we're seeing here is this at least temporarily changed [financial] intermediation process. And I think it's appropriate to put emphasis and perhaps a good deal of emphasis on that. But there's more to it than that. That is partly the reason I made the comment yesterday, and I've made it before, that if it were just M, whatever M you want, that looked funny, that argument would be quite credible. But it's not just M whatever; it's the whole shooting match that looks funny. Therefore, at the very least, I think in your explanation you have to try not to get too tied to this intermediation issue itself. The other thing that obviously can be brought to bear is the debt restructuring and all that. That's another way of saying that the questions that are running around in my mind go well beyond just the disintermediation phenomenon and the role of the intermediaries, short term and long term. I'm cautious about betting the ranch on that issue. The only other point I'd make in concluding, just to complicate matters further, is that if I wanted to, I could make a pretty good argument that price stability could turn out to be quite compatible with higher rates of growth of the money supply rather than lower. That again is just another way of saying that we're in a heck of a box in terms of how definitive we could be about much of anything.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. I just want to ask a question of Bill McDonough. I'm taking the opportunity [now], but the question is one that was more relevant earlier. I think we're talking about tactics here. I

have a fair amount of sympathy for the message [and] the credibility we want to [earn]. But the concern I have and the reason I strongly support staying with the existing ranges is that I simply don't think we know enough. I'm deeply concerned that to lower the range by 1/2 percentage point--the question I want to ask Bill McDonough is related to this--would say that we think we know something with some degree of precision. We have three audiences: the financial markets, the public, and the Congress. The question I have for Bill is whether in this environment, looking particularly at the financial markets, he agrees with my perception that the markets think the Ms are rather confused at this point and whether they would put a lot of weight on the credibility side if we lowered the [bottom of the] range from 2-1/2 to 2 percent.

MR. MCDONOUGH. If the Chairman makes a very strong statement without putting himself in too much of a box--in that regard I would support President Corrigan--that there is a commitment on the part of the FOMC to price stability, I think that is what is important. And it can be done in a way in which holding the M2 [range] as the Chairman suggests is going to be fully acceptable to the market. I think the market would say this: "If you say that you really are uncertain about what is going on in the monetary aggregates and therefore are going to leave them alone, that's fully understandable. If you say you don't know what is going on in the monetary aggregates and are studying it and are going to come up with an answer but in the meantime you are going to change the range, the story doesn't hold together." I think the market is always very confused about a story that doesn't hold together and is very accepting of a spokesman with [the Chairman's] degree of credibility saying: "We're not sure; we're studying it; and we're going to come up with an answer as soon as we have one." That's a very comprehensible, understandable, believable story.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I strongly support your recommendation. At this juncture--and this has been said a couple of times already--our first obligation is to tell the Congress what we know and what we don't know about M2. I think we know a good deal more than we knew at the last meeting but we certainly have not resolved all the uncertainties. In any event, we should share that with the Congress; and putting a great deal of emphasis on the ranges in this context just doesn't make a lot of sense to me. So, leaving the ranges where they are is fine with me. From an institutional point of view or a credibility point of view, being direct with the Congress is the way to go in an environment where it is widely recognized that there are some changing relationships and some mystery with regard to the aggregates and maybe other credit and financial variables as well. That will enhance credibility rather than undercut it. We're not going to fool anybody by pretending that we have some insights that we don't have, at least at this point.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. I would support your approach, although I have a lot of sympathy for Jerry Jordan's comments. The difficulty, as others here have said, is that we are in transition; we are uncertain. In that position, changing targets--whichever way--leaves open so many

questions that I think it will only confuse the participants, and that is unwise. So, I'd go along with your recommendation. I'd carefully explain it and, as Jerry Corrigan said, make a little [comment] on our record and our commitment to price stability in that context. I think that will be accepted better than our suggesting that we know something when we don't.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Well, Mr. Chairman I strongly support your suggestion. And for the reasons that have just been articulated by many, I don't think there's a thing in the world wrong with [acknowledging] uncertainty and [exercising] great caution in the face of basically changing conditions and a situation in which we don't know where those conditions are going to settle. I don't think any apology or any excuse whatsoever is necessary. It would be a mistake if we were to try to bluff our way through and say that we know more than we know or alternatively, at the other end of the spectrum, if we were to stick our head in the sand and say: "Never mind, we are still going to fly on the same old instruments." I don't think either of those courses would be credible. The key to credibility and integrity here is to be candid about this situation. We are working hard to reformulate the guidelines to policy [to foster] new understanding when that's possible to do. I'm not sure when it will be possible to do, which is the only other point I would like to make. I think we have to discipline ourselves and probably educate the Congress and the public to the fact that it may take some time before it's possible to do that again. It may be a while before conditions are sufficiently stable for us to have some confidence that we understand where we are and for things to have settled down so we are able to reformulate our basic guiding stars.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I would support your proposal. I do think there's a case for cutting [the range] a half point in 1993. It seems to me that it's simply time to do so in the normal rhythm of things. It was not unusual to skip last year. In the summer of '88 the Committee cut the ranges for the following year, skipped '89, cut in '90, and skipped '91. The difficulty is that it's '92 now and in the normal pattern it would be time to move. It would put the market on notice, independent of federal funds rate moves and other policy moves. The difficulty I see--and the reason I would agree with your proposal--is that it's simply difficult to send a clear signal in the current environment with the context of a distorted M2; it's difficult to separate the policy target from the questions of distortions of M2. What we lose is that we muddle the signal. I think there's no way to avoid the suspicion that we're moving the target down in part because M2 is weak. And I think we would have a better signal of long-term policy and our targets after this is better understood. It's unfortunate because we are moving up to a period where we have the capacity for reassessment of that inflation premium that Governor Angell talked about. And I am concerned when I look at what the market expects later this year and next year: They expect rates to go up. By setting the fed funds rates we'll get precious little market information on when to do that. Money hasn't been a reliable signal. So, I am a bit concerned that we'll find ourselves following the market up, lagging, and chasing credibility. And one way to try to

get ahead of it is to put the market on notice and send the signal early. I think we'll have a much clearer picture in the months ahead; and maybe we will not have to wait until February because I tend to think that much of this may be transitory. We'll see how the time deposit refugees feel if the stock market gets a little cool here! I do expect the yield curve to flatten in at least two ways. And I think the de-leveraging is running its course. It is true that we have these higher costs of intermediation which have already given the banks all-time record profits in the first quarter. So, they seem not to be suffering too much. Therefore, I think there is a case for cutting the ranges at this time. But the difficulty is that we would lose the signal in this environment, so I would support your proposal.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I completely agree with your proposal and support it for the reasons that you stated. The only thing I would add is that by lowering the ranges it's just possible that we might send some signal to the people who are viewing our outlook and expectations for the economy in terms of the [monetary] growth rate. I just don't think that's the signal we want to send.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I support your recommendation, Mr. Chairman, but I just have a nervous reaction as to how much we tell the world that we don't know. This is a jittery kind of situation. We have an unusual political situation and an uncertain trend to the economic recovery that most of us, I think, believe is genuine. And this institution is considered one of the anchors, one of the stable factors in this whole political and economic environment. If we are too forthcoming about how little we know about M2, which is the [measure] on which we have hung all of our policy rationale for the past several years, frankly I think that could be a very destabilizing element in the whole environment. So, I'd just caution that we should be very careful as to how much we say about how little we know.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Clearly, we're in this terrible gray area that Governor Kelley talked about yesterday. I'm having a bit of a hard time separating the discussion on the longer-range goals and the short-term action. To try to comment on the goals outside of some discussion about the short-term action I find a little difficult. It seems to me that if they were taken in conjunction, we'd have an opportunity to give two messages: A message about the strength of the economy and at the same time a signal with respect to our seriousness about inflation. As a citizen I also have some difficulty setting goals that we have no chance of meeting and that we're not intending to meet. In a managerial sense I've generally thought of goal-setting as something that makes a statement as to where one wants to go. I don't think goals are always set in an environment where one has full knowledge of all of the variables that make up what goes into those goals. So, I'd rather see a bit of a conjunction in the message that on the one hand we're going to ease to try to deal with the economy but at the same time we are making a statement about inflation with respect to our longer-run objectives.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, I support your recommendation primarily because I don't have a better idea. But I share Governor LaWare's sentiment that it's rather tricky trying to enhance our credibility by admitting that we don't know what is going on.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, let me ask a question. I probably misunderstood what you said the first time in light of your later comments, particularly your answer to Governor Angell. If in fact we go up [to Congress] and say that we are uncertain about where things are temporarily, that's one thing. The question I have is: If we think, as you suggested, that a continual demand shift may be going on, then aren't we really throwing monetary aggregates out the window on a permanent basis?

CHAIRMAN GREENSPAN. I don't think so because the type of shift that I was discussing is a long-term shift, in which what we're dealing with is a relatively small "add factor" not a short-term or even a major [unintelligible] break.

MR. LINDSEY. So, you would expect within the foreseeable future that we would be back to some kind of stable money/income relationship?

CHAIRMAN GREENSPAN. I would certainly think so.

MR. LINDSEY. Is it your expectation that that will be by '93 perhaps?

CHAIRMAN GREENSPAN. I'm going to comment when we get to the next agenda topic, the short-term [decision], on what I think is going on in the economy, which is not unrelated to that. Let me try to answer that question in that context because I need [to cite] some background to give you my point of view.

MR. LINDSEY. My third question about what you were saying is: Are you going up there with no anchor at all? In other words, if you say that temporarily we're not looking at M2, I think Milton Friedman and others have--

CHAIRMAN GREENSPAN. No, I'm not saying that.

MR. LINDSEY. Oh, good. Okay.

CHAIRMAN GREENSPAN. We are saying that we are looking at it. We're saying nothing more than we have basically said [before]. In other words, we are not saying it is meaningless. To say it is meaningless is a statement of knowledge. What we're saying is that something that had relationships has gone off the track. That basically stipulates that for this particular time it has no meaning; it is a state of knowledge we don't have. Indeed, it may be reflecting something quite significant, but we don't know that.

MR. PARRY. Implicit in your statement is that you would expect that uncertainty to continue through 1993?

CHAIRMAN GREENSPAN. No, I don't know. I'm saying I expect that the uncertainty will continue enough that we will not get through the next Humphrey-Hawkins hearings with any real insight into what is going on. It may well be that by September or October we'll have a much better sense of what is going on and a much better feel of what the relationships are. I might add that under those conditions I would think we would then take a firm shot at 1993. I myself would not be disinclined, under those conditions, to go lower.

MR. LINDSEY. Mr. Chairman, I think confusion demonstrates why you're such a wonderful person to represent the Fed.

CHAIRMAN GREENSPAN. I don't know if I like that but go ahead! [Laughter]

MR. LINDSEY. Well, I mean you managed to convince us all. I must admit I'm puzzled but--

MR. ANGELL. In other words you find it hard to vote the same way that I vote?

MR. LINDSEY. In view of the fact that you are on the other side of the table I'm not surprised. I look forward to seeing your Humphrey-Hawkins testimony, Mr. Chairman, in a tactical sense. [Laughter] But I appreciate your answer to the question and that we're not abandoning M2.

CHAIRMAN GREENSPAN. No, I have no intention of doing that because I, frankly, think it would be a mistake.

MR. LINDSEY. Okay.

CHAIRMAN GREENSPAN. It's the question of interpreting what we're looking at that's crucial. President Jordan.

MR. JORDAN. I have both a question about how this would be explained and also a recommendation. But before I get to either I have a couple of comments that may sound like digressions but to me at least they have a point. First, I'm in somewhat of an uncomfortable position having written in 1982 very positively and glowingly about the good relationship between M1 and nominal GNP and the stability of M1 velocity over the prior 20 odd years just at about the time it was breaking down. So, I am hesitant about riding a horse that is in the process of change. Some 20 to 25 odd years ago or more, there was a lot of discussion in this Committee, in System committees on the directive, and in academic circles about technological change and innovation--what was going on in the financial system--suggesting that the relationship between the narrow aggregate, M1, and economic activity would break down because of velocity growing extremely rapidly due to things like sweep accounts, point-of-sale transactions, automatic transfers, credit card utilization, and so on. The idea was that the demand for some narrow measures of transactions liabilities, maybe even currency, would decline and so velocity would [grow]. Well, we had exactly the opposite in spite of all that wisdom that went into what would be wrong with M1.

In the late 1970s there was a great deal of work done, some by the Board's staff, some by staff of the Reserve Banks and by

economists of commercial banks--the ABA advisory committee was very active in it--assisting in the effort to try to improve control of the narrow monetary aggregates. That wound up in the 1980 omnibus legislation. The way we got to the single uniform reserve ratio on all transactions liabilities was that we wanted to crown M1. We wanted to reduce the variability of the multiplier so that when balances shifted from Reserve City banks to country banks, members, nonmembers, savings and loans and on and on, we stopped getting all the noise we were getting. We entered into this legislation with Bob Weintraub's help [unintelligible]. That may have helped in the very short-run sense because nothing happened with M1; [that] would do us no good at all in terms of M2. My question first before the recommendation is: If the targets were not changed for '92 and '93, would that be accompanied--in addition to a statement that we're studying this and we're comfortable being below the target range pending results of studies and we're not going to do anything--by a fairly clear indication that we're not going to lower the range and we are going to [take] actions intended to bring the growth back within that range?

CHAIRMAN GREENSPAN. I'd be more inclined to imply--or even to state if necessary--that if the money supply were on track or we understood it, it would be the inclination of this Committee to lower the ranges. In other words, I'd make a statement that it's the philosophy of this Committee to move the ranges down, but in this context, prior to an understanding as to what the appropriate structure is, no action is being taken. My own inclination is to suggest that the view of the Committee--if we decide to go the way I was suggesting and I was just raising it as a suggestion--is that we would reiterate the long-term goals that we have previously stated and indicate that we do not believe that [the current] range captures the lowest level that we ultimately wish to achieve and that there is a further step to be taken. Don, am I correct that it was the last hearing--or was it a year ago?--when we originally moved to this level for the ranges and we stipulated that this was a way station to a lower level? I think reiterating that as our general purpose for our long-term strategy can be done without getting involved in actually saying that we would move the [ranges] down. That would imply that when the numbers have gotten back on track and we understand them, that the notion would reassert itself in the then context of relationships that we figure are stable.

MR. JORDAN. Given that response, I guess I come out where Bob Parry suggested in that he doesn't see what the cost is--

CHAIRMAN GREENSPAN. The cost is basically what has been raised by Governor Mullins and others: There is a danger here that we could be moving the ranges not as a [matter of] policy but as a pragmatic [adjustment] merely because we are more or less getting them down to where the numbers are. It's a very difficult thing to fight. It looks like an opportunistic as distinct from a principled action.

MR. JORDAN. My recommendation then is that we indicate in addition to the point that we are very seriously studying these relationships that we also are going to do more than just study this and we're going to be making recommendations in order to enhance both their control and maybe their relationship with economic activity. My preferred recommendation for some time on that idea is to move to a

system, which would require legislation, of a single very low reserve ratio applied to all non capital liabilities. On M2, we don't want a single reserve ratio as we currently have only on transactions liabilities and not on nontransaction liabilities. We have this oddity of unbound banks and surplus vault cash and on and on which confuses the issue even as to what total reserves are in the usual way of thinking. My guess is that [the single reserve ratio] would be well under 5 percent. It would both correct the competitive inequity problems in the banking industry today caused by the way FDIC insurance is assessed in combination with Reg D and the way we impose reserve requirements whether they're domestic oriented or funded [unintelligible] pay the higher tax or franchise fee than does a wholesale bank or money center bank.

CHAIRMAN GREENSPAN. Jerry, I think there's considerable sympathy around this table for that view. Remember that the original position regarding reserves on transactions balances largely reflected a view as to how this Committee would function operationally when the legislation was passed. Now that is no longer the case. If people are going to focus on M2, we would clearly want to look at the question of why we have reserves on transactions balances only. That is a very legitimate question. We have to look at the problem we may have with it, which is that if we do that something else will pop. It's not something that we can automatically get involved in because were we to do that, as we study it--which I'm sure is in fact your purpose--we probably would get a far greater ability to stabilize M2 growth but at the cost of significantly more volatile interest rates, at least in the short run. So, an interesting set of questions is involved, but it's a quite legitimate issue to be raised because I think there is a fundamental inconsistency in our approach to have targets for aggregates which we effectively can't control. I'm not sure we can control M2.

MR. ANGELL. That's the big point.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. A point of clarification: As I understand it, the proposal is to set tentative preliminary ranges for '93 and that we could revisit this, say, in October or November and actually change the ranges then rather than wait until February.

CHAIRMAN GREENSPAN. Yes, in fact that's precisely--

MR. MULLINS. Why don't we put it on the agenda as we get more information and this will give us another opportunity to say something instead of saying that we have--

CHAIRMAN GREENSPAN. What are you getting at?

MR. MULLINS. Well, on the FOMC meetings as we go forward when it comes time to consider this, let's just put it [on the agenda].

CHAIRMAN GREENSPAN. Do it formally?

MR. MULLINS. Yes, do it formally.

CHAIRMAN GREENSPAN. Yes, I think that's--

MR. MULLINS. Then we're communicating not just that we have decided to postpone until February consideration of--

CHAIRMAN GREENSPAN. I have not intended to imply that we would. That's the reason I said that we'd be sending up interim reports from the Committee.

MR. MULLINS. It might be useful to do it in October or November.

CHAIRMAN GREENSPAN. Well, supposing we--

MR. MULLINS. If we're not ready, it would not be useful!

CHAIRMAN GREENSPAN. I would say in the Humphrey-Hawkins testimony that it's our expectation that this issue would be revisited as soon as feasible, hopefully by the fall or whenever we're ready.

MR. MULLINS. Yes, I wouldn't expect you to commit in the Humphrey-Hawkins testimony but just for our own planning.

CHAIRMAN GREENSPAN. No, for our own planning this is on the agenda until we resolve it; it's on every six weeks with a report from Don because I don't think that we can put this aside until the question has been addressed. President McTeer.

MR. MCTEER. Just an observation, Mr. Chairman: I believe it's true that over past periods when we've observed stable velocity of various Ms, it has been stable because after the fact during the period of changing circumstances the definitions of the Ms have been changed to take account of changes in composition and so forth. So, they are sort of stable retroactively. With that background, I believe we're overstating our ignorance because I think we do know a lot about what has been happening to M2. Maybe we should be focusing more on that and perhaps less on the ranges. For example, if we adjust M2 over the past few months to what has been happening to stock and bond funds and perhaps RTC activity, I believe that we can make the case that M2, properly defined to take that into account, has been pretty much in the middle of our target ranges.

CHAIRMAN GREENSPAN. Yes, but then unfortunately the trouble is that if we carry that definition consistently back, it ceases to have the earlier robust relationship with nominal gross national product. I'm not sure that the changing definitions have created that much of an alteration in history. My recollection is that even though the definition of M2 has changed materially over time, it has always been stable back to the turn of century.

MR. MCTEER. I think it's the case with M2 and M1, though, that it's much more stable after the revisions backward.

CHAIRMAN GREENSPAN. I will not deny that.

MR. MCTEER. I think we would have--

CHAIRMAN GREENSPAN. The reason you can assume that is that we would not have published if it were less stable!

MR. MCTEER. In any case, I would hate for us to overstate our ignorance and have that be interpreted as our not having a clue as to what is going on. I think we know pretty much what is going on.

CHAIRMAN GREENSPAN. What we will do essentially is to indicate very much what the staff study suggests, which is a very clever insight into a number of issues, and say what pieces of information remain to be understood prior to our coming out with an answer. I think that's actually what we're doing. Any other comments?

I'd like to have separate votes on this since there may be differences. I would like to propose alternative I with the stipulation that for 1992 [we will retain the current ranges]. You have the language that goes with it. Don, would you give us your recommendation on the language here?

MR. KOHN. Just on 1992, assuming the Committee votes to retain the 2-1/2 to 6-1/2 percent range, the staff had put in a sentence, shown at the bottom of page 21 and the top of page 22 of the Bluebook, that the Committee might want to consider if it wanted to say that velocity increases might persist and that it recognized that [money] growth could be low. As I read this in the full light of the FOMC meeting, my recommendation is that, given the uncertainty, I wouldn't use the second half of this sentence saying that M2 and M3 could come in around the lower end of the ranges; we just really don't know. So, I think there are really two alternatives. One is to say: "In evaluating the aggregates, the Committee anticipated that developments contributing to unusual velocity increases could persist in the second half of the year" or something like that so at least you convey some sense that something unusual is going on. While you were talking I was writing something else similar to that: "In evaluating the growth of the aggregates relative to the ranges, the Committee recognized the unusual behavior of velocity apparently in train this year" or something along those lines. So, I would recommend against the second half of the suggested sentence. But the Committee might want to say something like the first half of the sentence in the directive. Obviously, this will be said in the Humphrey-Hawkins report, so it's not as if we wouldn't be communicating with the public. But you could say something in the directive about anticipating unusual velocity behavior this year.

CHAIRMAN GREENSPAN. The Humphrey-Hawkins report will be published before this is published.

MR. KOHN. Right.

CHAIRMAN GREENSPAN. So, this is really a moot question?

MR. KOHN. Sure. It's just a question of completeness of the record.

CHAIRMAN GREENSPAN. Yes.

MR. KOHN. It's not important.

CHAIRMAN GREENSPAN. The first [part of the] sentence I think probably makes sense and I'd leave it at that.

MR. ANGELL. The first half?

MR. KOHN. Just the first half of the sentence. Okay, so it would say: "The Committee anticipated that developments contributing to unusual velocity increases could persist in the second half of the year."

CHAIRMAN GREENSPAN. Period.

MR. BERNARD. This will be a vote on the 1992 ranges. The first sentence on the general objectives would stay the same and then continuing: "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 2-1/2 to 6-1/2 percent and 1 to 5 percent, respectively, measured from the fourth quarter of 1991 to the fourth quarter of 1992. The Committee anticipated that developments contributing to unusual velocity increases could persist in the second half of the year." And then to pick up on nonfinancial debt, about the middle of page 22: "The monitoring range for growth of total domestic nonfinancial debt also was maintained at 4-1/2 to 8-1/2 percent for the year."

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Hoenig	Yes
President Jordan	Yes
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Melzer	Yes
Governor Mullins	Yes
Governor Phillips	Yes
President Syron	Yes

CHAIRMAN GREENSPAN. Okay.

MR. ANGELL. Congratulations, Mr. Chairman

CHAIRMAN GREENSPAN. Wait a minute.

MR. BERNARD. And then for 1993 beginning about two-thirds or so the way down on page 22: "For 1993, the Committee agreed on tentative ranges for monetary growth, measured from the fourth quarter of 1992 to the fourth quarter of 1993, of 2-1/2 to 6-1/2 percent for M2 and 1 to 5 percent for M3. The Committee provisionally set the associated monitoring range for growth of domestic nonfinancial debt at 4-1/2 to 8-1/2 percent. 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."

MR. SYRON. May I ask a question just on the language? I'm sympathetic to the suggestion, but the concern about velocity also applies to what we're talking about for the '93 ranges. So, I'm

wondering if it would be better just to say that unusual velocity could persist, period, rather than to say it could persist in the second half of the year. If it was thought that that sentence would apply also to the '93 targets, that might be better because otherwise we don't have something that explicitly says that.

MR. KOHN. We do. The last sentence says: "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."

MR. SYRON. I saw that, but the earlier sentence that refers to '92 is a little more explicit.

CHAIRMAN GREENSPAN. Yes, the trouble is it creates the type of problem that Governor LaWare is concerned about. It makes too much of a "know-nothing" [unintelligible].

MR. SYRON. I understand that argument and I don't want to say that we don't know anything; but I think there is a difference in being able to say that the world has evolved and that our body of knowledge and ability to interpret--our internal computer, so to speak--hasn't diminished in terms of our effectiveness. But it's this external environment; it may be a subtle point and it may not be possible [to convey it]. I happen to think that's what the situation is, that our internal capacity to evaluate these things probably is greater because of the experience than it has been in the past but that the external environment is more difficult.

MR. KOHN. The sentence refers to velocity "increases," so I don't know whether the Committee wants to make that statement about next year particularly [unintelligible] ranges. I think it recognizes the fact that growth is coming in at under 2 percent, Q4 to June.

MR. SYRON. It was a suggestion and I withdraw it. But I can't withdraw a question! [Laughter]

MR. ANGELL. Don, is there any alternative language to "The Committee agreed on tentative ranges"? It seems to me that what we're saying here is something a little different than "agreed" on tentative ranges. I think what we've agreed to do is quite different; we are really saying that we are deferring a decision to change the range.

CHAIRMAN GREENSPAN. Can we say "The Committee tentatively placed" or something like that?

MR. ANGELL. Yes, any change in the wording would be helpful.

CHAIRMAN GREENSPAN. I think you're right that the word "agreed" is not the right word.

MR. LAWARE. "Tentatively established"?

MR. ANGELL. "Established" is tough.

MR. PRELL. The statute in force requires language close to this. I think it requires you to "establish"--

MR. KOHN. "Plans and objectives."

MR. PRELL. Yes, "plans and objectives." And one time we tried not to, though that was more extreme--

CHAIRMAN GREENSPAN. Well, this will be a minor issue because it will be published after the Humphrey-Hawkins report and we'll handle that in that respect.

MR. LAWARE. Why not just say the Committee "set" tentative ranges?

CHAIRMAN GREENSPAN. That's a good idea.

MR. ANGELL. Yes, "set" is better.

CHAIRMAN GREENSPAN. That's much better.

MR. ANGELL. Well, "plucked" might be even better!

CHAIRMAN GREENSPAN. I think "set" solves the problem.

VICE CHAIRMAN CORRIGAN. Right.

MR. ANGELL. Thank you.

MR. BERNARD. Change "set" to "established" in the other sentence?

CHAIRMAN GREENSPAN. Okay, sure.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Hoenig	Yes
President Jordan	No
Governor Kelley	Yes
Governor LaWare	Yes
Governor Lindsey	Yes
President Melzer	Yes
Governor Mullins	Yes
Governor Phillips	No
President Syron	Yes

CHAIRMAN GREENSPAN. Okay, let's now break for coffee.

[Coffee break]

MR. KOHN. A number of members yesterday gave the reasons I'd already written down for why the Committee might want to choose one of the other courses for the intermeeting period and I won't repeat them. I do have a few background points, though, to bring to the attention of the Committee as you make your decision on short-run policy. First, I can bring you up to date on the monetary aggregates; we do have some new information this morning and it suggests a further weakening in money growth and credit. The revisions are exclusively in the M1 category. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Mr. Kohn?

MR. ANGELL. Don, M1 growth from Q4 to June would be what?

MR. KOHN. Well, Governor Angell, I don't have that answer for the new M1, incorporating the latest revisions. I guess I'd subtract about 1/4 or 1/3 of a percentage point; growth from Q4 to June before was 12-1/4 percent so my guess would be 12 percent or a little under that.

MR. ANGELL. So it's approximately 12 percent--well within double-digits then?

MR. KOHN. Yes.

MR. ANGELL. And the 3-month growth rate of M1?

MR. KOHN. Well, it was 6 percent and now it would be 5 percent approximately.

MR. ANGELL. Thank you.

MR. SYRON. Don, what is your early look at next week?

MR. KOHN. For the week to be published M1 would be about flat and M2 and M3 would decline by about \$3-1/2 billion and \$9 billion respectively. I hasten to add that these are very preliminary data subject to substantial revisions.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Don, do you think the prime rate would respond to a 1/4 point cut in the fed funds rate?

MR. KOHN. I think it's highly likely. The banks didn't respond last time; I think another cut would put pressure on them. I suppose they might try to resist, especially if there weren't a discount rate cut at the same time. It would be a nice test of whether there is any aggressiveness out there in seeking loans.

MR. MCTEER. Do you have an educated guess about June employment numbers?

MR. KOHN. No.

MR. PARRY. Do you have a guess?

MR. KOHN. Mike has a guess.

MR. BLACK. Uneducated?

MR. PRELL. Our guess was 80,000. Just to bring you up to date, for those who don't have telerate screens today, the National Association of Purchasing Managers came out with a report this morning. The overall index was down [from] 56 and a fraction to 52 and a fraction. Construction put-in-place data for May came out; they were a little hard to read because they involved revised seasonal factors, but a quick look suggests that the numbers going from the

first to the second quarter were considerably stronger than we had anticipated, particularly in the state and local sector. So, offsetting some of the disappointment there--

CHAIRMAN GREENSPAN. We finally got a number that's higher than expected!

MR. PRELL. This state and local number is phenomenal; it's running very strong.

MR. BLACK. Was the private nonresidential unchanged?

MR. PRELL. Well, that's what is a little hard to read. It does not appear to be a drastic change from our expectation.

MR. ANGELL. Does that modify your real GDP for the second quarter?

MR. PRELL. Well, I think it helps it to stay in the 2 percent area.

CHAIRMAN GREENSPAN. Any further questions for Don?

MR. STERN. At the last meeting were we looking for 2-1/2 percent M2 growth for the second quarter or something like that?

MR. KOHN. We were looking particularly for about 1-1/2 percent in May and 3-1/2 percent in June, which we didn't get.

MR. STERN. Did you run a simulation or anything with the experimental model for the second quarter?

MR. KOHN. Not for the second quarter, or at least if we did, I'm not aware of it. Dave Lindsey, are you aware of anything? I didn't ask anyone for it.

CHAIRMAN GREENSPAN. Further questions? Jerry.

MR. JORDAN. With the advantage of whatever hindsight there is in the last few months, if you felt very strongly about 1-1/2 percent for growth of an aggregate in the second quarter--and it was talked about a couple of months back--would an experimental model have suggested that if there had been a sufficient cutting of the funds rate it would have produced that kind of growth? And would we know about which components of M3 are going down [unintelligible]?

MR. KOHN. I wouldn't know exactly what the ceteris paribus is there, but I think probably not. That is, the interest elasticities in those models, while still of the appropriate sign, assume that long rates react a little with short rates since there's a lot of yield curve [unintelligible]. [If] long rates go the wrong way or don't move at all, then the interest elasticities go essentially to zero or even turn around. But assuming long rates came out as they did over the second quarter, it would have taken a very large reduction in short-term interest rates--I don't know the number--to have gotten M2 growth into the 2 to 3 percent area over the quarter.

MR. JORDAN. It seems to me that there are only two ways we're going to get stronger M2 growth: If there is either a pickup in loan demand and banks bid more aggressively so that the yield curve on their liabilities shifts with the offering rate on time certificates versus regular savings and so forth; or if the banking industry decides to drop sharply the zero maturity deals. At some point there will be yields between zero maturity liabilities from checkables and regular savings and money market deposit accounts, versus time certificates [that] compete with other nonbank liabilities.

MR. KOHN. I think dropping the zero maturity yields isn't going to help M2 growth. In fact, that's basically the story we're telling for the rise in velocity in the second half of this year and into next year: That those zero maturity yields along with the effects of the FDIC Improvement Act (FDICIA) will be dropping offering rates. And while some of that will just keep money [in] time deposits to some extent, people with savings-type money in NOW accounts will be looking elsewhere to put that money outside of M2. So, I don't think dropping those rates will help.

MR. JORDAN. If balances shift from reservable liabilities to non-reservable liabilities, we're going to see either a contraction in bank reserves--Desk operations will be absorbing reserves--or a build-up, temporarily at least, in excess reserves. And the banking industry is going to be working to try to get rid of those excess reserves.

MR. KOHN. Right, and the federal funds rate would be under tremendous downward pressure.

MR. JORDAN. Exactly.

MR. KOHN. Right. And so as long as the Committee sets the federal funds rate with an instruction to Ms. Lovett to hit it, the reserves could contract under that situation. If the Committee were to choose to target a reserve level and that happened, then I think the federal funds rate would drop very substantially in the short run.

MR. JORDAN. So, we'd have a situation where bank reserves are going down with a constant funds rate and the interpretation would be that policy is unchanged while bank reserves are contracting?

MR. KOHN. That depends on how one measures policy.

CHAIRMAN GREENSPAN. Anything further? If not, let me get started on the discussion. I've puzzled about the fact that we as a group have a fairly general, consistent notion as to how the economy works and where we'd like it to be, and yet in yesterday's discussion it was fairly clear that there was a very significant difference among various [speakers]. I asked myself what is causing that to see if we can get a firm view as to how the system is working. As best I can judge, it all really started with Jerry Corrigan and others raising the point that if somebody wanted to certify the outcome in the Greenbook, we'd all say "Hurrah, that's perfect" and we'd sign off on it right now. I'm not aware of any of us who would argue strenuously that the outcome in the Greenbook is substantially inappropriate and that if it came out that way we would be anything but pleased. The

question really gets down to the notion of what could prevent that from happening.

While there were some comments--not a great number but enough to raise an issue--that the economy could conceivably turn out to be much stronger than the outlook in the Greenbook, the substantial concern was that it would fall short. That is, most of you who are in this camp suggested that the risks are on the down side, implying that in some way the economic system would falter. I think we have to ask ourselves why. What is it about the system that we are now observing that would have that particular characteristic? If we take the Greenbook forecast, we have a standard, old-fashioned economic forecast with old economic relationships, as Mike Prell put it. Maybe I shouldn't put words in his mouth! He'll come back at me and tell me he was misquoted! [Laughter] I'll [ascribe that description] to myself. We are having a significant expansion in operating profit margins, cash flow in the corporate sector is improving, and we are beginning to see it in the capital goods markets. History tells us that that process will feed in through the increased incomes and employment that a number of people are looking for. A conventional expansion of the type that is in a sense expressed in the Greenbook, or even something slightly higher, would be the normal expected outcome. That is what that view of the world exemplifies. Were that in fact the case, it's pretty obvious at this stage that where we are with monetary policy is probably where we ought to stay because there is no obvious need to move [rates] lower; in fact one can argue that it may be counterproductive in that context for us to move lower.

There is, however, the other model which is evolving over time, which I would hate to be required to put into structural form and try to estimate its parameters. In fact, I'd even prefer not to put it down in writing because it might get too clear! I'm not being facetious. There is a sense that what we're looking at really gets to [such] a set of relationships here. Let me try it out and see where I get because I think it would explain what the phenomenon is and would suggest to us what to look for to test whether the hypothesis is working. I start with something we've discussed before: namely, to explain the nature of the balance sheet restraint that resulted from a significant rise in assets during the 1980s, funded by debt, and a subsequent decline in market values of assets which created balance sheet impairment. The balance sheet impairment [leads] individuals and businesses to move their cash flow from the purchase of goods and services and investment goods toward debt reduction or other balance sheet repairs, essentially shifting the consumption function in a manner to generate a much higher saving rate and basically a pulling back on investment incentives in the business sector. Now, that is a phenomenon we have seen many times in the past--it's called [the panics of] 1873, 1893, 1907.... It's the classic balance sheet/market value crunch which induces a very significant liquidity freeze-up in the banking system and induces a tremendous shift of cash flow toward savings rather than to the purchase of goods and services. And you get the classic Keynesian contraction at that time.

It strikes me that what we effectively have been doing since 1989, I hope more consciously than otherwise, is to take the same adjustment process--which in the 19th century would have meant that the economy would have gone down sharply, the balance sheets would have been repaired reasonably quickly, and [the economy] would have

come back the usual way--and by injecting significant and continuous amounts of liquidity into the system, we in effect have prevented the liquidity freeze-up and have stretched out the adjustment process. The question, of course, is whether there is more adjustment that has to be done this way or less. Or do we know? I suspect that at this point we don't really know. But I do think this explains, or can explain, what basically has been happening in the last two years. When we continue to inject liquidity in the system, the adjustment process takes place; and when we stop injecting liquidity, after a while the economy begins to show symptoms of weakness again. That is another way of saying that the unmedicated economy goes back to the way it used to behave in the 19th century and it begins to get the [liquidity] freeze-up until we re-inject even small amounts of liquidity and the adjustment process continues. That, I believe, can explain the Christmas effect that we had. I think it explains the April injection. And the question that one has to ask is: If this is in fact the case, how long will it go on and what will happen if we stop moving toward supplying liquidity when a normal adjustment process is in fact to squeeze up the process and to tilt the economy toward a sharply increased propensity to save rather than to consume and go into investment goods?

If what we are seeing now is an indication that we haven't done enough and that the last injection has petered out, then presumably we will see some weakness in activity, which is very difficult to explain in the context of our standard models. In other words, it is very difficult in my judgment to take our standard models--to take the income flows that are moving the profit flows--and argue other than [that we will see] an increase in activity albeit modest. So, the key test of which of the models is basically working requires an evaluation of the short-term phenomena. And the reason why in Jerry Jordan's terms we are somewhat concerned about the turn in all of the monetary aggregates and the low level of nonfinancial debt creation, which incidentally would be obviously explained by this process, is that one would presume that if we are dealing with a sort of implosion propensity, we may see it in very modest financial intermediation and presumably also in a significant softness in loan demand, which is basically what we have.

So, if this does explain the phenomena--and let's assume that we now have done enough and that the data for the most recent weeks are phony and the economy is coming back--it does raise an interesting question on the other side of this whole process. Because if we had been injecting significant amounts of liquidity in the system--and at the moment I leave what I mean by that somewhat undefined--it would follow that when the balance sheet adjustment is complete, the level of liquidity would be too high and we would then be required to pull back in the growth [of money] as the economy begins to [gain strength] and as the cash flow, which has been drawn off at least in part into savings flows, starts to shift its proportions to a more normal .95 in personal consumption and a much higher response in the capital goods markets. I might say that the argument statistically, which raises some question about this hypothesis, is that it is difficult to find a significant rise in the saving rate. Granted, I'm only looking ex post; the argument that I'm making is ex ante. Nonetheless, if there were a significant rise in the saving rate, that would very strongly suggest that this is a model that is functioning.

Now, it may well be, as we have discussed at other times, that the personal saving rate is indeed actually higher than we are measuring it on the grounds that the statistical discrepancy may be reflecting a shortfall in wages and salaries or personal income. And that particular shortfall would be consistent with the fact that household employment data are actually much stronger than the payroll data; indeed, some analyses by the staff suggest that the next revision of the payroll data will be up. That might suggest, since personal consumption expenditures have not changed in this process, that raising income will put it all into savings. So, it may well be that looking back at this period after the fact we will indeed see what is seemingly the missing ingredient in this model: That we have a somewhat higher level ex post of savings than we [currently] seem to be getting. In any event, what all of this suggests is that the testing of these two models as to what is happening is essentially what we are seeing at this particular stage.

My own impression is that having eased 22 times so far [since May 1989]--is that what it is Don?--which has to be some sort of record, we have to be getting close to the point where this adjustment process is beginning to come to an end. I would suspect that at the point it does come to an end this economy could all of a sudden show some significant vibrancy. But, obviously, we don't have to go all the way because if, for example, the proportion of expenditures out of cash flow is rising, though it remains subnormal, the rate of growth in the economy will pick up, although less than its potential. So, I think it would be helpful to look not only at the economy directly but to a great extent at what is happening in the financial system for an indication as to what is going on. Having come through all of this, I would conclude that we have to watch very especially the nature of what is going on in the economy. I would suspect that were we to choose to move, say, 25 basis points and got a prime rate cut, we probably would get 50 basis points; and if this process of liquidity freezing up is what is occurring, then clearly that would be helpful at that particular time. I don't feel overly comfortable, frankly, with either of these two models at this stage. But I think they do capture, as best one can, the prevailing possibilities--the major probabilities--of where this economy is going. We're undoubtedly going to learn a good deal more in the next couple of weeks as to how this is all evolving.

I conclude by saying that, after listening to the general views regarding what this Committee is concerned about and adding up the number of people on the Committee who have taken different views, I am led, as I try to find the central tendency, to [propose] a mildly asymmetric directive toward ease but with the requirement that before any action is taken there be a telephone conference to explain why. I'm not sure that captures everybody; I suspect it probably does not. But having thought about trying to find where the central tendency is --where one captures the largest number of views and concerns of this Committee--that's pretty much where I come out. Actually, I find myself comfortable in that position, and I would like to raise it as a possible means by which we can resolve what is clearly a differing set of concerns about the immediate outlook that this Committee expressed in some detail yesterday. President Black.

MR. BLACK. Mr. Chairman having been in the uncomfortable position of supporting you [earlier] only 95 percent in my estimation,

I would like to express 100 percent agreement with this approach. I would add only thing: I think we ought to include the bracketed sentence on page 23 of the Bluebook which stresses the uncertainty.

CHAIRMAN GREENSPAN. Yes, I agree.

MR. BLACK. So, it's 100 percent agreement, not 98!

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I originally came with an expectation of recommending no change and a symmetric directive, but it became clear to me in the discussion yesterday that the weakness was not in the Twelfth District, so I certainly could accept your recommendation.

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, as I said yesterday, I have somewhat less confidence than I had in May that the recovery is on a sustainable path. But having said that, I don't think there's any substantial evidence that the economy is going into the tank in any sense. So, while there's a case to be made for some easing, I don't think that's the more persuasive argument at the moment and I would prefer to maintain our present policy and await further developments. And I think there's no particular harm in having an asymmetric directive, so I accept your proposal.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, given my comments yesterday, I'd favor alternative A and an easing move now, but I could accept alternative B with asymmetric language. Without necessarily meaning to put you on the spot, what kind of timing [are you contemplating] and what kinds of things might prompt the calling of a telephone conference?

CHAIRMAN GREENSPAN. I would say a fairly broad sense of cumulative weakness beyond where we are now. It's hard for me to be specific; there are so many different interests. I think we all know what the key elements are. But an evident break in the pattern of what we're seeing now would have to show up. I doubt if I can be any more specific than that. Let me say, for example, that if auto sales all of a sudden die, frankly, that would worry me because that has been one of the [unintelligible].

MR. KEEHN. You mean autos, employment, a series of things like that?

CHAIRMAN GREENSPAN. Plus let me say that even though we have argued strenuously about various monetary aggregates, that is not the same thing as saying that they are utterly irrelevant. Obviously, if we're getting evidence that loan demand is continuing to fall and the monetary aggregates are starting down in the context of other weakness, we should not disregard the financial measures even though there have been significant problems with them. At the margin, they are probably telling us something.

MR. KEEHN. Just the same, my view is that we have reached a point where some additional easing would be called for now; therefore, I would have a preference for "A." But the way that you phrased "B" with asymmetric language [toward ease] would be acceptable.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Mr. Chairman, for all the reasons I cited yesterday in my references to Pavlov and his dog and so forth, I would prefer "B" but I strongly prefer symmetric language.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. I come out the same place, Alan. I feel that symmetry is an important issue. At the last meeting we in effect communicated to the public--probably earlier than intended though it should be communicated this Friday--the fact that our having moved to symmetric language at that time was quite significant. And to move back to asymmetry toward ease would communicate the wrong [message] about how we ought to approach this process. There's no question about it: There's a lot of uncertainty now. But I don't think we can let ourselves get whipped around by these changing expectations the same way speculators in financial markets do. We have to take a much longer view and we have to be willing to look through one month or two months; we have to be looking at quarterly or longer numbers. So, in a sense the message we're sending here is a very confusing one and probably a much more significant one than anything we might do with long-run ranges. It gets back to the issue of: "Look at what we do and not what we say," but this is something that we say that's much more significant, I think, than the long-term ranges.

The reason I come out where I do is that first of all, I think we have an expansion in place somewhere around the economy's potential. I think at a minimum monetary policy is consistent with that expansion process. In other words, I don't have the sense that the economy is being choked by any means on the liquidity front. As the expansion progresses and it comes through in a number of ways--you just said it yourself in your comments and I think it's implicit in some things in the Bluebook--we're going to have to be going in the other direction. And to be thinking about additional ease now makes that next job that much tougher. Again, I don't want to flip-flop. It's really in the context of where we were last time. In general, thinking along those lines at this stage has some important credibility effects which could be reflected in long markets and in the foreign exchange market. I don't really put much credence in declines in longer-term yields that are supposedly associated with expectations of ease. I think what tends to happen is that when that sense develops, speculators [find] that a very effective vehicle in which to speculate. That's where one gets the most bang for the buck. The speculators get in there; they may drive yields down temporarily but in the event you could have a lot of sellers [who are] very disappointed. So, I take heart in the fact that whatever disappointment was reflected in our moving to asymmetry last time washed out fairly quickly and long-term yields worked their way down. Obviously, they may have come down a little further on some of this speculative behavior I'm describing, but I think that's how we're going to make our contribution. We took a stand last time and I think this is the time to stay with it.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. Well, I think we're at or near a point where we're going to have to ease, and asymmetry is broadly consistent with that. I'm sure all of us wish we had some stable beacon way off out there in the fog that we could latch onto and [unintelligible], but the fact is that there isn't that kind of beacon. While we may not be very happy that we have to look at these current economic indicators, in fact that's all there is right now that we can look at. And if the economy begins to weaken again, which I think already has started, it probably will need another shot of liquidity. We ought not fight that; we ought to accept it and move with it and do the best we can. I would not wait all that long. I don't think we need a whole lot of evidence piled on top of what we have to reach the point for easing. Also, if we get to that point, I wouldn't automatically think in terms of just a quarter point on the funds rate. A quarter point may bring down the prime rate but it may not. I don't think we need another present [such as the one] we gave the economy last December, but we could very well think in terms of 1/2 point on the discount rate and something comparable to that on the funds rate. So, I think we're looking at an easing move, and I suspect we'll have one before we sit around this table again.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. In some ways it seems strange, I suppose, to be confident at times such as these, but I ask myself what we need to do to have long bond rates lower by September 1 and I am very, very confident that [the answer] is for us to do as you suggest and that is to stand pat. I believe that the Federal Reserve does control long-run bond prices; it's much tougher than [controlling] the fed funds rate, but if we're going to control long bond prices, we have to do it by focusing on that [rate]. The uncertainty inflation premium is very disruptive to economic growth. I'm also confident that economic growth will be stronger if we stand pat and if we give the world a sense that we are indeed an independent central bank that has its eye upon the one thing we can do and that is to create an environment of price stability. That adds not only to long-run growth but I believe it adds to short-run growth in this environment. I understand that the Humphrey-Hawkins testimony has been pretty well determined, and I'm thinking about how our commitment to price level stability would come out if before that [testimony] or at that time [we were to ease]. We know that's not what is our guide, but the world will see it as a capitulation. It seems to me it would undermine that testimony that I understood you wanted to be there as a substitute for lowering the monetary aggregates growth ranges.

Now, like John LaWare and Tom Melzer, I strongly prefer symmetric language because that really is standing pat. I wonder, with the attention on symmetry that took place last time, whether we will get through the Humphrey-Hawkins testimony without this being known. It seems to me that even going from symmetry back to asymmetry sends a signal of uncertainty that the market doesn't need. So, I strongly prefer symmetric language. I heard what you said in regard to the way you're going to make your choices and I didn't hear anything about M2 being the guiding factor in that. So, in a sense, I'm very supportive of what you're saying, but I'm very concerned

about being in the same voting group with others who certainly want to ease quickly.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I, too, would prefer a symmetric directive at this point mainly because I think we shouldn't be in too big a hurry to take any action in the near term and should be prepared to assess a range of incoming data. I don't know which of your two models may be more appropriate in the current setting. It seems to me that another way to describe what is going on--in terms of a sluggish recovery, small gains in employment, small gains in spending, balance sheet restructuring, and all that--is that it's part of the price that has to be paid to bring down the rate of inflation. Perhaps if our credibility were higher, the price would be lower and we wouldn't have to endure some of this and we would see incoming numbers perhaps more to our intuitive liking. But I've become convinced, unfortunately, that our credibility really isn't all that high and that a period like this is probably what we have to endure to make progress on that side.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I would prefer to ease to accommodate the restructuring, but I could live with an asymmetric directive.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I support "B" and I would strongly prefer symmetric language; I identify myself with President Melzer and Governor Angell among others and their comments. But I would not vote "no" on an asymmetric directive because I do share your concern and others' concerns that [the economy] could possibly be faltering seriously here, although I very much doubt that. If it became clear--and I do mean clear, at the risk of being what some would call too late--that we were having a seriously faltering economy, then I could support an easing. Consequently, I would not vote against an asymmetric directive.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. This is a tough one. I guess the way I try to approach a lot of this financial confusion is that in my mind's eye I can conceivably see three profiles of the economy over the next several quarters. Each looks to me as if it has profoundly different implications. It is possible, although I think it's only a 10 percent probability, that we could have a 3-1/2 percent [growth] profile. If that turned out to be the case, the policy response to that is pretty easy: We'd have to start tightening. Then there is the 2-1/2 percent economy, an economy that as I said yesterday is quite consistent with the price stability goal based on Chart 17. I do think that that's the likely outcome. I would still put a 50 percent probability on that. And the policy response to that is also easy: We'd just sit where we are. But then there's the third scenario, the 1-1/2 percent profile, which in my mental processes carries with it something like a 40 percent probability. Now, that's the tough nut, because I personally believe, in the broadest possible context of public policy, that that outcome is unacceptable. Also, if we find ourselves in that profile after the fact and we're left in a

position in which we were trying to adjust policy after the fact, I think we'd have a helluva problem on our hands. Because I think there is not an inconsequential probability of that kind of outcome, I would rather squarely associate myself with an asymmetric directive.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, this obviously is as tough a situation for deciding what to do in the immediate situation, [as we've had] in some substantial period of time. But I must say that, for my own reasons, I find myself having views that are very similar to Jerry Corrigan's. In looking at the reasons, I find myself quite attracted to the second model as compared to the conventional model, in terms of what is happening with the economy. A part of that is looking at the serial optimism that has been in my own forecast based on the conventional model going back for some time and looking at the optimism that has been in all of our forecasts on a conditional basis. I am aware of the concerns that if the second model is [true] it means that inevitably we are overshooting and putting in too much liquidity, but I think we can sop that up afterwards. And what that tells me is that we need a more activist policy in terms of not being so concerned about relatively small movements in the funds rate. Though I think we come at this from somewhat different analytical schools, I am attracted to some of the questions that Jerry Jordan raised about credibility in the sense that if we said we're going to do something on the Ms but we're not doing it, I don't like the excuse that we were unwilling to move the funds rate to [achieve that]. Also, looking at what we might do right now, I do think that a move in the prime rate would be beneficial for the economy as a whole; I don't have a lot of concern that we'd see too much stimulus out of that, and I think we'd get [a prime rate cut if we eased]. To tell you the truth, in the absence of the jawboning that we've had from the Administration--if we weren't in such an awkward position--I would generally prefer to do something at this meeting. I have to disagree with Ed a little in that under ordinary circumstances I would have preferred [a cut of] 25 basis points at the meeting today. But in the environment we're in, with this amount of jawboning, I'd be cautious about pushing too hard for that. Where all of this leads me, to go back to Bob Black's analogy, is that I'm 60/40 in favor of what you're doing but that's heavily weighted by the notion that I think we should be asymmetric toward ease. And the indication that you've given that we would have a conference call to deal with that assuages my own concerns that we should generally [act] at meetings or when there is full Committee consultation.

CHAIRMAN GREENSPAN. President Jordan.

MR. JORDAN. I took your reference to 22 moves to be cuts in the funds rate over a period of time and then you made a reference to [that] coming to an end. If we're still on a track toward at least a lower inflation environment if not stable prices, measured somehow, then it shouldn't be the end of the moves because 3-3/4 percent is still too high whether one thinks in terms of real rates or [unintelligible]. The one reason that might be given for either going back to an asymmetric directive or to cut the funds rate now or in the future that I would oppose is weakness in the economy. If we're going to do something, that's the wrong reason to do it because it reinforces the idea that we try to fine-tune policy actions to

influence things we can't influence. Whatever uncertainty we have about the aggregates, I have more confidence in their giving us and the public at large information about the long run [unintelligible]-- where it's going to be next year and the year after--than the latest numbers produced by the Commerce Department or the BLS or the purchasing managers or realtors or any other particular group. We have a lot of uncertainty about those numbers [as well as] a tremendous amount of uncertainty [about] M2, but we can signal that we have more confidence in the [money] numbers by changing the funds rate based on them. Not doing it based on the Ms, I think, is not helpful to our longer-run case in terms of credibility.

I'm in a difficult position because we are below target on M2 and the decision has now been made not to lower the range for this year or next year. To be consistent then, given the model that we use for influencing the aggregates, we should be lowering the funds rate in order to show how serious we are about coming in at least at the bottom end of the range. That's so we will be credible when we say that the opposite is also true--that when we're at the top end of the range we're not going to hesitate then either. So, failure to cut the funds rate, given what is going on in the markets today, is in my mind a relative tightening policy action compared to the market, and I don't see any basis for that. Reserves are falling and all of the aggregates [are weak], and I think that's something we should not be willing to tolerate. But at the same time I would resist cutting the funds rate on a signal of weak economic activity. I'd like to do it today, but I wanted to do it today coupled with an announcement that we cut the target ranges for the long run at the same time we cut the funds rate and then let the analysts figure out whether we tightened or eased.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. As I look at the discussion that we've had and your models, I prefer your second model as well. I think it is suggesting that we still have an environment in the economy generally of great uncertainty and the building of liquidity. And in that context staying where we are is, as Jerry stated, a tightening. In addition, it's not just the money numbers but other financial information and the financial environment that suggest that we could and should ease. My strong preference, then, would be to ease now; however, I can live with an asymmetric directive. It's consistent with where I was at least last time. And if the information comes in, given the way you answered President Keehn, I can live with that.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. If we're not going to decide to ease today, then I would support your recommendation for "B" but with a symmetric directive. It may become necessary to ease a little later and if so it can be done with a symmetric directive. But if it's not necessary to ease later and we don't end up easing, I think symmetric language in the record would serve us better than asymmetric language.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I very much appreciate your efforts to find a consensus. What has struck me about the challenge

to the independence of the Federal Reserve is a need for us to speak with one voice as much as possible. Frankly, I find myself torn between your recommendation, which I will support, and President Jordan's recommendation which I also could support were he chairman! [Laughter] The reason I think his argument is compelling and I think your argument is compelling is that I believe both will end up iterating in the same direction. But we face tremendous uncertainties, tremendous challenges, both in the economic arena and in the political arena. And I would hope that your search for a consensus would produce one in this Committee because I do realize that the challenges you personally have ahead of you in the next month are great.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. We have an environment with both weakness in the aggregates, which we've seen for some time, and the risk of weakness in the real economy. So, I think "B" asymmetric toward ease is appropriate.

MR. BLACK. I'm not sure I'd say the same thing if I were speaking again. I supported the Chairman but then on further reflection I thought that if we had lowered the targets for next year I would support him more enthusiastically, if I may put it that way.

CHAIRMAN GREENSPAN. I am proposing a vote for a mildly asymmetric directive; that's alternative B with the presumption of a telephone conference prior to any move that might be initiated under that directive. Do you want to read the language?

MR. BERNARD. [Does the Committee wish to use the additional sentence proposed in the Bluebook, which reads]: "However, the recent unusual behavior of these aggregates suggests that the relationship between their growth and the Committee's long-run objectives is especially uncertain at this time."

MR. LAWARE. Do we want to say "especially uncertain at this time?"

SPEAKER(?). I don't like that "especially."

MR. SYRON. Governor LaWare has a point. "Uncertain" is uncertain enough!

MR. BLACK. We can say "slightly" or "somewhat."

MR. SYRON. "Could" be uncertain or "would" be uncertain.

CHAIRMAN GREENSPAN. Do we really need that sentence in here at this time?

MR. MULLINS. We've already got it regarding the '92 range.

MR. ANGELL. I think we need the sentence in, but I'd take "especially" out.

CHAIRMAN GREENSPAN. What's the view on that? Should we take "especially" out or keep it in? How many people feel "especially" would be better?

MR. SYRON. Please.

MR. LAWARE. I don't like the sentence.

SPEAKER(?). I don't like the sentence either.

CHAIRMAN GREENSPAN. Why don't we do this; why don't we have the whole thing read and let's see what it sounds like.

MR. ANGELL. With "especially" out.

CHAIRMAN GREENSPAN. With "especially" out in the reading.

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 might or slightly lesser reserve restraint would be acceptable in the intermeeting period. The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 in the period from June through September at annual rates of about 2 and 1/2 percent, respectively. However, the recent unusual behavior of these aggregates suggests that the relationship between their growth and the Committee's long-run objectives is uncertain at this time."

SPEAKER(?). Sounds bad.

MR. ANGELL. If we take the sentence out, how can we live with the 2 percent and the 1/2 percent?

SPEAKER(?). That's the problem.

MR. ANGELL. What do we have besides 2 percent and 1/2 percent? What is a better number than 2? If we say "about" and we want to be symmetric around it what number would you choose, Don?

MR. KOHN. Well, let's see. Do you want a whole number?

MR. ANGELL. No, I don't--

MR. KOHN. We gave you our best guess, i.e., 2 percent.

MR. ANGELL. 2 percent.

MR. LINDSEY. It's 2 percent for M2 and 1/2 percent for M3; that's what 2 and 1/2 mean; there are two lines.

MR. ANGELL. Oh, I see--2, okay.

MR. JORDAN. I am missing something here because the prior sentence refers to June through September.

MR. KOHN. Right.

MR. JORDAN. And the latter sentence says that their relationship to the long-run objectives is uncertain. Uncertain with respect to what? Is that compared to before or compared to something that we're less uncertain about?

CHAIRMAN GREENSPAN. I think there has to be a sentence in there but I feel uncomfortable with this sentence as it's constructed.

MR. SYRON. You're absolutely right; it's a problem.

MR. ANGELL. Well, why don't we take "long-run" out? Say "suggests that the relationship between their growth and the Committee's objectives is uncertain at this time."

MR. MELZER. Do we have more confidence in the funds rate?

MR. KOHN. It's certainly the case that this problem will be addressed extensively in the policy record as well as the [directive]; it's in the paragraph on the long-run ranges. The draft sentence was a response to a request made at the last meeting.

MR. MULLINS. Is it like the Surgeon General's warning?

CHAIRMAN GREENSPAN. No, I think the recent behavior of these aggregates--

VICE CHAIRMAN CORRIGAN. Perhaps to make it more operational we could say "However, the recent unusual behavior of the aggregates warrants especially close monitoring by the Committee" or something like that.

CHAIRMAN GREENSPAN. Well, I agree we do want to solve the question. It's obviously making this relationship more uncertain than usual, whatever it is. We basically have a problem [in that we need] to stipulate the reasons why we are putting in these rather low numbers. Because if we believe them and those were really functional with respect to the economy, then I think it's incumbent on us, as Jerry has been saying, to move them up. What we're trying to say here is a qualification: That while we're putting down these very low numbers, our view of the importance of these numbers is far less than is usually the case. That's where the issue is.

VICE CHAIRMAN CORRIGAN. Right.

MR. KOHN. The sentence feeds back into the previous sentence or the two sentences before. It says that in the context of the Committee's long-run objectives you will be looking at monetary developments. So, we've already sort of said that and this kind of--

MR. MULLINS. We could say something like "in view of the unusual behavior, we expect growth to be 2 percent and 1/2 percent."

MR. SYRON. Using 2 percent and 1/2 percent, I would think we'd want to focus further on the short run by saying that the Committee is particularly aware of the unusual relationship that exists with the monetary aggregates. I'd just add something like that

tagged on the end, which is not specific to our objectives. This [proposed language] raises as many questions as the problem [we're trying to address]. Why don't we just say that the Committee was acutely aware that the behavior [of the aggregates] has been unusual--not necessarily in those exact words.

MR. JORDAN. The previous sentence says "The contemplated reserve conditions are expected to be consistent with...." Is that where the uncertainty is? The last sentence suggests, though it's not clear to me, [not] what is consistent with reserves but what it means for the long run.

MR. ANGELL. I think you've hit it, Jerry. I think that's where the uncertainty is. We're not certain whether the contemplated reserve conditions are consistent with--

MR. SYRON. That's exactly right.

MR. BOEHNE. Then, why don't we just say: "The contemplated reserve conditions, although more uncertain than usual, are expected to be consistent" etc.

MR. KOHN. I don't think it's the conditions that are uncertain.

MR. SYRON. The point is that we don't know whether they are expected to be consistent; we have less expectation of consistency.

MR. LINDSEY. Do we have to have the "contemplated" sentence in there? Does the law require us to have a sentence that says "the contemplated reserve conditions"?

MR. KOHN. No, no.

MR. LINDSEY. Why don't we drop the whole issue since we're addressing it elsewhere?

MR. MULLINS. We put in forecasts and people notice [unintelligible].

MR. KOHN. Well, part of the idea behind putting this sentence in was to give a sense of flexibility--that you wouldn't have to react to this. Without such a sentence here the directive doesn't relate at all to the long-run ranges, which may be fine.

MR. MELZER. Just by stating those low growth rates on the very face of it we've indicated that we're willing to accept those growth rates even though they are below the target range. That is the confusion we're trying to clear up with that last sentence. I think we could take the last sentence out altogether.

MR. ANGELL. It seems to me that we could say "The contemplated reserve conditions are not likely to cause the monetary aggregates to return to their targeted ranges."

CHAIRMAN GREENSPAN. We could say "may not."

MR. ANGELL. Yes, "may not be consistent with the aggregates returning to their ranges."

MR. SYRON. "During this period" or "in this period of uncertainty" or something like that.

MR. LAWARE. Isn't it somewhat contradictory, though, to say that we're tilting toward ease and that it's going to result in a lower growth rate for M2 and M3?

MR. ANGELL. Well, in a way not, because if we were--

MR. LAWARE. That's the way it reads!

MR. BLACK. I think we could take that last sentence and attach it to the one before and say "in light of the recent unusual behavior of these aggregates."

MR. PRELL. Mr. Chairman, I hesitate to inject this but perhaps the thought that people have is that the Committee is adopting a policy that would be expected to move the aggregates back toward the range unless the recent unusual behavior of velocity persists. That would be a correct statement, but a non-quantitative one.

MR. ANGELL. I think that's accurate. I don't think we expect that. Look at this chart in the Bluebook and where "B" is.

MR. PRELL. But that assumes that the recent unusual behavior persists. What I'm saying is that unless it persists you'd expect [growth of M2] to move back because we would not expect to end up the year with only 2-1/2 percent [M2 growth] given our GDP forecast if normal velocity behavior were to resume.

MR. ANGELL. But Mike, Don's chart shows "A" and "B" below not only the cone but below the parallel lines. Both "A" and "B" are below the parallel lines and we ought to communicate--

MR. PRELL. I'm saying that isn't necessarily what is known to be the operative element in your policy concern. It is contingent on a continuation of unusually strong velocity. If you didn't get it, then you would expect [the aggregates] to come back. I apologize for the diversion.

MR. HOENIG. The ranges we have now reflect an expectation that these [aggregates] are going to fall below [for the year], and I think we should drop that last sentence because it only adds--

CHAIRMAN GREENSPAN. Let's try Jerry's suggestion for the last try at this because we're not--

VICE CHAIRMAN CORRIGAN. This is an alternative sentence that would say: "These growth rates in the monetary aggregates are a reflection of the continuing, uncertain relationships between the aggregates and the Committee's long-term objectives."

MR. JORDAN. But I thought it was the uncertainty about the Board staff's model and what interest rate and reserve conditions

would produce certain aggregates. There are two separate things: There's a velocity issue and--

CHAIRMAN GREENSPAN. Why don't we drop this whole thing?

MR. SYRON. Where are you going to start to drop?

MR. MELZER. Starting with "however"?

CHAIRMAN GREENSPAN. Starting with "however."

MR. MULLINS. And ending with "time."

MR. SYRON. I think that's a better suggestion. The problem is: Do we really think that these reserve conditions are expected to be consistent in the world that we're in now?

CHAIRMAN GREENSPAN. Let me put it this way. I would almost [be tempted] to drop the "contemplated reserve conditions" sentence.

MR. SYRON. Yes, that's what I would prefer.

MR. ANGELL. Well, Mr. Chairman, if we're going to delegate to you some [asymmetry], why can't we delegate to you [the task of] carefully going over this until you're satisfied that you have a [good] sentence? I would prefer to give you the authority to clean that up or take it out, whichever one you want.

MR. SYRON. Good idea.

CHAIRMAN GREENSPAN. That would be helpful if you would. If I have any serious questions, I will re-circulate a draft to the Committee if that's okay with everybody.

MR. ANGELL. Yes, it would be better than our trying to manufacture [one as we sit here].

CHAIRMAN GREENSPAN. Yes, this is a tough one. Okay, why don't we leave that and go to a vote.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Hoenig	Yes
President Jordan	Yes
Governor Kelley	Yes
Governor LaWare	No
Governor Lindsey	Yes
President Melzer	No
Governor Mullins	Yes
Governor Phillips	Yes
President Syron	Yes

CHAIRMAN GREENSPAN. Okay, our next meeting is on August the 18th, and we can adjourn for lunch.

END OF MEETING